



Issue Date	August 19, 2004
Audit Case Number	2004-AT-1014

TO: Karen Cato-Turner  
Director, Office of Public Housing, 4DPH

*James D. McKay*

FROM: James D. McKay  
Regional Inspector General for Audit, 4AGA

SUBJECT: West Palm Beach Housing Authority  
West Palm Beach, Florida

### INTRODUCTION

We reviewed the West Palm Beach Housing Authority's (Authority) administration of its housing development activities. The review was performed as part of our audit of the Department of Housing and Urban Development's (HUD) oversight of Public Housing Agency activities with related nonprofit entities. The primary objective of our review was to determine whether the Authority diverted or pledged resources subject to an Annual Contributions Contract (Contract) or other agreement or regulation to the benefit of other entities without specific HUD approval.

To accomplish our objective, we reviewed applicable HUD regulations, the Authority's Contract, the executed Declaration of Trust, and other program-related requirements. We reviewed the Authority's files and records, including financial statements, trial balances, general ledgers, bank loan and closing documents, and minutes from Board of Commissioners (Board) meetings. We also interviewed HUD and Authority officials.

We performed our review between February and April 2004. Our review generally covered the period from April 1, 1998, through March 31, 2003, and other periods as necessary. We performed our review in accordance with generally accepted Government auditing standards.

We discussed our audit results with HUD and Authority officials during our review and at an exit conference on July 2, 2004. The Authority provided written comments to our draft on July 13, 2004. Those comments are summarized in the finding and included in their entirety as Appendix B.

HUD provided written management decisions for the audit recommendations on August 6, 2004. OIG concurs with HUD's management decisions on all audit recommendations.

In accordance with HUD Handbook 2000.06 REV-3, you should submit final action documentation to your designated audit liaison when actions are completed. Also, please furnish us copies of any correspondence or directives issued because of the audit.

Should you or your staff have any questions, please contact Barry Shulman, Assistant Regional Inspector General for Audit at (305) 536-5387.

### **SUMMARY**

The Authority improperly encumbered low-income housing properties as collateral for a \$3 million line of credit. In addition, the Authority used \$150,000 in capital funds to defray expenses associated with housing development activities without HUD approval. Therefore, low-income housing assets were unnecessarily put at risk, and capital funds were used in violation of HUD requirements. We believe these actions occurred because the Authority had not established adequate controls to monitor transactions and ensure that they met with HUD requirements.

### **BACKGROUND**

The Authority is a public body within the State of Florida, created in 1938 under the provisions of the United States Housing Act of 1937. The Authority was organized to provide low-rent housing for qualified individuals in accordance with the rules and regulations prescribed by HUD.

The Authority is governed by the Board, which is composed of five members. The Mayor of the City of West Palm Beach, Florida, appoints the Commissioners for 4-year terms. The Board employs an Executive Director (Director) to manage the day-to-day operations of the Authority. The Board exercises all powers granted to the Authority pursuant to Chapter 421, Florida Statutes.

Currently, the Authority manages 732 dwelling units under its Low-Income Housing Program. In fiscal year 2003, the Authority received \$1.9 million in operating subsidies and \$1.8 million for its Capital Funds Program. The Authority also administers three Section 8 Programs with a total of 2,082 units and received more than \$14.8 million from HUD in fiscal year 2003.

Between April 2001 and March 2002, the Authority created several related entities in an attempt to receive Homeownership and Opportunity for People Everywhere (HOPE) VI funds and obtain tax credits to pursue housing development activities. These entities never operated since the HOPE VI funds and tax credits were never received. In 2001, the Authority purchased a 96-unit multi-family complex known as Newton Woods and Sierra West Apartments. The Authority is also developing a mixed-finance, mixed-income housing complex in a 14-acre area known as MerryPlace at Pleasant City.

**FINDING 1: The Authority Inappropriately Encumbered Assets and Used Funds Without HUD Approval**

The Authority did not comply with Federal requirements governing the management of low-income housing assets and the use of capital funds. It improperly encumbered three low-income housing properties as collateral for a line of credit with a bank. The Authority also used \$150,000 in capital funds to defray expenses associated with the development of a mixed-finance, mixed-income housing development project without HUD approval. Therefore, low-income housing assets were unnecessarily put at risk, and capital funds were used in violation of HUD requirements. We believe these actions occurred because the Authority had not established adequate controls to monitor transactions and ensure they met with HUD requirements.

**The Authority Inappropriately Encumbered Low-Income Housing Properties**

Part A, Section 7, of the Contract provides in part that the Authority shall not in any way encumber any project or portion thereof without the prior approval of HUD. Section 7 further prohibits the Authority from pledging assets of the project covered under the Contract as collateral for a loan.

A Declaration of Trust, executed in May 1989, requires the Authority to retain title to the property and refrain from transferring, conveying, assigning, leasing, mortgaging, pledging, or otherwise encumbering the property or any part thereof, except under conditions stated in the Contract or with HUD approval.

