Issue Date	
January 26, 2006	
Audit Report Number	
2006-SE-1001	

TO: Renee' Greenman, Region X, Director, Multifamily Housing Hub, 0AH

FROM: Joan S. Hobbs, Regional Inspector General for Audit, Region X, 0AGA

SUBJECT: Idaho Housing and Finance Association, Boise, Idaho, Did Not Monitor Subsidized Multifamily Projects in Accordance with Regulations or its Annual Contributions Contract with HUD

HIGHLIGHTS

What We Audited and Why

At the request of the Region X Multifamily Housing Hub, we audited Idaho Housing and Finance Association (Idaho Housing) due to concerns that (1) it allowed excess owner distributions; (2) it did not properly administer projects' residual receipts and replacement reserve accounts; and (3) a conflict of interest exists because Idaho Housing acts as lender, owner, management agent, and Section 8 contract administrator. In addition, we were concerned that Idaho Housing did not properly review changes in management fees to determine whether they were reasonable.

Our overall audit objective was to determine whether Idaho Housing monitored projects in accordance with its annual contributions contract with the U.S. Department of Housing and Urban Development (HUD) to ensure that project funds were expended appropriately.

What We Found

Idaho Housing did not monitor its subsidized multifamily housing projects in accordance with federal regulations or its annual contributions contract with HUD. Idaho Housing inappropriately authorized $3,721,738 in owner distributions in excess of allowable amounts from project funds. Idaho Housing allowed nonprofit owners, who are not entitled to any distributions, to receive distributions of project funds and limited distribution owners to receive distributions of funds in excess of the limitations imposed by federal regulations.

Idaho Housing also approved a duplicate request for reimbursement of $24,562 from a project's replacement reserve funds and approved $182,264 in disbursements from projects' replacement reserves without obtaining adequate supporting documentation.

In addition, contrary to the requirements of the *Code of Federal Regulations*, the housing assistance payments contracts, and its annual contributions contract, Idaho Housing allowed a conflict of interest situation to exist between itself and The Housing Company, a nonprofit owner of subsidized multifamily projects. A conflict of interest situation exists because Idaho Housing formed and holds substantial control over The Housing Company and is paid by HUD, under terms of its annual contributions contract, to monitor The Housing Company's subsidized projects.

Further, between January 1, 2001, and December 31, 2004, Idaho Housing approved revised management agreements for 10 projects. The revised agreements increased the management fees for these projects to $121,521 in excess of HUD's residential management fee range for Idaho.

What We Recommend

We recommend that the director, Region X Multifamily Housing Hub, require Idaho Housing to reimburse the projects $3,867,821 and to provide supporting documentation for $182,264 in unsupported costs or also return this amount to the projects. In addition, we recommend that HUD require Idaho Housing to comply with federal regulations and HUD guidelines when processing owner distributions, distributions from residual receipts and replacement reserves, and changes in management fees. We also recommend that the director, Region X Multifamily Housing Hub, require Idaho Housing take corrective action to dissolve the conflict of interest relationship or make a determination of default in accordance with paragraph 2.16(b)(2) of its annual contributions contract with Idaho Housing. If Idaho Housing is declared in default of the annual

contributions contract, we recommend the director assume the role of contract administrator or assign another contract administrator (including any associated administrative fee) over any projects that (1) are owned by The Housing Company, (2) receive Section 8 subsidy from HUD, and (3) are currently monitored by Idaho Housing.

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 Idaho Housing a draft report on December 13, 2005, and held an exit conference on January 6, 2006. Idaho Housing provided written comments on January 13, 2006. Idaho Housing agreed with much of the report in general, but disagreed with the inclusion of specific projects in the findings and recommendations. The complete text of Idaho Housing's response, along with our evaluation of that response, can be found in appendix B of this report. The exhibits Idaho Housing supplied with its response are too voluminous to include in this report but are available upon request. We considered Idaho Housing's response and exhibits and made changes to the report as appropriate.

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BACKGROUND AND OBJECTIVES

Idaho Housing and Finance Association (Idaho Housing) is Idaho's housing finance agency. Idaho Housing does not receive state-appropriated funds for its operations. However, it funds its programs from various sources, including the sale of tax-exempt mortgage revenue bonds. Its mission is to provide funding for affordable housing opportunities in Idaho communities where they are most needed and when it is economically feasible.

Idaho Housing participates in the development, finance, management, and tenant support for 59 projects under an annual contributions contract with the U.S. Department of Housing and Urban Development (HUD). Under this agreement, it functions as the agent for HUD in performing tasks in these areas as the Section 8 subsidy contract administrator. Idaho Housing's subsidy contract administration responsibilities include program compliance functions, to ensure that HUD-subsidized projects are serving eligible families at the correct level of assistance, and asset management functions, to ensure the physical and financial health of the projects. It processes the monthly housing assistance payments and is responsible for asset management functions, housing assistance payments contract (contract) compliance, and monitoring functions. It performs compliance reviews on these developments, including physical inspections and occupancy reviews. It holds and administers the replacement reserve, residual receipts, and all other appropriate escrow accounts for these projects. It also processes the monthly housing assistance payments.

The monthly housing assistance payments are based on contracts between the owner and Idaho Housing. These contracts are categorized as either old regulation or new regulation. New regulation projects are those with a signed agreement to enter into a contract on February 29, 1980, or later.

Owners of old regulation projects are not limited as to the amount of distributions they may receive from the project, except that the distribution may only be made after funds have been set aside or payment has been made for all project expenses.

Pipeline projects are treated like old regulation projects with respect to distributions. Although these projects are technically new regulation projects because the date of submission of the initial application was during a time of transition for HUD regulations, HUD allowed the projects to opt out of the limitation on distributions. Therefore, these projects, like old regulation projects, are not limited with regard to distributions.

New regulation projects are of two types: nonprofit and profit-motivated. Owners of new regulation nonprofit ownership projects are not entitled to distributions. Owners of profit-motivated new regulation limited distribution projects may only receive 6 percent (projects with elderly tenants) or 10 percent (family projects) of owner equity determined when the project was constructed. Owners of profit-motivated projects that are family projects with 50 or fewer units are exempt from the limitations on distributions. In this way, these projects are treated like old

regulation projects. Additionally, the contract for new regulation projects states that the contract will remain in effect for at least 20 years, regardless of whether the mortgage is prepaid.

Our overall audit objective was to determine whether Idaho Housing monitored projects in accordance with its annual contributions contract with HUD to ensure that project funds were expended appropriately. We also wanted to quantify any inappropriate owner distributions, disbursements from the residual receipts and replacement reserve accounts, and any excessive management fees.

RESULTS OF AUDIT

Finding 1: Idaho Housing Inappropriately Authorized $3,721,738 in Owner Distributions in Excess of Allowable Amounts from Project Funds

Idaho Housing inappropriately authorized owner distributions in excess of allowable amounts from project funds. It allowed nonprofit owners, who are not entitled to any distributions, to receive distributions of project funds and limited distribution owners to receive distributions of funds in excess of HUD's limitations. In addition, Idaho Housing improperly allowed distributions to be paid from the projects' residual receipts accounts and replacement reserves. This occurred because Idaho Housing did not properly implement federal regulations at 24 CFR [*Code of Federal Regulations*] Part 883 and HUD guidelines regarding owner distributions and use of residual receipts and replacement reserves. As a result, $3,721,738 in excessive distributions is unavailable to use for the projects' purposes. Of that amount, $747,776 disbursed from the residual receipts accounts is not available to reduce housing assistance payments or for HUD's use to provide housing assistance to other low-income individuals upon termination of the contracts.

Projects Adopted Subpart G of 24 CFR Part 883

We reviewed owner distributions for 19 projects under Idaho Housing's annual contributions contract with HUD. In 1988, owners of 11 of these projects amended their old regulation contracts and adopted 24 CFR [*Code of Federal Regulations*] subpart G, incorporating the limitation on distributions.

Idaho Housing told us these amendments were entered into with the understanding that there would be no limitation on distributions, as provided in 24 CFR [*Code of Federal Regulations*] 883.105(b)(2). Under this provision, the agency, the owner, and HUD may agree to make the revised subpart G applicable to the project with or without limitations on distributions and execute the appropriate amendments to the contract. However, there was nothing in the amendments or other documentation to indicate any of the parties originally agreed to opt out of the limitation on distributions. Further, the regulatory agreement for each project already limited distributions from the time of the projects' inceptions.

The owners of 9 of the 11 projects subject to the 1988 amendment later sold the projects to The Housing Company, a nonprofit owner/ management agent. This nonprofit assumed the prior owners' regulatory agreements as well as the contracts and amendments. Another project was already owned by a nonprofit. According to 24 CFR [*Code of Federal Regulations*] 883.306, as nonprofits, these owners are not entitled to any distribution of project funds. Nonetheless, we found Idaho Housing inappropriately authorized distributions to these owners from 1994 through 2004.

Idaho Housing Did Not Require the Projects to Use HUD's Surplus Cash Statement

Idaho Housing implemented a distribution policy, effective January 1, 1994, that conflicts with the federal regulations and HUD guidelines in HUD-OIG Handbook 2000.04 and HUD Handbook 4381.5. This policy requires the use of its own form rather than the HUD-required surplus cash statement. Idaho Housing did not direct owners to complete the HUD-required surplus cash statement to determine surplus cash, the amount of allowable owner distribution, and the amount to be deposited to residual receipts. Instead, Idaho Housing used its own form, the partnership distribution worksheet. This worksheet often gives a different result than the required surplus cash statement.

We calculated surplus cash for 16 projects from 2001 through 2004 using the required surplus cash statement. During this period for 11 of these projects, 31 distributions allowed by Idaho Housing were greater than available surplus cash calculated using HUD's surplus cash statement. For example,

- At the end of 2002, Aspenwood Apartments had a cash deficit according to HUD's surplus cash statement, but Idaho Housing authorized a distribution of $70,826 in early 2003;

- At the end of 2003, Eagle Manor had a cash surplus of $169,371, but Idaho Housing authorized a distribution of $187,010 in early 2004; and

- At the end of 2002, Westside Court had a cash surplus of only $2,579, but Idaho Housing authorized a distribution of $143,565 in early 2003.

Idaho Housing Policy Allows Special Purpose Distributions

Idaho Housing's 1994 distribution policy allows project owners distributions equal to the limited distribution allowed, plus a distribution for projects that meet Idaho Housing's special purpose criteria. Idaho Housing's senior compliance manager confirmed that this policy is effective for new regulation limited distribution and nonprofit projects. This is contrary to 24 CFR [*Code of Federal Regulations*] 883.306, which allows only limited distributions to profit-motivated project owners of elderly or large family projects and does not allow any distributions to nonprofit owners. As a result, the owner of Riverside Senior Housing, an old regulation nonprofit project subject to the 1988 amendment, inappropriately received a $242,666 special purpose distribution.

