



Issue Date March 16, 2007

Audit Report Number 2007-LA-1006

TO: Stephen Schneller, Director, San Francisco Office of Public Housing, 9APH

Joan S. Hobbs

FROM: Joan S. Hobbs, Regional Inspector General for Audit, Region IX, 9DGA

SUBJECT: The Housing Authority of the County of Santa Clara, San Jose, California, Did Not Adequately Determine and Support Section 8 Rents

HIGHLIGHTS

What We Audited and Why

We reviewed the Housing Authority of the County of Santa Clara's (Authority) Section 8 rent reasonableness determinations for its Section 8 Housing Choice Voucher program to determine whether they were consistent with U.S. Department of Housing and Urban Development (HUD) rules and regulations. We performed this review based on the size of the program and concerns raised by HUD.

What We Found

The Authority did not determine that rents charged to individuals receiving Section 8 housing assistance were reasonable. Further, it did not administer the rent reasonableness determinations in accordance with HUD rules and regulations or its HUD-approved administrative plan. Specifically,

- The specialist(s) performing the rent reasonableness determinations did not use the necessary characteristics of either the assisted unit or the units selected as comparables. Therefore the units were not comparable.

- The database used to obtain comparable units was not always up-to-date; contained data entry errors, duplicates, and erroneous information regarding the subject unit; and did not always contain a sufficient number of units that could be considered comparable for determining rent reasonableness.

What We Recommend

We recommend that the director of HUD's San Francisco Office of Public Housing require the Authority to

- Establish adequate controls and procedures to ensure that it makes Section 8 housing assistance payments based on reasonable rent determinations.
- Establish and implement policies and procedures to ensure that Authority specialists have information needed to determine reasonable rents. In addition, ensure that the database used to obtain comparables is up-to-date and free from errors and duplicates and contains a sufficient number of units to determine reasonable rents.
- Support or reimburse HUD for questioned housing assistance payments in the amount of \$17,391. In addition, recapture \$1.36 million, 8.7 percent of the administrative fees earned during the period, for not performing rent reasonableness in accordance with HUD rules and regulations.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We provided the Authority a draft report on February 9, 2007 and held an exit conference with officials on February 14, 2007. The Authority provided written comments on February 26, 2007. It generally agreed with the finding, but disagreed with the recommendation to recapture administrative fees. The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

The Housing Authority of the County of Santa Clara (Authority) provides rental subsidies and develops affordable housing for low-income families, seniors, and persons with disabilities living in Santa Clara County, California, the heart of Silicon Valley.

The Authority was established in 1967 by the Santa Clara County Board of Supervisors to administer a federal rent subsidy program authorized under the United States Housing Act of 1937. The Authority's mission is to improve the lives of low-income families, persons with disabilities, and seniors in Santa Clara County by providing affordable, high-quality housing.

The Authority's general operation is overseen by its board of commissioners, the members of which are appointed by the Santa Clara County Board of Supervisors. The board of commissioners consists of seven commissioners, one from each of the five supervisorial districts and two tenants of the Authority, one being a senior citizen. Each member is appointed for a four-year term, except for the resident commissioners, who are appointed for two-year terms.

The day-to-day operations of the Authority are carried out by the executive director, who manages all agency departments and activities, which include administration of the Section 8 program and related special programs. The Authority administers 15,956 vouchers under the Housing Choice Voucher program. Approximately 9,500 are for the County of Santa Clara and the remainder are vouchers for the City of San Jose. During fiscal years 2005 and 2006, the Authority paid more than \$254 million in housing assistance payments to owners participating in the program. Additionally, the Authority received more than \$15.6 million in administrative fees for administering the Section 8 program for the two fiscal years.

The audit objective was to determine whether the Authority's rent reasonableness determinations were consistent with U.S. Department of Housing and Urban Development (HUD) rules and regulations.

RESULTS OF AUDIT

Finding 1: The Authority Did Not Adequately Administer Its Rent Reasonableness Determinations in Accordance with HUD Rules and Regulations

The Authority did not adequately perform its rent reasonableness determinations to ensure that Section 8 rents were reasonable. We attribute this to the Authority's not complying with HUD rules and regulations or its own HUD-approved administrative plan. As a result, HUD overpaid \$17,391 in housing assistance payments and received more than \$15 million in administrative fees of which nearly \$1.4 million was unearned.

HUD Requires Rent Reasonableness Determinations

HUD requires housing authorities to determine whether rents are reasonable before approving a lease and when a landlord requests annual or special contract rent adjustments (see appendix E). The Authority's administrative plan stated that is used a "comparison method" and tested the subject unit against selected units in the same area with similar characteristics. Adjustments were to be made for favorable and unfavorable differences between the subject unit and the comparables. Amenities, unit condition, services, and facilities were also to be evaluated when determining rent reasonableness. This agrees with HUD regulations.

