TO: Dominique G. Blom, Deputy Assistant Secretary for Public Housing
Investments, PI

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

SUBJECT: The Office of Public and Indian Housing Is Taking Action to Oversee the
Section 202 Mandatory Conversion Program

HIGHLIGHTS

What We Audited and Why

We reviewed the U. S. Department of Housing and Urban Development's (HUD) Office of Public and Indian Housing’s oversight of public housing authorities compliance with the mandatory conversion of low-income housing units to the Section 8 Housing Choice Voucher program. We initiated the review based on our 2006 annual audit plan and our strategic plan to help HUD improve the execution of its fiscal responsibilities. The objective was to determine whether HUD had adequate oversight to ensure that Section 202 of the Omnibus Consolidated Rescissions and Appropriations Act of 1996 (Section 202) was followed by public housing authorities regarding the mandatory conversion of low-income housing units.

What We Found

Since March 2003, housing authorities were generally successful in complying with the mandatory conversion of low-income housing units to the Section 8 Housing Choice Voucher program. We reviewed all 28 public housing developments in HUD’s Region V that were subject to the mandatory conversion requirements to determine whether they were following Section 202 and 24 CFR [Code of Federal Regulations] Part 971. Except for the Detroit Housing Commission’s (Commission) Fredrick Douglass development, all developments
had either completed or were in the process of meeting the mandatory conversion requirements.

HUD approved the partial demolition of the Fredrick Douglass development in July 2001 based in part on its high vacancy rate. As of March 22, 2006, partial demolition had occurred; however, the development was still not meeting the mandatory conversion requirements and it had a vacancy rate of 43 percent.

The Office of Public and Indian Housing agreed to strengthen its procedures and controls to ensure that all public housing authorities comply with the mandatory conversion requirements. It also agreed to ensure that the Commission complies with the mandatory conversion requirements regarding the Frederick Douglass development.

**What We Recommend**

We recommend that the deputy assistant secretary for public housing investments implement additional procedures and controls to ensure that all public housing authorities comply with Section 202 and HUD’s regulations regarding the mandatory conversion of low-income housing units. We also recommend that the acting deputy assistant secretary initiate appropriate action to ensure that the Frederick Douglass development complies with Section 202’s requirements and HUD’s regulations regarding mandatory conversion.

**Auditee’s Response**

We provided our discussion draft audit report to the deputy assistant secretary for public housing investments and HUD’s staff during the review. We held an exit conference with the deputy assistant secretary on June 26, 2006.

We asked the deputy assistant secretary for public housing investments to provide written comments on our discussion draft audit report by July 12, 2006. She provided written comments with a proposed management decision dated July 11, 2006, regarding the recommendations included in this report. A management decision has been reached and the appropriate entries to HUD’s audit resolution and controlled actions tracking system will be made upon report issuance. The complete text of the written comments can be found in appendix A of this report.
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**BACKGROUND AND OBJECTIVE**

**Section 202 Mandatory Conversion Program.** The U.S. Department of Housing and Urban Development’s (HUD) Office of Public and Indian Housing issued a notice in the *Federal Register* dated September 26, 1996, implementing Section 202 of the Omnibus Consolidated Rescissions and Appropriations Act of 1996 (Section 202). The notice required public housing authorities to identify distressed public housing developments that cost more than Section 8 rental assistance and could not be reasonably revitalized. Affected low-income households of public housing developments would be offered Section 8 tenant-based or project-based assistance and would be relocated. Distressed public housing developments or affected buildings for which no reasonable means of revitalization existed would be removed from HUD’s public housing inventory.

The public housing developments that were subject to Section 202 must have been on the same or contiguous sites, must have been more expensive than Section 8 tenant-based assistance, could not have been revitalized through reasonable programs, and must have had 300 or more dwelling units and had a vacancy rate of at least 10 percent for dwelling units not in funded on-schedule modernization programs.