Owners Signed Perpetual Affordability Agreements

In 1994, Idaho Housing required some owners to sign a perpetual affordability agreement in exchange for an equity takeout as part of a bond refunding.[1] In 1997, Idaho Housing informed The Housing Company that distribution of "excess reserves" was an option. However, projects that had not yet committed to perpetual affordability would have to do so to receive distributions from the "excess reserves." The initial 1997 "excess reserves" distribution included the sum of the replacement reserve balance, interest earned, and residual receipts balance, less two months worth of operating budget and $3,000 per unit for replacement reserves. Later distributions for projects with perpetual affordability agreements also included operating cash on hand.

Idaho Housing's distribution of "excess reserves" in exchange for commitments to perpetual affordability is contrary to 24 CFR [*Code of Federal Regulations*] 883.306 for distributions to the owners of four new regulation limited distribution projects and six old regulation nonprofit projects subject to the 1988 amendment.

[1] See audit report no. 2005-SE-1008 for information on the bond refunding.

Idaho Housing Authorized Distributions to Be Paid from Residual Receipts and Replacement Reserves

Of the excess distributions Idaho Housing authorized, $747,776 and $11,275 were disbursed from the projects' residual receipts and replacement reserves, respectively. However, according to 24 CFR [*Code of Federal Regulations*] 883.306(e) and 883.702(e), residual receipts are to be used only to reduce housing assistance payments or for other project purposes, and upon termination of the contract, the residual receipts balance must be remitted to HUD. In addition, according to 24 CFR [*Code of Federal Regulations*] 883.703 and the contracts, replacement reserves are to be established to aid in funding extraordinary maintenance and repair of the project or for replacement of capital items. The excess owner distributions did not meet these requirements since the funds were distributed to the owners and were not used for project purposes, extraordinary maintenance, repairs, or replacement of capital items.

The Rest of the Distributions Were Paid From the Projects' Operating Accounts

The balance of the distributions were paid from the projects' operating accounts. Federal requirements dictate that any funds in the operating account in excess of those required to fund project operations and allowable owner distributions must be deposited to the residual receipts account. Since the distributed funds were in excess of what was required to operate the projects, the funds should have been deposited to the residual receipts account.

More Than $3.7 Million in Excess Distributions Is Not Available for Project Purposes

Since Idaho Housing did not follow federal regulations and HUD guidelines regarding owner distributions, excessive distributions to 13 projects totaling $3,721,738 will not be available to use when or if funds are needed for project purposes. In addition, these funds are no longer available to reduce housing

assistance payments or for HUD's use to provide housing assistance to other low-income individuals upon termination of the contracts. Appendix C details the excessive distributions by project.

The average excess distributions from 1994 through 2004 total $316,279 per year. These funds could be put to better use over the next year if Idaho Housing stops allowing these excess distributions.

Recommendations

We recommend that the director, Region X Multifamily Housing Hub,

1A. Require Idaho Housing to reimburse the projects' residual receipts accounts from nonfederal funds $3,710,463 for excessive partnership distributions that it inappropriately allowed (see appendix C).

1B. Require Idaho Housing to reimburse the applicable projects' replacement reserve accounts from nonfederal funds $11,275 for excessive partnership distributions that it inappropriately allowed from those accounts (see appendix C). However, if these replacement reserve accounts are fully funded, we recommend HUD require Idaho housing to reimburse the excessive distributions into the applicable projects' residual receipts accounts.

1C. Require Idaho Housing to implement procedures to ensure that nonprofit owners under new regulations (including 1988 amended projects) do not receive distributions of project funds and that limited distribution project owners do not receive distributions in excess of their allowed limited distributions. This will allow $316,279 in project funds to be put to better use over the next year.

1D. Require Idaho Housing to implement procedures to ensure the residual receipts account is used only to reduce housing assistance payments or for project purposes and not for owner distribution.

1E. Require Idaho Housing to implement procedures to ensure that replacement reserves are used only for extraordinary maintenance and repairs or replacement of capital items and not for owner distribution.

1F. Require that Idaho Housing use HUD's surplus cash statement to determine the surplus cash available for partnership distribution.

1G. Require Idaho Housing to amend its distribution policy to conform to the new regulations at 24 CFR [*Code of Federal Regulations*] 883.306 with respect to owners' distributions for all new regulation projects as well as for all projects subject to the 1988 housing assistance payments amendment incorporating limitations on distributions.

1H. Require Idaho Housing to discontinue use of the perpetual affordability agreement as a basis for determining owner distributions.

1I. Obtain a formal legal opinion as to whether the 1988 housing assistance payments amendments subject the owners of the projects to limitations on distributions in accordance with 24 CFR 883.702(e) and take the appropriate above actions based on that opinion.

Finding 2: Idaho Housing Approved One Duplicate and Other Unsupported Requests for Reimbursement from Project Replacement Reserves

Idaho Housing approved requests for reimbursement from project replacement reserve funds without obtaining adequate supporting documentation. This occurred because Idaho Housing did not always follow HUD guidelines and its own policies and procedures regarding expenditures from the reserve for replacement accounts. As a result, one project's replacement reserves were used to make a $24,562 duplicate payment to a vendor, and $182,264 in expenditures from 13 project replacement reserve accounts was not adequately supported. Idaho Housing's practices provide little assurance that reserve for replacement expenditures meet HUD's restrictions on the use of reserve for replacement funds.

We Reviewed Replacement Reserve Transactions for 21 Projects

Federal regulations at 24 CFR [*Code of Federal Regulations*] 883.703 and the contracts provide that a replacement reserve must be established and maintained in an interest-bearing account to aid in funding extraordinary maintenance and repair and replacement of capital items. We identified 21 limited distribution, nonprofit, or pipeline projects that are required to maintain this account under Idaho Housing's annual contributions contract with HUD. We reviewed replacement reserve transactions for these 21 projects over the years 2001 through 2004 and found that Idaho Housing staff did not always follow HUD guidelines or its own written policies and procedures.

Twenty-Six Reimbursements Were Not Properly Supported

HUD Handbook 4381.5 requires an invoice for payment, a written request, and a payment voucher in support of capital expenditures. Idaho Housing's replacement reserve agreement requires an invoice for payment for expenditures from the reserve for replacement accounts. Idaho Housing's new construction budget procedures also require that bids be submitted to Idaho Housing for all expenditures of more than $1,000. Nonetheless, from 2001 through 2004, Idaho Housing approved 24 reimbursements totaling $182,264 from projects' replacement reserve accounts without obtaining bids or invoices (see appendix D).

Idaho Housing's compliance manager stated that Idaho Housing is not strict with regard to compliance with its own requirements for owners to obtain bids, especially with respect to smaller projects. He also said that, at times, a verbal approval for the projects not to obtain bids is acceptable.

One Reimbursement Was a Duplicate

Our review also disclosed one disbursement was a duplicate submission for reimbursement of $24,562 for parking lot paving at Lake Country Apartments. The first request for reimbursement for the paving was paid in May 2002. This package included an invoice from the vendor. The second request for reimbursement was paid in August 2002. This request was part of a larger request that included the authorization and purchase order for paving the parking lot but not the invoice.

Idaho Housing Could Not Ensure Expense Payments Were Proper

Since Idaho Housing did not always require sufficient supporting documentation before reimbursement of expenses from replacement reserves, it did not detect the duplicate payment and cannot ensure that reserve for replacement expenditures totaling $182,264 complied with HUD's and its own restrictions on the use of reserve for replacement funds.

Recommendations

We recommend that the director, Region X Multifamily Housing Hub, require Idaho Housing to

2A. Return $24,562 from nonfederal funds for the duplicate payment to the project's replacement reserve account. However, if the replacement reserve account is fully funded, we recommend the reimbursement be made to the project's residual receipts account.

2B. Provide supporting documentation for the $182,264 in unsupported costs or return this amount to the projects' replacement reserve accounts (see appendix D). If the replacement reserve accounts are fully funded, we recommend the director require the reimbursement to be made to the projects' residual receipts accounts.

2C. Comply with HUD guidelines and its own policies and procedures in processing replacement reserve disbursements.

Finding 3: A Conflict of Interest Exists between Idaho Housing and The Housing Company

Contrary to HUD requirements, Idaho Housing allowed a conflict of interest to exist between itself and The Housing Company, a nonprofit owner of subsidized multifamily projects. Idaho Housing created and holds substantial control over The Housing Company; however, under terms of its annual contributions contract, HUD pays Idaho Housing to monitor The Housing Company's subsidized projects. This occurred because management controls are insufficient to ensure that Idaho Housing complies with federal requirements. Also, the close relationship between Idaho Housing and The Housing Company exists in order for Idaho Housing to assist The Housing Company to meet its operational needs for personnel and office space. However, because of the close relationship, HUD has no independent assurance that projects controlled by The Housing Company are operated according to program requirements. In addition, there is the potential for The Housing Company or its projects to receive special consideration.

The Housing Company Is an Affiliate of Idaho Housing

The Housing Company was formed in 1990 by Idaho Housing to facilitate Idaho Housing's mission to preserve affordable housing and develop new housing in underserved areas of Idaho. It is an affiliate of Idaho Housing. Two of Idaho Housing's board members also serve on the board of The Housing Company. Idaho Housing's president and executive director serves as the president of The Housing Company. The Housing Company's employees are Idaho Housing employees who are subcontracted to The Housing Company. Idaho Housing and The Housing Company share telephone and Internet systems, and managers for both entities meet together weekly. In addition, if The Housing Company ceases operations, all of its assets become the assets of Idaho Housing.

The vice president of The Housing Company is responsible for oversight of The Housing Company's activities and supervises all project management and development. Her immediate supervisor, who performs her annual evaluation, is the president and executive director of Idaho Housing. Consequently, the president of Idaho Housing has a measure of control over The Housing Company's activities.

Idaho Housing Is the Contract Administrator for The Housing Company's Projects

The Housing Company owns 13 projects that receive Section 8 subsidies under Idaho Housing's annual contributions contract with HUD. Idaho Housing is the contract administrator for these projects. In this capacity, Idaho Housing makes the monthly housing assistance payments to project owners and is required to perform various monitoring activities, including reviewing

- Owner calculations of tenant payments,
- Owner financial statements,
- Expenditures to ensure costs are reasonable and necessary,
- Payments to owners to eliminate overpayments or underpayments of Section 8 subsidies,
- Owner compliance with Section 8 requirements,
- Tenant files,
- Owner compliance with physical inspections, and
- Actions taken with regard to owner and tenant complaints.

Idaho Housing is also responsible for reviewing and paying special claims for vacancy loss and unreimbursed tenant damages as well as for calculating owner distributions.

This Relationship Violates Housing Assistance Payments Contracts and the Annual Contributions Contract

In effect, Idaho Housing is both owner and manager of The Housing Company and its projects and monitors its own actions with respect to the Section 8 assistance provided to these projects. This relationship violates requirements of Idaho Housing's old and new regulation contracts with The Housing Company's projects at paragraphs 2.18 and 2.11 respectively as well as its annual contributions contract with HUD at paragraph 2.18. These contracts prohibit members or officers of Idaho Housing from having a direct or an indirect interest in contracts during tenure or for one year after.