The Authority did not fully implement the requirements of their administrative plan. The Authority maintained a database of comparables based on rent surveys performed by its inspectors. Each inspector was required to locate and document 20-25 properties each month to be used as comparables to determine whether an assisted unit's rent was reasonable. Rent surveys were then scanned into the Authority's imaging system by region and bedroom size. The Authority specialist retrieved a listing of comparables from which to select three units to be used to make the determination. We found duplicate, triplicate, and erroneous information regarding the units in the system. Upon obtaining the listing of comparables, the Authority specialist would often select the highest, lowest, and a medium rent and average the three, thus deriving what was considered the "rent based on comparables." No adjustments were made because there was no information available on which to make the adjustments.

We determined the following:

- Individuals performing rent reasonableness determinations did not have adequate knowledge of the characteristics of either the assisted units or units used as comparables. Therefore, units were not always comparable.
- Rent reasonableness determinations were not always performed.
- Assisted unit rents exceeded rents for other assisted units in the same complex.

Specialists Did Not Obtain Adequate Support When Selecting Comparables

The Authority specialist performing the rent reasonableness determination did not use the necessary characteristics of either the assisted unit or the units selected as comparables. The only information the specialists generally used was the region (a region generally had eight or more zip codes), the unit's structure type (apartment, single family, etc.), and the unit's size (number of bedrooms). In addition, the approved administrative plan also states "Adjustments are made for favorable and unfavorable differences between the subject unit and the comparables."

It was the Authority's unwritten practice that the specialists selected comparables for the assisted unit from a system-generated comparable list. The specialist did not always retrieve information by obtaining the rent survey scanned in the Authority's imaging system, unit profile entered in the Public/Indian Housing Authority System database, or information from MetroScan. MetroScan is a subscription service describing itself as "...the nation's largest collector and provider of real estate focused public record information." The data are obtained from many sources including County Recorder and Assessor records. Although the Authority claimed that the specialists knew their areas, the system-generated comparables used for the assisted unit did not always meet requirements and the Authority could not show us any adjustment, either favorable or unfavorable, made during the rent reasonableness process.

As a result of not obtaining adequate information on the characteristics of either the assisted unit or the units selected as comparables, 40 of 50 cases reviewed, or 80 percent of the rent reasonable determinations, were not in accordance with HUD rules and regulations and accordingly were not supported and valid (see appendix D).

The following two cases are representative of the problem:

Tenant Subsidy #V30090

The specialist chose six properties in San Jose from the system-generated comparison list and averaged the rent of those six properties. The average rent was the basis for approving the contract rent. The specialist did not obtain adequate support for of the assisted and comparable units. There was an extreme difference in the determining factors for rent reasonableness, such as quality, square footage, and unit age.



Assisted Unit in San Jose

The assisted unit is a one-story, single-family residence with three bedrooms, one and one-half bathrooms, and 1,494 square feet in living area. It was built in 1953 and is average in quality and condition.



One of Six Units Selected as Comparable

This unit used as a comparable has two bedrooms, one bathroom, and 1,394 square feet in living area. This house is dilapidated (built in 1904) and is awaiting demolition.



One of Six Units Selected as Comparable

The unit used as a comparable has three bedrooms, two and one-half bathrooms, and 1,937 square feet in living space. It is a nice house with a two-car garage, was built in 2004, and is located in an upscale neighborhood.

The units selected as comparable were quite different in size, age, amenities, and quality. The specialist performing the rent determination did not obtain appropriate comparables to determine the reasonable rent. We were able to identify three units that were comparable and determined a reasonable rent. We identified there was \$1,092 in ineligible housing assistance payments during the period of our review.

Tenant Subsidy #V29749

One assisted apartment unit had comparables selected that included a unit in a triplex, a unit in a four-plex, and a single-family home. None of these were comparable to the assisted unit. No adjustments were made due to the triplex unit being 365 square feet smaller and the single-family unit 501 square feet larger.



Assisted Unit Is an Apartment in a Large Complex in Milpitas

The assisted unit is an apartment in a large complex. It has two bedrooms, one bathroom, and 997 square feet in living space.



Triplex Selected as Comparable to the Apartment Unit in a Large Complex in Milpitas

The assisted unit and the comparable are of a different structure type. This triplex was selected as a comparable to the apartment located in a large complex. It has two bedrooms, one bathroom, and 632 square feet in living space.



Four-Plex Selected as a Comparable to an Apartment Unit in a Large Complex in Milpitas

The assisted unit and the comparable are of a different structure type. This four-plex was used as a comparable for the assisted unit, which is an apartment. It has two bedrooms, one bathroom, and 882 square feet in living space.



