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TO: William Apgar, Assistant Secretary, Office of Housing, H

FROM: William D. Hartnett, District Inspector General, Office of Audit, 1AGA

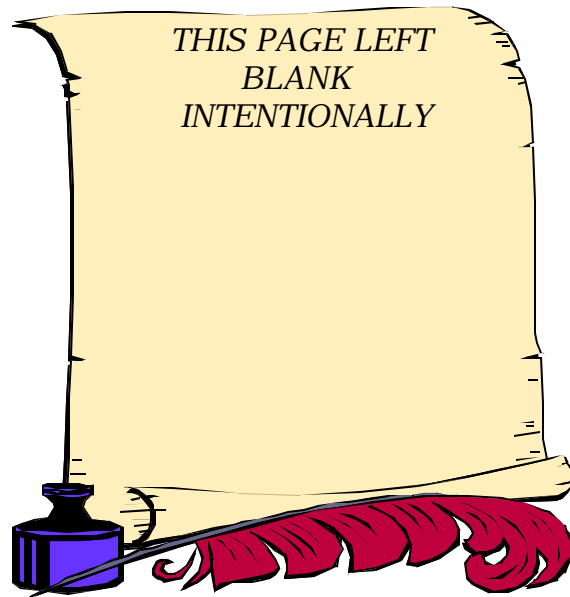
SUBJECT: Use of the Real Estate Assessment Center's Physical Inspection Assessments

We conducted an audit of the Office of Housing's use of physical inspection assessments generated by HUD's Real Estate Assessment Center (REAC) on multifamily properties insured by the Federal Housing Administration and/or receiving project-based subsidy under the Section 8 program. The purpose of our review was to evaluate actions taken to address and track corrections to the physical deficiencies disclosed through the REAC property inspections.

Although the Office of Housing utilizes the REAC property inspections within their servicing responsibilities, the report addresses the need for the Office of Housing to reinforce its assurances and improve its processes to strengthen the Department's oversight of its portfolio of insured and subsidized multifamily properties. Specifically, we determined that the Office of Housing does not have the proper assurances that corrective action is completed by the owner to the extent of all the physical deficiencies reported by the property's REAC inspection. This includes assurances that exigent health and safety violations are corrected within the required time frame and that complete property surveys identifying the magnitude of the physical deficiencies are performed. Further, we determined that the Office of Housing can improve the current notification process to field office staff of completed property inspection reports and exigent health and safety violations released by REAC.

Within 60 days, please provide us 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 not considered necessary. Also, please furnish us copies of any correspondence or directives issued related to this audit.

If you have any questions, please contact our office at (617) 565-5259.



Executive Summary

We conducted an audit of the Office of Housing's use of physical inspection assessments generated by HUD's Real Estate Assessment Center (REAC) on multifamily properties insured by the Federal Housing Administration and/or receiving project-based subsidy under the Section 8 program. As of January 10, 2000, a total of 20,151 of approximately 30,000 multifamily properties had completed inspection reports released since inception of REAC's physical inspection process in October 1998. At an average cost of \$661 per each physical inspection, the Department has expended over \$13.3 million dollars.

The primary purpose of our review was to evaluate actions taken to address and track corrections to the physical deficiencies disclosed through the REAC physical inspections. As part of our assessment, we reviewed actions taken by the Massachusetts and Connecticut State Offices of Housing on physical inspections performed.

Audit Results

Although we found the Office of Housing to be utilizing the REAC property inspections within their servicing responsibilities, we believe the Office of Housing can reinforce its assurances and improve its processes to strengthen the Department's oversight of its portfolio of insured and subsidized multifamily properties.

As of January 10, 2000, there were 2,221 properties (11 percent) of the 20,151 scoring between the passing threshold of 60, and the score at which the property is referred to the Department's Enforcement Center which is 30. In addition, there were 10,611 properties (53 percent) of the 20,151 with reported exigent health and safety violations. All of these properties would have required written owner certification to confirm repair and correction of the physical deficiencies and exigent health and safety violations cited. However, follow up inspections by the Office of Housing staff, to verify corrections or repairs to these REAC inspections, are not required and are not performed.

We believe this policy opens the door to potential false information being transmitted and certified by the project owner. For instance, problems associated with the absence of follow up inspections were confirmed during our review of the Massachusetts and Connecticut State Offices of Housing. Upon review of the owner's certifications that certain corrections or repairs were made at four sampled housing

properties, we determined that those corrections or repairs were actually completed at only three of the four properties.

We were advised that staff limitations hinder follow up site visit and/or re-inspections. We were advised that the REAC inspection performed the following year would identify any outstanding deficiencies from the previous year's inspection report. If the same deficiency exists the following year, the Office of Housing may take action against the project owner. However, it is not known what type of repercussion will occur, and it was agreed that there is no system established on how to handle repeat offenders. A November 26, 1999 proposed rule suggest ranking multifamily properties in three categories which would indicate if an inspection would be performed annually. The Department needs to recognize that repeat offenders will not be identified in the next annual REAC physical inspection, if in fact, the property is not required to have an inspection every year.

