
AUDIT REPORT



FAIRFIELD METROPOLITAN HOUSING AUTHORITY'S NONPROFIT DEVELOPMENT ACTIVITIES

LANCASTER, OHIO

The Authority Used Annual Contributions Contract Funds for
Development Activities Outside Its Annual Contributions
Contract

2006-CH-1005

DECEMBER 30, 2005

OFFICE OF AUDIT, REGION V
CHICAGO, ILLINOIS



Issue Date	December 30, 2005
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Audit Report Number	2006-CH-1005
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TO: Thomas S. Marshall, Director of Public Housing Hub, 5DPH
Lana Vacha, Director of Community Planning and Development, 5ED

FROM: 
Heath Wolfe, Regional Inspector General for Audit, 5AGA

SUBJECT: Fairfield Metropolitan Housing Authority; Lancaster, Ohio; The Authority Used Annual Contributions Contract Funds for Development Activities Outside Its Annual Contributions Contract

HIGHLIGHTS

What We Audited and Why

We audited the Fairfield Metropolitan Housing Authority's (Authority) activities with its related nonprofit organization. The review of housing authorities' development activities is set forth in our fiscal year 2005 annual audit plan. We selected the Authority for audit because it was identified as having high-risk indicators of nonprofit development activity. Our objective was to determine whether the Authority diverted or pledged resources subject to its annual contributions contract, other agreement, or regulation for the benefit of non-U.S. Department of Housing and Urban Development (HUD) developments without specific HUD approval.

What We Found

The Authority improperly transferred \$520,169 of its HOPE 1 and 5(h) Homeownership Plan sales proceeds to its nonprofit, the Lancaster Community Housing Corporation (Corporation). The Authority received \$337,191 from 10 HOPE 1 properties sold in 1995 and \$78,000 from two 5(h) Homeownership Plan properties sold in 1996. The sales proceeds were pooled and invested in certificates of deposit accumulating interest until 2004 when the Authority transferred the proceeds to the Corporation. The transfer occurred without HUD

approval and did not follow federal requirements regarding the use of the proceeds.

The Authority also transferred ownership of three properties that were rehabilitated using HUD's McKinney grant funds to the Corporation without HUD approval. The Corporation sold one property in 2004. The Authority and/or the Corporation did not reimburse HUD \$23,314 used to rehabilitate the property.

We informed the Authority's executive director and the director of HUD's Cleveland Public Housing Hub of minor deficiencies through a memorandum, dated December 21, 2005.

What We Recommend

We recommend that the director of HUD's Cleveland Public Housing Hub and/or the director of HUD's Columbus Office of Community Planning and Development require the Authority to (1) reimburse its HOPE 1 and 5(h) Homeownership Plan programs collectively \$520,169 from nonfederal funds for the improper transfer of the sales proceeds to its Corporation, (2) reimburse HUD \$23,314 from nonfederal funds for the McKinney grant funds used to rehabilitate the one property, and (3) implement procedures and controls to correct the weaknesses cited in this report.

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 issued because of the audit.

Auditee's Response

We provided our discussion draft audit report to the Authority's executive director and HUD's staff during the audit. The Authority's executive director declined our offer for an exit conference. We requested the Authority's executive director to provide written comments on our discussion draft audit report by December 17, 2005.

The Authority's executive director provided written comments to the discussion draft audit report dated December 14, 2005. The Authority disagreed with our findings and recommendations. The complete text of the Authority's written response, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

The Fairfield Metropolitan Housing Authority (Authority) was established under Section 3735.27 of the Ohio Revised Code. The Authority contracts with the U.S. Department of Housing and Urban Development (HUD) to provide low- and moderate-income persons with safe and sanitary housing through rent subsidies. The Authority's public housing program consists of 96 units. A five member board of commissioners governs the Authority. During the audit, the Authority's books and records were located at 1506 Amherst Place, Lancaster, Ohio. As of October 2005, the books and records were moved to 315 North Columbus Street, Lancaster, Ohio.

The Authority established the Lancaster Community Housing Corporation (Corporation), a 501(c)(3) nonprofit, to further affordable housing and family self-sufficiency for low- and very low-income families in central Ohio. The Corporation has no shareholders, and the sole member of the Corporation is the Authority.

We selected the Authority for audit because it was identified as having high-risk indicators of nonprofit development activity. Our objective was to determine whether the Authority diverted or pledged resources subject to its annual contributions contract, other agreement, or regulation for the benefit of non-HUD developments without specific HUD approval.

RESULTS OF AUDIT

Finding 1: The Authority Improperly Transferred \$520,169 to Its Nonprofit

The Authority improperly transferred \$520,169 of its HOPE 1 and 5(h) Homeownership Plan funds to its Corporation. The Authority received \$337,191 in proceeds from 10 HOPE 1 properties sold in 1995 and \$78,000 from two 5(h) Homeownership Plan properties sold in 1996. The sales proceeds were pooled and invested in certificates of deposit accumulating interest until 2004 when the proceeds were transferred to the Corporation. The transfer occurred without HUD approval and did not meet federal requirements regarding the use of the funds. The transfer occurred because the Authority's executive director believed the sales proceeds were not HUD funds. As a result, fewer funds were available to serve the Authority's low-income residents.

