audit report

OFFICE OF INSPECTOR GENERAL

Issue Date
May 31, 1996
Audit Case Number
96-CH-229-1009

TO: Robert J. Turner, Director of Housing, Michigan State Office

FROM: Dale L. Chouteau, District Inspector General for Audit, Midwest

SUBJECT: Partners For Affordable Home Ownership Program
Single Family Housing Division, Real Estate Owned Branch
Detroit, Michigan

We completed a review of the nine nonprofit organizations that bought properties at a 30 percent discount under the Partners For Affordable Home Ownership Program. The review was done to address the Michigan State Office's concern that some nonprofit agencies may have purchased homes from HUD at a 30 percent discount to make unallowed profits. Our objectives were to: assess the validity of HUD's concerns; and determine whether the nonprofit agencies complied with HUD's program requirements.

We concluded that six of the nine nonprofit organizations complied with HUD's requirements. Three nonprofit organizations, however, made unallowed profits and were not in compliance with HUD's requirements. The three organizations sold homes purchased from HUD at a 30 percent discount for amounts higher than allowed by HUD's program requirements. One of the three nonprofit agencies also violated HUD's conflict of interest requirements; another nonprofit agency did not have an adequate accounting system to capture property related costs and revenues; and, the third agency did not have a source of funds to finance its participation in the program. Officials for all three nonprofit agencies said they were not aware of HUD's program requirements, although they signed an addendum containing the sales restrictions with the purchase of each home. As a result, low and moderate income home buyers paid more for their homes than HUD's program intended.

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

Should your staff have any questions, please have them contact me at (312) 353-7832.

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Executive Summary

We completed a review of the nine nonprofit organizations that bought properties at a 30 percent discount under the Partners For Affordable Home Ownership Program. The review was done to address the Michigan State Office's concern that some nonprofit agencies may have purchased homes from HUD at a 30 percent discount to make unallowed profits. Our objectives were to: assess the validity of HUD's concerns; and determine whether the nonprofit organizations complied with HUD's program requirements.

Under HUD's Partners For Affordable Home Ownership Program, nonprofit organizations are allowed to purchase homes from HUD at a 30 percent discount from the HUD appraised value. The intent of the program is to expand home ownership by providing the nonprofit agencies an incentive to buy the homes, make needed repairs and resell the homes to qualified low-income buyers. HUD restricts the sale price the nonprofit agencies can charge the home buyer to the net development cost plus ten percent of the net development cost.

We concluded that six of the nine nonprofit organizations complied with HUD's requirements. Three nonprofit organizations, however, made unallowed profits and were not in compliance with HUD's requirements. The three nonprofit agencies sold HUD homes purchased at a 30 percent discount for amounts higher than allowed by HUD. One of the three nonprofit agencies also violated HUD's conflict of interest requirements; another nonprofit agency did not have an adequate accounting system to capture property related costs and revenues; and, the third agency did not have a source of funds to finance its participation in the program. Officials for all three nonprofit agencies said they were not aware of HUD's program requirements, although they signed an addendum containing the sales restrictions with the purchase of each home. As a result, low and moderate income home buyers paid more for their homes than HUD's program intended.

Second Chapel Hill Did Not Comply With HUD's Requirements

Second Chapel Hill, a nonprofit organization: (1) sold five homes it purchased from HUD for amounts higher than allowed; and (2) violated HUD's conflict of interest requirements. The Director of the organization said he was unaware of HUD's requirements. As a result, low and moderate income persons paid more for their properties than HUD's program intended, and Second Chapel Hill made unallowed profits of $80,488.

The 40/40 Institute Did Not Follow Requirements

The 40/40 Institute, a nonprofit organization, sold two homes purchased from HUD at a 30 percent discount for amounts higher than allowed by HUD's requirements. The 40/40 Institute did not have an adequate accounting system to capture property related costs and revenues. The Institute's president said he was unaware of HUD's requirements. As a result low and moderate income persons may have paid more for properties than HUD's program intended and the 40/40 Institute may have realized excessive funds of $3,291.

