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| Issue Date 2007-PH-0001 |
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| Audit Report Number January 12, 2007 |
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TO: Brian D. Montgomery, Assistant Secretary for Housing – Federal Housing
Commissioner, H

FROM:  John P. Buck, Regional Inspector General for Audit, Philadelphia Regional
Office, 3AGA

SUBJECT: HUD Controls Prevented Multiple Sales to Owner-Occupant Purchasers but
Did Not Ensure That Owners Occupied Residences as Required

HIGHLIGHTS

What We Audited and Why

We audited the single-family sales to owner-occupant purchasers under the jurisdiction of the U.S. Department of Housing and Urban Development's (HUD) Philadelphia Homeownership Center. We performed the audit at the request of the Homeownership Center's Quality Assurance Division. Our audit objective was to determine whether HUD's policy for single-family home sales to owner-occupant purchasers was followed and adequately monitored.

What We Found

HUD's policy for single-family home sales to owner-occupant purchasers was followed and adequately monitored to prevent multiple purchases by owner-occupant purchasers within a 24-month period. This is because HUD updated its Single Family Accounting Management System to ensure that Social Security numbers of purchasers were entered into the system and monitored to ensure that prospective owners had not purchased a HUD-owned property within the previous 2 years. However, for 15 of 51 owner-occupant purchases (29 percent) we

audited, owner-occupant purchasers did not comply with the 12-month residency requirement. This occurred because HUD did not implement a monitoring process to ensure that purchasers who certified that they would live in a home for 12 months met the residency requirement.

What We Recommend

We recommend that HUD consider eliminating the 12-month requirement by evaluating whether it is needed since enforcement of the requirement may not be practical and violations do not constitute a monetary loss to HUD. If HUD concludes that the 12-month residency requirement is essential, as appropriate, it should monitor compliance and enforce the requirement.

Auditee's Response

We provided the draft report to the Assistant Secretary for Housing – Federal Housing Commissioner on November 9, 2006. We discussed the report with the Deputy Assistant Secretary for Single Family Housing and officials from the Office of Single Family Asset Management on November 28, 2006. Formal written comments to our draft report were received on January 10, 2007. In its response, HUD stated it concurred with the audit report and had implemented the audit recommendations. It had evaluated the need for the 12-month residency requirement and concluded that the requirement should be retained because it supports its mission of promoting homeownership and preserving neighborhoods. However, HUD also concluded that implementing a formal monitoring program was not practical or cost-effective since violations do not constitute a monetary loss to HUD. Rather, HUD stated that the requirement itself serves as an effective deterrent and provides a basis for enforcement actions against violators.

HUD's written reply and actions meet the intent of our recommendations and constitute closeout of approved management decisions in accordance with HUD Handbook 2000.06, REV-3. The complete text of HUD's response can be found in appendix A of this report.

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BACKGROUND AND OBJECTIVES

An integral component of HUD's single-family real estate-owned disposition goals is to reduce the property inventory in a manner that expands homeownership opportunities and strengthens neighborhoods and communities. While both owner-occupant and investor purchasers may acquire HUD-owned properties, HUD designed the sales procedures to enhance owner-occupant purchase opportunities. When management and marketing contractors list HUD properties for sale, they establish an initial 10-day bidding period, which is only open to prospective owner-occupant purchasers. Since 1998, eligibility requirements have included certifying that (1) the buyer has purchased no other HUD-owned property within the last 24 months as an owner-occupant and (2) the property will be occupied as the primary residence for at least 12 months.

The Philadelphia Homeownership Center sold 80,034 HUD properties between August 16, 2001, and February 1, 2006. Approximately 58 percent (46,140) of the properties were sold to owner-occupants, while investors accounted for about 39 percent (30,975) of the sales. About 78 percent of the properties sold to owner-occupants were uninsured. Another 17 percent were sold FHA insured, while direct sales constituted the remaining 5 percent of the properties sold.

The objective of our audit was to determine whether HUD's policy for single-family home sales to owner-occupant purchasers was followed and adequately monitored.

RESULTS OF AUDIT

Finding: HUD Controls Prevented Multiple Sales to Owner-Occupant Purchasers but Did Not Ensure That Owners Occupied Residences as Required

HUD's policy for single-family home sales to owner-occupant purchasers was followed and adequately monitored to prevent prohibited multiple purchases by owner-occupant purchasers within a 24-month period because HUD updated its Single Family Accounting Management System to ensure that Social Security numbers of purchasers were entered into the system and monitored. However, the Philadelphia Homeownership Center did not ensure that owners occupied residences for the required 12-month period in 15 of 51 (29 percent) purchases we reviewed valued at approximately \$1 million. This occurred because HUD did not implement a monitoring process to confirm that purchasers who certified that they would live in the home for 12 months met the residency requirement.

Criteria

HUD Notice H 2003-1 states that HUD's sales procedures are structured to enhance opportunities for owner-occupant purchasers. The notice requires purchasers to certify on an addendum to the sales contract, form HUD-9548-D, that they have not purchased a HUD-owned property within the last 24 months. The notice also requires purchasers to certify on an addendum to the sales contract, form HUD-9548-D, that they will occupy the property as their primary residence for at least 12 months. Both of the requirements were previously contained in Housing Notice 98-7.