Single-Family Residence Used as Comparable for an Apartment Unit in a Large Complex in Milpitas

The assisted unit and the comparable are of a different structure type. This single family residence was used as a comparable for an apartment. It has two bedrooms and 1,498 square feet in living space.

As demonstrated above, the Authority's practice for determining rent reasonableness resulted in selecting comparables that were not similar to the assisted unit. The units selected as comparable were different in size, age, amenities, and quality.

Had the specialist followed proper procedures, an adequate comparable may still not have been found. The Authority's Public/Indian Housing Authority System contains its database used to make rent reasonableness determinations. However, we determined the database was not always up-to-date, contained erroneous information and duplicates, and did not always contain a sufficient number of units that could be considered comparable for determining rent reasonableness. In addition, a former inspection supervisor stated there were no controls over this database to ensure information entered was correct.

In nine cases, we were able to determine the reasonable rent for the assisted unit using information on comparable units entered in the Authority's database. Based on our review, there was a total of \$8,744 in ineligible housing assistance payments.

Rent Reasonableness Determinations Were Not Performed

In 10 percent of the files reviewed, rent reasonableness was either not performed or was performed after the disbursement of the housing assistance payment. There were three cases where rent reasonableness determinations were not performed at all. For tenant V76247, the Authority specialist accepted three “comparables” provided by the management company/owner without determining whether they were acceptable comparables. One of the properties was in a more upscale, gated complex, and its higher rent increased the contract rent for the assisted unit. We performed our own rent reasonableness determination, using three like and similar comparables, and determined the contract rent was unsupported. Therefore, we questioned a total of \$1,484.

In 2 of 50 cases reviewed, an increase in the housing assistance payment was paid before a rent reasonableness determination was made. In the case of tenant V20461, the lease began on November 1, 2005; however, the rent reasonableness determination was performed on December 5, 2005. The approval for an increase to the rent was made on January 3, 2006. We questioned the \$50 rent increase for two months as unsupported (see appendix C).

Assisted Unit Rent Exceeded Rents for Other Assisted Units in the Same Complex

HUD regulations and the Authority’s administrative plan also require that the approved rent does not exceed rents currently charged by the same owner for an equivalent assisted or unassisted unit in the same building or complex. We identified in 5 of 50, or 10 percent, of the cases reviewed, the assisted units’ rent exceeded rents for other assisted units of the same size in the same complex.

One apartment complex in San Jose has two buildings—3955 and 3975. Although the street numbers are different, the buildings are in the same complex, and according to the building management, the buildings and units are identical—one-bedroom apartments with 550 square feet in living space. However, rents charged to Section 8 tenants at the 3975 address were \$47 higher, starting March 2005, and \$50 higher, starting March 2006, than the rent charged to Section 8 tenants at the 3955 address. There were five units and the ineligible payment amounted to \$3,820.

See appendix D for a summary of all deficiencies identified during the review.

Conclusion

The Authority did not adequately determine Section 8 reasonable rents or administer the rent reasonableness determinations in accordance with HUD rules and regulations or its HUD-approved administrative plan. As a result, the Authority paid owners questioned costs of at least \$17,391 on the 50 units reviewed (see appendix C). This included \$12,564 in ineligible housing assistance payments and \$4,827 in unsupported payments. Therefore since the Authority did not properly administer its rent reasonableness determination process, we recommend that HUD recapture the appropriate amount of administrative fees pertaining to the rent reasonableness determination process.

For fiscal years 2005 and 2006, the Authority received more than \$15 million in administrative fees from HUD to administer its Section 8 housing program. Based on information received from its managers, we determined approximately 8.7 percent of employee time in the Housing Programs Division was dedicated to the rent reasonableness process. Therefore we recommend that 8.7 percent of the administrative fees or \$1.36 million be repaid to HUD.

Recommendations

We recommend that the director of the San Francisco Office of Public Housing require the Authority to

- 1A. Establish and implement controls to ensure policies and procedures are followed so that Authority specialists use information needed to determine reasonable rents.
- 1B. Establish and implement policies and procedures to ensure that the database used to obtain comparables is up-to-date and free from errors and duplicates and contains a sufficient number of units to determine reasonable rents.
- 1C. Conduct training for all individuals involved in rent reasonableness determinations on the approved policies and procedures.
- 1D. Reimburse HUD for ineligible housing assistance pays totaling \$12,564.
- 1E. Support or reimburse HUD for unsupported housing assistance payments of \$4,827 (see appendix C).
- 1F. Recapture 8.7 percent of the administrative fees for fiscal years 2005 and 2006 in the amount of \$1.36 million for not performing rent reasonableness determinations in accordance with HUD rules and regulations.

SCOPE AND METHODOLOGY

The scope of the audit was July 1, 2004, through June 30, 2006.