Detroit Non-Profit Housing Did Not Adhere To HUD's Requirements

The Detroit Non-Profit Housing Corporation sold two homes purchased from HUD at a 30 percent discount for amounts higher than allowed by HUD. The Corporation did not have a source for funds needed to participate in the program. The program administrator said she was not aware of the HUD's requirements regarding sale price restrictions. Consequently, low and moderate income persons paid more than HUD's program intended and the corporation received excess funds of $1,614 from the sales.

We recommend HUD require: the three nonprofit organizations to provide documentation to support the unsupported expenditures or prepay on the applicable homeowners' mortgages the amount of expenses that cannot be supported; the three nonprofit organizations to prepay on the applicable homeowners' mortgages the amount of ineligible expenses; Second Chapel Hill to eliminate the conflict of interest; the 40/40 Institute to develop an adequate accounting system; and, the Detroit Non-Profit Housing Corporation obtain a source of funds for continued participation in the program. We also recommend that the nonprofit agencies be removed from the program and administrative penalties be initiated if the nonprofit agencies do not comply with all of HUD's requirements and the recommendations in this report.

We presented our draft findings to the nonprofit organizations and the HUD Michigan State Office. We held an exit conference with the Director of Single Family Housing, Michigan State Office on May 20, 1996. The 40\40 Institute and the Detroit Non-profit Housing Corporation provided their written comments. Second Hill Chapel did not provide a written response to the audit. We included the written comments we received in their entirety with each finding.

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Introduction

Under the Partners For Affordable Home Ownership program, HUD allows nonprofit organizations to purchase homes from the HUD inventory at a 30 percent discount of HUD's appraised value. The homes are located in HUD designated revitalization areas. The intent of the program is to expand home ownership by providing the nonprofit agencies an incentive to buy the homes, make needed repairs and resell the homes to qualified low-income buyers. HUD restricts the sale price the nonprofit agencies can charge the home buyers to the net development cost plus ten percent of the net development cost.

HUD expects the program to reduce the inventory of its acquired properties in a manner that expands home ownership opportunities, strengthens neighborhoods and communities, and ensures a maximum return to the mortgage insurance fund. Under the program in Detroit, nine nonprofit organizations purchased 61 homes valued at $805,262 between November 1993 and September 1995.

Audit Objectives

Our objectives were to assess: the validity of HUD's concern that some nonprofit agencies were acquiring homes at a 30 percent discount to make unallowed profits; and determine whether the nonprofit organizations complied with HUD's requirements.

Audit Scope And Methodology

We interviewed HUD's staff to determine the reasons for their concern. We interviewed the staff at the nonprofit organizations to determine how the agencies operated their housing activities and what information the local HUD office provided to assist the nonprofit agencies in complying with HUD's requirements. We reviewed HUD's property disposition files containing property settlement and closing documents and the nonprofit organizations' records related to: housing activity accomplishments; cash disbursements; advertising; and other marketing documents. We reviewed the documents to assess the agencies' compliance with HUD's requirements.

The audit covered the period November 19, 1993 through September 30, 1995. We extended the period as necessary. Our field work was conducted between September 1995 and April 1996. The audit period was longer than normal because of delays caused by the Government furloughs and a higher priority audit assignment. We conducted the audit in accordance with generally accepted government auditing standards. We provided a copy of this report to the Director of Housing, Michigan State Office.

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Second Chapel Hill Did Not Comply With HUD's Requirements

Second Chapel Hill, a nonprofit organization: (1) sold five homes it purchased from HUD for amounts higher than allowed; and (2) violated HUD's conflict of interest requirements. The Director of the organization said he was unaware of HUD's requirements. As a result, low and moderate income persons paid more for the properties than HUD's program intended and Second Chapel Hill made unallowed profits of $80,488.

HUD's Requirements

HUD Regulation 24 CFR 291 and HUD Notice H94-74 allow nonprofit organizations to purchase HUD acquired properties at a 30 percent discount of the properties' appraised values provided the nonprofit organizations comply with HUD's requirements.

HUD Notice H94-74 and the Model Land Use Restriction Addendum signed by the applicable nonprofit organizations and HUD say, unless an exception is granted in writing by HUD, the initial purchaser (nonprofit organization) of a property at a 30 percent discount shall not resell the property for an amount that exceeds the net development cost plus ten percent of the net development cost. Net development cost is the total cost of the project. It includes such items as acquisition cost, architectural fees, permits and survey expenses, insurance, and taxes, but excludes overhead and any developer's fees.