The Authority violated its Contract with HUD by improperly encumbering three low-income housing properties as collateral to secure a \$3 million line of credit with a Florida bank (Bank). On April 15, 2002, the Board authorized the Authority to obtain financing for the development of MerryPlace at Pleasant City. On May 17, 2002, the Authority executed a Mortgage and Security Agreement (Agreement) with the Bank, placing as collateral a first mortgage on the land and all improvements of seven properties owned by the Authority. Among the seven properties initially placed as collateral, three were low-income housing properties with a total assessed value of \$631,734.

<u>Property Address</u>	<u>Property Value (2003)</u>
428 19th Street	\$ 290,350
437 19th Street	217,510
438 18th Street	<u>123,874</u>
Total	<u>\$ 631,734</u>

The Director stated that the Authority's bond counsel negotiated the Agreement with the Bank, including the selection of the encumbered properties. However, the Director stated that she did not recognize the properties as being low-income housing assets when she signed the Agreement. As of March 2004, the Authority had used more than \$2.8 million from the line of credit, and the loan is due in November 2004.

The Authority did not provide evidence of HUD approval to encumber low-income housing assets. Therefore, low-income housing assets were unnecessarily encumbered and put at risk in violation of HUD requirements.

### **The Authority Inappropriately Used Capital Funds**

Title 24 of the Code of Federal Regulations, Parts 941.604 and 941.606, requires the Authority to submit a detailed proposal, prepared in the form prescribed by HUD, including but not limited to an identification and description of the proposed site, site plan, and neighborhood.

The Authority's accounting records reflect that between March and June 2002, it used \$150,000 of its 2001 Capital Funds Program to pay costs associated with housing development activities. The disbursements included charges for a) property acquisitions, b) appraisal fees, and c) consulting fees. Although HUD approved the 2001 Capital Funds Program budget, the Authority failed to follow program requirements related to the acquisition of property in developing mixed-finance, mixed-income housing projects. The Authority did not provide evidence that it complied with program requirements that it submit an acquisition proposal and obtain HUD approval before using the capital funds. Therefore, HUD cannot assure that the property would be developed for the intended purpose and that HUD's interests and rights would be protected. The Director claimed she was familiar with the applicable regulations but did not examine them carefully.

During our review, the Authority initiated procedures to correct the improper use of funds through a budget revision to its 2001 Capital Funds Program and proposed to HUD the use of Section 8 Program administrative fees to rectify the deficiency. In a letter dated April 15, 2004, HUD informed the Authority that it failed to submit an acquisition proposal and obtain HUD's approval before making any disbursements. HUD also advised the Authority that it approved the Authority's proposed corrective action plan providing for the immediate transfer of \$150,000 in Section 8 administrative fees to the low-income housing operating fund.

### **AUDITEE COMMENTS**

The Authority attributed the encumbrance of low-income housing assets to an error. The Authority is in the process of refinancing the line of credit and will remove the low-income housing properties from the Agreement. The Authority maintained that there was no improper use of capital funds and that the deficiency was corrected. The Authority stated that it currently has an extensive internal control policy.

The Authority disagreed with imposing administrative actions against the Director. The Authority believes that the actions of the Director and others did not rise to this level of error.

## **OIG EVALUATION OF AUDITEE COMMENTS**

In general, the Authority's comments and actions are responsive to the finding. If fully implemented in a timely manner in accordance with HUD requirements, the actions should correct the deficiencies discussed in the finding and improve administration of the Low-Income Housing and Capital Fund Programs.

We withdrew a draft recommendation to consider appropriate administrative action against the Director and others for the violation of HUD requirements.

HUD concurred with all audit recommendations and provided a detailed corrective action plan. HUD plans for the Authority to complete each final action within 60 to 120 days. The Office of Inspector General for Audit (OIG) concurs with HUD's management decisions for all audit recommendations.

### **RECOMMENDATIONS**

We recommend you assure that the Authority

- 1A. Remove the improper encumbrance of the low-income housing assets, valued at \$631,734, and pursue all available options to ensure that the best interests of the Authority and HUD are served.
- 1B. Reimburse \$150,000 to its Contract projects from its Section 8 Program excess administrative fees to correct the improper use of capital funds.
- 1C. Establish and implement adequate policies and procedures to ensure the proper use of capital funds and that low-income housing assets are not encumbered without HUD approval.

## MANAGEMENT CONTROLS

Management controls include the plan of organization, methods, and procedures adopted by management to ensure that its goals are met; the processes for planning, organizing, directing, and controlling program operations; and the systems for measuring, reporting, and monitoring program performance.

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

- o Compliance with Laws and Regulations - Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- o Safeguarding of Resources - Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

To assess the relevant controls, we:

- o Interviewed HUD and Authority officials;
- o Reviewed the regulations governing the program; and
- o Reviewed loan and closing documents, trial balances, and general ledgers and audited financial statements.

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

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

The Authority violated its Contract with HUD by using three low-income housing properties as collateral for a \$3 million line of credit with a bank without HUD approval.

The Authority violated HUD requirements by using \$150,000 of its Capital Fund Program for housing development activities without HUD approval.