In addition, when certification of corrective action of exigent health and safety violations is reported by the project owners, the owners do not always specify when the corrective action was completed. Instances are occurring where the owners submit the certification weeks and even months after the inspection. We believe that prompt correction of health and safety violations is important and if owners are not required to certify as to when the items were mitigated, there is a potential that the owners may become lax in making the corrections in a timely manner.

Our review of the Massachusetts and Connecticut State Offices of Housing also showed that there is no evidence or assurances that ten of thirteen project owners required to complete property surveys have done so. The property surveys are a vehicle to determine the full extent of the physical deficiencies that are present and in need of correction or repair. The property surveys are important to the overall physical inspection process, whereas the REAC inspectors cannot be expected to inspect all of a property's units. We believe if the requirement of complete property surveys is not enforced, owners may only be concerned with the deficiencies in the inspected units, when in actuality similar problems may exist in other units.

Furthermore, improvement is needed in the current notification process to Housing field office staff when completed property inspection reports and exigent health and safety violations are available on the Multifamily Housing Real Estate Management System (REMS). Where no systematic notification system is operated by the REAC or the Office of Housing, the responsibility of identifying newly released inspection reports and exigent health and safety violations falls upon the field office staff. Field office staff must be aware of property inspection schedules, and must take the time to query inspection data from REMS to identify newly released inspection reports and health and safety violations. We believe this may be an unnecessary added burden to a depleted field office staff, whereas a more beneficial electronic notification system can be developed and operated by the REAC or the Office of Housing.

Recommendations

We are recommending the Office of Housing consider strengthening owner certifications pertaining to the correction and repair of physical deficiencies reported through the REAC inspections, and continue to develop a system and procedures to identify owners that have subsequent REAC inspections which depict the same physical deficiencies that were cited the prior year and certified as corrected. Policies should be established on action to be taken if it is determined that the same physical deficiencies exist. Further, we are recommending the Office of Housing require the owner to not only certify to corrected deficiencies, but indicate the time frame of such corrections, and develop stronger procedures to assure complete property surveys are performed and submitted by the owner. Finally, we are recommending the Office of Housing develop and operate a more beneficial notification system of released property inspections, which will lessen the burden of the field office staff.

Findings and
Recommendations
Discussed

We discussed the finding with Department officials during the course of our audit. By letter dated March 28, 2000, the Deputy Assistant Secretary for the Office of Housing provided a detailed response to each recommendation discussed in the draft report. We have included the Department's pertinent comments in the Finding section of this report. The Department's full response is included in Appendix C.

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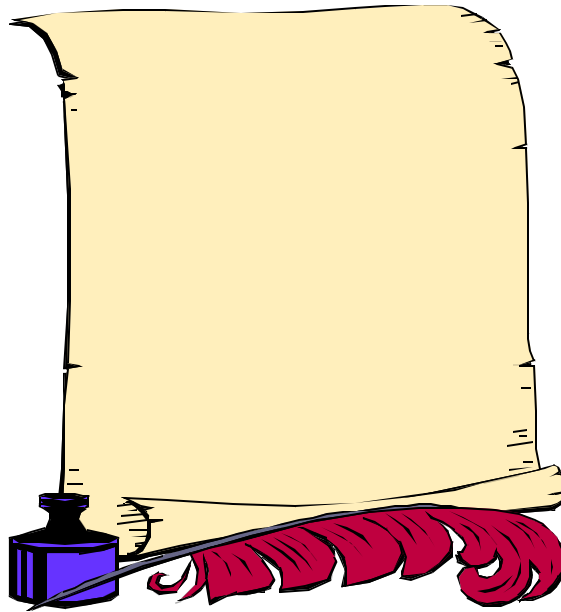


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Abbreviations

DEC	Departmental Enforcement Center
HUD	Housing and Urban Development
KPMG	Klynveld, Peat, Marwick, Goerdeler
MIO	Management Improvement Operations
OIG	Office of Inspector General
REAC	Real Estate Assessment Center
REMS	Real Estate Management System

Introduction

The Real Estate Assessment Center (REAC) is a new national management center within HUD established to centralize and standardize the way the Department evaluates the condition of approximately 3,300 public housing authorities and over 30,000 properties insured by the Federal Housing Administration and/or receiving project-based subsidy under the Section 8 program. The REAC is designed to give the Department a more comprehensive and consistent vehicle for portfolio oversight and for prioritizing and directing its resources to public housing authorities and multifamily properties.

According to the protocol agreement between the Office of Housing and the REAC executed November 9, 1999, ultimate responsibility for overseeing the individual multifamily projects continues to belong to the Office of Housing. The REAC only performs the assessments and does not resolve any project issues arising from those assessments.

Property physical inspection scores have both number and letter parts. The number part gives an overall score for the basic physical condition of a property, including health and safety problems other than those associated with smoke detectors. The number part is a weighted average of the numerical scores calculated for five physical inspection areas including site, building exterior, building systems, common areas and dwelling units.