To accomplish our objective, we

- Reviewed relevant HUD handbooks, *Code of Federal Regulations* citations, and any other guidance.
- Reviewed related information from HUD systems.
- Interviewed HUD and Authority personnel to obtain background information about the Authority and its Section 8 program.
- Interviewed property managers and at least one owner to obtain information on both assisted and unassisted units selected as comparables.
- Obtained relevant documents from the Authority pertaining to the review of rent reasonableness determinations.
- Selected nonstatistical samples and performed reviews of 50 tenant files.
- Conducted on-site visits to all assisted and comparable units included in the 50 files reviewed.
- Performed rent reasonableness determinations on nine of the files reviewed.

We took photographs of most assisted and unassisted units selected as comparables for all files reviewed totaling at least 200 properties.

We performed on-site work at the Authority, located at 505 West Julian Street, San Jose, California, from May through November 2006.

We performed our review in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Administration of the Section 8 program as it relates to rent reasonableness determinations in compliance with HUD regulations,
- Maintaining complete and accurate records, and
- Safeguarding Section 8 program resources.

We assessed the relevant controls identified above.

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

Significant Weaknesses

Based on our review, we believe the following items are significant weaknesses:

- The Authority did not have controls to ensure it followed federal regulations and its HUD-approved policies and procedures provided in the administrative plan to properly administer the rent reasonableness determinations or safeguard Section 8 resources.
- The Authority did not have controls to ensure its records were complete and accurate.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible <u>1/</u>	Unsupported <u>2/</u>	Unreasonable or unnecessary <u>3/</u>
1D	\$12,564		
1E		\$4,827	
1F			\$1,362,601

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local policies or regulations. We determined that housing assistance payments of \$12,564 are ineligible costs because the Authority did not adequately determine Section 8 reasonable rents or administer the rent reasonableness determinations in accordance with HUD rules and regulations or its HUD-approved administrative plan.
- 2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures. In this instance, we determined that \$4,827 in rents was unsupported because the rent reasonableness determinations were not done in accordance with HUD rules and regulations. In some cases, we were able to determine appropriate rents based on like and similar comparable properties. Appendix C details the unsupported costs by tenant.
- 3/ Unreasonable/unnecessary costs are those costs not generally recognized as ordinary, prudent, relevant, and/or necessary within established practices. Unreasonable costs exceed the costs that would be incurred by a prudent person in conducting a competitive business. The administrative fees paid to the Authority to administer the Section 8 Housing Choice Voucher program were not fully earned because the Authority did not fulfill its administrative duties relative to rent reasonableness determinations. During the period of our review, the Authority received more than \$15 million in administrative fees for administering the Section 8 program. We determined 8.7 percent of the full-time employees in the Authority's Housing Programs Division were performing rent reasonableness functions. Therefore, we recommend recapturing 8.7 percent of the administrative fees, or \$1,362,601.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

EXECUTIVE DIRECTOR
ALEX SANCHEZ



HOUSING AUTHORITY OF THE COUNTY OF SANTA CLARA

February 26, 2007

Joan S. Hobbs
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Office of Inspector General, Region IX
611 West Sixth Street, Suite 1160
Los Angeles, CA 90017-3101

RE: Draft Audit Report – Rent Reasonableness
Audit Scope: July 1, 2004 through June 30, 2006

Dear Ms. Hobbs:

We received the Discussion Draft Audit Report dated February 9, 2007, and met with Helen Sparks and Elizabeth Sarmiento of your staff on February 14, 2007, for the exit conference. While audits can be difficult for both the auditor and the audited entity, we understand their purpose and take the opportunity to use the outcome to improve our programs.

Comment 1

We concur with the finding that we did not always follow our Administrative Plan with regard to rent reasonability, however, we would like to point out that our practices still resulted in rents that were generally rent reasonable and well below our Voucher Payment Standards. The audit discovered only 1.28% (\$17,391) of questionable housing assistance payments (HAP) out of a total of approximately \$1.35 million disbursed in HAP over the 2-year audit period. Nonetheless, we realize the importance of the rent reasonability process and being compliant with our administrative plan, and have endeavored since the auditors first completed their review last year to correct the identified problems. Our corrective actions are described below.

Comment 2

Regarding the recommended penalty of a \$1.36 million recapture of administrative fee, however, we strongly disagree with the auditors' recommendation and request this penalty be eliminated. Our objection considers three important facts: 1) Similar OIG audits of other housing authorities resulted in little or no administrative fee recapture even when larger amounts of questionable housing assistance payments (HAP) were discovered; 2) The penalty is grossly disproportionate to the amount of questionable HAP found and the impact of the errors; and 3) The OIG's 2001 audit of the rent reasonability regulations themselves found the regulations did not provide significant benefit to the Section 8 program whereas the housing authority's alternate methods for doing this process, while "non-compliant," still resulted in reasonable rents. These issues and additional concerns we have about the penalty are outlined below.