### **FOLLOW-UP ON PRIOR AUDITS**

The most recent OIG audit of this housing authority was conducted in 2001. The report (No. 2002-AT-202-1801, dated October 30, 2001) did not contain findings relevant to our audit objectives.

Grau & Company, P.A, prepared the most recent audited financial statements for the fiscal year ending March 31, 2003, and provided the Authority with an unqualified opinion. The report did not contain findings relevant to our audit objectives.

**SCHEDULE OF QUESTIONED COSTS AND FUNDS PUT TO BETTER USE**

<u>Recommendation Number</u>	<u>Ineligible<sup>1</sup></u>	<u>Funds Put to Better Use<sup>2</sup></u>
1A		\$ 631,734
1B	<u>\$ 150,000</u>	<u>                    </u>
Total	<u>\$ 150,000</u>	<u>\$ 631,734</u>

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<sup>1</sup> 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.

<sup>2</sup> Funds Put to Better Use are quantifiable savings that are anticipated to occur if an OIG recommendation is implemented, resulting in reduced expenditures in a subsequent period for the activities in question. Specifically, this includes costs not incurred, de-obligation of funds, withdrawals of interest, reduction in outlays, avoidance of unnecessary expenditures, loans and guarantees not made, and other savings.

AUDITEE COMMENTS



West Palm Beach  
Housing Authority

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**REPLY TO DRAFT OIG HUD RELATED AUDIT MEMORANDUM**

To: James D. McKay  
Regional Inspector General for Audit, 4AGA

CC: Karen Cato-Turner  
Director, Office of Public Housing, 4DPH

From: Laurel Robinson, Executive Director  
West Palm Beach Housing Authority

A handwritten signature in black ink, appearing to read 'Laurel Robinson', written over the printed name in the 'From:' field.

Subject: Written Comments to Draft Audit Related Memorandum pursuant to exit  
Interview held by teleconference July 2, 2004

Thank you for the opportunity to provide comments to the draft report referenced above.

The stated purpose of this particular audit was “to determine whether the Authority diverted or pledged resources subject to an Annual Contributions Contract (ACC) or other agreement or regulation *to the benefit of other entities* (emphasis mine) without specific HUD approval.” Although we acknowledge that audits authorized by the OIG can rightfully focus on any aspect of a Housing Authority’s operations, it bears noting that no other entities were, or have been, involved in any development activities undertaken by this PHA to date. While the particulars of our action may be subject to corrective recommendations, at no time did this Authority undertake anything unallowable by HUD.

Recommendation 1A: Require the Authority to remedy the improper encumbrance of the LIH assets valued at \$631,734, and pursue all available options to ensure the best interests of the Authority and HUD are being served.

WPBHA 1A response: This encumbrance occurred in error. When the 72 parcels in our development site were being assembled, the bank financing the line of credit listed parcels owned by the HA by property control number and legal description only, no addresses were used. In our review of these documents prepared by legal counsel, the HA did not recognize that some lots under a deed of trust had been included. Not all the lots under this particular ACC were listed in the loan document, but three were. At this time, the Authority has assembled all 72 parcels in the site and is refinancing this original loan

with another bank. The offending lots are removed as collateral. Initial pre-approval to include these lots was not sought from HUD because the Authority was unaware of their inclusion in the original document. In the improbable instance that the original bank would have been forced to sell assets pledged to satisfy the terms of the agreement, other, non-ACC encumbered land owned by the Authority would have been more than adequate to cover the debt.

Recommendation 1B. Require the Authority to reimburse to its ACC projects, from its Section 8 Program excess administrative fees, for the improper use of capital funds.

WPBHA 1B response: The Authority maintains that there was no improper use of capital funds. While the Authority considered using capital funds to purchase land for development (as allowed by HUD) and did indeed transfer capital funds to its development account to do so, it was able to reverse all entries and use of funds prior to closing out both the capital fund and its financial statements. HUD permission to revise the capital fund budget was sought and given; the financial entries were reversed, and no activity pursued prior to HUD approval was finalized either in the grant close out or audited financial statements.

Recommendation 1C. Require the Authority to establish and implement adequate policies and procedures to ensure the proper use of capital funds, and that LIH assets are not encumbered or pledged without HUD approval.

WPBHA 1C response: An extensive internal control policy currently exists. In the instance of the encumbered lots, HUD approval was not sought because we did not recognize the legal description, absent addresses. In the instance of the capital fund/admin fee swap, no other entity was involved, and the HA was able to unwind the entire transaction prior to closing out any funds.

Recommendation 1D. Consider appropriate administrative action against the Authority's Executive Director and others for the violation of HUD requirements as cited in the report.

WPBHA 1D response: Administrative action is appropriate for consistent egregious and willful violations. The actions of the Executive Director and others do not rise to this level of error. Both instances are isolated, in which the flaw was the Authority's failure to gain prior HUD approval for an activity HUD allows. This approval was not sought in the encumbrance issue because the Authority did not recognize the legal descriptions of three lots in a fourteen acre site. This approval was not sought in the fund swap issue because the action was undone prior to finalization. It is the firm belief that administrative action against persons associated with these activities is unwarranted.