



Issue Date	October 25, 1996
Audit Case Number	97-SE-111-0001

TO: Diana Goodwin Shavey, Director, Office of Housing, 0AH

FROM: A. George Tilley, District Inspector General for Audit, 0AGA

SUBJECT: Section 8 Rent Recoveries
Alpine Ridge Litigation
Seattle Office of Housing

We audited the Seattle Office of Housing's recovery of past overpayments made to Section 8 project owners. We wanted to understand the history of the Alpine Ridge litigation and the process used to obtain recovery of overpayments; to evaluate the calculations of the overpayments; and to determine whether HUD is collecting what is authorized under court orders.

Our report contains three findings. These findings disclose that the Office of Housing has calculated overpayments of \$3.8 million to be collected and has waived interest in exchange for repayment terms not included in the court order authorizing collection of overpayments. Second, Housing misapplied a local Annual Adjustment Factor to past rent increases, resulting in up to \$3.7 million in excessive Housing Assistance Payments to Section 8 project owners. Finally, Housing has not attempted collection of overpayments in one case where an owner sold its project during the Alpine Ridge litigation.

This report is limited to our field work in the Seattle Office of Housing. We also intend to do reviews at other offices that are recovering overpayments made to Section 8 owners. During our review, we will evaluate their calculations of overpayments and collection activity.

Within 60 days, please give us a status report for each recommendation in the 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 review.

Should you or your staff have any questions, please contact me or Wayne Rivers at (206) 220-5360.

(THIS PAGE INTENTIONALLY LEFT BLANK)

Executive Summary

We audited the Seattle Office of Housing's recovery of past overpayments made to Section 8 project owners. We performed the audit to obtain assurance that Housing has properly calculated the overpayments and is collecting all that is due. These overpayments occurred due to litigation commonly referred to as "Alpine Ridge". In 1993, the Supreme Court overturned lower court decisions on Alpine Ridge, which resulted in vacated court orders that had required HUD to pay higher rents. As a result, the lower courts authorized HUD to collect these past overpayments by offsetting future Section 8 payments to the owners.

Housing has calculated and is collecting \$3.8 million of overpayments from plaintiffs.

We reviewed the Seattle Office of Housing's (Housing's) calculations of overpayments due to HUD from Section 8 project owners involved in litigation against HUD (*Alpine Ridge, et. al. v. HUD*). We did this by comparing Housing's calculation process to Headquarters instructions and the court order allowing HUD to collect past overpayments. Our recalculations of the total amount due and Housing's calculations differed for 17 of the 20 total projects. We discussed the significant differences for 15 of these 17 projects with Housing staff and agreed on changes. The differences, both positive and negative, total about \$370,000.

In determining the amount due under the court order, Housing followed Headquarters instructions which were silent on interest. However, the Director of Housing required owners to follow additional repayment terms in exchange for waiving interest that HUD was entitled to collect. Housing used the ability to charge interest to encourage owners to accept repayment terms not provided for in the court order. The Director of Housing believed waiving interest in favor of accelerated repayment terms was in the best interest of the Government. Still, interest will be charged if owners do not accept the revised repayment terms.

Housing also pursued recovery of overpayments made to owners who billed at higher rates while the Alpine Ridge lawsuit was pending. These overpayments not subject to the court order were included in Housing's calculations of the amount due.

Housing applied a local Annual Adjustment Factor (AAF) for a two year period. This application did not agree with the

Housing overpaid housing assistance when it applied a local factor twice rather than once as approved.

former Regional Administrator's initial approval, which specified a twelve-month period. Housing staff stated they did this due to an appeal from a project owner and in accordance with guidance from HUD Headquarters. As a result, about 61 project owners in the Seattle Primary Metropolitan Statistical Area (PMSA) received the benefit of a twice-applied high local AAF. These owners received up to \$3.7 million in excessive Housing Assistance Payments (HAPs). The rents at these projects continue to reflect the application of the high local AAF and HUD continues to pay about \$57,500 in excessive HAPs per month. This misapplication occurred because Housing obtained guidance from HUD staff not involved in the original decision and did not consult the staff who were involved.

Housing has not attempted to collect overpayments on an Alpine Ridge project that was sold.

Housing has not attempted to collect overpayments on a project that was sold during Alpine Ridge litigation although it has a statutory obligation to do so. Through discussions with Headquarters, Housing decided to not pursue collection because the project was sold to a public housing authority (a non-profit entity) which was not a party to the Alpine Ridge lawsuit. As a result, HUD has not collected \$21,651 in overpayments from either the previous or current owner.