The letter part specifically indicates whether health and safety problems were observed during the inspection of the property. For the alphabetic part, lower case letters from “a” to “c” are used. The lower case letter “a” will be given if there are no health and safety deficiencies; the lower case “b” will be given if there are one or more non-life threatening health and safety deficiencies; and the lower case letter “c” will be given if there are one or more life threatening health and safety deficiencies. Letter grades will have two forms including with and without an asterisk (*); with the asterisk designating that the property has at least one smoke detector deficiency.

Projects that have health and safety conditions will receive written citations from the REAC inspectors on the day of the inspection. Life threatening conditions also known as exigent health and safety violations must be corrected within 72 hours from the date of the inspection.

Updated field guidance entitled “Instructions to the Field for REAC Physical Inspections,” including procedures to appeal REAC inspections and the latest notification of exigent and fire safety hazard observed, was issued September 28, 1999. According to the guidance, for properties scoring 60 or above, the owner should be instructed to make required repairs as indicated by their inspection results as part of their ongoing maintenance program.

For projects that receive a REAC physical inspection score of 31 to 59 points, the field office staff should inform the owner that a Proposed Plan of Correction is required within thirty days of the owner’s receipt of the inspection report. The owner must pay particular attention to the items classified as health and safety, severe and major, and then conduct their own survey of the property based on HUD’s

findings and random sample. The Plan should include corrections made, a description of the survey, and a plan to correct all outstanding deficiencies within sixty days of the Proposed Plan (ninety days from receipt of report). For projects with scores in the range of 31 to 45 points, the Proposed Plan of Correction must be in Management Improvement Operations (MIO) Plan Format, or an equivalent of such.

Projects that score below 30 points will be referred by the REAC to the Departmental Enforcement Center (DEC). The DEC, established by the Department's 2020 Management Reform, works in a collaborative fashion with HUD's program areas by consolidating the bulk of HUD's enforcement efforts and by resolving the most difficult and most significant, outstanding non-compliance issues among recipients of HUD program resources in the areas of Housing, Public and Indian Housing, Community Planning and Development, and Fair Housing and Equal Opportunity.

A protocol exists between the DEC and the Office of Housing dated February 23, 1999. The protocol provides that all physical inspections of properties scoring 30 points or less will be referred simultaneously to the Housing HUB Director and the DEC. The DEC will immediately begin the evaluation process and will have primary responsibility for assessment. During the evaluation process, Housing Program Offices continue to be responsible for routine asset management tasks.

OIG Audit Related Memorandum 99-BO-199-0802, dated September 30, 1999, provided that the REAC's physical inspection assessment subsystem has the potential to be a useful tool for informed decision making on a national basis. However, for that to be realized, the Office of Public and Indian Housing and the Office of Housing need to take the appropriate action to address the assessments performed by the REAC.

As of January 10, 2000, a total of 20,151 multifamily property inspection reports were released. At an average cost of \$661 per each physical inspection, the Department has expended over \$13.3 million dollars. Of the 20,151 properties, 2,592 (13 percent) scored below the passing threshold of 60. A summary of the inspection scores are as follows:

Inspection Score	Number of Properties	Percent of Total
60-100	17,559	87%
31-59	2,221	11%
0-30	371	2%

In addition, there were 10,611 properties of the 20,151 (53 percent) cited for exigent health and safety violations.

Audit Objectives

The overall audit objective was to evaluate actions taken by the Office of Housing staff to address physical deficiencies

disclosed through REAC inspections. Specific audit objectives were to identify and analyze:

- The process of transmitting multifamily property inspection reports to the owners/agents and the HUD State Offices, including the notification of exigent health and safety violations; and
- The procedures HUD uses to ensure complete property surveys, and correction of all physical deficiencies cited, including exigent health and safety and violations.

Audit Scope and Methodology

We selected a sample of nineteen multifamily housing properties serviced by the Massachusetts and Connecticut State Offices of Housing. Eight of the nineteen properties are located in Connecticut, and the remaining eleven are located in Massachusetts. (Appendix A) For the sample selected, we determined what actions were taken by the Housing staff by: (1) obtaining and reviewing the project servicing files; (2) reviewing related protocols and/or internal procedures issued; (3) discussing with Multifamily Program Center Directors and staff, as needed, to obtain information on the actions taken with respect to the properties, or any discrepancies/concerns; (4) reviewing the Real Estate Management System (REMS) database to determine if the Housing staff had updated the system as appropriate with the results produced by the REAC and the actions taken by Housing; and (5) comparing and evaluating the actions taken by Housing with the protocols and/or internal procedures issued.

We identified any time lapse from the initial REAC inspection date to when the first action was taken by Housing in response to the inspection results (of the nineteen sample projects) and if there were any trends (i.e. decreases or increases in time).