Idaho Housing Does not Have Controls in Place to Prevent Conflicts of Interest

We determined this conflict of interest relationship was allowed because Idaho Housing lacks the management controls to ensure that it complies with the requirements of the CFR [*Code of Federal Regulations*], its annual contributions contract with HUD, and its housing assistance payments contracts with project owners. Each of these include prohibitions against this type of relationship.

HUD Has No Assurance These Projects Are Operated in Accordance with Program Requirements

Since Idaho Housing is so closely tied to the ownership of The Housing Company, HUD has no independent assurance that The Housing Company's subsidized projects are operated in accordance with the requirements of the Section 8 program. Additionally the potential exists for The Housing Company or its projects to be granted special consideration or concessions not available to other projects monitored by Idaho Housing.

Recommendations

We recommend that the director, Region X Multifamily Housing Hub,

3A. Require Idaho Housing take corrective action to dissolve the conflict of interest relationship. If Idaho Housing does not take the corrective action, we recommend the director make a determination of default in accordance with paragraph 2.16(b)(2) of its annual contributions contract with Idaho Housing. If Idaho Housing is declared in default of the annual contributions contract, we recommend the director assume the role of contract administrator or assign another contract administrator (including any associated administrative fee) over any projects that (1) are owned by The Housing Company, (2) receive Section 8 subsidy from HUD, and (3) are currently monitored by Idaho Housing.

3B. Require that Idaho Housing implement controls to ensure that any conflict of interest relationships will not be allowed in the future.

Finding 4: Idaho Housing Approved Excessive Management Fees for 10 Idaho Projects

Between January 1, 2001, and December 31, 2004, Idaho Housing approved excessive management fees for 10 subsidized projects. This occurred because Idaho Housing did not establish an appropriate management fee range and did not have a process for assessing the reasonableness of requests for management fee increases. As a result, from 2001 to 2004, 10 projects paid $121,521 in management fees in excess of HUD's residential management fee range for Idaho. The excessive management fee payments could have been used for other project purposes, deposited in the residual receipts account and used to reduce housing assistance payments, or upon termination of the contract, revert to HUD to be used for other low-income housing purposes.

The Contract Administrator Is Responsible for Reviewing Management Fees

Under HUD Handbook 4381.5, Idaho Housing is required to perform a management fee review when a project owner or agent requests an increase in the management fee percentage. This is to ensure that approved fees do not significantly exceed the amount that independent agents and owners would ordinarily negotiate for comparable services at projects in the same geographic/cost area, except as justified by conditions that require more time and effort on the part of the management agent.

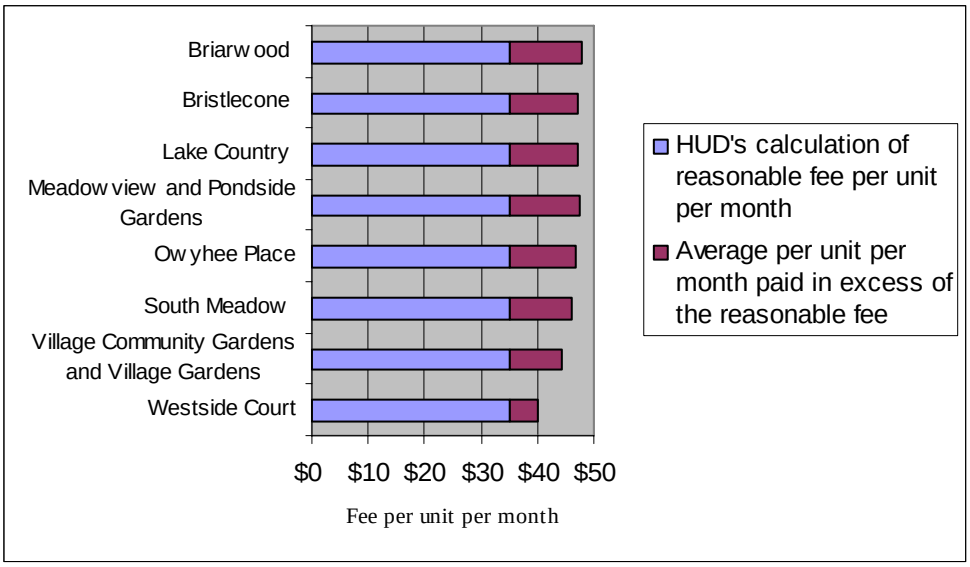
The maximum residential management fee range for projects in Idaho, as computed by HUD for 2001-2005, was $35 per–unit–per–month. Although Idaho Housing is not required to use HUD's computed management fee range, it must use some range. It must follow the same procedures HUD uses to determine the maximum fee range (i.e., the procedures in chapter 3 of HUD Handbook 4381.5). Since Idaho Housing did not compute its own residential management fee range, it should have used HUD's maximum residential management fee of $35 per–unit–per–month.

Ten Projects Are Paying Excessive Management Fees

New regulation limited distribution and nonprofit projects are required to maintain a residual receipts account. Deposits to this account come from project

funds in excess of the amount needed for project operations, reserve requirements, and permitted distributions. We identified 10 new regulation projects that have restrictions on their residual receipts accounts that also had a change in the management agreement between January 1, 2001, and December 31, 2004. Nine of these projects are owned by The Housing Company, an affiliate of Idaho Housing (see finding 3).

We selected these projects for review since any excess funds beyond those needed for project operations and the allowable distributions would ultimately be remitted back to HUD. We compared the actual management fees paid for these projects to HUD's computed maximum residential management fee of $35 per–unit–per–month. Only eight projects are identified in the chart below because The Housing Company has historically reported Meadowview and Pondside Gardens together as one project and Village Community Gardens and Village Gardens together as one project.



Excessive Management Fees Could Have Been Used for Other Low-Income Housing Purposes

We found that these projects paid $121,521 from 2002 through 2004 for management fees in excess of the amount they would have paid by using the maximum HUD-determined fee of $35 per unit per month. These excessive management fee payments are costing the applicable projects an average total of $41,707 per year. The excessive payments could have been used for other project purposes or deposited in the residual receipts account. The additional residual receipts could then be used to reduce housing assistance payments or, upon

termination of the contract, revert to HUD to be used for other low-income housing purposes (see appendix E).

Lack of Management Controls Contributed to the Excessive Management Fees

Idaho Housing's lack of adequate management controls contributed to the excessive management fees. Idaho Housing does not have specific written policies and procedures to ensure management fees are reasonable. Idaho Housing did not calculate its own reasonable management fee range for multifamily units in Idaho or adopt HUD's residential management fee range. Further, Idaho Housing did not assess requests for increases in the management fee percentage to determine whether the requested percentage was reasonable.

Recommendations

We recommend that the director, Region X Multifamily Housing Hub,

4A. Require Idaho Housing to reimburse the applicable projects' residual receipts accounts from nonfederal funds for excess management fees of $121,521 paid (see appendix E).

4B. Require Idaho Housing to adopt HUD's residential fee range for management's fees or calculate its own residential fee range for management fees using the process prescribed in Management Agent Handbook 4381.5, chapter 3.

4C. Require Idaho Housing to instruct the owner/management agents for the applicable projects to immediately reduce the management fees to a reasonable amount to allow $41,707 in project funds to be put to better use over the next year.

4D. Require Idaho Housing to prepare and implement a policy to review management fee percentage changes for reasonable assurance that management agents do not receive excessive fees.

4E. Obtain a formal legal opinion as to whether HUD Handbook 4381.5 applies to these projects and take the appropriate above actions based on that opinion.

SCOPE AND METHODOLOGY

To achieve our audit objectives, we reviewed applicable federal regulations, HUD handbooks, Idaho Housing written policies and procedures, and project files for the 59 subsidized projects administered under the annual contributions contract between Idaho Housing and HUD. In addition, we interviewed local HUD staff and Idaho Housing staff. We performed audit work at Idaho Housing's offices in Boise, Idaho, and at HUD's Office of Housing - Multifamily Hub in Seattle, Washington, from November 2004 through October 2005. Our audit generally covered the period January 1, 2001, through December 31, 2004, and was expanded as needed.

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:

- Program operations – Policies and procedures that officials of the audited entity have implemented to reasonably ensure that a program meets its objectives and that unintended actions do not result.

- Compliance with laws and regulations – Policies and procedures that officials of the audited entity have implemented to reasonably ensure that resources used are consistent with laws and regulations.

- Safeguarding resources – Policies and procedures that officials of the audited entity have implemented to reasonably prevent or promptly detect unauthorized acquisition, use, or disposition of 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:

- Idaho Housing does not have controls in place to ensure that project funds are used in accordance with federal regulations at 24 CFR [*Code of Federal Regulations*] 883.0306 (See findings 1 and 4).
- Management controls do not reasonably prevent or promptly detect the improper use of project resources (See findings 2 and 4).
- Management controls are insufficient to ensure that Idaho Housing complies with the requirements of the CFR [*Code of Federal Regulations*], the housing assistance payments contracts, and the annual contributions contract (see finding 3).

APPENDIXES

Appendix A

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

Recommendation number	Ineligible 1/	Unsupported 2/	Funds to be put to better use 3/
1A	$3,710,463		
1B	$11,275		
1C			$316,279
2A	$24,562		
2B		$182,264	
4A	$121,521		
4C			$41,707
Totals	**$3,867,821**	**$182,264**	**$357,986**

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.