HUD's Controls Prevented Multiple Purchases within a 24-Month Period

HUD implemented appropriate system controls to ensure that its policy for single-family home sales to owner-occupant purchasers was properly followed, and it adequately monitored sales to prevent prohibited multiple purchases within a 24-month period.

On June 10, 2002, an audit report concerning single-family sales to owner-occupant purchasers (Audit Report 2002-PH-0002) was published. The audit found that purchasers often failed to comply with the 24-month requirement contained in HUD Notice H 98-7. At that time, HUD did not have an adequate monitoring process in place to prevent multiple purchases from occurring. Based

on the 2002 audit, HUD modified its Single Family Accounting Management System to ensure that Social Security numbers of purchasers were entered into the system, and it began checking Social Security numbers to ensure that the prospective owners had not purchased a HUD-owned property within the previous two years.

These controls have successfully prevented multiple purchases by a single owner within a 24-month period. Using automated audit techniques, we performed a data query on the total universe of 46,086 owner-occupant sales made by the Philadelphia Homeownership Center between August 2001 and January 2006 to determine whether the procedures implemented by HUD prevented multiple purchases within 24 months. No potential violations were found after HUD fully implemented the controls in August 2003.

HUD Did Not Monitor Its 12-Month Residency Requirement

HUD did not have controls in place to ensure that owners occupied residences for the required 12-month period. It had not implemented a monitoring process to ensure that purchasers who certified that they would live in a home for 12 months met the residency requirement.

Our June 10, 2002, audit report (Audit Report 2002-PH-0002) noted that purchasers did not occupy the properties for 12 months as required by HUD Notices H 98-7 and H 2003-1. The June 2002 audit showed that HUD did not have an adequate monitoring process in place to enforce the 12-month residency requirement. HUD responded to that audit by stating that it would use its out-stationed single-family staff to conduct home visits to owner-occupied residences to verify compliance with the requirement. However, Philadelphia Homeownership Center officials informed us that the home visits were not made due to the danger associated with these types of inspections. Further, they stated that management and marketing contractors are not responsible for monitoring or checking the residency requirements for owner-occupants. The Philadelphia Homeownership Center staff acknowledged that they also do not monitor owner-occupant residency requirements.

Owners Did Not Always Comply with the Residency Requirement

For 15 of the 51 cases (29 percent) audited, valued at approximately \$1 million, owner-occupant purchasers did not comply with the 12-month residency requirement. In each case, the owner-occupant purchasers signed a certification

stating that they would reside at the property for at least 12 months. The Philadelphia Homeownership Center had jurisdiction over 46,086 owner-occupant purchases, valued at \$4.3 billion, made from August 16, 2001, through January 31, 2006. We randomly selected and reviewed an attribute sample of 51 of these purchases, valued at \$4 million, to determine compliance with the 12-month residency requirement. We determined that 15 purchasers appeared to have violated the terms of their certifications, based on a review of public records (deed transfers, property searches, person summaries, and person locators), confirmations from postmasters, and phone calls to the subject properties. While our audit provided strong indicators that purchasers violated the 12-month occupancy rule, additional verification, such as home visits previously proposed by the Homeownership Center, would be needed to verify the violations.

Conclusion

HUD's implementation of controls to prevent multiple purchases by a single owner within a 24-month period has eliminated the most serious potential violations, whereby investors posing as owner-occupants purchase multiple properties, and enhanced opportunities for owner-occupant purchasers. However, our audit provided strong indicators that purchasers under the jurisdiction of the Philadelphia Homeownership Center violated the 12-month occupancy rule. Our audit disclosed that:

- 15 of 51 (29 percent) owner-occupant purchasers we reviewed did not comply with the 12-month residency requirement.
- HUD did not have controls in place to ensure that purchasers who certified they would be owner-occupants remained in their residences for the required 12-month period.
- Homeownership Center officials do not believe enforcement of the 12-month residency rule is feasible.
- Violations of the residency requirement do not constitute a monetary loss to HUD.

In addition, HUD cannot control the unexpected circumstances which might compel an owner-occupant to legitimately move out of their residence prior to living there for 12 months (for example: divorce, job loss, necessary relocation, etc.). Consequently, it is our opinion that HUD should evaluate and consider eliminating the 12-month residency requirement. If HUD concludes that the 12-month residency requirement is essential, as appropriate, it should monitor compliance and enforce the requirement.

Recommendations

We recommend that the assistant secretary for housing – federal housing commissioner

- 1A. Evaluate the need for the 12-month residency requirement and consider eliminating it if appropriate.
- 1B. If HUD concludes that the 12-month residency requirements is essential, as appropriate, monitor compliance and enforce the requirement.

