



Issue Date	June 23, 2006
Audit Report Number:	2006-AO-1001

TO: Ben L. Johnson, Director, Single Family Homeownership Center, 8AHH

FROM: *Rose Capalungan*
Rose Capalungan, Director, Hurricane Recovery Audit Oversight Division, GAH

SUBJECT: Southwest Alliance of Asset Managers, LLC, Addison, Texas; Did Not Effectively Enforce The Lease Terms Over Payment of Property Utilities

HIGHLIGHTS

What We Audited and Why

We audited Southwest Alliance of Asset Managers, LLC (Southwest Alliance), a management and marketing contractor for the United States Department of Housing and Urban Development's (HUD) real estate-owned properties held off market for disaster victims.

The audit was initiated in conjunction with the President's Council on Integrity and Efficiency, as part of its examination of relief efforts provided by the Federal government in the aftermath of hurricanes Katrina and Rita. Our objective was to determine whether Southwest Alliance complied with HUD's regulations, procedures, and instructions in the management of HUD's real estate-owned properties held off market for disaster victims.

What We Found

Southwest Alliance generally complied with the terms of its Management and Marketing contract, with one exception. It did not effectively ensure that the disaster victims transferred the billing of property utility services into their names within seven days of occupancy, as required by the lease agreements. As a result, after occupancy by tenants, HUD paid \$79,306 in utility costs for 636 leased properties during the period, from September 2, 2005 through April 25, 2006.

What We Recommend

We recommend that the Director of HUD's Denver Office of Single Family Homeownership Center instruct Southwest Alliance of Asset Managers, LLC to take appropriate action against the tenants who do not comply with the lease requirements over utility payments, and require Southwest Alliance to initiate collection actions against tenants to recover the \$79,306 HUD paid for utility costs.

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

During the audit, we provided the results of our review to Southwest Alliance management. We also provided our discussion draft audit report to HUD's staff during the audit. We conducted an exit conference with Southwest Alliance management on June 1, 2006.

We asked the president of Southwest Alliance to provide comments on our discussion draft audit report by June 2, 2006. The president provided three-paged written comments dated June 1, 2006. The complete text of the written response, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVE

In July 2004, Southwest Alliance of Asset Managers, LLC (Southwest Alliance) was formed as a limited liability company in which Realty Marketing Associates of Las Vegas, Inc. and First Preston Management, Inc. of Addison are members. Southwest Alliance represents the combined resources of the two members in managing and marketing affordable housing and promoting homeownership. Felix DeHerrera is the President of Southwest Alliance.

In August 2004, the U.S. Department of Housing and Urban Development (HUD) contracted with Southwest Alliance to provide management and marketing services for HUD's single-family program in the States of Texas and New Mexico. In September 2005, HUD made homes available for disaster victims under the Temporary Housing Assistance Program of the Robert T. Stafford Disaster Relief and Emergency Assistance Act as a result of Hurricanes Katrina and Rita. Such program was designed to assist people whose homes were damaged by disaster to have a temporary place to live until repairs can be completed or permanent housing solution is identified. This program was available only to homeowners and renters who are legal residents of the United States and who were displaced by the disaster. Subsequently, HUD modified its initial contract with Southwest Alliance to provide services in managing, marketing, preparing and repairing properties held off market to house disaster victims.

As of April 25, 2006, Southwest Alliance manages 714 properties that are occupied by disaster victims and located in North and South Texas. During our audit period, from September 2005 through December 2005, HUD had reimbursed Southwest Alliance \$3,821,577 in fees and other costs for managing, preparing, and repairing the properties held off market for disaster victims.

We audited Southwest Alliance's management of HUD's real estate-owned properties for disaster victims. The audit was initiated in conjunction with the President's Council on Integrity and Efficiency, as part of its examination of relief efforts provided by the Federal government in the aftermath of hurricanes Katrina and Rita.

Our objective was to determine whether Southwest Alliance complied with HUD's regulations, procedures, and instructions in the management of HUD's real estate-owned properties held off market for disaster victims.

RESULTS OF AUDIT

Southwest Alliance Did Not Effectively Enforce the Lease Terms Over Payment of Property Utilities

Southwest Alliance generally complied with the terms of its Management and Marketing contract, with one exception. It did not effectively ensure that the disaster victims transferred the billing of property utility services into their names within seven days of occupancy, as required by the lease agreements. As a result, after occupancy by tenants, HUD paid \$79,306 in utility costs for 636 leased properties during the period, from September 2, 2005 through April 25, 2006.

Tenants Did Not Pay Utility Costs

Under its contract with the U.S. Department of Housing and Urban Development (HUD) Southwest Alliance is responsible for ensuring that utility costs for properties are paid before properties are leased, and after lease up that tenants timely assume this responsibility.