Section 202 requires that a public housing development’s cost of operations be analyzed to determine whether it is more expensive to renovate and operate the low-income housing units than it is to provide Section 8 assistance to current residents or relocate them to other available developments. For a public housing development for which revitalization is deemed the more expensive option, additional analysis is undertaken to assess its long-term viability if revitalized. Under current definitions, viability includes achieving structural/system soundness and full occupancy. These factors, along with an analysis of market support, must be considered to establish the appropriate long-range plan for the use or reuse of a public housing development. Low-income housing units that do not pass the tests involved in this analysis and that cannot be revitalized through reasonable programs are required by Section 202 to be removed from HUD’s public housing inventory.

Section 202 is a continuing requirement. It provides HUD the authority to ensure that certain distressed public housing developments are properly identified and removed from the inventory. HUD may take appropriate actions to ensure the removal of developments from the inventory when a public housing authority has failed to adequately develop or implement a plan to do so.

Section 537 of the Quality Housing and Work Responsibility Act of 1998 (Section 537) repealed Section 202. Although Section 202 was repealed, developments identified by public housing authorities or by HUD, before the enactment of Section 537 for conversion or for assessment of whether such conversion is required, continue to be subject to the requirements of Section 202 and 24 CFR [*Code of Federal Regulations*] Part 971 until such requirements are satisfied.

Our objective was to determine whether HUD had adequate oversight to ensure that Section 202 was followed by public housing authorities regarding the mandatory conversion of low-income housing units.
RESULTS OF AUDIT

Finding: HUD Is Taking Action to Oversee the Section 202 Mandatory Conversion Program

The Office of Public and Indian Housing agreed to establish and implement additional monitoring procedures and controls to ensure that all public housing authorities comply with the requirements of Section 202 and HUD’s regulations. It also agreed to ensure that the Detroit Housing Commission (Commission) complies with the mandatory conversion requirements regarding the Frederick Douglass development.

Section 202 was approved on April 26, 1996. In 1999, HUD initially identified 222 developments subject to Section 202’s requirements. They included 29 developments for eight public housing authorities in HUD’s Region V (states of Illinois, Indiana, Michigan, Minnesota, Ohio, and Wisconsin). It was determined that one development was not subject to Section 202’s requirements because the vacancy rate was less than the program’s threshold of 10 percent. The remaining 28 developments have been demolished, had units demolished and modernization work done, have demolition in process, or have approved plans. Only the Commission’s Frederick Douglass development failed to meet Section 202’s requirements regarding mandatory conversion.

In 1997, HUD’s consultant recommended that the Frederick Douglass development’s six high-rise towers be demolished. This recommendation was based upon the consultant’s analysis of the market, the physical design and condition of the development’s towers, and the likelihood that the towers could achieve the goals of Section 202. The Commission wanted to maintain all six high-rise towers and held meetings and corresponded with HUD’s Office of Public and Indian Housing’s Office of Policy, Programs, and Legislative Initiatives in an effort to determine the disposition of the high-rise towers. In July 2001, HUD approved the demolition of two towers at the Frederick Douglass development and the Commission’s plans to use the site for the construction of a community center and recreational green space for the use of the remaining residents at the development. HUD concurred with the Commission’s determination that the partial demolition will help ensure the viability of the remaining portion of the development.

According to Section 202, a development is deemed viable in the long term if, after reasonable investment, it (1) can sustain structural/system soundness and full
occupancy, (2) will not be densely configured relative to similar housing in the community, (3) will not constitute an excessive concentration of very low-income families, and (4) has no detrimental site impairments. The development must meet these requirements for a minimum of 20 years, or 30 years if it has undergone rehabilitation equivalent to new construction.

The Frederick Douglass development had a 43 percent vacancy rate as of March 2006 and was not viable. According to 24 CFR [Code of Federal Regulations] 971.13, HUD has the authority to take appropriate actions to ensure the removal of developments from the inventory when a public housing authority has failed to adequately develop or implement a plan to do so. The Commission failed to make the Frederick Douglass development viable and, in this instance HUD did not oversee the Frederick Douglass development to note that the development had a high vacancy rate.