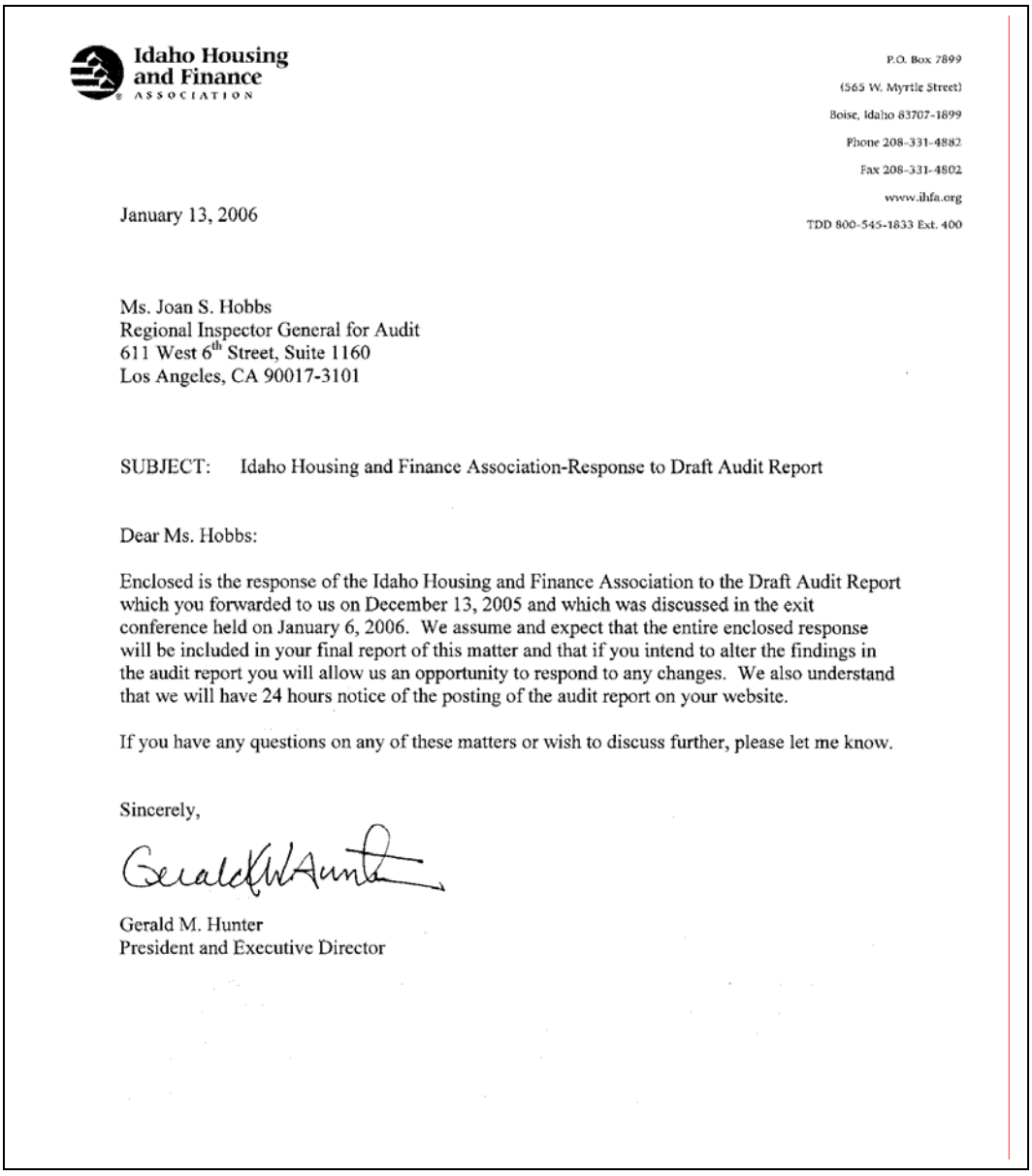
2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.

3/ "Funds to be put to better use" are quantifiable savings that are anticipated to occur if an Office of Inspector General (OIG) recommendation is implemented, resulting in reduced expenditures at a later time for the activities in question. This includes costs not incurred, deobligation of funds, withdrawal of interest, reductions in outlays, avoidance of unnecessary expenditures, loans and guarantees not made, and other savings.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**



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January 13, 2006

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Regional Inspector General for Audit
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Los Angeles, CA 90017-3101

SUBJECT: Idaho Housing and Finance Association-Response to Draft Audit Report

Dear Ms. Hobbs:

Enclosed is the response of the Idaho Housing and Finance Association to the Draft Audit Report which you forwarded to us on December 13, 2005 and which was discussed in the exit conference held on January 6, 2006. We assume and expect that the entire enclosed response will be included in your final report of this matter and that if you intend to alter the findings in the audit report you will allow us an opportunity to respond to any changes. We also understand that we will have 24 hours notice of the posting of the audit report on your website.

If you have any questions on any of these matters or wish to discuss further, please let me know.

Sincerely,

Gerald M. Hunter
President and Executive Director

IDAHO HOUSING AND FINANCE ASSOCIATION
RESPONSE TO FINDINGS OF THE OFFICE OF INSPECTOR GENERAL,
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

I. INTRODUCTION

The Office of Inspector General (OIG) identified four findings resulting from their audit. Summary responses to these findings are provided in this introduction, with more detailed specific responses provided in Section II.

Finding 1

The Idaho Housing and Finance Association (the "Association") disagrees with the OIG's conclusion that the Association authorized $3,721,738 in owner distributions in excess of allowable amounts from project funds. The Association has identified $436,310 of excess distributions, which it previously discussed with HUD during a November 2004 conference, and at that time, presented a plan to HUD officials for recovering said amounts. With HUD's concurrence, the Association will execute this plan.

Comment 1
Comment 2

The discrepancy in amount occurs because the OIG has incorrectly presumed that certain Old Regulation properties not subject to distribution limits were converted to New Regulation, limited distribution properties as part of a 1988 HAP amendment. In its December 23, 2004 letter, the Seattle HUD Regional office acknowledged that the 1988 Amendment projects were without limitation on distribution. This conclusion is supported by the facts and circumstances more fully described below in Section II.

Finding 2

Comment 3

As reported by the OIG, the Association did identify a duplicate payment from a project replacement reserve and other replacement reserve disbursements where adequate supporting documentation was not found in applicable files. The Association believes these disbursements were valid and appropriate, or were corrected at a future time. Consistent with the OIG's recommendation, the Association will obtain appropriate documentation for said disbursements or recover unsupported amounts from project owners. However, the Association disagrees that all project reserves identified by the OIG are subject to HUD regulatory restrictions. This disagreement is due to the OIG's misapplication of HUD handbook provisions and the inclusion by the OIG of 1988 Amendment projects presumed by OIG to be New Regulation limited distribution projects.

Comment 4

Finding 3

Comment 5

The Association categorically denies the OIG's assertion that, "the Association allowed a conflict of interest situation to exist between itself and The Housing Company," an affiliated nonprofit corporation. The Housing Company was created in 1992 following extensive discussions and cooperation with HUD's Portland Regional Office. In a letter dated July 11, 1990 the Region's Chief Counsel identified the cross-supporting nature of the two organizations and stated, "For the time being, the

Comment 6

participation of [The Housing Company] as a Project owner or principal would not be deemed to be the participation of [the Association] as an owner pursuant to 24 CFR Sec. 883.102(a)." Since that time and until November 2004, there has been no opinion expressed by HUD of any problem or conflict associated with the Association's administration of HAP contracts on properties owned by The Housing Company. The overall nature and organization of The Housing Company and its Board of Directors, comprised of a majority of outside independent members, has not changed.

To the extent the OIG and HUD now disagree with the former HUD Regional Chief Counsel's opinion, the Association is prepared to acceptably resolve any conflicts HUD may identify, as was reported to HUD in November 2004. However, it is important to recognize that a change in HUD's position on this matter should not be construed as a deficiency in the Association's management, nor imply the Association "allowed" a conflict to develop. To do so would be a clear mischaracterization of the facts.

Finding 4

Comment 7

The Association disagrees with the OIG's contention that $121,521 in excess management fees was paid for property management services. The OIG's conclusion is based on HUD guidelines and regulations that do not apply to state agency financed (HFA) projects, such as those in question. The OIG concludes that the Association should have developed a range of approved fees for determining management fee acceptability. There is no reason to believe the Association's determination of an acceptable management fee is any less reasonable because it did not establish a range as HUD has done for its directly monitored projects. HUD guidelines and regulations do not require the Association to develop or apply such a range, and the Association believes the management fees paid were reasonable and reflects market pricing for the project types, locations and sizes.

Comment 8
Comment 2

II. SPECIFIC RESPONSES TO FINDINGS

Finding 1: Idaho Housing and Finance Association Inappropriately Authorized $3,721,738 in Owner Distributions in Excess of Allowable Amounts from Project Funds.

Comment 9

Finding 1 of the Draft Audit Report is based primarily on the OIG's position that certain 1988 amendments (the "1988 Amendments") of Housing Assistance Payments Contracts ("HAP Contracts") rendered the related projects subject to limitations on distributions. To the extent that there are any limitations on distributions or restrictions on residual receipts accounts for these projects, they would have to be derived from the New Regulation limitations on distributions. As is discussed below, the 1988 Amendments were not intended by the parties to subject the related projects to limitations on distributions and this is permitted under the Section 8 New Regulations[1] (see 24 CFR

[1] The reference to "New Regulations" here refers to 24 CFR Part 883, effective February 29, 1980 for projects for which initial applications were submitted on or after February 29, 1980.

Comment 10

883.105(b)(2). In fact, it would have been foolish and completely contrary to their self interest for Section 8 project owners to amend their HAP Contracts to require limitations on distributions of project funds. Moreover, in December, 2004, the HUD Seattle Regional Office agreed that the 1988 Amendments did not subject those projects to limitations on distributions under the New Regulations. If the 1988 Amendment projects are removed from this finding as not subject to limitation distributions, then only four (4) projects and $436,310 remain at issue in this finding.

1. The 1988 Amendments Did Not Subject the Projects to Limitations on Distributions.

Comment 11

Finding 1 makes the assumption that all of the projects involved are New Regulation projects subject to limitations on distributions for these projects, and therefore, that distributions made contrary to the requirements in the New Regulations and the related handbooks and procedures must be repaid by the Association. In fact, except for the Aspenwood, C Street Manor, Eagle Manor and Westside Court projects, the HAP Contracts here are clearly Section 8 Old Regulation[2] contracts. The OIG has apparently misinterpreted the 1988 Amendments as converting those projects to New Regulation projects subject to limitations on distributions.

Comment 12

The 1988 Amendments were each a one page document that referenced the application of Subpart G of the Section 8 New Regulations, but did not mention any limitations on distributions for those projects. The Association believes that this was done by the owners involved to achieve a somewhat beneficial treatment for security deposit purposes. The Association contacted representatives of the project owners signing the 1988 Amendments and the Association employee who signed the 1988 Amendments. The representatives of the owners indicated that at that time the amendments were signed, there was no intention of limiting distributions for any of the projects. Each of the projects was an Old Regulation project and the owners had much more to lose than they could have possibly gained by subjecting the projects to limitations on distributions[3]. The employee of the Association that signed each of the 1988 Amendments, when contacted, confirmed that there was no expectation that there would be a limitation on distributions as a result of the 1988 Amendments. The Association has received signed statements from owner representatives and from the former Association employee confirming these matters. The HUD official signing the 1988 Amendments, Ron Duzy [now retired], was also contacted on the matter, and indicated that he could not recall whether or not there was an intention to limit distributions but that it did not seem likely that an owner would request an amendment to limit distributions for its project. Certain of the owners signing the 1988 Amendments subsequently sold these projects to The Housing Company. During the course of that sale nothing was indicated by the selling owners to indicate that these projects had been converted to New Regulation projects subject to limitations on distributions. This would have been especially relevant to the

Comment 13

Comment 11
Comment 14

[2] The reference to "Old Regulations" here refers to 24 CFR Part 883, effective April 15, 1975.
[3] The Association's research indicates that there is a slight benefit to owners regarding the amount of security deposit permitted under the New Regulations in as much as the amount of the security deposit could be the greater of one month's gross family contribution [potentially zero] or $50, whereas under the Old Regulations the security deposit was limited to one month's gross family contribution and therefore possible nothing.

Housing Company since it is a nonprofit owner and as such would not have been eligible for distributions under the New Regulation distribution requirements.

The 1988 Amendments are permitted under 24 CFR Section 883.105 (b) (2) which states:

> "(2) The Agency, Owner and HUD may agree to make the revised subpart G of this part applicable (with or without the limitation on distributions) and execute appropriate amendments to the Agreement or Contract."