Inappropriate Transfer of Federal Funds

The Authority inappropriately transferred HUD funds to pay the expenses of development activities not under an annual contributions contract for its nonprofit Corporation. The monies received from the sale of the HOPE 1 and 5(h) Homeownership Plan properties were pooled and invested in certificates of deposit accumulating interest until 2004. The Authority inappropriately transferred \$520,169 in sales proceeds to the Corporation from June to August 2004.

The HOPE 1 grant agreement, between HUD and the Authority, required the Authority to use sale proceeds from the initial sale of units to eligible families for the cost of a homeownership program. The costs include operating expenses, improvements to the project, business opportunities for low-income families, supportive services related to the homeownership program, additional homeownership opportunities, and other activities approved by HUD, either as part of the approved application or as later approved by HUD. According to 24 CFR [*Code of Federal Regulations*] Part 906, 5(h) Homeownership Plan sales proceeds may be used for sale and administrative costs that are necessary and reasonable for carrying out a homeownership plan and/or retained by a public housing authority and used for housing assistance to low-income families.

Contrary to the HOPE 1 and 5(h) Homeownership Plan requirements, the Authority transferred sales proceeds to its nonprofit Corporation. The funds were transferred to the Corporation without HUD approval, and the Authority did not follow federal requirements regarding the use of the funds. The Authority's executive director believed that HUD's approval was not needed. She also believed the sales proceeds were not federal funds because HUD signed the

release of declaration of trusts for the properties. As a result, fewer funds were available to serve the Authority's low-income residents.

Recommendations

We recommend that the director of HUD's Cleveland Public Housing Hub require the Authority to

- 1A. Reimburse its HOPE 1 and 5(h) Homeownership Plan programs collectively \$520,169 from nonfederal funds for the improper transfer of the sales proceeds to its nonprofit Corporation.
- 1B. Implement procedures and controls to ensure the Authority's use of the properties and/or sales proceeds meets HOPE 1 and/or 5(h) Homeownership Plan requirements.

Finding 2: The Authority Improperly Transferred Three Properties Its Nonprofit, and One Property Was Later Sold

The Authority was awarded a \$136,286 State of Ohio Permanent Housing Program for Handicapped Homeless Grant (Grant) in December 1989. The Grant was funded with McKinney funds from HUD. The Authority was responsible for acquiring and renovating three properties for chronically mentally disabled persons. The Grant required a 20-year commitment after initial occupancy of the properties.

In 2001, the Authority requested permission from HUD to sell one unit and also requested that the remaining two properties be used for an alternate use for the direct benefit of lower income persons. HUD agreed but asked that the Authority notify it if the Authority decided to dispose of a HUD-funded property. Without HUD approval, the Authority transferred ownership of the three properties to its nonprofit Corporation in May 2004. In September 2004, the Corporation sold one unit for more than \$146,000. The Authority failed to notify HUD of the sale and reimburse HUD the funds used to rehabilitate the sold unit. As a result, HUD did not receive its share of the sales proceeds and has no assurance the two remaining properties will continue to benefit low to moderate-income families.

Federal Funds Were Not Used Properly

Without HUD approval, the Authority transferred ownership of the three properties to its nonprofit Corporation in May 2004. The Corporation sold the property located at 841 East Main Street in September 2004. It did not notify HUD that the unit was sold and failed to reimburse HUD \$23,314 as required by the Grant agreement. The Authority's executive director said HUD was not notified because the Corporation was the owner of the unit at the time of the sale.

The Authority was responsible for acquiring and renovating three properties for chronically mentally disabled persons under the Grant. In February 2001, the Authority sent a request to HUD to withdraw from further participation in the Grant. The Authority included five possible uses of the properties in its request. One possible use was to sell one property so it could pay off the mortgage held by the Ohio Department of Mental Health, which provided required matching funds for the Grant. The Authority also requested that the two remaining properties be used for an alternate use for the direct benefit of lower income persons. In August 2001, HUD responded to the Authority's request and agreed that it could use the properties for the stated alternate use. However, HUD cited federal regulations requiring that the Authority repay the full amount of the acquisition/rehabilitation advance if the properties were used for less than 10 years following the date of initial occupancy. For each full year that the properties are used for permanent housing following the expiration of the 10-year period, the amount that the Authority will be required to pay will be reduced by one-tenth of the original advance. HUD declared that the Authority had met the

original 10-year commitment but had 9 years remaining for the 20-year commitment. The Authority would be required to pay back a percentage of the original advance if it disposed of any of the properties before the expiration of the 20-year commitment. HUD requested the Authority to notify it if the Authority decided to dispose of the properties so HUD could discuss what documentation the Authority would be required to submit to finalize the Grant process.

We notified HUD of the one property sale and calculated that \$23,314 should be reimbursed to HUD. The property was sold 14 years into the 20-year commitment. The Authority drew down \$96,497 in Grant funds. It used \$38,856 in Grant funds for improvements for the 841 East Main Street property. Therefore, the amount the Authority would be required to repay HUD is reduced by four-tenths (40 percent). The amount the Authority would be required to repay HUD is 60 percent of the Grant funds for the sold unit (60 percent times \$38,856).

Recommendations

We recommend that the director of HUD's Columbus Office of Community Planning and Development require the Authority to

- 2A. Reimburse HUD \$23,314 from nonfederal funds for the Grant funds used for the sold property cited in this finding.
- 2B. Implement procedures and controls to ensure the Authority's use of the remaining two properties and/or any future sales proceeds meet federal and state requirements.

