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August 17, 2001 **2001-FW-1807**

MEMORANDUM FOR: Ronald C. Bailey
Director, Denver Homeownership Center, 8AHH

/SIGNED/

FROM: D. Michael Beard
District Inspector General for Audit, 6AGA

SUBJECT: Community Housing Fund
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 Community Housing Fund's purchase of Real Estate Owned (REO) properties. Our objectives were to determine whether Community Housing Fund 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 of Community Housing Fund's management and employees, past and present Community Housing Fund tenants, Ranscott Construction's[1] owner and one of its employees, and homebuyers. Further, we reviewed property files maintained by Community Housing Fund, HUD REO case files, FHA loan files, conducted on-site reviews of the properties, and analyzed Community Housing Fund's financial data. Our audit scope included properties purchased by Community Housing Fund from January 1, 1998, through May 14, 2001.

Our audit concluded Community Housing Fund did not meet HUD's affordable housing program's objectives and Community Housing Fund received excess profits from the resale of properties obtained under the affordable housing program.

We recommended HUD remove Community Housing Fund from its affordable housing program and require Community Housing Fund to repay excess profits to pay down the homebuyers' mortgages.

We sent a draft of this audit memorandum to Community Housing Fund on August 7, 2001. Community Housing Fund provided oral comments on July 9, 2001, and written comments on August 13, 2001. Overall, Community Housing Fund disagreed with the findings and stated the

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[1] Community Housing Fund used Ranscott Construction as its repair/rehabilitation contractor.

draft memorandum "is incomplete and inaccurate in its reporting of our activities and its description of HUD's Programs." However, Community Housing Fund did not provide documentation or specifics to support its statement.

Within 60 days please give us, for each recommendation made in this memorandum a status report on: (1) corrective action taken; (2) proposed corrective action and date to be completed; or (3) why action is considered unnecessary. Also, please furnish us copies of any correspondence or directive issued because of this review.

If you have any question contact William W. Nixon, Assistant District Inspector General for Audit, at 817-978-9309.

Attachment

Background

Community Housing Fund was formed in 1992, to work with low-income families to help them purchase their own homes. Community Housing Fund's office is located in Irving, Texas. A Board of Directors oversees the operation of Community Housing Fund and its five employees.

According to its 2000 Annual Report,[2] Community Housing Fund:

> "realized many families wanted to own homes but could not immediately qualify for mortgages. As a result, Community Housing Fund developed its lease-purchase program, wherein it purchased a property, rehabilitated it back to Federal Housing Administration (FHA) standards, and entered into a lease that enabled the family to purchase at any time they were able to qualify for a mortgage. Throughout the process, Community Housing Fund met as needed individually with the families to answer any questions and guided the home purchasing progress."

In HUD's attempt to increase affordable housing opportunities to low- and moderate-income homebuyers, HUD encouraged nonprofit organizations to participate in HUD's FHA programs. Nonprofit and governmental organizations can participate in these programs by being the mortgagor, purchasing homes through the HUD Homes Program, providing Secondary Financing, or Downpayment Assistance.[3]

Community Housing Fund participated as a mortgagor and as a purchaser of homes through the HUD Homes Program.

Community Housing Fund could purchase properties from HUD or other parties, and obtain FHA insured mortgages. HUD required Community Housing Fund "to qualify for the mortgages by demonstrating to the mortgagee providing the financing that they have the management ability to administer its programs and the financial capability to support the mortgage(s)." The nonprofit mortgagor is eligible for the same low downpayment terms as an owner occupant mortgagor.

Also, Community Housing Fund purchased homes through the HUD Homes Program (REO Discount Sales Program). HUD sold properties at discounts ranging from 10 to 50 percent off the as-is appraised value of the property(s). Under the most common program, it could purchase HUD owned properties at a 30 percent discount if the properties are in a HUD designated revitalization area. HUD owned properties, which are not in a revitalization area, could be purchased at a 10 percent discount.

HUD principally used the Community Housing Fund's Affordable Housing Program to determine whether to approve it in participating in HUD's discount sales program or be approved

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[2] HUD requires nonprofits to submit Annual Reports.

[3] Mortgagee Letter 00-08.

as a mortgagor. Among other things, this program described Community Housing Fund's purpose for participating in the FHA programs, how low- and moderate-income persons benefited from the program, and how the program passed along to low-income persons any savings received from the discounted purchase of a HUD-owned property. The Homeownership Centers (HOC) reviewed and approved the Affordable Housing Plans for their jurisdictions.