Comment 15

Thus, under the Section 8 New Regulations, the amendment to apply subpart G must be "with or without limitation on distributions." The 1988 Amendments do not expressly state that they are with a limitation on distributions; nor do they state that they are without such limitation. Statements received from the representatives signing for the project owners for these projects and from the person signing for the Association both indicate that it was intended that there be no limitation on distributions. It is clear that a project owner would have no incentive to sign (and would not have signed) an amendment of its Old Section 8 Regulation HAP contract if it meant that it would be limited in receiving distributions of excess funds. Most of the 1988 Amendment projects were sold to the Housing Company with no indication that they were subject to New Regulation distribution requirements. In fact, subsequent to the 1988 Amendments, distributions were allowed for the projects which exceeded the limitations under the Section 8 New Regulations and this would evidence a course of conduct and intent by the parties that the 1988 Amendments were "without limitations" on distributions. Under applicable contract law, it is appropriate to consider surrounding circumstances and the intent of the parties where a provision is silent on its face and the meaning is not clear as to a particular term. See Roberts v. Hollandsworth 582 F.2d 496 (1978) 9th Cir. Court of Appeals and Jensen v. Westberg 707 P2d 490, 109 Idaho 379 (1985). Therefore, based on the intent of the parties as described above, these amendments should be read as providing for the application of subpart G of the Section 8 New Regulations without limitation on distributions.

Comments 11, 14

The above interpretation of the 1988 Amendments was accepted by the HUD Seattle office in its letter of December 23, 2004 to the Association, concerning a determination of whether certain of these projects were subject to limitations on distributions [Landmark Towers; Owyhee Place and Riverside Senior were not identified by HUD for audit at that time]. See Exhibit A, attached hereto for an excerpt of that letter regarding HUD's Finding No. 1. The December 23, 2004 letter, in its description of HUD's Finding No. 1, sets forth a chart of projects including projects listed in the OIG finding which are described by HUD as not subject to limitations on distributions even though the HUD letter specifically references these projects as having the 1988 Amendments.

Comment 10

Therefore, it is clear that these projects should not be subject to limitations on distributions due to the 1988 Amendments, and therefore, there is no basis on which to make any findings that the Association inappropriately authorized owner distributions for any of the 1988 Amendment projects whether from the projects' operating accounts or

from residual receipts accounts. To reach any other interpretation, such as that requested by the OIG where the Association would be required to repay millions of dollars for disbursements for old regulation projects that were, in each case, used by a nonprofit corporation for valid affordable housing purposes and not used for personal gain, would be to work a great injustice here.

Comment 16

Finding 1 also asserts that the projects were initially subject to regulatory agreements limiting distributions. The referenced regulatory agreements were Association, not HUD, regulatory agreements, imposed by the Association as a condition for its loan financing and were subject to change and revision by the Association without restriction for projects not subject to new regulation limitations on distributions. The Association revised distribution limitations for various projects not subject to limitations on distributions, including those committing to perpetual affordability, by establishing a revised distribution policy in 1994. That policy, however, is explicit in providing that all distributions are subject to the requirements of HUD's restrictions on distribution, stating: "D. HUD Regulations Control: In the event any of the above requirements are inconsistent with any applicable U.S. Department of Housing and Urban Development (HUD) regulation or policy, such HUD regulation or policy shall take precedence." Thus, the alleged statement of the Association's senior compliance officer to the effect that the policy applies to both New Regulation and Old Regulation projects is correct in as much as the policy does limit distribution for New Regulation restricted projects through HUD's limitations.

Comment 17

The OIG has also alleged that the Association allowed distributions to be paid from reserves and residual receipts accounts contrary to the Section 8 New Regulations. Here again the only reason such reserve and residual receipts accounts existed for the 1988 Amendment projects was because the Association, not HUD, had required them as a condition for the financing of the Projects. These accounts would not have been required for projects not subject to Section 8 New Regulation limitations on distributions and the Association should not be penalized for distributing these funds.

2. OIG Allegations with Respect to Surplus Cash Calculations, Payments from Residual Receipts and Reserves, Distribution Policy Provisions and Perpetual Affordability Provisions All Depend Upon Classification of a Project as a New Regulation Project Subject to Limitations on Distributions.

Comments 11, 15

The OIG has alleged that distributions were made by the Association without complying with certain handbook requirements for surplus cash statements, improperly from residual receipts and reserve accounts, improperly for special purposes, wrongfully under perpetual affordability agreements and under a distribution policy contrary to the New Regulations. The OIG citations of restrictions on disbursements from residual receipts accounts are all based on New Regulation requirements for limitations on distributions. In each case, for those projects which were covered by the 1988 Amendments and are not subject to limitations on distributions, these allegations do not apply.

Comment 18

Further, in the case of the OIG's statement that a HUD form surplus cash statement is required. Although the Association has been informed that such statement is

no longer available from HUD on HUD Clips, the Association is currently using and will continue to use, the form for New Regulation projects subject to limitations on distribution.

3. The Association has Already Proposed to HUD a Resolution for Those Projects Which Were Originally New Regulation Limited Distribution Projects and Which Received Excess Distributions.

There are four (4) projects [Aspenwood, C Street Manor, Eagle Manor and Westside Court] that were originally subject to limitations on distribution under the New Regulations which the OIG has indicated received distributions which exceeded the limitations under the New Regulations. The Association was aware of this when it met with Regional HUD representatives in Seattle in November, 2004 concerning HUD's 2004 compliance review and proposed a resolution of the matter that would result in a repayment to the residual receipts account for each of these projects. That resolution involved a combination of recouping the excess prior distributions from owners' future distributions and a refinancing of the referenced projects. The Association is still willing to undertake this resolution in order to effect the repayment requested for those projects.

Comment 19

4. Responses to Specific OIG Recommendations.

The Association's specific responses to the specific recommendations of the OIG for Finding 1 are as follows:

For 1A. and 1B., the Association is willing to provide repayment of the amounts under the resolution proposed to HUD in November, 2004 and discussed under 3. above, through a refinancing of the projects and withholding of future distributions to owners for the Aspenwood, C Street Manor, Eagle Manor and Westside Court projects. It would be wrong and inappropriate to require reimbursement for the projects covered by the 1988 Amendment where no limitation on distribution was intended, as described above.

Comment 19

For 1C.,1D. and 1E., the Association believes that it has in effect procedures to avoid improper distributions, but is willing to implement further procedures to assure that owners who are subject to New Regulation limitations on distributions (which do not include the 1988 Amendment Projects) receive only limited distributions.

Comment 15

The Association is willing to use the surplus cash statement as requested in 1F. for those projects subject to New Regulation limitations on distributions (which do not include the 1988 Amendment Projects).

Comment 15

With respect to 1G., it has always been the Association's intent that its distribution policy conform to all HUD requirements as described above including the new regulations where applicable. To the extent that HUD should desire an amendment to the Association's distribution policy for further clarification as to projects subject to New Regulation limitations on distributions, the Association will comply.

The Association will agree not to use a perpetual affordability agreement as a basis for distributions to a project owner which is subject to New Regulation limitations on distributions.

Finding 2: Idaho Housing Approved One Duplicate and Other Unsupported Requests for Reimbursement from Project Replacement Reserves.

1. There Has Been No Material Non-Compliance With HUD Requirements by the Association.

Finding 2 alleges that the OIG reviewed a number of disbursements from certain project replacement reserves and claims that there was a duplicate disbursement for one project and that for certain others there were no supporting invoices in the files. There is also an allegation that HUD or Association procedures were not followed in making disbursements.

Comment 20

First, it is important to note that for all of the projects that are Old Regulation projects or 1988 Amendment projects not subject to limitations on distributions, the HUD handbook requirements do not apply as there are no restrictions on owners from receiving distributions. This would apply to the Briarwood, Bristelcone, Lake Country, Owyhee Place, Pondside/Meadowview, South Meadow and Riverside Senior projects. In addition, the Mill Creek project is an Old Regulation project.

Comment 21

Regardless of the applicability of the handbook requirements, the Association believes it is appropriate to use reserve disbursements for the benefit of the projects, and will require this. Any funds not so used will be required to be paid back to the reserve accounts or taken from future project distributions.

Comment 20

HUD Handbook 4381.5 does not apply to state housing finance agency (HFA) financed projects such as those involved here. The finding assumes that the Handbook 4381.5 applies to repair and replacement account disbursements by HFA financed projects. In fact, the applicable regulations and the Handbook, make it clear that approval of such matters and similar management issues are to be determined by the HFAs themselves, under their own procedures, and not by HUD. 24 CFR 883.703 cited by the OIG, was not in effect during the years 2001-2003, having been replaced by a cross reference to 24 CFR 800, Subpart F through Subpart G of the 883 Regulations. 24 CFR 602 (2)(B)(iv) grants the discretion to the HFA, saying "Funds will be held by the Agency's other mortgagee or trustee for bondholders as determined by the Agency, and may be drawn from the reserve and used only in accordance with Agency guidelines and with the approval of, or as directed by, the Agency." The HFA guidelines are not required by the regulations to mandate either bids or invoices for withdrawals of reserves, and there is no HUD policy requiring bids for work paid from HFA replacement reserve accounts.

Comment 22

Since 1975, HUD has, by regulation and otherwise, made it clear that, because HFAs are taking the primary risk by financing Section 8 multi family projects, the HFAs

Comment 23

should have a great deal of latitude and flexibility in monitoring the management and operation of those projects, and therefore, HUD established separate regulations and requirements for HFAs that "finance the construction and rehabilitation of housing and assume the risks of default and foreclosure on developments they finance." 24 CFR 883.101 as published April 15, 1975. HUD recognized this in the early Section 8 Old Regulations, stating that "to allow these agencies flexibility in developing programs to meet housing needs, special policies and procedures are provided." The current Section 8 New Regulations similarly provide: "Subject to audit and review by HUD to assure compliance with Federal requirements and objectives, Housing Finance Agencies (HFAs) shall assume responsibility for project development and for supervision of the development, management and maintenance functions of owners."

Comment 28

Further, the Handbook cited by the OIG finding makes it clear that its provisions are set forth for use by HUD officials who are charged with approving management agents, management fees and related matters for projects directly administered by HUD. In Chapter 1, Section 1.2.b "Applicability," the Handbook is clear that "Depending upon the circumstances, HUD, the Administration for Rural Housing and Economic Development Services (ARHEDS), or a state/local agency will be responsible for oversight of management agent activities." This acknowledges that HUD does not monitor management issues for HFA projects. Section 1.3 "Purpose of This Handbook" states "This handbook describes the procedures that Loan/Asset Management and other HUD staff need to follow in working with and monitoring management agents of HUD-insured and HUD-assisted properties." There is no express requirement that HFAs such as the Association follow the Handbook procedures.

Comment 20

Although the Association does not dispute that it is in its best interest for an HFA to have a process to assure that repair and replacement reserve account monies are used for project purposes, there is nothing in the regulations, the ACC, the HAP contracts or the Handbook that specifically imposes the requirements referenced by the OIG on an HFA. In any event, the Association has obtained and/or will obtain evidence that these reserve distributions were properly used for project purposes, determined that each of the management fees at issue is reasonable as discussed below or will require project owners to repay these amounts to the reserve accounts.