SCOPE AND METHODOLOGY

We conducted the audit at the Authority's Lancaster, Ohio office from May to October 2005.

To determine whether the Authority diverted or pledged resources subject to its annual contributions contract, other agreement, or regulation for the benefit of non-HUD developments without specific HUD approval, we reviewed

- Applicable laws, regulations, and HUD program requirements at 24 CFR [*Code of Federal Regulations*] Parts 841 and 906, and Appendix A, Section 725; the State of Ohio's Grant agreement; Office of Management and Budget Circular A-87; and HUD's release of declaration of trusts;
- The Authority's accounting records, annual audited financial statements for 2003 and 2004, general ledgers, bank statements and cancelled checks, policies and procedures, board meeting minutes and resolutions for 2003 and 2004, cost allocation plans for 2003 and 2004, voucher for payment of annual contributions and operating statements for 2003 and 2004, HOPE 1 and 5(h) Homeownership Plan agreements, annual contributions contract number C-5106; settlement statements, and organizational chart;
- The Corporation's accounting records, general ledgers, bank statements, board meeting minutes and resolutions for 2003 and 2004, articles of incorporation, and organizational chart; and
- HUD's files for the Authority.

We also interviewed the Authority's and the Corporation's employees and board members, and HUD staff.

The audit covered the period from January 1, 2003, through December 31, 2004. This period was adjusted as necessary. We performed our audit 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,
- Compliance with applicable laws and regulations, and
- Safeguarding resources.

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 objective:

- Program operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Validity and reliability of data – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.
- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Safeguarding resources – Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

We assessed the relevant controls identified above.

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

Significant Weakness

Based on our audit, we believe the following item is a significant weakness:

- The Authority lacked procedures and controls to ensure that federal funds were used in accordance with applicable requirements (see findings 1 and 2).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/
1A	\$520,169
2A	<u>23,314</u>
Totals	<u>\$543,483</u>

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 polices or regulations.

Appendix B

AUDITEE COMMENTS AND OIG EVALUATION

Ref to OIG Evaluation

Auditee Comments



FAIRFIELD METROPOLITAN
HOUSING AUTHORITY



Mary Bozman
Executive Director

"Serving our Community with Safe and Affordable Housing"

December 14, 2005

Mr. Heath Wolfe, Regional Inspector General for Audit, Region V
U. S. Department of Housing and Urban Development
Office of Inspector General
200 N. High Street, Room 334
Columbus, Ohio 43215-2499

Dear Mr. Wolfe:

This response is in regards to the audit findings outline dated December 2, 2005.

Finding 1

The Authority inappropriately transferred \$520,169 in sale proceeds to the Corporation from June to August 2004.

The HOPE 1 grant agreement, between HUD and the Authority, required the Authority to use sale proceeds from the initial sale of units to eligible families for the cost of a homeownership program. The costs include operating expenses, improvements to the project, business opportunities for low-income families, supportive services related to the homeownership program, additional homeownership opportunities, and other activities approved by HUD, either as part of the approved application or as later approved by HUD. According to 24 CFR [Code of Federal Regulations] Parts 725 and 906.5(h) Homeownership Plan sale proceeds may be used for sale and administrative costs that are necessary and reasonable for carrying out a homeownership plan and/or retained by a public housing authority and used for housing assistance to low-income families.

Contrary to the HOPE 1 and 5(h) Homeownership Plan requirements, the Authority transferred sale proceeds to its nonprofit Corporation. The funds were transferred to the Corporation without HUD approval, and the Authority did not follow federal requirements regarding the use of the funds.

The Fairfield Metropolitan Housing Authority disagrees with the finding that FMHA improperly transferred assets to its non-profit. The following are responses to specific portions of the findings:

IMPROPER USE OF THE FUNDS:

FMHA views the use of the funds are in compliance with past (in force at the time of implementation of the grants) and current federal regulations and further are in compliance with the grant documents

Federal Regulations specifically detail the eligible uses of the sales proceeds.

Past Regulations (1996-2000 Code of Federal Regulations)

TITLE 24--HOUSING AND URBAN DEVELOPMENT (

CHAPTER IX--OFFICE OF ASSISTANT SECRETARY FOR PUBLIC AND INDIAN HOUSING,
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

PART 906--SECTION 5(h) HOMEOWNERSHIP PROGRAM
Sec. 906.15 Use of sale proceeds.

(a) General authority for use. Sale proceeds may, after provision for sale and administrative costs that are necessary and reasonable for carrying out the homeownership plan, be retained by the PHA and used for housing assistance to low-income families (as such families are defined

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Comment 1

Comment 2

under the Act). The term "sale proceeds" includes all payments made by purchasers for credit to the purchase price (e.g., earnest money, down payments, payments out of the proceeds of mortgage loans, and principal and interest payments under purchase-money mortgages), along with any amounts payable upon resale under Sec. 906.14, and interest earned on all such receipts. (Residual receipts, as defined in the ACC, shall not be treated as sale proceeds.)