FINDING

The Draft Audit Report indicated that *"The Authority did not determine that rents charged to individuals receiving Section 8 housing assistance were reasonable. Further, it did not administer the rent reasonableness determinations in accordance with HUD rules and regulations or its HUD-approved administrative plan."*

Comment 1

We concur that we did not always administer our rent reasonableness determinations in accordance with our administrative plan, however, we disagree with the broad across-the-board statement that we *"did not determine that rents charged... were reasonable,"* implying that we *never* performed rent reasonability. While there were some instances discovered in the audit that show rent reasonability was apparently not determined, the vast majority of the cases had some sort of rent reasonability performed, even if it was not done according to regulations or policy. And in those cases where rent reasonability was missing or incomplete, we concur that there was \$17,391 in questionable HAP payments.

In order to bring our practices in line with our policy and HUD regulations, we have made the following corrective actions:

1. We researched, purchased and implemented use of GoSection8, a web-based service providing thorough and up-to-date rent comparables as well as property rental listings. GoSection8 rent comparables are gathered by local professional property appraisers and the system was designed to make adjustments when comparing units using many of the elements required by HUD regulations. We began utilization of this service in January 2007 and currently have approximately 1,300 comparable properties accessible to our staff in this new database and this number continues to rise daily.
2. We have revised our administrative plan to reflect a more reasonable and realistic application of the nine elements provided in HUD regulations for determining rent reasonableness. GoSection8 applies the required adjustments pertaining to these elements when rent comparables are not a perfect match for the unit in question and complies with both our administrative plan and HUD regulations on this matter.
3. We are providing ongoing training to Inspections Unit staff regarding HUD requirements for determining rent reasonableness, use of the GoSection8 system, negotiation skills, and communication. Much of this training is conducted by outside vendors (i.e., Fred Pryor seminars). We also continue to assess our processes and look for ways to improve our compliance with HUD regulations and enhance our efficiency.
4. We have established an internal audit position and rent reasonability will be one of the key areas for our audits.

We believe these corrective actions fully address the issues raised in the audit and comply with the recommendations listed in the Draft Audit Report.

Comment 2

PENALTY (Recapture of \$1.36 million administrative fee)

With regard to the recommendation that HUD recapture a \$1.36 Million (or 8.7 percent) administrative fee earned over the two-year period covered by the audit, we strongly disagree and believe this penalty is excessive, unfair and arbitrary, and request that it be eliminated for the following reasons:

1. The administrative fee recapture is not consistent with other OIG audit penalties.

OIG audits conducted at other housing authorities for rent reasonableness activities resulted in a much smaller or no administrative fee recapture recommended, even when there were thousands of dollars more in questionable housing assistance payments. For example, the recent audit of the Housing Authority of the County of Contra Costa, which administers 6,800 vouchers and \$74 million in HAP, resulted in a recommended recapture of \$82,659 in HAP and \$77,997 in administrative fee. An audit of the rent reasonableness activities of the Housing Authority of the City of Los Angeles resulted in a recommendation of a recapture of \$186,881 in HAP and *no* recapture of administrative fee.

When these outcomes are compared to the penalties in our case of \$17,391 in HAP and \$1.36 million in administrative fee, the penalty seems extremely inconsistent, anomalous and excessive, and should therefore be eliminated. Our review of OIG audits across the country revealed many other instances where audits of Section 8 processes resulted in penalties of repayment of overpaid HAP, yet there was *no* administrative fee recapture.

Additionally, since our audit happened to review files over a 2-year period of time, the administrative fee recapture was then tallied for a 2-year period of time. If the audit happened to be for only 6 months (as was the case for the Contra Costa audit cited above), but still had the same amount of error, then the administrative fee penalty would presumably have been 75% less. This methodology for calculating a penalty seems unnecessarily arbitrary and has resulted in an administrative fee recapture that is excessive and inconsistent, and should therefore be eliminated.

Comment 3

2. The administrative fee recapture is grossly disproportionate to the errors found.

Out of 50 files reviewed, 40 "*were not done in accordance with HUD rules and regulations.*" Out of those 40, there were 24 cases with questionable housing assistance payments in the amount of \$17,391 over the two year period reviewed. The total housing assistance paid for those 50 households for that same period was approximately \$1,356,000 and, therefore, \$17,391 represents only 1.28% of the total assistance provided. While no amount of unsupported assistance should be acceptable, this is a relatively minor amount of error when you consider the total HAP represented by the audited files.