2. The Association Will either Obtain Evidence that the Replacement Reserve Amounts Were Expended for Project Purposes or Require Repayment by Project Owners of the Reserve Disbursements.

Comment 24

Regarding the $24,562 duplicate payment from the Lake Country replacement reserve account, the Association agrees that a duplicate disbursement was incorrectly made. The error was identified but not directly adjusted. Because Lake Country is an Old Regulation project without limitations on distributions, Association staff elected to cure any resultant reserve deficiency during a subsequent reserve analysis consistent with the Association's replacement reserve policy of $3,000 per unit. This was completed and the reserve was funded to this level in June, 2004 (See documentation attached under Exhibit B).

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Comment 3

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Comments 20, 22

Comment 26

Comment 27

Regarding disbursements without invoices or bids, the Association has requested from each of the involved owners and/or their management agents that they provide the documentation to show that the funds disbursed from the management accounts was in fact for repair and/or improvement of the projects. Some invoices obtained so far are included under Exhibit B. Research identifying the remaining items is expected to be completed by January 31, 2006. If satisfactory documentation is not received, owners will be required to refund undocumented amounts to the reserve accounts, or have the amounts of undocumented withdrawals deducted from future project distributions.

Because evidence of bids is time sensitive, the Association will make a best efforts attempt to provide appropriate documentation to support the reasonableness of identified disbursements without bids. However, for Old Regulation projects without limitations on distributions, the Association believes that disbursements with valid invoices demonstrating that reserve funds were used for project purposes should not be required to reimburse the entire amount of the disbursement back to the replacement reserve.

Finding 3: A Conflict of Interest Exists Between Idaho Housing and The Housing Company.

Finding 3 implies that the Idaho Housing and Finance Association (Association) has willfully or negligently created a conflict of interest in monitoring Section 8 projects owned by The Housing Company contrary to provisions in the regulations and the ACC which provide that members or officers of a housing finance agency may not have a direct or indirect interest in the housing assistance payment contracts. The OIG fails to mention that the "interest" mentioned in the regulations and the ACC has generally been interpreted as a financial or economic interest in HUD Office of General Counsel opinions. No member or officer of the Association has ever had any financial or economic interest in any housing assistance payments contract for a Section 8 project of The Housing Company.

Finding 3 incorrectly and erroneously states that the Association was specifically told by HUD when the Association formed The Housing Company (then Housing Idaho, Inc.) that the Association should not monitor The Housing Company's performance. This is not correct. The OIG appears to refer to advice from HUD's Legal Counsel in Portland. In fact, prior to establishment of Housing Idaho, Inc. (the prior name of The Housing Company) in 1990, Legal Counsel to the Portland Office (Robert Chatham) was contacted to determine the permissibility of the Association monitoring projects to be owned by a nonprofit entity with a minority of board members who were also affiliated with the Association as well as the participation of this nonprofit in the Section 202 program. Mr. Chatham responded that the nonprofit should not participate in the 202 program due to the involvement of the Association [The Housing Company never participated in the 202 program]. However, Mr. Chatham did approve of the nonprofit owning projects that would be monitored by the Association and that these projects would not be considered Association projects, stating:

> "Utilizing Idaho Housing, Inc. as a principal in an entity (local non-profit, joint venture, etc.) acquiring IHA-financed Section 8 Projects presents a

somewhat different issue. For the time being, the participation of Idaho Housing, Inc. as a Project owner or principal would not be deemed to be the participation of IHA as an owner pursuant to 24 CFR Sec. 883.102(a). This case is distinguishable from the Sec. 202 case because we don't have the public instrumentality prohibition, merely the concern about the conflict of roles." [note that Mr. Chatham refers to Housing Idaho, Inc. the prior name of The Housing Company as "Idaho Housing, Inc."]

Comment 6

The nonprofit was then formed on this basis, with three (3) of its five (5) board members from outside the Association, and its Section 8 projects were acquired by the nonprofit and monitored by the Association. Since that time, the Association and its counsel have, on various occasions, conferred with HUD officials and HUD counsel on the matter but no objections to the Association's affiliation with The Housing Company were raised.

Until a HUD compliance review in 2004, the Association's practices were not questioned by HUD. During a meeting with HUD in November, 2004 regarding this and other issues, HUD's counsel, Donald Miller, was asked to research the conflict of interest question further and he subsequently provided an opinion, attached to HUD's letter to the Association, dated December 23, 2004, indicating that, based on current policy and statutes, he believed that continued monitoring by the Association of Section 8 projects owned by The Housing Company was a conflict of interest. No action was requested by HUD at that time, pending an OIG review. Although the Association did not completely agree with Mr. Miller's analysis, it has indicated it's willingness to resolve the matter in a manner acceptable to HUD, provided that the Association is treated consistently on the same basis as other state or local agencies and public housing authorities that monitor Section 8 compliance and also own, or have affiliates that own, Section 8 projects in Region X. Under such conditions, the Association continues to be willing to resolve this matter with HUD in a manner where the Association would cease to monitor Section 8 projects of The Housing Company.

With respect to the OIG specific recommendations 3A. and 3B., the Association, as indicated above, is willing to resolve this matter in a manner acceptable to HUD. The Association believes that sub-contracting oversight of properties owned by The Housing Company to a third party HUD-approved contract administrator would effectively remove any conflict issues.

Finding 4: Idaho Housing Approved Excessive Management Fees for 10 Idaho Projects.

1. Finding 4 Incorrectly Applies HUD Requirements to the Monitoring of Management Fees by Housing Finance Agencies.

Comment 28

a. HUD Handbook 4381.5 Rev-2 Is Not Required to Apply to State Housing Finance Agency (HFA) Regulation of Management Fees on HFA Financed Projects.

Comment 29

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Finding 4 is erroneous in several other ways. The finding assumes that Chapter 3 of HUD Handbook 4381.5 applies to management fee determinations by state housing finance agencies ("HFAs") financed projects, such as the projects here. In fact, the applicable regulations and the Handbook, make it clear that approval of management fees and other management agent issues are to be determined by the HFAs themselves, under their own procedures, and not by HUD.

Since 1975, HUD has, by regulation and otherwise, made it clear that, because HFAs are taking the primary risk by financing Section 8 multi family projects, the HFAs should have a great deal of latitude and flexibility in monitoring the management and operation of those projects. Therefore, HUD established separate regulations and requirements for HFAs that "finance the construction and rehabilitation of housing and assume the risks of default and foreclosure on developments they finance." 24 CFR 883.101 as published April 15, 1975. HUD recognized this in the early Section 8 Old Regulations, stating that "to allow these agencies flexibility in developing programs to meet housing needs, special policies and procedures are provided." The current Section 8 New Regulations similarly provide: "Subject to audit and review by HUD to assure compliance with Federal requirements and objectives, Housing Finance Agencies (HFAs) shall assume responsibility for project development and for supervision of the development, management and maintenance functions of owners."

Further, the Handbook, cited by Finding 4, makes it clear that its provisions are set forth for use by HUD officials who are charged with approving management agents, management fees and related matters for projects directly administered by HUD. In Chapter 1, Section 1.2.b "Applicability," the Handbook is clear that "Depending upon the circumstances, HUD, the Administration for Rural Housing and Economic Development Services (ARHEDS), or a state/local agency will be responsible for oversight of management agent activities." This acknowledges that the HFA, not HUD, monitors management issues for HFA projects. Section 1.3 "Purpose of This Handbook" states "This handbook describes the procedures that Loan/Asset Management and other HUD staff need to follow in working with and monitoring management agents of HUD-insured and HUD-assisted properties." There is no stated requirement that HFAs, such as the Association, follow the Handbook procedures. On the first page of Chapter 3 dealing with "Allowable Management Fees from Project Funds," the Handbook is clear that "This chapter addresses reviews of management fees requiring HUD approval." Nowhere in the Handbook or any of the regulations does it state that HUD approval is required for management fees on HFA financed projects. Further, on the same page in Chapter 3, the Handbook states "As provided for in project Regulatory Agreements and rental assistance contracts, for certain projects HUD determines the amount of fee that may reasonably be paid out of project funds." This section is referring to projects with HUD regulatory agreements, not HFA regulatory agreements. In neither the HFA (Association) regulatory agreements nor the applicable Housing Assistance Payment contracts is there any provision stating that HUD determines the amount of management fees for these projects. It is clear that the Handbook provisions and procedures by their own

Comments 28, 29

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terms are not required to apply to HFA financed projects. Furthermore, Handbook provisions do not have the force of law as do statutes and regulations.

Although the Association does not dispute that that management fees for HFA financed Section 8 projects should be reasonable, there is nothing in the regulations, the ACC, the HAP contracts or the Handbook that specifically imposes this requirement on an HFA. Nor is there any requirement that a determination of reasonableness must include a determination of a range of management fees or any requirements that an HFA use HUD's range of management fees. In any event, the management fees at issue are reasonable as discussed below. The Association does not use a fee range to determine reasonableness but has made its determination on a case by case basis and on the basis of a reasonable percentage of net collected rents. There is no reason to believe that the Association's determination is any less reasonable than establishing a range as HUD has done for its directly monitored projects.

b. The Association Established Limitations for Management Fees for its Portfolio of Projects at the Time It Financed the Projects and These Limitations Continue to be Reasonable.

When Association began financing its portfolio of Section 8 projects in the late 1970s and early 1980s, it established for most of these projects a limitation on management fees at a maximum of 7% of net collected rents ("NCR"). This was based upon limitations on management fees for other government subsidized low income housing projects known to the Association at that time, as well as the fact that many of these projects involved elderly or disabled tenants or other special needs populations or were in rural and remote areas of the state (Idaho is a predominantly rural state). This limitation of 7% of NCR has continued until today for those projects. The results of a recent review of the management fees for subsidized low income housing projects indicates that HUD project rents averaged 8.40% of Estimated Gross Income ("EGI") and tax credit project rents at 7.04% of EGI and therefore, the 7% of NCR limit is within the current market in Idaho for management fees for such projects. A few of the Association financed projects, including the nine (9) projects referenced by the OIG and now owned by The Housing Company, initially had per unit per month ("PUPM") management fees. The management fees for these projects were brought under the 7% of NCR limitation in 2001 on the same basis as most of the other Association financed and monitored projects. Not only was the 7% of NCR limit a reasonable standard at its inception and continues to be reasonable today, as described above, but in 2001 the 7% of NCR limit was the market standard for low income assisted, HFA projects in Idaho since the Association financed projects make up a large majority of such projects in Idaho. Thus, the 7% of NCR standard was reasonable at its inception and continues to be reasonable for such projects for a mostly rural state like Idaho.

2. Finding 4 Incorrectly Assumes that Various Old Regulation Projects Were Converted to New Regulation Projects Subject to Limitations on Distributions.