(b) Permissible uses. Sale proceeds may be used for any one or more of the following forms of housing assistance for low-income families, at the discretion of the PHA and as stated in the HUD-approved homeownership plan:

(1) In connection with the homeownership plan from which the funds are derived, for purposes that are justified to ensure the success of the plan and to protect the interests of the homeowners, the PHA and any other entity with responsibility for carrying out the plan. Nonexclusive examples include nonroutine maintenance reserves under Sec. 906.11; a reserve for loans to homeowners to prevent or cure default or for other emergency housing

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needs; a reserve for any contingent liabilities of the PHA under the homeownership plan (such as PHA guaranty of mortgage loans); and a reserve for PHA repurchase, repair and resale of homes in the event of defaults.

(2) In connection with another HUD-approved homeownership plan under this part, for assistance to purchasers and for reasonable planning and implementation costs.

(3) In connection with a State or local homeownership program for low-income families, as described in the homeownership plan, for assistance to purchasers and for reasonable planning and implementation costs. Under such programs, sales proceeds may be used to construct or acquire additional dwellings for sale to low-income families, or to assist such families in purchasing other dwellings from public or private owners.

(4) In connection with the PHA's other public housing that remains under ACC, for any purposes authorized for the use of operating funds under the ACC and applicable provisions of the Act and Federal regulations, as included in the HUD-approved operating budgets. Examples include maintenance and modernization, augmentation of operating reserves, protective services, and resident services. Such use shall not result in the reduction of the operating subsidy otherwise payable to the PHA under 24 CFR part 990.

(5) In connection with any other type of Federal, State, or local housing program for low-income families, as described in the homeownership plan.

The permitted uses noted above are general in nature and it is the Authority's belief that item 5 addresses the Authority's use of these funds. HUD, through numerous initiatives, have encouraged Housing Authorities to use funds available to it to leverage other funds to aid in the development of affordable housing. One methodology presented is for an Authority to develop a non-profit entity and/or to partner with a non-profit in order to pursue opportunities that advance affordable housing for low-income families. Further, the funds were used to provide office space for the Authority. Surely, this is an eligible use.

Comment 2

Current Regulations

24 CFR Part 906 references the current regulations regarding Public Housing Homeownership Programs. This Section speaks to eligible uses of the funds, but does not provide specific direction as to the requirements regarding obtaining HUD approval of the use of these funds.

Comment 3

§ 906.31 Requirements applicable to net proceeds resulting from sale.

- (a) *PHA use of net proceeds.* The PHA must use any net proceeds of any sales under a homeownership program remaining after **payment of all costs of the sale for purposes relating to low-income housing and in accordance with its PHA Plan.**

This is the only reference found in this Section of the Code of Federal Regulations that specifically speaks to use of net proceeds resulting from sale of units. The Authority's interpretation of this Section is that the sales proceeds must be utilized in accordance with the PHA Plan. It is the Authority's understanding that the Authority prepares an Agency Plan and updates that plan annually for submission to HUD. This Plan notifies HUD of planned actions of the PHA. This plan details all of the Authority's planned activities. The activity for which these funds were used was noted in the Authority's submitted agency plan.

If the plan instead referred to the homeownership plan then please consider the following:

The HOPE 1 approved Implementation Grant Application for the Fairfield Metropolitan Housing Authority, as prepared by CONSOC Housing Consultants, did follow the HOPE FOR PUBLIC AND INDIAN HOUSING HOMEOWNERSHIP PROGRAM Section 725. As with all grants, the application must state the needs and the criteria that are specific to its community and its agency.

The HOPE 1 Implementation Grant Application that was submitted to Mr. David Kellner, Director of the Public Housing Division, U.S. Department of Housing and Urban Development, on May 14, 1992 includes Exhibit 22, Attachment 7, and the FMHA PLAN FOR USE OF PROCEEDS FROM SALES.

The plan states: "At its regular meeting of May 13, 1992, the Fairfield MHA Board of Commissioners unanimously passed a motion concluding with:

"THEREFORE, Be it resolved....that funds coming to the authority because of the sale of public housing properties through the HOPE program will be used to provide management resources, seed money, matching funds, and other financial assistance for activities that will provide for affordable housing, homeownership opportunities, family self-sufficiency, etc. for area low- and lower-income families.

The Authority has every intention to use these funds to help with the development of additional housing for its clientele, using a variety of programs at the federal and state level. It is, of course, difficult to predict in 1992 what the best use of funds will be to achieve these purposes in 1994-95, as the units are sold."

Chairman of the Fairfield MHA Board of Commissioners, Carl Heister presided over the board at this time, (May 13, 1992) and also at the time the Resolution 483-03 was approved to transfer these funds to the FMHA nonprofit (Lancaster Community Housing Corporation).

In Resolution 296-97 "regarding the formation of the affiliated non-profit corporation" **"WHEREAS, the FMHA desires to form a non-profit corporation under the laws of the State of Ohio as an "instrumentality" of the FMHA to assist it with its general statutory objectives and purposes",** the Board of Commissioners of the FMHA realized the need to provide a vessel that could address the needs of future housing gaps in our community.

The FMHA Board of Commissioners is the **controlling** board of the Lancaster Community Housing Corporation as they appoint the trustees who govern it.

Comment 4

Comment 5

REQUIREMENTS REGARDING HUD'S APPROVAL FOR USE OF THE FUNDS:

The FMHA argues that via its approved HOPE 1 Implementation Plan "that HUD approval for the transfer of funds was not specific nor was it precise in the 24 CFR Appendix A to Subtitle A, Section 725" as presented in your finding outline. The use of the proceeds was left loose in the FMHA approved application plan as it is difficult to predict precisely and specifically what the needs would be and that is how it was approved. FMHA's position regarding approval is: the Authority Notified HUD of its pending action and proposed use of the funds prior to the transitions.