Additionally, 50 files is not statistically representative of the 9,527 Section 8 vouchers our agency administers for the County allocation of over \$75 million in HAP annually. Therefore, the small sample OIG tested, with its large margin of error, cannot be used to extrapolate that

Comment 2

the deficiencies discovered were prevalent across the entire 9,527 files throughout a two year period. The results of this audit, therefore, do not support the recommended broad penalty assessed on *all* of our rent reasonableness processing for the entire program over a two year period. Consequently, when the Draft Audit Report states on page 5 that our agency “...received more than \$15 million in administrative fees of which nearly \$1.4 million was unearned,” it is not a statement of fact and cannot be ascertained with any certainty from the sample size reviewed.

Since the amount of questionable HAP (\$17,391) is extremely small (1.28%) when compared to the total HAP dispersed for those cases within the audit scope, and since the findings in a fifty file sample are not statistically representative of 9,527 cases, accordingly, an across-the-board penalty of 8.7% (or \$1.36 million) in administrative fees (apparently intended to correspond to the amount of our *total* rent reasonableness activity) is grossly disproportionate and not supported and should, therefore, be eliminated.

3. The administrative fee recapture erroneously implies gross negligence and/or fraud.

Comment 4

Our non-compliance with HUD regulations where rent reasonableness is concerned was not done with intent to undermine or defraud the system, but rather grew out of an environment where staff had to deal with time and work constraints, a barrage of regulations and policies, and desperate tenants. Although our staff did not always follow the “rules,” the process they did follow maintained regard for the program objectives and ultimately did result in housing assistance payments that were generally rent reasonable.

Comment 5

This is supported by the results of an OIG audit dated August 29, 2001 and entitled Rent Reasonableness for Section 8 Tenant-Based Units (No. 2001-SE-103-0802) that was conducted to determine if HUD’s rent reasonableness requirements were cost effective, adequate and worked as prescribed. The audit found that while none of the four housing agencies studied (one of which was our agency) was in full compliance with HUD’s rent reasonableness requirements, staff was still able to establish reasonable rents using “non-compliant” methods. Out of 141 units tested in that study, 140 were determined to have a reasonable rent.

It is important to note that Santa Clara County has some of the highest rents in the country and HUD was compelled to implement a special increase in Fair Market Rents for larger bedroom sizes during the audit review period, yet we maintained our Voucher Payment Standards at the level in effect before the increase and continued to keep our rents below that level.

Additionally, the following facts attest to the fact that our staff has always exercised fiduciary responsibility in disbursing over \$250 million in housing assistance payments:

- We receive daily telephone calls from frustrated owners;
- Over 300 new contracts were denied during the period of review due to unjustifiable rents;
- Approximately 5,400 rent reductions were made during this period as a result of drastically reduced Fair Market Rents.

Comment 2

The *massive* \$1.36 million administrative fee penalty recommended implies gross negligence and complete disregard for our responsibility of handling HUD funding, which is not true as outlined above and as evidenced by the audit which did not disclose such improprieties, and therefore, the penalty should be eliminated.

4. The basis of the penalty calculation is not logical.

Comment 6

The recapture of \$1.36 million in administrative fee is excessive and unreasonable because it has no logical basis. The Draft Audit Reports states on page 13 under the section entitled Conclusion: "...we determined approximately 8.7 percent of employee time in the Housing Programs Division was dedicated to the rent reasonableness process. Therefore, we recommend that 8.7 percent of the administrative fees or 1.36 million be repaid to HUD."*

This basis for calculation is not logical for two reasons:

- a. This basis assumes that the administrative fee pays *only* for the Housing Programs Department staff. In fact, the administrative fee also pays for staff in administrative and finance departments and includes non-employee expenses as well. Therefore, if 8.7% of employee time in the Housing Programs Department is spent on the rent reasonableness process and if one wanted to take a commensurate amount from the administrative fee, it would *not* translate to a recapture of 8.7% of the total administrative fee earned.
- b. The basis also assumes that 8.7% of the total time spent by all employees in the Housing Programs Department is spent on rent reasonableness activities. While we can concur that the majority of employees who do rent reasonableness as part of their job actually do spend 8.7% of their time on rent reasonableness (and an additional two employees spend approximately 90% of their time on rent reasonableness), that does not mean that 8.7% of *all* the employee time in the Housing Programs Department is spent on rent reasonableness activities.

Taking these points into consideration, one would first exclude the accounting and management fees as well as costs related to employees *not* performing rent reasonableness processes from the total administrative fee before calculating the penalty. The resulting penalty would in fact be only a fraction of the \$1.36 million recommended. In addition, since the audit determined that *20% of the files audited were in compliance*, and therefore should not be subject to penalty, the resulting penalty would then have 20% deducted. Also, 45% of those files not processed in a HUD-compliant way still maintained rent reasonableness and had *no* questionable HAP, therefore the penalty would be further reduced by 45%.