We identified any time lapse between the initial REAC inspection date and the date when the inspection report is released to the field office staff in the Massachusetts and Connecticut State Office of Housing.

We performed on-site visits to four of the nineteen sampled projects (two projects in Connecticut and two projects in

Massachusetts) to ensure owner certified corrections were performed. (Appendix A)

We selected an additional sample of eight multifamily housing projects serviced by the Massachusetts and Connecticut State Office of Housing. For the sample selected, we held discussions via telephone calls and onsite visits to determine how and when the REAC inspection reports and notification of exigent health and safety violations were received and what actions were taken by the owners and/or management agents to address the inspection results. Four of the eight sampled properties are located in Connecticut, and the remaining four are located in Massachusetts. (Appendix B)

We held interviews with the appropriate Massachusetts and Connecticut State Office Housing Directors and staff, and Housing Headquarters Directors and staff.

We obtained and summarized the results of related work performed by the Office of Inspector General in conjunction with the Fiscal Year 1999 HUD Financial Statement Audit.

We obtained and summarized the results of related work performed by KPMG, Certified Public Accounting Firm, on the Fiscal Year 1999 Federal Housing Administration Financial Statement Audit.

Audit work was performed from June 1999 through January 2000 and covered the period October 1, 1998 through June 30, 1999. Where appropriate, the review was extended to include other periods.

We conducted the audit in accordance with generally accepted auditing standards.

Housing Needs to Improve Its Processes of Physical Inspections

As of January 10, 2000, there were 20,151 released multifamily property physical inspections of approximately 30,000 properties insured by the Federal Housing Administration and/or receiving project-based subsidy under the Section 8 program. HUD's Office of Housing does not have the proper assurances that corrective action is completed by the owner to the extent of all the physical deficiencies reported by the property's REAC inspection. This includes assurances that exigent health and safety violations are corrected within the required time frame, and that complete property surveys identifying the magnitude of the physical deficiencies are performed. Further, improvement is needed in the current notification process to Housing field office staff on the release of completed property inspection reports and exigent health and safety violations. We believe that if the Office of Housing reinforces its assurances and improves its processes, it will strengthen the Department's oversight of its portfolio of insured and subsidized multifamily properties.

Owners Required to Certify Corrections

Updated field guidance entitled "Instructions to the Field for REAC Physical Inspections" was issued September 28, 1999 and provides the field offices with instructions on how to manage REAC inspection results. For housing properties scoring less than 60 and greater than 30, the Housing field office staff is to take the most action in resolving physical deficiencies with the owner. Upon final completion of all repairs, including the exigent health and safety violations, the owner must provide written certification to the field office. Acceptable certification must be in the form of a signed letter on the owner's letterhead. Field offices may require pictures, copies of owner inspections, etc. as backup. There may also be a follow-up inspection under the HUD Quality Assurance component to ensure satisfactory completion of all repairs. However, the field office is not required to do follow-up inspections of any kind.

Over 50% of Inspections Required Owner Certification

As of January 10, 2000, there were 2,221 properties (11 percent) of the 20,151 scoring between the passing threshold of 60, and the score at which the property is referred to the Department's Enforcement Center which is 30. In addition, there were 10,611 properties (53 percent) of the 20,151 with reported exigent health and safety violations. All of these properties required written owner certification to confirm repair and correction of the physical deficiencies and exigent health and safety violations cited. However, follow up inspections by

the Office of Housing staff to verify corrections or repairs to these REAC inspections, are not required and are not performed.

The Director of the Office of Housing for Portfolio Management advised that staff limitations hinder follow up site visits and/or re-inspections. It was advised that troubled projects (projects with a score of 30 or less) will be referred to the Department's Enforcement Center which will conduct follow up inspections and monitor the correction progress. However, the non-troubled projects are to be trusted as business partners to provide accurate certifications of corrections.

Stronger Owner
Certification is Needed

We believe this policy opens the door to potential false information transmitted and certified by the project owner. We further believe that the Office of Housing should consider strengthening owner certifications.

False Information Evident in
the New England District

Problems associated with the absence of follow up inspections were confirmed during our review of the Massachusetts and Connecticut State Offices of Housing. Upon review of the owner's certifications that certain corrections or repairs were made at four sampled housing properties, we determined that those corrections or repairs were actually completed at only three of the four properties.

We were advised by the Director of Portfolio Management that the REAC inspection performed the following year would identify any outstanding deficiencies from the previous year's inspection report. If the same deficiency exists the following year, the Office of Housing may take action against the project owner. However, it is not known what type of repercussion will occur in the case of repeat deficiencies. The Director agreed that there is no system established at this point on how to handle repeat offenders.

System Needed to Process
Repeat Offenders

Since the second round of physical inspections by REAC is now underway, we believe that it is pertinent the Office of Housing establish a system and procedures to identify and govern repeat offenders. We believe that the establishment of a system used in conjunction with a stronger owner certification policy will assist the Office of Housing in properly monitoring its multifamily housing portfolio.