Comment 6

- A letter dated July 28, 2004 to Mr. Thomas Marshall, Director, Office of Public Housing, and U.S. Department of Housing and Urban Development, outlined the need for the Acquisition of Office Space, and disclosed the funding that was to be used for the acquisition were funds donated from the FMHA, including HOPE 1 and 5(h), to its non-profit organization (LCHC). A similar letter was sent to Mr. Marshall a year before that.
- The FMHA Audit report of 2003 that was submitted to HUD, gave **full disclosure** of the transfer of these funds in its Management Discussion and Analysis report. The FDA Schedule also reflected this transfer. The FMHA argues that HUD did not dispute these transfers via findings, citations, or letter indicating that the use and/or transfer of these funds were inappropriate as communicated in the audit report. If HUD felt this was inappropriate there was no comment or communication that would indicate so.
- The FMHA Plan detailed much of the proposed actions

The FMHA believes that it is in compliance with the HOPE 1 and the 5(h) plans as written and approved for its agency. The Fairfield FMHA is a high performing Housing Authority and believes that the administrative procedures taken including Board Resolutions, full disclosure via Independent audit and other unproductive attempts to get guidance and answers from HUD via the telephone meets the criteria of compliance.

FMHA feels the impact issue "*fewer funds were available to serve the Authority's low-income residents*" of this findings outline is without merit. The FMHA and the LCHC maintain a Grant Agreement dated January 1, 2004 with RECITALS including "Whereas, the Fairfield Metropolitan Housing Authority has donated cash assets and fixed assets with income potential to be used for the furtherance of the housing needs of Lancaster and Fairfield County". Note: the FMHA board is the controlling board. As sole member of the LCHC it appoints members to the LCHC Board of Trustees. The LCHC is an instrumentality of FMHA. **THUS, THIS TRANSATION IS AN IDENTITY OF INTEREST TYPE AND DOES NOT NESSARELY CHANGE GOVERNANCE OVER USE OF THE FUNDS. The funds were in fact used to obtain facilities to better serve the low income residents of Fairfield County.**

Even though the Lancaster Community Housing Corporation is in very early stages of operation (approximately 1 year active), not only did they provide a building for the FMHA administrative offices, who in fact spend 100% of their income assisting LMI families, they also assisted low income families participating in FMHA's home ownership program with at least \$34,000 in homeownership assistance in the form of cash for closing costs, inspection fees, and a forgivable second mortgage. They have purchased a 2-bedroom house located at 219 W. Mulberry Street to rent to a low-income family at a cost of \$72,000 which is currently being renovated with costs expected to exceed \$8,000. During the past 6 months LCHC has been working with Lutheran Social Services, who operate an adult homeless shelter (which the state has determined to no longer

be fit) to locate and purchase a new facility which will meet state requirements and increase their ability to help additional men and women. They also need a site that is large enough to provide some day-programming. The LSS headquarters have held the project up, but LCHC stands as a willing partner in this important housing gap in Fairfield County.

It has also been discussed during planning sessions which will continue in 2006 a set-aside of approximately \$20,000- \$50,000 for additional home ownership assistance. Also in 2006, LCHC is planning to apply for the ROSS grant for additional assistance for homeownership for LMI families.

Rest assured that the LCHC activities in the past as well as those planned for the future are indeed intended to help low income families in Fairfield County. The audit statement, "As a result, fewer funds were available to serve the Authority's low-income residents" is unfounded. As a result the FMHA in partnership with LCHC is in a better position to serve Fairfield County residents.

AMOUNT OF THE TRANSACTION:

In addition, the FMHA disputes the amount listed under recommendations 1A of the finding outline. The amount stated in the outline was \$520,169.00. The initial proceeds from the sales of the HOPE 1 program were: 9 homes @ \$35,000.00 and 1 home @ \$25,000 with a promissory note to pay \$1,000.00 per year for a period of 10 years for a total of \$35,000.00. The initial proceeds from the sale of the two 5(h) properties were \$78,000.00. The total proceeds from the sale of the properties \$428,000.00. The amount of \$520,169.00 represents the proceeds from the sale of \$428,000.00 plus the investment interest of \$92,169.00. Neither the HOPE 1 agreement nor the 5(h) agreement of the approved implementation grant defines investment interest dollars as part of the proceeds of the sale and therefore, should not be included.

FMHA'S COMMENTS/APEAL REGARDING OIG'S REVIEW:

As noted above, FMHA, its Staff, Legal Counsel and Governing Board firmly believe the uses of the funds as detailed meet the intent and spirit of HUD's regulations if not the evolving and changing regulatory requirements. If ultimately HUD determines a programmatic review would serve the public interest, the authority would:

- Submit in the format provided by HUD a request to utilize the said funds to carry-out the activities reviewed by OIG.
- Transfer any and all assets funded by the sale proceeds from the instrumentality to FMHA.

Without HUD approval, the Authority transferred ownership of the three properties to its nonprofit Corporation in May 2004. The Corporation sold the property located at 841 East Main Street in September 2004. It did not notify HUD that the unit was sold and failed to reimburse HUD \$23,314 as required by the Grant agreement. The Authority's executive director said HUD was not notified because the Corporation was the owner of the unit at the time of the sale.