While this more logical basis for the calculation intended by the auditors results in a penalty that is a fraction of the recommended \$1.36 million, we still contend that this penalty would be completely inappropriate and excessive for the previously stated reasons (#1, 2 and 3 above) and should, therefore, be eliminated.

*Elsewhere in the Draft Audit Report it states something different from "8.7 percent of employee time"; page 17, paragraph 3 states "We determined 8.7 percent of the full-time employees in the Authority's Housing Programs Division were performing rent reasonableness functions." Employee time versus number of employees are two very different measurements. We have assumed that employee time was the intended measurement.

Joan S. Hobbs, Regional Inspector General for Audit
February 26, 2007
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Comment 2

For these reasons outlined above, we strongly disagree with the administrative fee penalty of \$1.36 million recommended in the Draft Audit Report and request that it be eliminated. I would like to reiterate that we respect the audit process and have worked diligently to bring our program into compliance. I simply ask that the administrative fee penalty be reconsidered and eliminated since it is not commensurate with the impact our actions had (or did not have) on the Section 8 program as a whole.

Thank you for considering these points. If I can provide more information, please call me at (408) 993-2905.

Sincerely,

HOUSING AUTHORITY OF THE
COUNTY OF SANTA CLARA



Alex Sanchez
Executive Director

OIG Evaluation of Auditee Comments

Comment 1 Since the Authority agreed with the finding and is already taking corrective action, we have no further comment on the finding. However, we would like to point out, that while we agree that the rents in some cases were below the voucher payment standards, the Authority should still comply with HUD rules and regulations, as well as its HUD-approved administrative plan. Further, while our audit report only discussed results of the 50 tenant files we reviewed, it should be pointed out that the Authority consistently failed to administer its rent reasonableness determinations in accordance with HUD requirements.

Comment 2 The methodologies used for calculating the administrative fee to be recaptured under this audit as well as our audit of Housing Authority of the County of Contra Costa were consistent. The amount was based on the percentage of full-time-equivalent employees dedicated to the rent reasonableness process, and applied to our audit scope. We consulted with the director of the San Francisco HUD Office of Public and Indian Housing, and obtained his concurrence with the methodology used. As discussed in Comment 5, the percentage was based on information obtained directly from the Authority's managers in the housing programs division. Therefore, we believe the administrative fee recommended for recapture is accurate and did not make any changes to the amount. The Authority can work with HUD during the audit resolution process if it feels that the amount is inaccurate.

As discussed in Comment 1, the Authority consistently failed to administer its rent reasonableness determinations in accordance with HUD requirements. Therefore, we believe the Authority did not earn the applicable portion of the administrative fees. This systemic problem was the basis for recommending recapture of a percentage of the administrative fee. Each external audit we conduct has different circumstances, including different scopes and different reasons for the deficiencies, so it is inappropriate to compare each audit as though they were the same.

Comment 3 The Authority is paid the administrative fee to correctly and adequately administer the Section 8 program. The rent reasonableness determinations, while only a part of the entire process, are integral to administering the Section 8 program correctly. As discussed in Comment 1, the Authority consistently failed to administer its rent reasonableness determinations in accordance with HUD requirements. While we agree that we only questioned housing assistance payments for 24 cases, the fact remains that 40 out of 50 files (80 percent) we reviewed were not done in accordance with HUD requirements. In these 40 files, we found that the selected "comparables" were not really comparable to the assisted units. We could not determine rent reasonableness in every case, partly due to the inadequacy of the Authority's database.

- Comment 4** Our report states that the Authority disregarded HUD requirements and the Authority agreed in its written response that it did not administer its rent reasonableness determinations in accordance with HUD requirements. Our audit disclosed that housing assistance payments were made although reasonable rents were not determined according to HUD requirements.
- Comment 5** The results of our audit disclosed the Authority, for the period July 1, 2004 through June 30, 2006, was not following HUD requirements in determining whether rents were reasonable. Therefore, we determined there was no assurance the current rents were reasonable. The audit period for OIG audit report dated August 29, 2001, was November 1998 through March 2001. We cannot address what the Authority's policies and procedures were during that time for determining rent reasonableness.
- Comment 6** We believe the 8.7 percent is accurate and logical, based on the information we were provided during the audit. We interviewed all section managers involved in the rent reasonableness process and determined that 8.7 percent of the full-time-equivalent employees in the housing program perform work related to the rent reasonableness process. Based on our review, the Authority should return the unearned administrative fees because it did not comply with rent reasonableness requirements and lacked sufficient data to perform the determinations. If this percentage needs to be adjusted for administrative and finance department employees, the Authority can provide this information to HUD during the audit resolution process.