SCOPE AND METHODOLOGY

To accomplish our objectives, we

- Used computer-assisted audit techniques to download data from the Single Family Accounting Management System to create a database of owner-occupant and investor sales. We then developed a statistical sampling plan based on the Homeownership Center's selection of a sample of properties to review for data and occupancy validation.
- Reviewed procedures, controls, and documents pertaining to sales of properties to owner-occupants under the Single Family Property Disposition program to validate automated data files.
- Reviewed applicable HUD handbooks and housing notices.
- Conducted interviews with HUD Single Family Homeownership Center personnel and owner-occupants.

In addition, we relied in part on data maintained by HUD in the Single Family Data Warehouse and Single Family Accounting Management System. We did not perform a detailed analysis of the reliability of these programs.

The audit generally covered the period from August 16, 2001, to January 31, 2006. We conducted our fieldwork from February through October 2006.

We performed our review in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Monitoring procedures to prevent multiple purchases by owner-occupant purchasers within a 24-month period.
- Monitoring procedures to ensure that owner-occupant purchasers occupy residences for the required 12-month period.

We assessed the relevant controls identified above.

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

Significant Weaknesses

Based on our review, we believe there are no significant weaknesses.

APPENDIX

Appendix A

AUDITEE COMMENTS



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

JAN 10 2007

MEMORANDUM FOR: John P. Buck, Regional Inspector General for Audit, Philadelphia
Regional Office, 3AGA

FROM: Brian D. Montgomery, Assistant Secretary for Housing-Federal
Housing Commissioner, H

SUBJECT: OIG Audit-HUD Controls Prevented Multiple Sales to Owner-
Occupant Purchasers but Did Not Ensure That Owners Occupied
Residences as Required

Thank you for the opportunity to respond to the draft report provided to us on November 9, 2006 and to the revised language agreed upon in a meeting held on November 28, 2006 with the Deputy Assistant Secretary for Single Family Housing and managers and staff from the Office of Single Family Asset Management. The following is the Office of Housing's response to the recommendations made in the draft report and your email message of November 29, 2006.

1.A. Evaluate the need for the 12-month residency requirement and consider eliminating it if appropriate.

We have evaluated the need for the 12-month residency requirement and determined that it, coupled with execution of an owner-occupant certification, directly supports HUD's purpose by establishing a written commitment to homeownership on the part of purchasers.

The purpose of HUD's property disposition program as defined at 24 CFR 291.1(b) is to expand homeownership opportunities and strengthen neighborhoods and communities. HUD provides a preference period for owner-occupant purchasers as a means of encouraging sales to owner-occupants. Individuals who purchase during the preference period are required to sign a certification that they intend to occupy the property as a primary residence for a period of 12 months following closing.

HUD concurs with the conclusion in the OIG audit that on-going monitoring of the 12-month residency requirement may be impractical. However, we believe that with or without a formal monitoring protocol, the requirement is an effective deterrent, which discourages investors from bidding improperly and directs more homes to owner-occupants in furtherance of HUD's purpose. Additionally, the occupancy requirement and certification are essential because they provide a mechanism for enforcement when policy violations are identified.

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1.B. If HUD concludes that the 12-month residency requirement is essential, monitor compliance and enforce the requirement as appropriate.

Monitoring

The Office of Single Family Asset Management reviewed options for establishing a formal monitoring program for owner-occupancy. Housing concluded that there was no cost benefit to HUD since the Department incurs no financial loss as a result of violations of this rule. Further, it is unlikely that Housing will have budget funding of \$1 million, the estimated cost for a contract modification to conduct the monitoring activity. As discussed below, potential violators are referred to OIG for further investigation and possible enforcement action.

Enforcement

HUD currently employs a number of methods for enforcing compliance with the owner-occupancy requirement. HOC staff members respond to complaints about potential violations received from members of the public, M&M contractors, local listing brokers or other program participants and then attempt to verify occupancy using one or more of the following methods:

- Direct contact with the purchasers through occupancy verification letters or phone calls,
- Address verification through the post office
- Data base searches of deed transfers or multiple listings entries
- Drive by observation

If the complaint is validated, the case is referred to OIG for pursuit of penalty or sanction.

As indicated by the OIG in its audit report, enforcement against individual violators is generally not pursued, as the potential return is limited to \$6,500 in civil money penalties. Further, establishing "intent" to defraud the government is difficult in individual cases. However, Housing routinely makes referrals to the OIG and OIG investigations have resulted in successful prosecutions.

Summary

HUD has determined that the 12-month occupancy requirement supports the Department's mission of promoting homeownership and preserving neighborhoods and should be retained. HUD has also determined that the cost of implementing a formal monitoring program for owner-occupant purchases outweighs the limited benefits that would be derived from such a program but that the requirement itself serves as an effective deterrent and provides a basis for enforcement actions against violators. Further, the Department has taken recent steps to strengthen its enforcement effectiveness through publication of a Disciplinary Actions Against HUD-Qualified Real Estate Brokers rule and by strengthening the language of its Sales Contract with respect to the owner-occupancy and broker certifications. Finally, the Department will continue to aggressively pursue enforcement against violators.

Attachments