Comments 15, 20

Finding No. 4 states that the Association approved excessive management fees for ten (10) alleged New Regulation Section 8 projects due to a failure to determine that the management fees were "reasonable" within a range established pursuant to HUD Handbook 4381.5 Rev-2. Finding 4 makes the assumption that all of the projects involved are Section 8 New Regulation projects subject to limitations on distributions, and therefore, that the alleged excess management fees must be restored to project residual receipts accounts. This would not be required for Section 8 Old Regulation projects not subject to limitations on distributions. In fact, except for Westside Court, the Housing Assistance Payments (HAP) Contracts for these projects are clearly Section 8 Old Regulation contracts. The OIG has misinterpreted certain amendments to those contracts entered into in 1988 (the "1988 Amendments") as converting those contracts to New Regulation projects subject to limitations on distributions. See the extensive discussion of this under Finding 1. above, describing how the project owners and IHFA never intended the 1988 Amendments to apply the New Regulation limitations on distribution and the concurrence of the HUD Seattle office on this matter. Since these projects are not subject to limitations on distributions, there would be no basis for the OIG to claim that the Association should restore the amount of allegedly excess management fees to a residual receipts account since, under the Section 8 Old Regulations, the project owners can withdraw and spend surplus cash or other project funds for any purposes, including increased management fees and residual receipts accounts are not even a requirement.

Comment 30

3. HUD Regional and Area Offices Have Not Questioned the Association's Management Fee Standards.

The Regional and Area offices of HUD have not at any time questioned the Association's standards for management fees nor given any notice that the fee limitations were improper. Further, there have been no directives from the regional or area offices to the Association requiring that it follow the HUD Handbook guidelines in determining and reviewing management fees or for fee ranges. This is the first time any such questions on management fees have been raised. In fact, approximately three (3) years ago, the Association spoke with HUD about the recent HUD notice of a revised HUD management fee range, and was told that the Association was not bound by HUD's schedule.

Comment 30

4. Under These Circumstances HUD Should Allow Prospective Corrective Actions to be Taken and Not Impose Monetary Penalties or Requirements.

Since all of the projects, except the Westside Court project, should be classified as projects not subject to New Regulation limitations on distributions, those projects should be removed from this finding. With respect to the Westside Court project, the Association did evaluate management fees for that project, and determined that the project's management fees were reasonable and there was no change in the management agent fee when the management agent of the project was transferred in 2004. Transfer documentation, including the $40 PUPM management fee, was submitted to HUD at that time without objection. The Association is not required to use the procedures set forth in the Handbook since the provisions of the Handbook, by their own terms, are not required

Comment 35

Comments 28, 29

to be applied to state housing finance agency financed projects. This process has not been questioned by the regional HUD office.

In addition, as provided in Section 24 CFR 883.607(b) of the applicable regulations:

> "The ACC will provide that, if the Agency fails to comply with any of its obligations, HUD may determine that there is a substantial default and require the Agency to assign to HUD all of its interests under the Contract; however, HUD will continue to pay annual contributions in accordance with the terms of the ACC and the Contract. Before determining that an Agency is in substantial default, HUD will give the agency a reasonable opportunity to take corrective action." (emphasis supplied)

Under the above circumstances, any corrective actions should be prospective only and should not impose what amount to monetary penalties here.

5. Responses to Specific OIG Recommendations.

With respect to OIG recommendations 4A. through 4D., no amounts are required to be paid into the residual receipts accounts. First, because all but one of the projects should be treated as not subject to New Regulation limitations on distributions and therefore not subject to management fee restrictions, as discussed above. In addition, the management fee provisions of Handbook 4381.5, chapter 3, as to management fee ranges are not intended to specifically limit management fees for HFA financed projects like the projects at issue here, and the management fees were, and are, reasonable. Nor should any such fees be reduced in the future for such projects unless the fees are then determined to be unreasonable.

III. CONCLUSION

As described above, the Association is willing to take the corrective actions it has suggested for resolution with HUD of the Association's contract administration for projects owned by The Housing Company, to cause repayment of excess distributions for projects clearly subject to New Regulation limitations on distributions, and to demonstrate reasonable documentation for reserve withdrawal. It would be wrong, however, to require repayment of distributions for projects that were never intended to be subject to limitation on distributions. It would also be wrong to require repayment of management fees for such projects not subject to distribution limitations or to apply HUD handbook management fee range provisions not intended for HFA projects where such fees are reasonable considering applicable market standards.

OIG Evaluation of Auditee Comments

Comment 1 The letter to which Idaho Housing refers also states that HUD made this acknowledgement subject to a review of the issue by the OIG.

Comment 2 Because of a disagreement with the Region X Multifamily Hub, we included additional recommendations that they obtain a formal legal opinion and take action based on that opinion (Findings 1 and 4).

Comment 3 OIG reviewed the documents provided by Idaho Housing in support of the duplicate payment and the unsupported payments and adjusted the unsupported amount identified in our report by $6,083 as a result.

Comment 4 Although Idaho Housing disagrees that replacement reserves for all projects we identified are subject to HUD restrictions, each project we identified is subject to these restrictions either because they are new regulation projects or because they adopted 24 CFR 883 Subpart G in 1988. Subpart G of 24 CFR 883 contains requirements for the replacement reserve accounts for these projects. These requirements do not exempt any projects except partially assisted projects.

Comment 5 The guidance to which Idaho Housing refers does not consider two very important facts. The executive director of Idaho Housing is also the president of The Housing Company. In addition, all assets of The Housing Company revert to Idaho Housing upon dissolution of The Housing Company. We believe this would have changed the opinion of HUD's Portland Regional Office. Also, as stated in our report, Idaho Housing was told that it should not monitor its own performance as an owner/manager. Further, this guidance provided an alternative suggesting that HUD or a public housing authority could provide oversight over these projects.

Comment 6 In our exit conference with Idaho Housing, the Region X multifamily representative agreed that it wasn't until about 2000 that HUD first noticed that there was such a close relationship between Idaho Housing and The Housing Company. In December 2004, HUD issued a legal opinion stating that Idaho Housing was in a conflict of interest situation. However, Idaho Housing has agreed to implement recommendations 3A and 3B in this report, which should resolve the conflict of interest issue.

Comment 7 Although Idaho Housing does not believe that HUD Handbook 4381.5 applies to these projects, the Handbook itself states that it applies to HUD-assisted projects that receive Section 8 assistance. In addition, the management agreement for all of The Housing Company projects specifically states that the owner will receive its management fee in accordance with HUD Handbook 4381.5.

Comment 8 Since Idaho Housing does not have its own process to determine whether a fee is reasonable, it should have followed HUD's process as found in the Handbook.

Comment 9 Whether the amendments were intended to limit the distributions is immaterial. The amendments themselves do not state that this provision will not apply.

Comment 10 The Region X HUD office agreed with Idaho Housing's assessment of which projects were limited distribution projects under the new regulations subject to review of the issue by the OIG.

Comment 11 As stated in our report, there was nothing in the amendments to indicate any of the parties originally agreed to opt out of the limitation on distributions. Further, the regulatory agreement for each project already limited distributions from the time of the projects' inceptions. It was not until after The Housing Company purchased the projects and entered into a perpetual affordability agreement that distributions were allowed to The Housing Company in excess of the limitations.

Comment 12 Each of the project owners that Idaho Housing contacted owned projects that now belong to The Housing Company. In addition, most of the projects for which Idaho Housing received these statements of intent were small, family projects that would have been exempt from limitations on distributions in accordance with the regulations.

Comment 13 These signed statements were received by Idaho Housing 16 years after the amendments were signed. As stated in our report, there was nothing in the amendments or other documentation to indicate that the owners originally intended to opt out of the limitations on distributions.

Comment 14 The projects purchased by The Housing Company were already limited as to distributions by the regulatory agreements between the owners and Idaho Housing. In addition, Idaho Housing then allowed no distributions to The Housing Company on these projects even after purchase, as is proper under the regulations. However, once The Housing Company entered into a perpetual affordability agreement, Idaho Housing began allowing distributions.

Comment 15 Since Subpart G of 24 CFR 883 incorporates the limitations on distributions, the owners of these projects should have made some reference in the amendment if they did not intend to limit the distributions. For example, the pipeline projects were allowed to opt out of the limitations on distributions because of the timing of the signing of the agreement to enter into housing assistance payments contracts. The owners of these projects, with Idaho Housing and HUD approval, crossed out the sections of the contract that dealt with limitations on distributions. This was appropriate. However, as noted before, the amendments are silent on the issue of whether the owners will opt out of the limitations.

Comment 16 The regulatory agreement does not state or even indicate that it is, "…subject to revision by the Association without restriction for projects not subject to new regulation limitations on distributions." In fact, section 13 of the regulatory agreement states that the agreement shall remain in effect as long as Idaho Housing is the holder of the mortgage loan or has any interest in the property.

Comment 17 When the owners of projects entered into the housing assistance payments amendment in 1988, the projects became required to maintain a replacement reserve account in accordance with 24 CFR 883.703. This is included in Subpart G. Therefore, regardless of whether these projects are held to limited distribution, unlimited distribution, or nonprofit status, they are still required to follow the rules for replacement reserves.

Comment 18 As stated in our report, Idaho Housing did not direct owners to complete the HUD-required surplus cash statement. In addition, during our review, we found of 16 projects, only one submitted a surplus cash statement for each year 2001 – 2004 and only one project submitted a surplus cash statement for one year. None of the other 14 projects submitted a surplus cash statement. In fact, the notes to the financial statements for four projects stated that computation of surplus cash based upon HUD guidelines was superseded by the Idaho Housing distribution policy.

Comment 19 If the four projects to which Idaho Housing are referring are allowed to refinance at a lower rate, use the financing savings to repay the excessive distributions, and the change in rate is not used to lower the subsidy to the projects, then HUD, in effect, will be making the reimbursement instead of the owner or Idaho Housing. In addition, each of these four projects are subject to the McKinney Act and Idaho Housing would be required to reimburse HUD for one half of the savings attributed to a refinance.[2]

Comment 20 The finding does not deal with distributions, but with replacement reserves. As noted in comment 16, when the projects adopted Subpart G of 24 CFR 833 they became required to maintain a replacement reserve account for extraordinary maintenance and repair or replacement of capital items. Additionally, HUD Handbook 4381.5 states in paragraph 6.51 that HUD may not always be the contract administrator, but a state agency may be and that state agency Section 8 projects are specifically covered under this section. The Handbook does not differentiate between old regulation and new regulation projects, nor does it differentiate between limited distribution, unlimited distribution, and nonprofit projects. Paragraph 6.53(b)(3) states that the contract administrator will specifically review replacement reserve transactions for propriety and will ensure that the owner/manager is complying with regulatory requirements. This chapter

[2] See audit report number 2005-SE-1008 for information on McKinney Act projects.

further states that monitoring regulatory agreements requires verification that replacement reserve account transactions are authorized and that vouchers, invoices, and other evidence of distribution and expense payments are proper.

Comment 21 Replacement reserves are not to be used simply "…for the benefit of the projects…" but are only to be used, in accordance with 24 CFR 883.703(a), for extraordinary maintenance and repair and replacement of capital items.

Comment 22 Although 24 CFR 883 does not mandate that bids or invoices for withdrawals of reserves for replacements be obtained, Idaho Housing policies require both bids and invoices and HUD Handbook 4381.5 paragraph 6.55 states that vouchers and invoices should be reviewed to ensure that distribution and expense payments are proper.