Appendix C

SUMMARY OF QUESTIONED COSTS

File	Subsidy #	Lease Effective	Months Questioned	Ineligible Costs	Unsupported Costs
1	V00282	1-Mar-05	16	764	
2	V76247	1-Apr-05	14	1484	
3	V01765	1-Jun-05	5		365
4	V20017		0		0
5	V79464	1-Nov-05	5	1260	
6	V29749		0		0
7	V29749	1-Jan-06	6		522
8	V78758	1-May-06	2		638
9	V78758		0		0
10	V78927		0		0
11	V73551	1-Mar-05	16	764	
12	V31095		0		0
13	V21423		0		0
14	V78752		0		0
15	V72084		0		0
16	V74183		0		0
17	V48168		0		0
18	V01305	1-Mar-05	16	764	
19	V78993	1-Nov-05	8	1000	
20	V20238	1-Mar-05	16	764	
21	V31103		0		0
22	V28178		0		0
23	V28178		0		0
24	V73597	1-Jul-05	5	861	
25	V30090	1-Jan-06	6	1092	
26	V27595		0		0
27	V20461	1-Nov-05	2		100
28	V26638		0		0
29	V77678		0		0
30	V27011		0		0
31	V27486	1-May-06	2		100
32	V27757	14-Mar-06	3	267	
33	V26760	1-Mar-06	3		921
34	V23389		0		0
35	V72606	1-Mar-05	16	764	
36	V78506	1-Mar-05	14	1610	
37	V72380		0		0
38	V22364	1-Jan-06	6		522
39	V71655	1-Jun-06	1		30
40	V78939	1-Oct-05	9		1,485
41	V77735		0		0
42	V74463		0		0
43	V30826		0		0
44	V24272		0		0
45	V79458		0		0
46	V79488	1-Nov-05	8	960	
47	V79420	1-Dec-05	7	210	
48	V78550		0		0
49	V21347		0		0
50	V78178	1-Feb-05	1		144
	Total			12,564	4,827

Appendix D

SCHEDULE OF DEFICIENCIES

File	Tenant Subsidy #	1	2	3	4	5	6
1	V00282	x					x
2	V76247	x			x		
3	V01765	x		x			
4	V20017	x					
5	V79464	x	x	x			
6	V29749	x	x				
7	V29749	x	x				
8	V78758	x		x			
9	V78758	x					
10	V78927	x					
11	V73551	x					x
12	V31095	x	x				
13	V21423	x		x			
14	V78752	x		x			
15	V72084						
16	V74183	x	x				
17	V48168	x					
18	V01305	x					x
19	V78993	x					
20	V20238	x					x
21	V31103	x					
22	V28178	x	x				
23	V28178	x					
24	V73597				x		
25	V30090	x					
26	V27595						
27	V20461					x	
28	V26638	x					
29	V77678						
30	V27011	x					
31	V27486	x	x				
32	V27757						
33	V26760	x	x				
34	V23389	x	x				
35	V72606	x					x
36	V78506	x					
37	V72380	x	x				
38	V22364	x	x				
39	V71655	x		x			
40	V78939				x		
41	V77735						
42	V74463						
43	V30826						
44	V24272	x	x				
45	V79458	x		x			
46	V79488	x		x			
47	V79420	x		x			
48	V78550	x		x			
49	V21347	x					
50	V78178	x		x		x	

Legend

- 1 Assisted and comparables used are not like and similar.**
- 2 "Comparable unit" with different structure type.**
- 3 "Comparable unit" with different unit size.**
- 4 Rent reasonableness determination not performed.**
- 5 Rent reasonableness performed after housing assistance payment disbursement.**
- 6 Assisted unit rent exceeded rents for other assisted units in the same complex.**

Appendix E

APPLICABLE REGULATIONS

The following sections of the *Code of Federal Regulations* apply to rent reasonableness determination:

24 CFR 982.507 states the following:

- The PHA [public housing authority] may not approve a lease until the PHA determines that the initial rent to owner is a reasonable rent. **Section 982.507(a)(1)**
- The PHA must redetermine reasonable rent (a) before any rent increase in the rent to the owner, (b) if there is a 5 percent decrease in the published FMR [identify acronym] in effect 60 days before the contract anniversary, or (c) if directed by HUD. **Section 982.507(a)(2)**
- The PHA must determine whether the rent to owner is a reasonable rent in comparison to rent for other unassisted comparable units. **Section 982.507(b)**

24 CFR 982.54 states: “The PHA must adopt a written administrative plan that establishes local policies for administration of the program in accordance with HUD requirements.

24 CFR 982.158(f)(7) states: “The PHA must keep the following records for at least three years. Records to document the basis for PHA determination that rent to owner is a reasonable rent (initially and during the term of a HAP [housing assistance payment] contract).”

24 CFR 982.152(2)(d) states: “HUD may reduce or offset any administrative fee to the PHA, in the amount determined by HUD, if the PHA fails to perform PHA administrative responsibilities correctly or adequately under the program.”