HUD required Community Housing Fund to provide annual reports on the properties it purchased at a 30 percent discount and recertify their organization and affordable housing programs on a biannual basis.

HUD approved Community Housing Fund's participation in its programs as shown:[4]

- February 16, 1999, the Denver HOC approved Community Housing Fund for participation in HUD programs as an agency providing a lease/purchase program together with downpayment and closing cost assistance.

- April 1, 1999, the Denver HOC approved Community Housing Fund to purchase homes under the HUD/FHA insured program.

- June 15, 1999, the Atlanta HOC approved Community Housing Fund to purchase HUD REO with a 30 percent discount.

- December 3, 1999, the Santa Ana HOC approved Community Housing Fund to purchase one property at a time in Las Vegas, Nevada; and Phoenix, Arizona; until it demonstrated its ability to sell or rent the properties.

- August 23, 2000, the Denver HOC approved a compromise that allowed Community Housing Fund to purchase REO properties only but not utilize FHA financing on these properties.

- July 23, 2001, the Denver HOC temporarily suspended Community Housing Funds' approval to purchase REO at a discount pending the results of this audit.

As of March 9, 2000, Community Housing Fund owned 483 properties in Dallas/Fort Worth, Texas; Tampa/St. Petersburg, Orlando; and Riviera Beach, Florida. Community Housing Fund had planned to expand its operations into Fort Lauderdale, Florida.

Audit Objective, Scope, and Methodology

Our audit objectives were to determine whether Community Housing Fund was legitimate and independent (not under the influence, control, or direction) of other parties and passed on the

[4] Community Housing Fund had to obtain the approval of the individual HOCs.

benefits of discounts received on the purchase of HUD homes to low- and moderate-income homebuyers.

To accomplish our objectives, we conducted interviews of Community Housing Fund's management and employees, past and present Community Housing Fund tenants, Ranscott Construction's[5] owner and one of its employees, and homebuyers. Further, we reviewed property files maintained by Community Housing Fund, HUD REO case files, FHA loan files, conducted on-site reviews of the properties, and analyzed Community Housing Fund's financial data.

The Denver Office of Inspector General (OIG) selected the ten properties to be reviewed from the individual Single Family Asset Management System (SAMS) reports on the selected nonprofit. They attempted to select properties purchased at a 30 percent discount and then subsequently resold. Whenever possible, every effort was made to select 30 percent discounted properties that were then resold by the nonprofit to individuals that used FHA insurance. Community Housing Fund purchased a total of 154 properties from HUD at a 30 percent discount. Of these 154 properties, Community Housing Fund subsequently resold 7 properties.[6] Individuals obtained FHA insured mortgages for four of the seven resold properties. They randomly selected from the 154 properties. We added an additional property to the sample because the buyer was a Community Housing Fund employee.

The audit included properties purchased by Community Housing Fund from January 1, 1998, through May 14, 2001. We performed our fieldwork from May 30, 2001, through July 9, 2001. We conducted our audit in accordance with generally accepted government auditing standards.

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5 Community Housing Fund used Ranscott Construction as its repair/rehabilitation contractor.

6 One property selected by the Denver OIG was initially identified as a resold property. However, additional audit work determined the property had not been resold, but remained in Community Housing Fund's inventory as a rental property.

Community Housing Fund Failed to Meet Affordable Housing Objectives.

Community Housing Fund amassed a real estate portfolio of over 400 properties, did not maintain a program to move tenants to homeownership, sold property to investors and an employee, received profits in excess of 110 percent of its net development costs, calculated net development costs incorrectly, could not support its net development costs, and maintained a conflict-of-interest with its repair/rehabilitation contractor. Community Housing Fund believed it met the objective of providing affordable housing because it provided long-term rentals to Section 8 participants. However, HUD's objective was to increase opportunities for affordable homeownership to low- and moderate-income persons. Providing rental properties did not accomplish HUD's homeownership objectives. HUD should remove Community Housing Fund from participating in the nonprofit affordable housing program and require them to pay down the mortgage for properties sold in excess of 110 percent of development costs that it cannot support.

Criteria.

HUD allowed Community Housing Fund under certain circumstances to receive up to a 30 percent discount on the sales price of a property. Mortgagee Letter 97-5 intended for Community Housing Fund to perform necessary repairs and resell the property to individuals/families who intend to occupy and whose income does not exceed 115 percent of the median income for the area, when adjusted for family size. The resale price of the property could not exceed 110 percent of the net development cost. Lenders should expect to receive a Land Use Restriction Addendum with the REO Sales Contract, which specifies the obligations of the buyer on properties purchased at a discount in excess of 15 percent.