Southwest Alliance did not effectively enforce the lease terms over utility payments. As of April 25, 2006, Southwest Alliance had leased 700 properties requiring tenant payments of utility services. However, instead of the tenants, HUD continues to pay for the utility costs for 636 of the 700 properties.

Southwest Alliance was aware of the nonpayment and in November 2005 Southwest Alliance started monitoring tenants who were not paying property utility bills. Southwest Alliance's Marketing Specialist used a system called Home Trackers system to acquire the tenants' utility information and verify whether the utilities were transferred to the tenants' names. She also took corrective actions such as follow-up phone calls and certified mailings and tracked responses on a spreadsheet. As of April 5, 2006, about 75 to 100 certified letters were returned to Southwest Alliance out of a batch of at least 300 certified letters that were sent out.

Southwest Alliance Did Not Timely Inform HUD

Months after the utility issue surfaced, Southwest Alliance asked HUD for guidance. In an April 6, 2006 electronic mail message to HUD, Southwest Alliance wanted to know if HUD would continue to reimburse Southwest

Alliance for the utility costs it paid for tenant occupied properties. Southwest Alliance also needed guidance on tenant evictions and a confirmation from HUD regarding reimbursement for eviction costs.

HUD told Southwest Alliance that tenants would not be evicted for failure to pay utilities. HUD advised the contractors including Southwest Alliance to be more proactive in encouraging the tenants to convert utilities such as notifying the tenants. As of April 25, 2006, HUD paid a total of \$79,306 for utility bills after the tenants occupied the properties and continues to pay for utility services despite HUD's guidance to pursue tenants of these funds. We found nine percent of tenants complied with the lease agreements regarding their responsibilities over utility costs, and in fairness to these compliant tenants, HUD should require Southwest Alliance to initiate collection actions against a total of 91 percent (or 636 of 700) non-compliant tenants.

Recommendations

We recommend that the Director of HUD's Denver Office of Single Family Homeownership Center

- 1A. Instruct Southwest Alliance of Asset Managers, LLC to take appropriate action against the tenants who do not comply with the lease requirements over utility payments.
- 1B. Require Southwest Alliance of Asset Managers, LLC to initiate collection actions against tenants to recover the \$79,306 HUD paid for utility costs.

SCOPE AND METHODOLOGY

We performed our audit work between January and May 2006. We conducted our audit at Southwest Alliance's Office in Addison, Texas and HUD's Houston Field Office.

To achieve our objective, we relied on hard copy data from Southwest Alliance, and data contained in HUD's Single Family Assets Management System. We relied on the transmittal payment histories provided by Southwest Alliance and HUD Santa Ana Home Ownership Center.

In addition, we interviewed six tenants; and the appropriate HUD's management and staff, and Southwest Alliance's management and staff involved in managing and marketing HUD's real estate-owned properties, overseeing and/or processing the repairs of the properties, inspecting the properties, and processing management fees and other cost reimbursements, lease agreement and other related agreements.

Further, we reviewed HUD's directives, Management and Marketing contract and any modifications or change orders, monthly evaluation or assessment reports on Southwest Alliance's management of HUD's real estate-owned properties, and the standard lease executed between HUD and the tenants. We also reviewed the appropriate Southwest Alliance's accounting, inspection, repair and other records; and the Tenant Move-In Inspection and Acceptance Agreement executed between the tenants and Southwest Alliance and its contractor on behalf of HUD. We performed site visits of ten properties.

The audit covered the period of September 1, 2005, through December 31, 2005. This period was adjusted as necessary. We conducted the 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.

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

Significant Weakness

Based on our audit, we determined there were no significant weaknesses existed in Southwest Alliance's management of HUD's Real Estate-Owned properties held off market to house disaster victims.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/
1B	<u>\$79,306</u>
Totals	<u>\$79,306</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 policies or regulations.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

Comment 1

Comment 2



Southwest Alliance
of Asset Managers, LLC

June 1, 2006

Ms. Rose Capalungan
Director
Hurricane Recovery Audit Oversight Division
Office of Inspector General
U.S. Department of Housing & Urban Development
500 Poydras Street, 11th Floor
New Orleans, LA 70130

Dear Ms. Capalungan:

Thank you for your May 19 letter giving us the opportunity to provide comments on the draft Audit Report on Southwest Alliance of Asset Managers, LLC. Southwest Alliance, an SBA-approved 8(a) joint venture, has performed at the highest level in support of HUD's hurricane relief goals. Stepping up in response to this national crisis, Southwest Alliance retooled itself essentially overnight from a property resale business into a landlord to many of the hardest hit victims of last year's hurricanes. We are extremely proud of the work we did to house 756 evacuee families.