HUD Regulation 24 CFR 291.435 (b) says each purchaser of property must comply with conflicts of interest requirements. These requirements say no person who is an employee, agent, consultant, officer, or elected or appointed official of the lessee or purchaser of property may obtain a personal or financial interest or benefit from the lease or purchase of the property.

Homes Were Sold For Excessive Amounts

Between April and August 1995, Second Chapel Hill, a nonprofit organization, purchased ten homes from HUD at a cost of 30 percent less than the HUD appraised value. The organization sold five of the ten homes and identified the costs and revenues for each home in its property records. The records showed it sold four of the five homes for amounts that exceeded HUD's program requirements. Although Second Chapel Hill's records showed the fifth home was not sold at an excess amount, we determined it was. For all five houses, Chapel Hill did not have invoices to support all reported rehabilitation work. Costs charged to four of the five homes included advances to an investor that were not allowable costs. As a result, the organization sold all five homes for amounts that exceeded HUD's program requirements. The excess amounts ranged from $9,344 to $24,286 per house. The organization made unallowed profits totalling $80,488 for the five homes.

	8486 Brace	9560 Plainview	13597 Westwood	14559 Vaughan	8083 Prest
Net Cost	$22,209	$24,233	$13,534	$33,841	$18,831
10 Percent Fee	2,221	2,423	1,353	3,384	1,883
Total Cost and Fee	24,430	26,656	14,887	37,225	20,714
Less Sales Price	34,900	36,000	33,000	55,500	45,000
Unallowed Profit	$10,470	$ 9,344	$18,113	$18,275	$24,286

Second Chapel Hill sold all of its properties based on the property's market appraised value after rehabilitation rather than based on Chapel Hill's net development costs plus the 10 percent fee. Our computation of the 10 percent fee in the above table does not include the following ineligible and unsupported rehabilitation costs that Chapel Hill claimed:

	Ineligible	Unsupported
8486 Brace	$1,500	$ 8,487
9560 Plainview	0	10,530
13597 Westwood	4,500	10,512
14559 Vaughan	1,500	9,542

8083 Prest	1,500	17,983
Total	$9,000	$57,054

If Second Chapel Hill could provide documentation to support all of the unsupported costs, its excess profits would be reduced to $23,434 ($80,488 - $57,054).

The Director of Second Chapel Hill said he was unaware of the program requirements. However, the Director signed an addendum, with the purchase of each home, that stated the nonprofit organization could not resell the property for an amount in excess of the net development cost plus ten percent of the net development cost.

Conflict of Interest Requirements Were Violated

Second Chapel Hill contracted with an investor, Bralen, Inc. to finance the purchase, rehabilitation and marketing of the HUD homes. Bralen provided all the financing and Gannon Real Estate, owned by Bralen acted as a broker to sell the homes. The president of Bralen is Second Chapel Hill's Treasurer. Therefore the Treasurer had a conflict of interest as defined in HUD's Regulation 24 CFR 291.435.

Second Chapel Hill had a contract with Bralen, Inc. that provided for Bralen to supply all acquisition and repair funds. The contract called for Gannon to market the properties, and Bralen and Second Chapel Hill to share all surplus funds equally.

Gannon Real Estate received a total of $23,000 for marketing and broker's fees for the sale of the five homes. The fees were not based on a percentage of the sale price as is the standard industry practice in the Detroit area. The broker received a flat fee; $6,000 for three homes and $2,500 for two homes. Gannon's fees for the five properties exceeded the seven percent local industry standard by $8,692. For example, Gannon received a flat broker's fee of $6,000 for the sale of the property at 8486 Brace. By local practice, the 7 percent broker's fee on a sales price of $34,900 would have been $2,443. Gannon received $3,557 in excess of the industry standard.

Auditee Comments

The Executive Director said Second Chapel Hill would not provide written comments to the audit.

Recommendations

The Director, Office of Housing, Michigan State Office should:

1A. Require Second Chapel Hill to provide invoices to support the unsupported expenditures of $57,054 or prepay on the applicable mortgages the amount that cannot be supported.