HUD defined the net development cost as the total cost of the project, including items such as acquisition cost, architectural fees, permits and survey expenses, insurance, rehabilitation, and taxes. Community Housing Fund could also include amounts for acquisition financing, management fees and selling expenses. Further, HUD allowed Community Housing Fund to include up to 3 months' mortgage payments, less all rents received. The net development cost could not include gifts to the eventual purchaser for the downpayment, financing or closing costs, nor any other related expenses associated with that buyer's purchase of the property.

If the sales price exceeds 110 percent of the net development cost, then Community Housing Fund must use the excess profit to pay down the existing mortgage. The underwriter, prior to closing the loan, must review supporting documentation. Community Housing Fund had the responsibility to make sure they were in full compliance with all HUD requirements. Further, the profit on the sale of one property cannot be offset by the lesser profit or loss on another property.

Also, HUD prohibited Community Housing Fund from having a conflict-of-interest with individuals or firms that may provide acquisition or rehabilitation funding, management or sales services, or other services associated with the property.

HUD could remove a nonprofit from the program for the following reasons:[7] Mortgagee Letter 00-08, Attachment 4 listed reasons for removal including:

(i) Discounts received by the nonprofit agency in purchasing HUD Homes are not adequately passed on to the homeowner; or
(ii) The nonprofit agency does not achieve the majority of the goals as outlined in their affordable housing plans.

Community Housing Fund Amassed a Real Estate Portfolio of Over 400 Properties.

Community Housing Fund amassed a real estate portfolio of over 400 properties since its inception. Community Housing Fund used this real estate portfolio as Section 8 rental properties. HUD's Discount Sales Program's objective was to increase affordable opportunities to low- and moderate-income homebuyers. For properties purchased from HUD, Community Housing Fund received a 30 percent discount to rehabilitate the property and then sell the property to low- and moderate-income persons. However, Community Housing Fund rented its real estate portfolio to Section 8 participants with no program to move the participants to homeownership. HUD allowed Community Housing Fund to have long-term rentals.[8] However, HUD did not intend Community Housing Fund to become a traditional market rate landlord. Community Housing Fund believed it met the objective of providing affordable housing because it provided the rental housing. By failing to provide a program to move Section 8 tenants to homeownership, Community Housing Fund did not meet HUD's affordable housing program requirements.

Community Housing Fund Provided No Program to Move Tenants to Homeownership.

In interviews of the tenants, all five expressed a desire to become a homeowner. Further, all but one stated Community Housing Fund never provided any counseling to them about homeownership. Community Housing Fund reported to HUD that it provided a lease-purchase program to its tenants. However, in reality, Community Housing Fund collected monthly rents from local housing authorities and its tenants. Of the properties reviewed, no tenant had a lease-purchase agreement with Community Housing Fund. Also, Community Housing Fund knew which properties it could rent prior to the purchase of the property.

For example, Community Housing Fund purchased the property at 2249 Leacrest on July 22, 1999. However, Community Housing Fund signed a rental agreement with the tenant on July 13, 1999. Additionally, Dallas Housing Authority notified Community Housing Fund on July 17, 1999, that $603 was a reasonable rent. On July 21, 1999, Community Housing Fund requested an increase in rent to $675. Dallas Housing Authority increased the rent to $664. Community Housing Fund made monthly mortgage payment of $408.[9] On this property, Community Housing Fund received $256 monthly above its mortgage payment on this property.

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[7] Mortgagee Letter 00-08.
[8] Mortgagee Letter 96-52.
[9] This amount is rounded to the nearest dollar.

Community Housing Fund Sold to Investors and an Employee of Its Repair/Rehabilitation Contractor.

Community Housing Fund sold two of the five properties reviewed to investors. Community Housing Fund's affordable housing program stated it rehabilitated the properties then entered into a lease that enabled a family to purchase the property. HUD sold properties to nonprofits to increase opportunities to low- and moderate-income homebuyers. Selling properties to investors that rented out the properties did not meet this objective. Further, none of the other three homebuyers were Community Housing Fund tenants prior to their purchase of property.

Employee Received Preferential Treatment.

Also, the Community Housing Fund sold the property on Calle Del Sol to a prior employee of Ranscott Construction.[10] Prior to the employee working at Ranscott Construction, this employee worked for Hildenbrand Associates, a company operated by the President of Community Housing Fund. Presently the employee works for Community Housing Fund. The Community Housing Fund's President stated Community Housing Fund sold the Calle Del Sol property at cost.