After a five-month audit involving interviews of over 15 Southwest Alliance personnel (as well as several evacuees and HUD personnel) and the production of over 21,000 pages of documents for review, the draft Audit Report found that "there were no significant weaknesses" in Southwest Alliance's hurricane relief work and identified only one area of concern. See Draft Report at 9. Given the massive scope and extremely difficult circumstances of the hurricane relief effort, the result of the audit is a testament to Southwest Alliance's commitment and abilities.

The one area of concern was that Southwest Alliance "did not effectively ensure that disaster victims transferred the billing of property utility services into their names within seven days of occupancy, as required by the lease agreements." See Draft Report at 5. The report concluded that this resulted in HUD paying \$79,306 in utility costs that should have been borne by the evacuees. We of course acknowledge the importance of ensuring that the government's funds are protected, but we respectfully disagree with the proposed finding on this issue.

First, we do not agree that Southwest Alliance delayed in notifying HUD of this issue. The Draft Report states that Southwest Alliance did not seek guidance from HUD until "[m]onths after the utility issue surfaced." See Draft Report at 6. We respectfully disagree with this statement.

As the Draft Report observes, Southwest Alliance raised the utility issue in an April 6, 2006 electronic mail message to HUD. See Draft Report at 6. But that was not Southwest Alliance's first notification to HUD. On October 3, 2005 -- almost immediately after the leasing program began in September 2005 -- Southwest Alliance notified HUD that a number of hurricane victims were not transferring utility services into their names.¹ This notification informed HUD of the steps Southwest Alliance was taking to attempt

¹ We produced this document to you on May 17, 2006, labeled SWAP 0001.

Ms. Rose Capalungan
June 1, 2006
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Comment 3

to have the evacuees assume responsibility for their utilities. Southwest Alliance then explained that, as long as the utilities remained in HUD's name, Southwest Alliance would submit the utility invoices for reimbursement by HUD. In short, Southwest Alliance alerted HUD to this issue as soon as it arose, in a notification that explained the problem, the steps Southwest Alliance was taking with the evacuees, and the financial consequences to HUD if those steps proved ineffective. In addition, HUD's REO Director, Nancy Sullivan, confirmed and supported Southwest Alliance's actions during the OIG Exit Conference call with staff on June 1, 2006.

Second, we do not agree that Southwest Alliance was under an obligation to disconnect utilities where an evacuee did not transfer the utilities into his or her own name. The Draft Report states that, under the terms of the lease signed by the evacuees, "Southwest Alliance is required to start the process to disconnect utility services for tenants who do not transfer services into their own names within seven days of occupancy." See Draft Report at 5.

Southwest Alliance has no obligation to disconnect evacuees' utility service, after seven days or otherwise. Neither the Management & Marketing contracts between Southwest Alliance and HUD nor the contract modifications and related guidance that HUD issued for hurricane relief contain any such requirement. The lease agreement that the evacuees are required to sign likewise does not impose this obligation, both because it contains no such language and because, in any event, it is not an agreement between HUD and Southwest Alliance and thus could not impose any obligation on Southwest Alliance.

The reference to disconnecting utilities after seven days appears only in the Tenant Move-In Inspection and Acceptance Agreement. Southwest Alliance prepared this document in an attempt to help protect HUD's interests. A document that Southwest Alliance prepared itself, that was not required or even generated by HUD, and that is not an agreement between HUD and Southwest Alliance plainly cannot impose an obligation on Southwest Alliance to take any action.

Third, even putting aside the absence of any contractual obligation, we dispute the suggestion that Southwest Alliance should have initiated punitive action against the evacuees. As the report acknowledges, "HUD must authorize punitive actions against non-compliant tenants." See Draft Report at 5. In fact, HUD not only refrained from authorizing punitive action against the evacuees, it specifically barred Southwest Alliance from taking punitive action such as evictions.² As confirmed by HUD on the OIG Exit Conference Call of June 1, 2006.

Although it was not up to Southwest Alliance to decide whether or not to take punitive action against evacuees who failed to assume responsibility for their utilities, we certainly understand the basis for HUD's decision not to allow punitive action. As noted in the Draft Report, Southwest Alliance took a number of steps to encourage evacuees to assume responsibility for their utilities, including follow-up phone calls and certified mailings. See Draft Report at 5. But given the trauma the evacuees went through and the financial pressure many of them are under as a result of losing their homes and jobs due to the hurricanes, there is good reason for HUD not to take punitive actions such as disconnecting the utilities or evicting the evacuees.

² In an April 6, 2006 electronic mail message to Southwest Alliance, for example, HUD stated in no uncertain terms, "We will NOT evict any residents for failure to pay utilities." We understand that this was the Department's position throughout the hurricane relief effort and that this message simply memorialized HUD's consistently held view.