1B. Require Second Chapel Hill to prepay the applicable mortgages a total of $23,434 for ineligible expenses claimed and excess profits taken.

1C. Require Second Chapel Hill to prepay the applicable mortgages a total of $8,692 for the excessive broker's fees charged.

1D. Require Second Chapel Hill to immediately eliminate the conflict of interest.

1E. If the above recommendations are not satisfactorily resolved, remove Second Chapel Hill from participation in the program and initiate administrative penalties.

The 40/40 Institute Did Not Follow HUD's Requirements

The 40/40 Institute, a nonprofit organization, sold two HUD homes purchased at a 30 percent discount for amounts higher than allowed by HUD's requirements. The 40/40 Institute did not have an adequate accounting system to capture property related costs and revenues. The Institute's president said he was unaware of HUD's requirements. As a result, low and moderate income persons may have paid more for properties than HUD's program intended and the 40/40 Institute may have realized unallowed profits of $3,291.

HUD's Requirements

HUD Regulation 24 CFR 291 and HUD Notice H94-74 allow nonprofit organizations to purchase HUD acquired properties at a 30 percent discount of the properties' appraised values provided the nonprofit organizations comply with HUD's requirements.

HUD Regulation 24 CFR 291.405(2)(i) requires a private nonprofit organization to have a functional accounting system that operates according to generally accepted accounting principles. A functional accounting system should be able to track property costs and revenues.

HUD Notice H94-74 and the Model Land Use Restriction Addendum signed by applicable nonprofit organizations and HUD say, unless an exception is granted in writing by HUD, the initial purchaser (nonprofit organization) of a property at a 30 percent discount shall not resell the property for an amount that exceeds the net development cost plus ten percent of the net development cost. Net development cost is the total cost of the project. It includes such items as acquisition cost, architectural fees, permits and survey expenses, insurance, and taxes, but excludes overhead and any developer's fees.

Homes Were Sold At Amounts That Exceeded HUD's Guidelines

The 40/40 Institute sold two HUD homes acquired at a 30 percent discount for $3,291 more than the net development cost plus ten percent fee of the net development cost. The Institute received excessive payments of $2,016 for the home at 15779 Heyden and $1,275 for the home at 19480 Beaverland.

The Institute did not have an adequate accounting system to track property related costs and revenues. The individual property files contained support for the acquisition costs; however, they did not contain any records to support the costs for claimed repairs, holding costs, and management fees.

As of December 1995, the Institute had sold four of 22 homes that it purchased from HUD between April 1994 and December 1995. Five of the remaining 18 homes were occupied by potential buyers, one had suffered a casualty loss, and the others were vacant. The Institute could not provide cost reports, cancelled checks, or signed contracts to show how much had been spent to repair and market its unsold properties. It also did not have rental/leasing records for the occupied properties. As a result, two properties were sold at amounts that may exceed HUD's guidelines, and records are not available to support future sales.

For example, the Institute purchased the home at 15779 Heyden for $22,066 and sold it for $29,102. The Institute claimed that its net development cost was $33,459: $22,066 for the acquisition cost; $6,910 for repairs, $2,758 for interest, $1,100 for holding costs, and $625 for management fees. The purchase was funded by a private mortgage in the amount of $22,066. We estimated the interest cost on the mortgage to be $2,558. The Institute did not have sufficient documentation to support the repair costs, holding costs or management fees. Since there is no evidence to verify these costs, we calculated the net development cost as $24,624 ($22,066 acquisition cost plus $2,558 for interest). As a result, the Institute received excess funds of $2,016 on the sale.

Net Development Cost per Institute	$33,459
Net Development Cost per Audit	24,624
10 percent Allowable Fee	2,462
Total Cost and Fee per Audit	27,086
Sales Price	29,102
Profit	$ 2,016

The President of the Institute said he had recently acquired competent accounting help to set up a proper accounting system. Additionally, he said he was unaware of HUD's program requirements. However, with the purchase of each home, he signed an addendum that stated the nonprofit organization could not resell the property for an amount in excess of the net development cost plus ten percent of the net development cost.