Comment 23 Although HUD allows state housing finance agencies flexibility in monitoring the management and operation of these projects, the state housing finance agency is still required to follow the regulations and handbooks that apply to these projects.

Comment 24 Our analysis of the documentation does not show that the duplicate disbursement from the replacement reserve account was reimbursed to the same account. The documentation actually shows the following:

- There was a deposit to the replacement reserve account in June of 2004 in an amount more than three times the amount of the duplicate reimbursement.
- According to the note written on the support, the deposit to the replacement reserve account was to replenish the $132,000 requirement for replacement reserves to be fully funded at $3,000 per unit and 44 units, not to reimburse the account for a duplicate payment as stated by Idaho Housing's executive director and its attorney.
- The check for the deposit to the replacement reserve account came from the project's operating account, not from the twice-paid vendor or the owner.

Comment 25 Our analysis of the documentation Idaho Housing provided for the Briarwood transaction at our exit conference revealed that it did not support the transaction. Further, some of the documentation appeared to have been altered. Idaho Housing then provided us with other documents to support this transaction. The documents from the vendor did not match the transaction and the work order again appeared to have been altered.

Comment 26 The purpose of the conflict of interest provision in the annual contributions contract and the housing assistance payments contracts is to avoid a conflict in activities performed to serve the public and those performed to promote one's own interests and to prevent one from obtaining special benefits as a result of the close relationship. There is nothing in these provisions that state that the prohibition is only against a direct financial benefit. Although the executive director of Idaho Housing may not receive a direct financial benefit as a result of

his position as the president of The Housing Company, his actions in that position and the performance of The Housing Company would directly affect his reputation and could therefore indirectly affect his future financial position.

Comment 27 Idaho Housing is correct in its quote of HUD's legal counsel in guidance provided by HUD's Portland's Office of OGC during 1990. However, Idaho Housing did not complete the quote in which HUD's legal counsel cautioned very strongly against monitoring its own performance as an owner/manager. In fact, HUD's legal counsel even offered a solution suggesting that HUD or a public housing authority could perform the contract administrator role with regard to these projects. In addition, HUD's legal counsel explained that its guidance should not be taken as definitive answers. Therefore, since there was an apparent inconsistency in what was being said, Idaho Housing should have acted further to resolve the issue. Further, it is not apparent from the letter to which Idaho Housing refers that it informed HUD that the executive director of Idaho Housing would also be the president of The Housing Company or that the assets of The Housing Company would revert to Idaho Housing if The Housing Company was dissolved. We believe this information could have altered HUD's legal counsel opinion in this case.

Comment 28 HUD Handbook 4381.5 states in chapter 1, paragraph 1.1 that the handbook applies to HUD-assisted as well as HUD-insured projects. Figure 1-2 shows that the types of properties and programs affected include rental assistance projects in the Section 8 multifamily program area. Although paragraph 1.2 states that a state or local agency may be responsible for oversight of management agent activities, nowhere in the handbook does it say that state housing agencies are exempt from using this handbook. Also, since Idaho Housing is the agent of HUD, it must follow these procedures.

Comment 29 Figure 3-5 of HUD Handbook 4381.5 shows that limited distribution and nonprofit projects, regardless of how project rents are set, are required to receive an after-the-fact review of management fees. Again, as stated above, nowhere in this chapter does it say that state housing agencies are exempt from the provisions of this chapter.

Comment 30 Idaho Housing states that it is responsible for approval of management fees and other management agent issues under its own procedures. However, by its own admission, it does not have any procedures in place by which to ensure that approved fees do not significantly exceed reasonable amounts as described in HUD Handbook 4381.5. In addition, the management agreement between the owner and the lender (Idaho Housing) for the projects owned by The Housing Company states that the owner will receive a management fee, "…in accordance with HUD Handbook 4381.5 Rev 2…" Therefore, Idaho Housing should have used HUD's procedures to determine if the increase in management fees was reasonable.

Comment 31 As stated in our report, the objective of HUD's requirement that management fees be reviewed when a project owner or manager requests an increase in the management fee percentage is to ensure that those fees do not exceed that ordinarily paid in like circumstances between independent agents and owners. The authority for state housing agents to assume responsibility for these projects does not absolve them of the responsibility to review the management fees for reasonableness.

Comment 32 Idaho Housing did not properly monitor the increase in management fees for these projects. It simply approved the increases without any analysis of reasonableness.

Comment 33 Idaho Housing documentation did not show that it made its determination of reasonableness of management fee increases on a case-by-case basis. As stated in comment 30, Idaho Housing does not have a process in place to determine if a management fee is reasonable. In fact, the senior housing compliance manager told us that they just looked at the seven percent fee that was being requested by The Housing Company and decided it was reasonable.

Comment 34 HUD Handbook 4381.5 does not require any review of management fees if there has not been a request for a change in management fee percentage or a change in the management agent. This is to give the agent an incentive to maximize collections as well as to increase the agent's fee yield to offset the effects of inflation. Therefore, we did not review management fees established at project inception. However, a management fee percentage must be reviewed if a change in the percentage or in the management agent is requested. According to this Handbook, the fee percentage should be reviewed when one of the above changes are made in order to determine if the per-unit-per-month dollar amount is reasonable. The Handbook also states, in 3.19 b. that the "[r]esidential fee yield used for establishing the range(s) must be computed by applying the residential fee percentage to the monthly rent potential for all revenue-producing units (adjusted to reflect a 95 percent collection rate)." In 3.19 b. (2), it states that "[y]ields must be computed on a per-unit per-month basis." In 3.20 c. it states that if the yield is not reasonable (in comparison to what was calculated above) the fee percentage may not be approved. As stated in our finding, HUD calculated a reasonable management fee in accordance with this Handbook. Idaho Housing allowed management fees for these projects to exceed that amount from $5 to $13 per-unit-per-month by approving a flat seven percent fee.

Comment 35 We believe the corrective action referred to may include repayment to projects or to HUD to correct the improper use of funds authorized by Idaho Housing.

Appendix C

SCHEDULE OF EXCESSIVE OWNER DISTRIBUTIONS (FINDING 1)

		Deficiencies						
Project	**Ineligible amount**	**A**	**B**	**C**	**D**	**E**	**F**	**G**
Aspenwood	$ 43,186		X	X		X	X	
Briarwood	384,116	X		X		X	X	
Bristlecone	366,838	X		X		X	X	
C Street Manor	92,117		X	X		X	X	X
Eagle Manor	168,808		X	X		X	X	
Lake Country	471,765	X		X				
Landmark Tower	125,708	X		X			X	
Meadowview/Pondside	330,004	X		X		X	X	X
Owyhee Place	116,602	X						
Riverside Senior	979,693	X		X	X	X	X	X
South Meadow	273,769	X		X		X	X	
Village Community Gardens/Village Gardens	236,933	X				X		
Westside Court	132,199		X	X		X	X	
Total	**$3,721,738**							

A. 1988 housing assistance payments amendment - Owners of these projects signed the 1988 housing assistance payments amendment adopting subpart G of 24 CFR [*Code of Federal Regulations*] 883. Nonprofit owners should not have been allowed any distributions. Otherwise, distributions should have been limited.

B. New regulation limited distribution projects - Under the new regulations, distributions to the owners of these projects are limited to 6 percent on equity. The ineligible amount is the amount in excess of that 6 percent.

C. Surplus cash statement not used - Owners of these projects received excess distributions in part due to the difference between use of Idaho Housing's partnership distribution worksheet and HUD's surplus cash statement.

D. Special purpose distributions - Idaho Housing allowed this owner to receive a special purpose distribution under its policies even though the owner of this project is a nonprofit organization and is not entitled to any distributions under the 1988 housing assistance payments amendment (see A. above).

E. Perpetual affordability agreement - Idaho Housing allowed owners of these projects excess distributions after they signed a perpetual affordability agreement even though these owners are entitled to only a limited distribution or to no distribution as nonprofit owners under the new regulations or the 1988 amendment.

F. Residual Receipts - Idaho Housing allowed owner distributions to be paid from residual receipts even though these funds are required to be used to reduce housing assistance payments or for project purposes only.

G. Replacement Reserves - Idaho Housing allowed owner distributions to be paid from replacement reserves even though these funds are required to be used only for extraordinary maintenance and repair or replacement of capital items. Specifically, Idaho Housing allowed a total of $11,275 ($8,325, $1,308, and $1,642) to be paid from the replacement reserves of C Street Manor, Pondside/Meadowview, and Riverside Senior.

Appendix D

UNSUPPORTED DISBURSEMENTS FROM REPLACEMENT RESERVE ACCOUNTS (FINDING 2)

	2001		2002		2003		2004	
Project	**No bids**	**No invoice**	**No bids**	**No invoice**	**No bids**	**No invoice**	**No bids**	**No invoice**
Aspenwood		9,490				1,558*	8,385	
Briarwood		1,693						
Bristlecone					19,726			
C Street Manor		20,000						15,000
Imperial				267				
Lake Country			10,091					
McConnell Building		3,429						5,800
Mill Creek	2,115	11,161					3,114	
Owyhee Place							2,329	
Payette Plaza		4,188	4,011			13,850		
Riverside Senior Housing				17,882				
Silver Hills				1,455				1,375
South Meadow			13,000 6,150		6,195			
Totals	**2,115**	**49,961**	**33,252**	**19,604**	**25,921**	**15,408**	**13,828**	**22,175**

*Information on the invoice was insufficient

Total 2001-2004 expenditures without required bids $ 75,116
Total 2001-2004 expenditures without required invoices $107,148

Appendix E

EXCESSIVE MANAGEMENT FEES (FINDING 4)

Project	Mgt fee[1] 2002	Mgt fee[1] 2003	Mgt fee[1] 2004	Maximum mgt fee[2] per year	Excess mgt fee[4]
	a	b	c	d	e
Briarwood	$ 21,624	$ 23,592	$ 23,705	$ 16,800	$ 18,521
Bristlecone	15,484	17,899	17,515	12,600	13,098
Lake Country	23,314	26,060	25,359	18,480	19,293
Meadowview and Pondside Gardens	22,940	26,153	26,152	18,480	19,805
Owyhee Place	15,719	19,304	19,041	13,440	13,744
South Meadow	20,939	23,334	23,675	17,220	16,288
Village Community Gardens and Village Gardens	26,814	31,405	32,573	23,940	18,972
Westside Court[3]	-	-	14,400	12,600	1,800
Total	$ 146,834	$167,747	$182,420	$ 120,960	$ 121,521

[1]This is the actual management fee paid by the owner from project funds according to each project's annual audited financial statements.

[2]This is the maximum allowable management fee based on 100 percent occupancy and HUD's maximum $35 per-unit-per-month residential management fee range for Idaho. The amount shown for each project equals the number of units multiplied by the $35 fee multiplied by 12 months.

[3]Westside Court did not have a change in management fee or management agent until 2004. Therefore, there is not a value listed in the table above for 2002 and 2003.

[4]For all projects except Westside Court, e=(a+b+c)-(d*3). Since Westside Court had no changes in management fees until 2004, e=c-d.