Since March 2003, HUD’s Office of Public and Indian Housing has not provided adequate oversight of the Section 202 mandatory conversion program. HUD’s deputy assistant secretary for policy, programs, and legislative initiatives said that her office never provided oversight to ensure that public housing authorities complied with Section 202 or 24 CFR [Code of Federal Regulations] Part 971 regarding mandatory conversion of low-income housing units. Effective May 8, 2006, HUD’s assistant secretary for public and Indian housing assigned oversight of the Section 202 mandatory conversion program to the Office of Public and Indian Housing’s Office of Public Housing Investments.

The Office of Public and Indian Housing’s deputy assistant secretary for public housing investments agreed on June 1, 2006, to implement procedures and controls to provide additional oversight to ensure public housing authorities comply with the mandatory conversion requirements. The deputy assistant secretary also agreed to ensure that the Commission complies with the mandatory conversion requirements regarding the Frederick Douglass development.

**Recommendations**

We recommend that HUD’s deputy assistant secretary for public housing investments

1A. Implement additional procedures and controls to ensure that public housing authorities comply with Section 202 and HUD’s regulations regarding the mandatory conversion of low-income housing units.

1B. Initiate appropriate action to ensure that the Frederick Douglass development complies with the Section 202’s requirements and HUD’s regulations regarding mandatory conversion.
SCOPE AND METHODOLOGY

To achieve our audit objective, we

- Reviewed Sections 202 and 537;
- Interviewed current and former staff from HUD’s Office of Policy, Programs, and Legislative Initiatives; the Special Applications Center; field Offices of Public Housing; and public housing authorities; and

The review covered the period from October 1, 2004, through December 31, 2005. This period was adjusted as necessary. 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,
- Compliance with applicable laws and regulations, and
- Safeguarding resources.

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

Relevant Internal Controls

We determined the following internal controls were relevant to our objective:

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

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization’s objectives. We noted no significant weaknesses in HUD’s Office of Public and Indian Housing’s current internal controls.
APPENDIXES

Appendix A

AUDITEE COMMENTS

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-3000

OFFICE OF PUBLIC AND INDIAN HOUSING

JUL 11 2006

MEMORANDUM FOR: Heath Wolfe, Regional Inspector General for Audit, 5AGA

FROM: Dominique Blunt, Deputy Assistant Secretary, Office of Public Housing
Investments, PI

SUBJECT: Response to Discussion Draft Audit Report – Internal Audit Office of Public and
Indian Housing’s Oversight of PHA Compliance with Section 202 Mandatory
Conversion

The following is our written comments on the recommendations related to the Draft Audit
wherein you recommend HUD’s Acting Deputy Assistant Secretary for Public Housing
Investments:

Recommendation A, 1. Implement adequate procedures and controls to ensure PHAs comply
the requirements of Section 202 of the Omnibus Consolidated Rescissions and Appropriations
Act of 1995 and HUD’s regulation.

Action Completed, 1. The Office of Public and Indian Housing in general and the Office of
Public Housing Investments in particular have established and implemented adequate procedures
and controls to monitor and provide oversight to ensure PHAs comply with the requirements of
Section 202 and HUD’s regulations.

Section 202, codified in 24 CFR Part 971, was administered through the Office of Policy,
Programs and Legislative Initiatives. The successor program to Section 202, with requirements
found at 24 CFR Part 972, Conversion of Tenant-Based Housing to Tenant-Based Assistance,
became effective on April 20, 2006. This program is administered by the Special Applications
Center (SAC) in Chicago. The responsibility for the Section 202 program was recently
transferred from the Office of Policy, Programs and Legislative Initiatives to the Office of Public
Housing Investments, and is also now administered through the SAC. Actions undertaken to
establish and implement adequate controls, then include the following:

1. The Assistant Secretary for PHA, on May 8, 2006, officially transferred programmatic
responsibilities to the Deputy Assistant Secretary for Public Housing Investments
(OPHI), Special Applications Center (SAC);

2. All applicable records located in HUD Headquarters have been prepared, packaged and
shipped to the SAC for their utilization and retention;

3. The SAC will modify its web site to include Section 202 instructions and information;

4. Training by both current and former coordinators of the Section 202 has been coordinated with individuals working in the SAC; and

5. The SAC will assume responsibility for closing out the Section 202 program, including ensuring compliance with its requirements. PHAs that failed to comply with the Section 202 requirements found in 24 CFR 971 will be fully subject to the requirements of 972.