Annual Inspections Might
Not Be Performed On All
Properties

The Office of Housing also needs to recognize that a November 26, 1999 proposed rule suggested ranking multifamily properties in three categories which would indicate if an inspection would be performed annually. The three categories proposed in the rule are: (1) the highest 20 percent of a physical condition inspection will be designated Standard 1 performing properties and will be required to undergo a physical inspection once every three years; (2) the next highest 30 percent will be designated Standard 2 performing properties and will only be required to undergo a physical inspection every two years; and (3) the remaining 50 percent will be designated Standard 3 performing properties and will continue with the annual physical inspection currently required under HUD covered programs. Therefore, the Office of Housing should be aware that repeat offenders may not be identified in the next annual REAC physical inspection, if in fact, the property is not required to have an inspection every year.

Owner Certifications Are
Often Not Descriptive

When the certification of corrective action of exigent health and safety violations is reported by the project owners, the owners do not always specify when the corrective action was completed. Instances are occurring where the owners submit the certification weeks and even months after the inspection. It is not to say that the correction of exigent health and safety violations are not completed in the required 72 hours, but that the Department has no assurance of such. We believe that prompt correction of health and safety items is important and if owners are not required to certify as to when the items were mitigated, there is a potential that the owners may become lax in making the corrections in a timely manner.

The Director of Portfolio Management agrees that the responses from the owners should state how much time has elapsed before the exigent health and safety corrections were complete; especially if the responses are not received until months after the inspection was performed. The Director believes that the field office staff should follow up to find out when the corrections were completed.

No Assurances of Complete Property Surveys

Furthermore, the owners are required to complete property surveys with corrective action plans for properties that receive an inspection score below the passing threshold of 60. The property surveys are a vehicle to determine the full extent of the physical deficiencies that are present and in need of correction or repair. The property surveys are important to the overall physical inspection process, whereas the REAC inspectors cannot be expected to inspect all of a property's units. Our review of the Massachusetts and Connecticut State Offices of Housing showed that there is no evidence or assurances that ten of thirteen project owners, that were required to complete property surveys, have done so. It is not to say that owners are not conducting property surveys, but according to our review, the Department has no assurances of such.

The Director of Portfolio Management agreed that the field office staff may not be enforcing confirmation of completed property surveys. The Director stated that Housing Headquarters personnel will have to emphasize to the field offices the importance of the results of the property surveys conducted by the owners. We believe if this is not enforced, owners may only be correcting the deficiencies in the inspected units, when similar problems may exist in other units.

Notification of Released Inspections Can Be Improved

We believe the current process by which Housing field office staff is notified of when completed property inspection reports and exigent health and safety violations are available on the Multifamily Housing Real Estate Management System (REMS) can be improved. The responsibility of identifying newly released inspection reports and health and safety violations falls upon the field office staff, where no systematic notification system is operated by the REAC or the Office of Housing. Field office staff must be aware of property inspection schedules, and must take the time to query inspection data from REMS to identify newly released inspection reports and health and safety violations.

We believe this may be an unnecessary added burden to a depleted field office staff, whereas a more beneficial electronic notification system can be developed and operated by the REAC or the Office of Housing. It is possible the absence of a proper notification system would inhibit the field office staff from taking timely action, and in the case of exigent health and safety

violations, immediate action against the owner to correct the items within the required 72 hour time frame.

Improved Processes Can Strengthen Oversight

Although we found the Office of Housing to be utilizing the REAC property inspections in their servicing responsibilities, we believe that if the Office of Housing reinforces its assurances and improves its processes it will ultimately strengthen the Department's oversight of its portfolio of insured and subsidized multifamily properties. Furthermore, we believe that improvements made by the Office of Housing will help the Department to achieve the REAC's mission to protect the public interest by identifying and assessing the risk of loss from physical deterioration of properties; and to assist the Department in focusing its resources most effectively to raise the quality of the HUD housing portfolio, thereby enhancing the quality of life for residents by helping to ensure decent, safe and sanitary housing.

Auditee Comments

The Department indicates in its response to the draft report that "Housing questions whether a review of two offices, selected non-randomly and located in the same Multifamily HUB jurisdiction, can reasonably represent a review of a national program". The Department responds that an independent audit, conducted by KPMG and which states that FHA made notable progress in its ability to monitor its insured portfolio, more accurately reflects Multifamily Housing's effectiveness in using REAC physical inspection assessments.

In their response, the Department disagrees with our recommendation for a stronger form of certification in completion of repairs or health and safety items. The Department disagrees for reasons such as (1) the Department plans to initiate a system of spot checking; and (2) a certification relating to repairs is difficult to enforce unless the item is major and long standing. The Department also indicates that the draft report draws an incorrect conclusion that poorly performing projects won't be inspected each year. The response states that the bottom 50 percent of the properties, which encompasses all the properties with scores below 60, and properties scoring as much as 20 points higher will be subject to annual inspection requirements.