Auditee Comments

Written comments for the 40\40 institute were prepared by the accountant the Institute retained to implement an accounting system. The accountant said:

We were retained by the 40\40 Institute several weeks ago to implement an accounting system pursuant to Generally Accepted Accounting Principles. To that end, we have set the Institute up on its computer with software that, if used properly, would accomplish our objectives. Thus far, we have gone through all of its records through 1994. Presently, we are working on the data for 1995. We anticipate having the records up-to-date by mid-June of this year.

The inventory of houses except for two or possibly three will be carried under the HUD Notice H94-74 and the Model Land Use restriction addendum. When we are done, the Institute will be able to track its inventory according to HUD guidelines and/or programs under which the inventory was purchased.

After discussing this matter with the Institute's President, we feel confident that the new system with the attendant procedures will serve the Institute well.

OIG Evaluation of Auditee Comments

Although the Institute said it is in the process of establishing an adequate accounting system, the response by the Institute's accountant did not address the unsupported expenditures that our recommendation said should be prepaid on the applicable mortgages.

Recommendations

The Director, Office of Housing, Michigan State Office should:

2A. Require the 40/40 Institute to provide documentation that supports $3,291 in expenditures claimed or prepay on the applicable mortgages the amount that cannot be supported.

2B. Verify that the Institute has established an accounting system that will properly capture costs or remove the Institute from the program.

Detroit Non-Profit Housing Did Not Adhere to HUD's Requirements

The Detroit Non-Profit Housing Corporation sold two HUD purchased homes for amounts higher than allowed by HUD. The Corporation did not have a source for funds needed for program participation. The program administrator said she was not aware of the HUD requirement regarding sale price restrictions. Consequently, low and moderate income persons paid more for the properties than HUD's program intended and the corporation received excess funds of $1,612 from the sales.

HUD's Requirements

HUD Regulation 24 CFR 291 and HUD Notice H94-74 allow nonprofit organizations to purchase HUD acquired properties at a 30 percent discount of the properties' appraised values provided the nonprofit organizations comply with HUD's requirements.

HUD Notice H94-74 and the Model Land Use Restriction Addendum signed by applicable nonprofit organizations and HUD say, unless an exception is granted in writing by HUD, the initial purchaser (nonprofit organization) of a property at a 30 percent discount shall not resell the property for an amount that exceeds the net development cost plus ten percent of the net development cost. Net development cost is the total cost of the project. It includes items such as acquisition cost, architectural fees, permits and survey expenses, insurance, and taxes, but excludes overhead and any developer's fees.

HUD Notice H94-74 requires nonprofit agencies to have financial resources to handle property related costs. HUD Regulation 24 CFR 291.410 (c)(5)(iii) requires nonprofit agencies to provide evidence of financial and other resources to meet the obligations of the property related costs.

Homes Were Sold For Excessive Amounts

The Detroit Non-Profit Housing Corporation sold two HUD homes it purchased at a 30 percent discount for amounts that exceeded the acceptable HUD guidelines. The funds were paid directly by the home buyers since the corporation did not have funds or credit available to purchase the homes itself. According to program requirements, the Corporation should have had its own source of funds. On the same day that each property was purchased from HUD, the nonprofit corporation immediately sold the property to the home buyer. The corporation sold the homes at HUD's list price rather than its purchase price plus the HUD allowable 10 percent development fee. As a result, the corporation received excessive funds of $1,612 as follows:

	7145 Tuxedo	22430 Barbara
Net Development Cost	$3,396	$11,956
10 Percent Fee	340	1,196
Total Cost and Fee	3,735	13,151
Sales Price	4,500	14,000
Excess Funds Realized	$ 764	$ 848

The Corporation's program administrator said she was not aware of any written program requirements regarding HUD's restrictions on the sale price. However, with the purchase of each home, the president signed an addendum that stated the nonprofit organization could not resell the property for an amount in excess of the net development cost plus ten percent of the net development cost.

The intent of selling a nonprofit agency property at a 30 percent discount is to allow the nonprofit to make improvements to bring the properties to acceptable standards for sale to low and moderate income persons. The nonprofit agencies are allowed to recover their development costs, plus a 10 percent fee to cover the administrative expenses incurred during the process. We believe buying and selling properties on the same day with no improvements being made, is a violation of the intent of the program and normally would not justify the 10 percent fee for administrative costs.