SAC Timetable for 202 Program Implementation

Notify field Operations of the change in responsibility, and alert them that the Field Offices will be expected to provide input on closing the program out expeditiously. TARGET – July 30, 2006

Modify Website TARGET – Aug 30, 2006

Analysis of approved Section 202 files
- Review approval documents and verify that the applications are currently reflected in PIC
- Compare actual progress to that in the approved implementation schedule
- Initial notification of discrepancies to HA/Field Office. TARGET – September 30, 2006

Track approved 202 to completion
- Monitor unit removals through PIC for compliance with agreed upon schedule
- Report on progress to DAS for OPHI quarterly STARTING December 30, 2006

PHI requests concurrence with management decision pending final action: PHI concurs with the Recommendation A and requests, since adequate procedures and controls have been implemented, that the recommendation be closed as resolved.

The following is our written comments on the recommendation related to the Draft Audit wherein you recommend HUD’s Acting Deputy Assistant Secretary for Public Housing Investments:

Recommendation B. – Initiates appropriate action to ensure that the Detroit Housing Commission’s Frederick Douglas development complies with the Section 202 requirements.

Action Currently in Progress - HUD took over receivership of the Detroit Housing Commission (DHC) and is in the process of ensuring all housing units subject to the Consolidated Annual Contributions Contract are in compliance with HUD regulations. The DHC is a June 30 Fiscal Year End housing authority, and will be expected to comply with the required conversion regulations as spelled out in 24 CFR 972 when it submits its Housing Authority Plan in 2007.

SAC is working on refining its software to determine conversion candidates in anticipation of being ready for those housing authority’s which must address their candidate status beginning in
April 2007. Initial runs of the program have shown that the Frederick Douglas and Jefferies developments are both conversion candidates. This information has been shared with the Detroit HUD staff as part of a unit removal training present by the SAC management on June 15, 2006. HUD will issue specific instructions to the Receiver to ensure this compliance with respect to the Section 202 program on September 15, 2006. Even though the Receiver is a HUD employee, and supporting staff are HUD employees and contractors, HUD will ensure that the Detroit Housing Commission and its Frederick Douglas development are knowledgeable of, and comply with, applicable requirements.

**PIH requests concurrence with management decision pending final action:** PIH agrees with the recommendation and requests a final action target date of December 31, 2009, to ensure actions have been completed in accordance with the recommendation.

We appreciate your consideration of our request to close draft recommendation A as being resolved and provide a Final Action Target date of December 31, 2009, for recommendation B.
Appendix B

FEDERAL REQUIREMENTS

HUD’s regulations at 24 CFR [Code of Federal Regulations] 971.3(d) state that public housing authorities will meet the test for assuring long-term viability of identified housing only if it is probable that, after reasonable investment for at least 20 years (or at least 30 years for rehabilitation equivalent to new construction) the development can sustain structure/system soundness and full occupancy, will not be excessively densely configured to standards for similar housing in the community, will not constitute an excessive concentration of very low-income families, and has no other site impairments which clearly should disqualify the site from continuation as public housing.

HUD’s regulations at 24 CFR [Code of Federal Regulations] 971.7(a) state that Section 202 is a continuing requirement and the secretary will establish timeframes for submission of necessary information annually through publication of a Federal Register notice.

HUD’s regulations at 24 CFR [Code of Federal Regulations] 971.13 state that Section 202 provides HUD the authority to ensure that certain distressed developments are properly identified and removed from public housing authorities’ inventories. HUD may take appropriate actions to ensure the removal of developments from the inventory when a public housing authority has failed to adequately develop or implement a plan to do so.