The Authority was responsible for acquiring and renovating three properties for chronically mentally disabled persons under the Grant. In February 2001, the Authority sent a request to HUD to withdraw from further participation in the Grant. The Authority included five possible uses of the properties in its request. One possible use was to sell one property so it could pay off the mortgage held by the Ohio Department of Mental Health, which provided required matching funds for the Grant. The Authority also requested that the two remaining properties be used for an alternate use for the direct benefit of lower income persons. In August 2001, HUD responded to the Authority's request and agreed that it could use the properties for the stated alternate use. However, HUD cited federal regulations requiring that the Authority repay the full amount of the acquisition/rehabilitation advance if the properties were used for less than 10 years following the date of initial occupancy. For each full year that the properties are used for permanent housing following the expiration of the 10-year period, the amount that the Authority will be required to pay will be reduced by one-tenth of the original advance. HUD declared that the Authority had met the original 10-year commitment but had 9 years remaining for the 20-year commitment. The Authority would be required to pay back a percentage of the original advance if it disposed of any of the properties before the expiration of the 20-year commitment. HUD requested the Authority to notify it if the Authority decided to dispose of the properties so HUD could discuss what documentation the Authority would be required to submit to finalize the Grant process.

Comment 7

We notified HUD of the one property sale and calculated that \$23,314 should be reimbursed to HUD. The property was sold 14 years into the 20-year commitment. The Authority drew down \$96,497 in Grant funds. It used \$38,856 in Grant funds for improvements for the 841 East Main Street property. Therefore, the amount the Authority would be required to repay HUD is reduced by four-tenths (40 percent). The amount the Authority would be required to repay HUD is 60 percent of the Grant funds for the sold unit (60 percent times \$38,856).

FMHA does not dispute the basic facts noted in the finding. However we dispute the conclusions reached and recommendations made. FMHA request that the following be considered

CONCLUSION REACHED

The **impact** of the finding outline that pertains to the HUD assurance that the two McKinney properties may not be used to benefit low-moderate income families is disputed. The mission of the FMHA and its instrumentality, LCHC is to fulfill the directive to provide safe and affordable housing to low-moderate income families and via FMHA and LCHC resolutions clearly give direction that these properties will be maintained for the benefit of low-moderate income families.

The sale of the E. Main property was for the good of the community in furtherance of maintaining and increasing the supply of affordable housing in that:

- LCHC has used the funding resource to purchased replacement affordable housing.
- The buyer of the property is a development corporation that would bring into our community jobs, tax dollars, and retail sales.
- The development company bought not only the FMHA property but also all the properties in a one-half block radius.
- If this property had not been sold it could have provided a negative impact on the community and would remain a financial drain on the limited financial resources of FMHA.

Recommendation Made:

The amount of reimbursement stated in Recommendation 2A, in FMHA's view is misstated and should be reduced or eliminated based on the following:

- The McKinney Permanent Housing Program was ineffective for both the Housing Authority and the Fairfield County Community Mental Health Board. The Mental Health Board was unable to maintain the occupancy in these units for the handicapped homeless and it was almost impossible to find eligible tenants who met the criteria in the guidelines. Some units would set empty for months until a qualified tenant was housed. Neither for lack of homeless people nor for lack of those with permanent mental disabilities, but for people who could fit the eligibility requirements as the regulations for that program was written. It was a difficult program to manage and quite labor intensive on several levels. Two of the units were supposed to house 3 people, but most of the time they were occupied by only one person (strangers especially strangers with mental disabilities just could not live together). The rents on the units were as low as \$100.00. The particular house in question was the worst one of all to manage as the participants who were housed there were particularly difficult to manage and damaging to the units and there was constant need for maintenance, repair, inspection and intervention.
- The Housing Authorities role in this program was to provide all the maintenance labor and supplies, pay all utilities on the properties, and to administer the program funding for the administrative grant of the FMHA and the Fairfield County Mental Board. **The amount of the operating grant for the FMHA was \$47, 775.00 for the 10 year period or \$4777.50 per year. This amount was consumed by utilities alone.**

As noted in the finding, after the initial 10 year period, the Housing Authority notified HUD that it wished to opt out of the program. HUD approved. We have reviewed our files and find that what communication/correspondence received from the HUD representative assigned to this program, did not mention any repayment or cite a regulation that might lead us to that conclusion that after the ten year period such payment would be required. FMHA acknowledges that lack of understanding at the time may not be reason enough to forgive this error based on cited program requirements, but we do request that this fact be taken into consideration.

FMHA's COMMENTS REGARDING OIG'S RECOMMENDATION

During this operating period the McKinney program was indebted to the Housing Authority for approximately \$40,000.00 for which FMHA was not reimbursed. There were a total of 4 units in which maintenance, utilities and other services were provided by FMHA. The unit in questions was a double (839 & 841 E. Main Street) the amount of \$20,000.00 (\$40,000.00/4x2) should reduce the reimbursement FMHA owes to \$3,314.00 (\$23,314.00 - \$20,000.00). That calculation did not take into account the extreme extra amount of maintenance labor and materials, plus administrative staff time that was used to assist the clients who rented these units. This amount may create a hardship to the Authority, but we believe it is fair and we apologize for this oversight.