The Department responds that the importance of timely completion of exigent health and safety violations should not be approached in a mechanistic way as if to say that anything other than correction within the required 72 hours is a failure. The response states that “we should strive to meet the time goal, but the real goal is mitigation”.

In addition, the Department responds that Housing has already implemented an improved notification system through an existing set of formatted reports available through REMS. The response states that anyone who has access to the REMS reporting database can generate a formatted report at any time; reports that will list properties within a specific HUB, within a specific range of scores, and within a specific range of release dates.

Finally, the Department’s response states that Housing does not agree with the statement in the draft report that suggests that a significant weakness exists in the use of REAC assessments. The response states that “Housing has more data on the physical condition of its inventory and is utilizing it in a more consistent and effective way than ever in its history”.

OIG Evaluation of Auditee Comments

The Department misconstrues our draft report to read that the Office of Housing ineffectively uses physical inspection assessments generated by the REAC. The Department responds in disagreement over statements suggesting that a significant weakness exists in the use of REAC assessments, and that the audit performed by KPMG more accurately reflects Multifamily Housing’s effectiveness.

No where in the audit report is it mentioned that the Office of Housing is ineffectively using the REAC physical inspection assessments. Our audit report only addresses the need to reinforce and improve processes, which would strengthen the Department’s oversight of its multifamily portfolio. This includes processes over the Department’s ability to ensure corrective action to physical inspections performed, and the distribution of completed inspection reports to Housing field office staff.

The Department is in disagreement over a stronger owner certification policy citing how difficult one is to enforce, and the

initiation of a spot checking system. The development of a spot checking system would be an adequate improvement. However, the Department needs to establish policies on action to be taken against an owner if it is determined that corrections which were said to be completed, were in fact not. Depending on the severity of the items in question, for any enforcement action to be successful, a stronger owner certification policy would be most beneficial.

Further, the Department cites that it is incorrect to conclude that poorly performing projects won't be inspected each year. Our report does not draw this conclusion. In response to comments made that outstanding physical deficiencies would be identified in the following year's inspection, our report merely reminds the Office of Housing of the November 26, 1999 proposed rule which suggest ranking multifamily properties in three categories, depicting how often a physical inspection will be performed. The proposed rule does not identify what properties fall into each specific category. According to the Department's response to the draft report, "final cut offs have not been determined". As a result, we believe the Office of Housing should continue to be aware of the proposed rule when determining final designations for each category, and if they chose, to rely on annual inspections to identify outstanding physical deficiencies.

We agree with the Department that a goal of exigent health safety violations is mitigation. However, these are life threatening violations and there were guidelines established for completion. Our report does not suggest that anything other than meeting those guidelines of correction within 72 hours is a failure. Our report indicates that there are instances occurring where the owners submit their certification weeks and even months after the inspection, without specifying when corrective action was completed. The Department does not have assurances in these instances of when the corrective action was taken. The Department does not know whether the repairs were completed in 86 or 110 hours as opposed to 72 hours, whether there was a delay due to extenuating circumstances, or whether it was entirely neglect on the part of the owner. What our report is saying is that the Department should have these assurances.

In their response, the Department speaks of an improved notification system through an existing set of formatted reports available through REMS. Although the Department's response does not specifically state that the responsibility of extracting data from these reports falls upon the field office staff, we believe that to be the case. We further believe that asking the field office staff to query inspection data from REMS to identify newly released inspection reports and exigent health and safety violations may be an unnecessary added burden to a depleted field office staff. We believe that a more beneficial electronic notification system should be developed, which would systematically alert the field office staff of released physical inspections

Recommendations

We recommend that HUD:

- 1A. Strengthen owner certifications pertaining to correction and repair of physical deficiencies reported through the REAC inspections.
- 1B. Continue to develop a system and procedures to identify owners that have subsequent REAC inspections which depict the same physical deficiencies that were cited the prior year and certified as corrected. Establish policies on action to be taken against an owner if it is determined that the same physical deficiencies exist.
- 1C. Require the owner to not only certify to corrected deficiencies, but to indicate the time frame of such corrections, specifically when related to exigent health and safety violations.
- 1D. Develop stronger procedures ensuring complete property surveys are performed and submitted by the owner, and that all physical deficiencies identified throughout the property are corrected.
- 1E. Develop and operate a more beneficial notification system of released property inspections and exigent

health and safety violations, to lessen the burden of the field office staff.

Management Controls

In planning and performing our audit, we considered the management controls of the Office of Housing, specifically as related to the physical inspections performed by the Department's Real Estate Assessment Center, in order to determine our audit procedures and not to provide assurances on internal controls.

Management controls consist of a plan of organization and methods and procedures adopted by management to ensure that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data is obtained, maintained, and fairly disclosed in reports.

Relevant Management Controls

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

- Physical Inspections
- Tracking Corrective Actions

We assessed all relevant control areas identified above.

A significant weakness exists 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 is obtained, maintained, and fairly disclosed in reports.