The employee received preferential treatment. Specifically, the employee received housing counseling from Community Housing Fund's President prior to the purchase of the property. Further, the president admitted she resold the property for Community Housing Fund's cost. As shown in the table below, Community Housing Fund made a profit on six properties resold except the property resold to the employee.

Table 1: Calculation of Community Housing Fund's Profit

	HUD Sale Price	30 Percent Discount	Total Acquisition Cost to Community Housing Fund	Net Development Costs less Acquisition Costs	Sales Price to Home Buyer	Community Housing Fund's Profit
3517 Calle Del Sol	$75,100.00	$22,530.00	$75,928.50	$14,078.11	$73,000.00	($17,006.61)
10239 San Lorenzo	$40,000 .00	$12,000.00	$30,187.59	$30,741.95	$65,000.00	$4,070.46
2462 Highwood	$52,000.00	$15,600.00	$37,224.34	$28,952.13	$73,000.00	$6,823.53
10523 Newcombe	$53,000.00	$15,900.00	$38,655.44	$13,995.82	$60,000.00	$7,348.74
2140 Springhill	$63,000.00	$18,900.00	$44,640.00	$29,311.77	$84,200.00	$10,248.23
2260 Peavy Circle	$81,600.00	$24,480.00	$58,934.25	$19,025.89	$90,000.00	$12,039.86

[10] This memorandum later discusses an apparent conflict of interest between Ranscott Construction and Community Housing Fund.

Community Housing Fund Received Profits in Excess of 110 Percent of Net Development Costs.

Community Housing Fund received profits in excess of 110 percent of its net development costs. Specifically, Community Housing Fund received $9,386 in excess profits for four of the six properties reviewed. Mortgagee Letter 97-5 and addendums to HUD's sales contract required Community Housing Fund's resale price not exceed 110 percent of the net development cost. Additionally, Community Housing Fund did not document its net development costs. Also, Community Housing Fund included unallowable costs in its computation of net development costs.

For four of the six properties reviewed, Community Housing Fund received profits in excess of 110 percent of its net development costs. Of the six properties reviewed, Community Housing Fund only met HUD sales requirements on 3517 Calle Del Sol[11] and 10239 San Lorenzo.

HUD allowed Community Housing Fund to sell properties at 110 percent of the net development costs. Net development costs included acquisition costs, architectural fees, permits and survey expenses, insurance, rehabilitation, and taxes. The table below shows the amount above 110 percent of net development costs that Community Housing Fund sold the six properties reviewed.

Table 2: Excess Profit Calculation

	Net Development Cost	*Resale Cost*	*Percentage of Development Costs*	*110% of Net Development Cost*	*Difference*
3517 Calle Del Sol	$90,006.61	$73,000.00	81.11%	$99,007.27	($26,007.27)
10239 San Lorenzo	$60,929.54	$65,000.00	106.68%	$67,022.49	(2,022.49)
2462 Highwood	$66,176.47	$73,000.00	110.31%	$72,794.12	205.88
2140 Springhill	$73,951.77	$84,200.00	113.86%	$81,346.95	2,853.05
10523 Newcombe	$52,651.26	$60,000.00	113.96%	$57,916.39	2,083.61
2260 Peavy Circle	$77,960.14	$90,000.00	115.44%	$85,756.15	4,243.85
Total Excess Profit					**$ 9,386.40**

Net Development Cost Calculated Incorrectly.

The Community Housing Fund did not calculate its net development costs correctly because Community Housing Fund used unallowable costs in its calculation. For example, on 2140 Springhill Community Housing Fund calculated its net development cost as $81,143.[12] To compute this amount, Community Housing Fund calculated the net development cost as the sales price less the 30 percent discount plus closing cost amounts it paid for the HUD closing.

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[11] Sold to the employee.

[12] This number is rounded to the nearest dollar. Community Housing Fund reported this amount in its annual report to HUD dated March 9, 2001.

Community Housing Fund then added maintenance fees; insurance; interest; and costs for rehabilitation, survey, inspection; and utilities to the computation and totaled the net development cost. However, Community Housing Fund included the amount it paid for closing costs as its maintenance fee. Mortgagee Letter 97-5 expressly prohibited closing costs in the calculation of net development costs. As a result of Community Housing Fund's use of the unallowed costs, it inflated its net development costs.