Comment 8

In conclusion the FMHA request that the Office of Inspector General for Audit take into consideration the dates of the Grants: 1989 McKinney, 1990-1991 HOPE 1 and 5(h) and numerous regulatory changes HUD has made in the interim regarding the administration of HUD funded programs, the fact that HUD has loss personnel that were familiar with these older programs and grants and there ability on a day to day basis provide technical assistance regarding the older programs that are no longer funded or active. The FMHA has been diligent in its effort to obtain information. The FMHA has had to rely on the information that was available to us and on its proactive Board to make the final decisions. We do believe that in all fairness, the downsizing of HUD and the turnover in roles at both HUD and FMHA must be considered, not to mention the huge changes from paper and hard copy to electronic filing of the historical data.

The FMHA has always been committed to following the Federal requirements in any program it has administered for HUD, as our record of a HIGH PERFORMER will support. We have also been financially responsible as a lack of audit findings would support, not to mention that it was through smart investments that we made additional money for the benefit of Fairfield county.

Comment 9

We believe it is counterproductive, to be penalized for being proactive in our community and operating with NO intent to deceive. The FMHA steadfastly adheres to the fact that to the best of our knowledge and ability as well as research and other resources available, that effort was made to be in compliance with the Federal Regulations guiding the HOPE 1, 5(h), and the McKinney programs. FMHA through its non-profit affiliate LCHC has spent the funds to acquire two of the HOPE 1 properties and for the Acquisition of office space to assist the growth of the Section 8 program from 600 to 899, to continue to promote the Family Self-Sufficiency Program and the Homeownership Program as well as our Public Housing Program and provide the space for its staff.

With the acquisition of the new office building, we are able to provide office space for Lutheran Social Services, a homelessness shelter and transitional housing provider as well as for FMHA and LCHC; clearly this increases services to low-income families. For the first time ever we have adequate parking for staff and clients and our customer service has never been better as we are now located within walking distance of the Dept of Jobs and Family Services and are finally on the public transit bus route making access to our services more convenient for clients. Not only are we better able to serve our customers, but also will be able to increase our income by leasing the old office building, thereby offsetting the increased expense of the larger location. The FMHA Board of Commissioners, its staff, the LCHC Board of Trustees and the LCHC staff all feel the acquisition of this building was a wise investment and in the best interest of all concerned.

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December 14, 2005

The FMHA does not have funds available to reimburse the HOPE account and again we state that to the best of our interpretation, we have followed the approved grant and section 725 regarding the proceeds of sale as we believe the our office is "a management recourse" as well as "a financial assistance activity that will provide for affordable housing, homeownership, family self-sufficiency, etc for low and lower-income families" as stated in the plan.

It is in earnest that we implore that you revisit your initial findings and with a broad brush, reconsider your initial views.

Respectfully Submitted


Mary Bozard, Executive Director
Fairfield Metropolitan Housing Authority

Cc: Ronald Farrell
Dave Kellner
Gezi Mahone
Tom Marshall
Paul Adler

OIG Evaluation of Auditee Comments

- Comment 1** As previously mentioned in finding 1, the grant agreements for both the HOPE 1 and 5(h) Homeownership programs contain explicit language regarding the use of sales proceeds. The HOPE 1 grant agreement states that the sales proceeds may be used for other activities approved by HUD, either as part of the approved application or as later approved by HUD. The 5(h) implementing agreement, between HUD and the Authority, states that sales proceeds shall be used in accordance with the Authority's homeownership plan and must obtain HUD approval to modify any provisions of the plan. However, the Authority failed to follow the grant agreements
- Comment 2** We agree that HUD encouraged housing authorities to use available funds to leverage other funds to aid in the development of affordable housing. However, as previously mentioned, the Authority must obtain HUD approval to modify any provisions to its homeownership plan. The Authority's plan submitted to HUD discussed the Authority's efforts to sell up to 20 single family public housing units to low and lower income families.
- Comment 3** The Authority incorrectly cited HUD's requirements at 24 CFR [*Code of Federal Regulations*] Part 906.31(a) regarding the Authority's use of net sales proceeds for its 5(h) Homeownership program. The regulations for the 5(h) program were revised effective April 1, 2004. However, 24 CFR [*Code of Federal Regulations*] Part 906.3, requirements applicable to homeownership programs previously approved by HUD, states in section (a) that any existing section 5(h) homeownership program continues to be governed by the requirements of Part 906 or Part 904 of this title, respectively, contained in the April 1, 2002, edition of 24 CFR [*Code of Federal Regulations*] Parts 700 to 1699. The April 1, 2002, edition of 24 CFR [*Code of Federal Regulations*] Part 906.15 governs the use of sale proceeds from the Authority's 5(h) program. The Authority cited Part 906.15 in its comments on page 1 and 2. Part 906.15 requires the Authority to obtain HUD approval to modify any provisions of its plan.
- Comment 4** The Authority was required by its HOPE 1 grant agreement to have other activities approved by HUD, either as part of the approved application or as later approved by HUD prior to its use of sales proceeds outside the grant agreement.
- Comment 5** According to the Authority's records, the Authority transferred \$25,078 on June 18, 2004, and \$495,091 on July 30, 2004, for a total of \$520,169. These transfers clearly occurred prior to the Authority's July 28, 2004, letter to HUD's director of the Cleveland Public Housing Hub. The subject of the Authority's July 2004 letter provided to us during the audit was acquisition of office space. The letter stated that the Authority's nonprofit organization reserved funds that will be adequate for the purchase of this facility. Additionally, the letter stated that the Authority worked with its nonprofit to set up development accounts to further current and future programs. The letter did not reference the HOPE I or 5(h) program funds.