Significant Weaknesses

Our review identified significant weaknesses over the Department's ability to effectively ensure controls over the corrective action to physical inspections performed by the Real Estate Assessment Center, and the distribution of completed inspection reports to Housing field office staff. Specific weaknesses were identified in all the management control areas disclosed above. These weaknesses are described in the Finding section of this report.

Multifamily Housing Properties Reviewed

Property Name	City	State	Inspection Date	Inspection Score (1)	Field Office
Litchfield Heights	Winsted	CT	06/25/99	45b*	CT State Office
Southfield Apartments (2)	Newington	CT	06/23/99	52b*	CT State Office
Squire Village	Manchester	CT	03/31/99	54c*	CT State Office
West Hartford Fellowship	West Hartford	CT	03/15/99	75c*	CT State Office
Woodview Apartments (2)	East Haven	CT	03/04/99	59b	CT State Office
Southwood Apartments	Naugatuck	CT	02/17/99	52a*	CT State Office
Granby Group Homes	Granby	CT	12/10/98	31b	CT State Office
St. Martin Towers	New Haven	CT	11/17/98	26c*	CT State Office
Forest Hills	Jamaica Plain	MA	08/10/99	38c*	MA State Office
Pond View Apartments	Jamaica Plain	MA	07/29/99	53c*	MA State Office
Cape Cod United Church	Falmouth	MA	07/26/99	98a	MA State Office
Park Gardens	Roxbury	MA	07/23/99	47b*	MA State Office
South End Tenant Houses II	Boston	MA	06/17/99	89c*	MA State Office
Pynchon Terrace I	Springfield	MA	04/03/99	78c*	MA State Office
Countryside Village (2)	Malborough	MA	03/26/99	49c*	MA State Office
Fruit Sever Merrick Apartments	Worcester	MA	03/25/99	19c*	MA State Office
Sargeant West Apartments	Holyoke	MA	03/04/99	73c*	MA State Office
Emerson Manor (2)	Longmeadow	MA	11/20/98	53b	MA State Office
Ulin House	Brighton	MA	11/19/98	34a*	MA State Office

- 1) The asterisk (*) designates that the property has at least one smoke detector deficiency.
- 2) Indicates the properties that we performed onsite inspections to ensure owner certified corrections were made.

Multifamily Housing Owners/Agents Interviewed

Property Name	City	State	Inspection Date	Inspection Score (1)	Field Office
Southfield Apartments	Newington	CT	06/23/99	52b*	CT State Office
Canterbury Gardens	New Haven	CT	06/07/99	55b*	CT State Office
Squire Village	Manchester	CT	03/31/99	54c*	CT State Office
Southwood Apartments	Naugatuck	CT	02/17/99	52a*	CT State Office
Forest Hills	Jamaica Plain	MA	08/10/99	38c*	MA State Office
Florence Apartments	Boston	MA	08/03/99	48c*	MA State Office
Park Gardens	Boston	MA	07/23/99	47b*	MA State Office
Bay State Apartments	Springfield	MA	06/02/99	41c*	MA State Office

(1) The asterisk (*) designates that the property has at least one smoke detector deficiency.

Auditee Comments



U. S. Department of Housing and Urban Development
Washington, D.C. 20410-9000

OFFICE OF THE ASSISTANT SECRETARY
FOR HOUSING-FEDERAL HOUSING COMMISSIONER

MAR 28 2000

MEMORANDUM FOR: William D. Hartnett, District Inspector General, Office of
Audit, IAGA

FROM: Shaun Donovan, Deputy Assistant Secretary for Multifamily Housing Programs,
HT

SUBJECT: Comments on March 2, 2000 Draft Audit Report
Use of the Real Estate Assessment Center's Physical Inspection Assessments

This is in response to your March 2, 2000 memorandum requesting comments on the subject Draft report (the "Report") concerning the use of Real Estate Assessment Center's (REAC) physical inspection assessments. We wish to make the following general comments with regard to the Report and specific comments with regard to the Recommendations contained in the Report.

General Comments:

Housing has adopted a balanced approach to utilizing the REAC physical inspections. That balance includes measured responses to physical condition findings which vary based on the assessment of the property. Scores of 30 and below go to the Departmental Enforcement Center. Assessments with scores of 60 and above are generally considered passing and, because of that success, owners are requested to incorporate repair needs in their ongoing maintenance plans. Some properties are cited for Exigent Health and Safety (EHS) issues, something never before attempted by the Department in this scale.

Note: The Report incorrectly quotes the Director of the Office of Portfolio Management, as saying that owners of projects above 30 are "trusted business partners." That remark applied to projects with passing inspection scores, i.e. scores of 60 and above. Another incorrect reference is the Report's use of the term "life-threatening health and safety" violations. The correct term to describe these items is Exigent Health and Safety, or EHS.