Community Housing Fund Cannot Support Its Net Development Costs.

For other properties reviewed, Community Housing Fund could not provide support for information it reported to HUD in its Annual Report for its net development costs. Specifically, Community Housing Fund maintained no invoices of services or rehabilitation provided. The president stated it routinely "purged" its files.

To support the rehabilitation, Community Housing Fund provided a check written to Ranscott Construction. Although the check showed Community Housing Fund paid Ranscott Construction, it did not provide evidence of allowable activities to include as net development costs. Further, Community Housing Fund did not maintain an arms-length transaction between itself and Ranscott Construction.

The president believed there was no requirement to maintain supporting documentation for its net development cost. On March 9, 2001, Community Housing Fund reported to HUD how it met its affordable housing goals and amounts spent on acquisition and rehabilitation. To support the reported rehabilitation amounts, Community Housing Fund believed a copy of the cancelled check, to its repair/rehabilitation contractor, provided sufficient documentation. However, as of June 1, 2001, Community Housing Fund began maintaining detailed supporting documentation of its repair/rehabilitation costs.

Based on its records, Community Housing Fund received $9,386 in excess profit. However, Community Housing Fund's records did not provide supporting documentation for its net development cost. The president admitted it could not provide evidence of its net development cost. Since Community Housing Fund could not provide supporting documentation for its net development costs, HUD should require Community Housing Fund to pay the $107,343 it received in excess profits, as shown in the following table.

Table 3: Pay Down Mortgage Amounts Because Community Housing Fund Cannot Support Costs

	Unsupported Costs[13]	Amount Net Development Cost If Community Housing Fund Cannot Provide Support	110% of Unsupported Net Development Costs	Amount Community Housing Fund Would Owe If It Cannot Support Expenses
3517 Calle Del Sol	$0.00	$90,006.61	$99,007.27	$ 0.00
10523 Newcombe	$ 8,077.00	$52,852.54	$58,137.79	8,884.70
2260 Peavy Circle	$14,125.00	$52,051.47	$57,256.62	15,537.50
2462 Highwood	$24,765.00	$49,186.77	$54,105.45	27,241.50
2140 Springhill	$25,218.00	$27,433.26	$30,176.59	27,739.80
10239 San Lorenzo	$25,400.00	$52,560.14	$57,816.15	27,940.00
				$107,343.50

Community Housing Fund Maintained Conflict-of-Interest with Contractor.

Finally, Community Housing Fund's President had a conflict-of-interest with its repair/rehabilitation contractor, Ranscott Construction. Mortgagee Letter 97-5 states there may not be a conflict-of-interest with individuals or firms that may provide acquisition or rehabilitation funding, management or sales, or other services associated with the property. Specifically, the president had a personal relationship with the owner of Ranscott Construction. Ranscott Construction provided all of the repair/rehabilitation work performed on properties purchased by Community Housing Fund. Community Housing Fund paid Ranscott Construction a lump sum and Ranscott Construction hired subcontractors to perform the work. Ranscott Construction's owner admitted he made a lot of money performing this work. During an 11-month period, Community Housing Fund paid Ranscott Construction over $1.9 million. Neither Community Housing Fund nor Ranscott Construction could provide any supporting documentation for the work. Because of the conflict-of-interest and lack of supporting documentation, Community Housing Fund could not support its net development costs.

As a result of Community Housing Fund's lack of a program to move its tenants to homeownership, selling to investors and an employee, selling properties in excess of 110 percent of net development costs, and maintaining a conflict-of-interest with its repair/rehabilitation contractor, Community Housing Fund did not meet HUD's affordable housing objectives. HUD should remove Community Housing Fund from its affordable housing program and have Community Housing Fund pay down the mortgages where they received excess profits.

[13] Payments to Ranscott Construction.

Recommendations:

We recommend that the Director, Denver Homeownership Center:

1A. Remove Community Housing Fund from participating in the nonprofit affordable housing program for noncompliance with affordable housing objectives.

1B. Require Community Housing Fund to provide HUD with a listing of all HUD properties sold and the net development costs for those properties.

1C. Require Community Housing Fund to support its net development costs.

1D. Require Community Housing Fund to pay down the mortgage for properties sold in excess of 110 percent of development costs that it cannot support.

1E. Require Community Housing Fund to report on future sales of all HUD purchased properties and support its net development costs for these properties. Further, Community Housing Fund should pay down the mortgages of those properties sold in the future in excess of 110 percent of net development cost.

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