Auditee Comments

The Executive Director for the Detroit Non-Profit Housing Corporation provided the following comments:

Detroit Non-Profit Housing Corporation has been operating under a previous program and was not aware of the changes that were referred to under regulation 24 CFR 290, HUD Notice H94-74 and HUD Regulation 24 CFR 291.410 (c)(5)(iii). We were not notified of any meeting being conducted by HUD nor did we receive any literature of the above mentioned program changes.

Detroit Non-Profit Housing Corporation is acting in good faith. We feel it would be unjust to be removed from the program or to reimburse HUD, since all of our actions were based on a prior program.

Detroit Non-Profit Housing Corporation recently received the above mentioned HUD Regulations and HUD Notices. Henceforth, Detroit Non-Profit Housing Corporation will adhere to current regulations and notices. We have secured financing through a lending institution for future purchases.

OIG Evaluation of Auditee Comments

The Detroit Non-Profit Housing Corporation said it was not aware of changes under Regulation 24 CFR 290, HUD Notice H94-74 and HUD Regulation 24 CFR 291.410 (c)(5)(iii). Regulation 291.410 has not changed and was also applicable to the previous program referred to by the Housing Corporation. HUD Notice H94-74 is a new notice applicable for the 30 percent discount program. Regulation 24 CFR 290 is not applicable to the 30 percent discount program. Under the previous program mentioned by the auditee, the same requirement existed for financial resources. Additionally, with the purchase of each home, the Housing Corporation signed an addendum that stated the terms under which the nonprofit could sell the home.

The Housing Corporation said it has secured financing for future purchases and has received necessary regulations, but it believes it would be unjust to have to repay the excess funds realized. The intention of the 30 percent discount program is to allow homes to be purchased at a discount so that nonprofit agencies can make improvements before selling them to low and moderate income persons. We believe it is unjust for the low and moderate income families to be paying more for homes than intended by HUD. The Housing Corporation should prepay on the applicable mortgages, the amount of excess funds it realized on the sale of the homes.

Recommendations

The Director, Office of Housing, Michigan State Office should:

3A. Require the Detroit Non-Profit Housing Corporation to prepay on the applicable mortgages a total of $1,612 in excess funds received.

3B. Require the Detroit Non-Profit Housing Corporation to obtain financing for its participation in the program, make improvements to properties purchased or remove the Corporation from the program.

3C. If the above recommendations are not satisfactorily resolved, initiate administrative penalties against the Corporation.

Internal Controls

In planning and performing our audit, we considered the internal controls of the management of the nonprofit organizations in order to determine our auditing procedures and not to provide assurance on internal controls. Internal controls consist of the plan of organization and methods and procedures adopted by management to ensure that: resource use is consistent with laws, regulations, and policies; resources are safeguarded against waste, loss, and misuse; and reliable data are obtained, maintained, and fairly disclosed in reports.

Relevant Internal Controls

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

- Accounting system

We assessed the relevant controls identified above.

It is a significant weakness if internal controls do not give reasonable assurance that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data are obtained, maintained, and fairly disclosed in reports.

Significant Weaknesses

Based on our audit, the following item is a significant weaknesses:

Accounting system. One nonprofit organization did not have an adequate accounting system to capture property related costs and revenues (see Finding 2).

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Follow Up On Prior Audits

This was the first OIG audit of the nonprofit organizations. The last independent audit reports issued on the nonprofit organizations did not contain any findings related to this report.

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Schedule of Ineligible and Unsupported Costs

Recommendation Number	Type of Questioned Costs Ineligible 1/	Unsupported 2/
1A		$57,054
1B	$23,434	
1C	8,692	
2A		3,291
3A	____	1,612
Totals	$32,126	$61,957

1/ Ineligible costs are costs charged to a HUD 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 costs charged to a HUD-financed or insured program or activity whose eligibility cannot be determined at the time of the audit since such costs were not supported by adequate documentation or there is a need for a legal or administrative determination on the eligibility of the costs. The costs require a future decision by HUD program officials. The decision, besides obtaining supporting documentation, might involve a legal interpretation or clarification of Departmental policies and procedures.

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