At the outset, Housing questions whether a review of two offices, selected non-randomly and located in the same Multifamily Hub jurisdiction, can reasonably represent a review of a national program. Rather, the findings of this Report have more relevance to implementation in a particular Hub office. The IG should refer to the statistically valid,

random sample used by KPMG, the IG's contract auditor, in the review of the FHA Financial Statements as one supporting a credible national audit. In auditing the monitoring of FHA-insured projects, which entailed a review of the same monitoring aspects as were covered in the subject Report, KPMG stated the following in its independent audit report on the FHA's FY1999 financial statements: "*FHA made notable progress in its ability to monitor its insured portfolio.*" We think the progress and improvement highlighted in the FHA audit report more accurately reflects Multifamily Housing's effectiveness in using REAC physical inspection assessments.

Comments on Recommendation 1A.

The Report (Page 6) recommends that a stronger form of certification of completion of repairs or health and safety items, one pursuant to the False Claims Act, is needed. Housing believes that it is inappropriate to ask owners to sign False Claims certification for three reasons. First and most importantly, the Department plans to initiate a system of spot-checks using REAC inspectors. This is a more effective way of ensuring the certifications are accurate. Second, even if obtained, a certification relating to repairs is difficult to enforce unless the item is major and long-standing. Too many items in troubled properties are fixed and then damaged a second time. Third, as noted elsewhere in this response, 50 percent of the projects (100 percent of the projects in poor condition) will be inspected every year.

Comments on Recommendation 1.B.

The Report (Page 7) draws the incorrect conclusion that poorly performing projects won't be inspected each year. The bottom 50% of the properties, which encompasses all the properties with scores below 60, and properties scoring as much as 20 points higher (final cut offs have not been determined) will be subject to annual inspection requirement. If the IG is proposing that yearly reinspection of all projects is necessary, Housing strongly disagrees. As noted above, the Department plans to initiate a system of spot-checks using REAC inspectors, and there are other indicators - FASS assessments, tenant complaints, feedback from Community Builders, etc. - that would warrant a follow-up inspection for a particular project.

Comments on Recommendation 1.C.

The Report (Page 7) notes the importance of timely completion of EHS findings and that EHS certifications do not always contain a date of completion. Housing has set an aggressive time frame for EHS completion. We know there will be times when owners cannot meet this due to the complex nature of the corrections needed. This should not be

approached in a mechanistic way as if completion in, say, 86 or 110 hours as opposed to 72 hours, is a failure. We should strive to meet the time goal, but the real goal is mitigation. A degree of flexibility on the part of owners and field offices, especially in the initial phase of PASS implementation and Multifamily follow-up, is needed in some cases where EHS repairs are delayed due to extenuating circumstances.

Comments on Recommendation 1.D.

The Report (Page 8) describes the importance of owners submitting property surveys for properties under the 60 threshold and for field offices to follow up on owner compliance. Housing agrees with the Report in this regard, and that emphasis must be placed on assuring owner compliance with the property survey requirement for projects between 31 and 59. We would note, though, that the annual inspection for these properties mitigates any risk associated with any owner noncompliance.

Comments on Recommendation 1.E.

The Report mentions that improvement could be made in terms of the process by which field office staff are notified when completed property inspection reports and EHS violations are available in the Multifamily Real Estate Management System (REMS), and a systematic notification system is suggested. The Report seems to be referring to an Excel file that provides information on inspections that have been released to Housing which some offices have used as a point of reference. Housing has already implemented an improved notification system through the existing set of formatted reports available through REMS, which includes a report (R03 Inspection List) that can be generated for a specific HUB and PC; for a score range; and for a "released date" range.

Anyone who has access to the REMS reporting database can generate the formatted report at any time. The existing set of formatted reports includes several reports regarding EH&S items, one of which generates a list of properties with EHS items that were inspected in a certain date range and for a specific HUB and/or PC. Therefore, field staff do not need the REAC Excel file to identify properties that were inspected during a specific timeframe. They can use the existing REMS query capabilities.

In commenting on the oversight of physical inspections, the Report makes no mention of improvements Housing has made, especially in terms of obtaining release dates from REAC to judge more accurately the field office effort in obtaining compliance. Further, the Report makes no reference to monitoring reports which have been formatted so that project managers and supervisors can see what inspections have been released each week, and what remains to be done from prior weeks.

In summary, Housing does not agree with the statement in the Report (Page 11) that suggests that a significant weakness exists in the use of REAC assessments. Housing has more data on the physical condition of its inventory and is utilizing it in a more consistent and effective way than ever in its history. Baseline physical inspection data on the entire multifamily portfolio through HUD's state-of-the-art physical inspection process is nearing completion in March 2000, and Housing has initiated actions to address thousands of identified EHS violations. Moreover, enforcement actions can now be initiated on the small percentage of projects with unacceptable physical inspection scores. For the first time, HUD now knows the physical condition of its multifamily housing portfolio, and is taking action to assure housing quality standards are met.

Housing sets ambitious goals for itself and aggressive standards for owners. To suggest that falling short of full achievement of those goals is a significant weakness invites Housing to set minimal goals for itself and owners, assuring that achievement will be easier. That is not something that Housing wants to do.

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