Ms. Rose Capalungan
June 1, 2006
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Comment 4

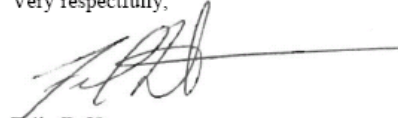
Indeed, in light of the government's humanitarian decision to devote many millions of dollars to relief for the evacuees, incurring \$79,306 in utility bills on behalf of the evacuees is not necessarily a waste -- it is \$79,306 to keep the lights and water working for evacuees who had their lives turned upside down. Moreover, even putting aside humanitarian considerations, it would be detrimental to HUD's financial interest to disconnect the utilities while a property remains occupied. The damage likely to result from disconnecting the utilities in an occupied property (e.g., due to the use of candles and fires in place of electric lights and heat, and the use of alternatives in place of running water and toilets) far outweighs the cost to HUD of paying for the utilities.

Fourth, putting aside the merits of the issue, the Draft Report overstates the magnitude of the issue. Although the Draft Report does not specify how the \$79,306 figure was calculated, we believe that this sum includes utility costs paid on behalf of many evacuees who took responsibility for their utilities but had a temporary time lag while the utilities were switched over to their names. We believe those temporary costs should be excluded from the calculation, and that the resulting figure would be substantially lower. It is also worth noting that the \$79,306 figure amounts to less than \$125 per property occupied by the hurricane evacuees, which seems to be a minor expense compared to the magnitude of the work done and the benefits conferred through the relief effort.

Finally, the Draft Report recommends taking punitive action against evacuees who have not assumed responsibility for utility payments, and to initiate collection actions against those evacuees. It of course is for HUD to decide how to proceed. But as explained above, we believe it would be both unwise and contrary to the humanitarian spirit of the hurricane relief effort to take punitive action and file lawsuits against the evacuees. To the extent HUD does choose to adopt these recommendations, Southwest Alliance will seek reimbursement for the costs it incurs for any such punitive actions and lawsuits.

We appreciate this opportunity to provide comments on the Draft Report. We are justifiably proud of the work Southwest Alliance performed on behalf of HUD in a moment of national crisis, under the most difficult circumstances and in the service of a truly worthy cause.

Very respectfully,



Felix DeHerrera
President

OIG Evaluation of Auditee Comments

Comment 1	We commend Southwest Alliance for stepping up in response to the national crisis by retooling itself quickly from a property resale business into landlord to at least 756 families displaced as a result of Hurricanes Katrina and Rita.
Comment 2	Southwest Alliance stated that it informed HUD as early as October 2005 about tenants not paying utility bills. However, Southwest Alliance was mainly concerned that HUD would authorize reimbursement of the tenant utility bills paid by the contractor. It was only months later in April 2006, when HUD's Santa Ana Homeownership Center informed Southwest Alliance that HUD would no longer reimburse utility costs, that the contractor sought written guidance on how to resolve the problem to include the option of tenant evictions.
Comment 3	Southwest Alliance disagreed that the tenant lease agreement required it to start the process to disconnect utility services for tenants who did not transfer services into their names within seven days. Southwest Alliance contends that the reference disconnecting utilities after seven days appears only in the Tenant Move-In Inspection and Acceptance Form that it prepared on behalf of HUD. We determined that Southwest Alliance incorporated the Tenant Move-In Inspection and Acceptance Agreement into page one of the tenant lease agreement that was executed between the tenants and the landlord (Southwest Alliance on HUD's behalf). The Tenant Move-In Inspection and Acceptance Agreement therefore was part of the lease agreement, and was also executed between the tenant and the landlord (Southwest Alliance on HUD's behalf) on the same date as the date the lease agreement became a binding agreement. Although HUD must authorize punitive actions against non-compliant tenants, as its contractor, Southwest Alliance must enforce the terms and conditions of the lease agreements. Among those terms, Southwest Alliance is required to start the process to disconnect utility services for tenants who do not transfer services into their names within seven days of occupancy. Southwest Alliance must aggressively enforce the lease terms through punitive actions such as disconnecting utility services. In addition, Southwest Alliance needs to aggressively pursue collection of utility costs from tenants whose utilities were paid by HUD on their behalf.
Comment 4	Southwest Alliance disagreed with the total utility costs HUD paid for non-compliant tenants. Southwest Alliance stated that the total should be substantially lower after excluding the temporary costs for the temporary time lag the tenants took to switch the utility services into their names. We did not decrease the total utility costs cited in our report because based upon Southwest Alliance's accounting and other related records, HUD paid a total of \$79,306 for tenant utility bills as of April 25, 2006. It is important to also emphasize that there were other tenants who complied with the lease agreements regarding their responsibilities over utility costs, and therefore for fairness, HUD should require Southwest Alliance to initiate collection actions against non-compliant tenants to recover the \$79,306 HUD paid for their utility costs.