OIG Evaluation of Auditee Comments

- Comment 6** We agree that the Authority's 2003 audit report gave full disclosure of the transfer of funds. However, the transfers did not occur until June and July of 2004. The financial statements are misstated as reported. The Authority also misstated its financial statements for 2004 when it reported that a \$100,000 transfer of equity was made to its nonprofit corporation. As of October 13, 2005, this transfer had not occurred.
- Comment 7** In section 1 of the 5(h) implementing agreement, sale proceeds includes all payments made by the purchasers for credit to the purchase price, together with any amounts payable upon resale under the regulations, and interest earned on all such receipts. We agree that the HOPE I agreement does not include a reference to interest earned. However, the Authority pooled its HOPE I and 5(h) funds together in a certificate of deposit to accumulate interest income. The Authority must provide adequate documentation to support the interest earned by each source of funds.
- Comment 8** The Authority provided a request to HUD discussing the Authority's desire to opt out of the McKinney program on February 28, 2001. On August 23, 2001, HUD provided a response to the Authority's request. On page 2 of HUD's response, HUD specifically stated that its records showed that the project began occupancy in May 1990 and had met the 10 year commitment benchmark. The letter also stated that nine years remained of the 20 year commitment that will require the Authority to pay back a percentage of the original advance. The letter went on to state that the Authority notify HUD if the Authority decides to proceed with the disposition of the HUD funded property.
- Comment 9** We do not agree with the Authority's statement that there was no intent to deceive. As previously mentioned, the Authority misstated its audited financial statements for the years ended December 31, 2003, and 2004. Additionally, the Authority prepared Section 8 year end settlement statements for the years ended December 31, 2003, and 2004 that did not accurately depict the financial transactions the Authority made with its Section 8 operating reserve funds. The misstatements were mentioned above in comment 6. These misstatements were done in an effort to avoid the possible recapture of Section 8 operating reserve funds by HUD.

Appendix C

FEDERAL AND STATE REQUIREMENTS

Finding 1

The HOPE 1 implementation grant agreement states in article X that the grantee shall use the proceeds, if any, from the initial sale of units to eligible families for the costs of a homeownership program, including operating expenses, improvements to the project, business opportunities for low-income families, supportive services related to the homeownership program, additional homeownership opportunities, and other activities approved by HUD, either as part of the approved application or as later approved by HUD. The use of sales proceeds under article X (1) shall be governed by the requirements of 24 CFR [*Code of Federal Regulations*] Appendix A, Section 725 as they may from time to time be amended.

According to 24 CFR [*Code of Federal Regulations*] appendix A, section 725, the entity that transfers ownership interests in units to eligible families or another entity specified in the approved application shall use the proceeds, if any, from the initial sale for costs of a homeownership program, including operating expenses, improvements to the project, business opportunities for low-income families, supportive services related to the homeownership program, additional homeownership opportunities, and other activities approved by HUD, either as part of the approved application or later on request.

Section 3 of part I of the 5(h) implementing agreement between HUD and the Authority, states the Authority agrees that sales proceeds shall be used only in accordance with the plan and the requirements and provisions of the agreement and certifies that the plan complies with 24 CFR [*Code of Federal Regulations*] 905.15, as applicable, governing the use of sales proceeds. Section 3 also requires the Authority to obtain HUD approval under section 17.2 to modify any of the provisions of the plan.

According to 24 CFR [*Code of Federal Regulations*] 906.15(a), sales proceeds may, after provision for sale and administrative costs that are necessary and reasonable for carrying out a homeownership plan, be retained by the public housing authority and used for housing assistance to low-income families.

Finding 2

The State of Ohio Permanent Housing Program for Handicapped Homeless grant agreement (HUD Number OH16P89-303) with the Authority incorporates by reference HUD's permanent housing program regulations at 24 CFR [*Code of Federal Regulation*] Part 841, the application and any modifications to the application that were made with the approval of HUD and the grantor, and the notifications of funding approval and any later amendments made by HUD. The agreement states that for each full year that the project is used for permanent housing for the handicapped homeless following the expiration of the 10-year period, the amount of the acquisition/rehabilitation advance that the grantee will be required to repay will be reduced by one-tenth of the original advance.

According to 24 CFR [*Code of Federal Regulations*] 841.310(b)(2), the recipient must repay the full amount of the acquisition/rehabilitation advance if the project is used for permanent housing for less than 10 years following the date of initial occupancy. For each full year that the project is used for permanent housing following the expiration of this 10-year period, the amount that the recipient will be required to pay will be reduced by one-tenth of the original advance. If the project is used for permanent housing for 20 years following the date of initial occupancy, the recipient will not be required to repay any portion of the acquisition/rehabilitation advance under this section.

According to 24 CFR [*Code of Federal Regulations*] 841.315(a), if assistance in the form of an acquisition/rehabilitation advance or a moderate rehabilitation grant is provided for a project and the project is sold or otherwise disposed of during the 20 years following the initial occupancy of the project, the recipient must comply with such terms and conditions as HUD may prescribe to prevent the recipient from unduly benefiting from the sale or the disposition.