We held an exit conference with the Director of Housing for the Seattle Office on July 26, 1996. We provided the Director with draft findings for written comments on September 16, 1996. We received the written comments on October 3, 1996. The Director generally agreed with our findings and conclusions. We evaluated her comments, incorporated the comments into the findings, and revised the recommendations as we considered appropriate. A copy of the comments is included as Appendix A.

Table of Contents

Management Memorandum	i
-----------------------	---

Executive Summary	iii
-------------------	-----

Introduction	1
--------------	---

Findings

1	Housing Has Calculated and is Collecting Overpayments from Plaintiffs	5
2	Housing Overpaid Housing Assistance When it Applied a Local Factor Twice Rather Than Once, As Approved.	9
3	Housing Has Not Attempted To Collect Overpayments on an Alpine Ridge Project That Was Sold.	15

Appendices

A	Auditee Comments	19
B	Distribution	20

Abbreviations

HUD	U.S. Department of Housing and Urban Development
HAP	Housing Assistance Payments
AAF	Annual Adjustment Factor

PMSA Primary Metropolitan Statistical Area

Introduction

In order to assist low income persons in the housing market, HUD has entered into Housing Assistance Payments (HAP) contracts with multifamily housing owners. Under these HAP contracts, HUD pays the difference between the contract rent agreed to and the residents' rent contribution (this difference is referred to as a Section 8 payment). There are two methods of adjusting rents. HAP contracts provide for adjustments of the contract rent to either reflect increases in market rents in the area (through Annual Adjustment Factors or AAFs) or to reflect increases in project expenses (budget-based). Generally, Section 1.9(b) of each AAF HAP contract states that contract rents shall be adjusted by applying the applicable AAF most recently published. Section 1.9(d) generally states that such adjustments shall not result in material differences between the rents charged for assisted and comparable unassisted units. This has been interpreted by HUD to mean rents charged should not be substantially different than rents for comparable unassisted units.

Legal arguments on AAF HAP contracts favored owners until a Supreme Court ruling in May 1993.

Sections 1.9(b) and 1.9(d) of the HAP contracts and the issue of comparability have been the source of disputes and legal arguments between owners and HUD. Owners have maintained that the contracts entitle them to annual rent adjustments based on applications of AAFs. Meanwhile, HUD has maintained that it has the right to conduct rent comparability studies and limit rent adjustments based on market surveys.

In 1988, the Ninth Circuit ruled under *Rainier View Associates v. United States* that the HAP contracts require HUD to apply AAFs in adjusting rents, without limitations. HUD appealed this ruling to the Supreme Court, which declined to hear the case. The Ninth Circuit ruling resulted in different requirements for rent adjustments across the nation. Partly in response to this ruling and to obtain conformity in the rent adjustment process, HUD promoted and Congress passed Section 801 of the Housing and Urban Development Reform Act of 1989 (Section 801). Section 801 explicitly authorized HUD to limit rents based on comparability studies and required HUD to provide owners who did not receive "full AAF rent increases" a partial retroactive remedy for lost rent attributable to HUD's comparability studies.

In response to Section 801, a group of owners (Alpine Ridge plaintiffs) filed a suit (*Alpine Ridge, et. al. v. HUD*) alleging

that Section 801 was unconstitutional because it impaired the owners' rights to due process. The Alpine Ridge plaintiffs contended that they had a vested contractual right to rent adjustments based on AAFs, which Section 801 impaired without due process. On

September 19, 1990, the US District Court for the Western District of Washington ruled for the owners, stating that the HAP contracts clearly do give the owners rights to AAF rent adjustments and Section 801 is unconstitutional because it violates the owners' due process rights.

Through this court decision and subsequent injunctions issued on April 16, 1991, and April 17, 1992, the District Court ordered HUD to make payments to the Alpine Ridge plaintiffs. The court ordered HUD to

- set rents at the levels that would have resulted if all past rent adjustments were based on AAFs;
- pay the Alpine Ridge plaintiffs all rents wrongfully withheld from September 20, 1990, forward; and
- make all prospective rent increases based on full AAFs.

HUD complied with these court orders, but appealed the decision to higher courts. The US Court of Appeals for the Ninth Circuit upheld the US District Court's decision on February 7, 1992. The US Supreme Court heard the case and unanimously reversed the Ninth Circuit Court of Appeals' decision on May 3, 1993. The Supreme Court did not consider the constitutional issue, since it ruled that owners have no right to AAF based rent adjustments and Section 1.9(d) of the HAP contracts imposes an overall limitation on rent increases, giving the government the ability to limit rents that materially exceed comparable unassisted units. In this ruling the Supreme Court essentially ruled that the Rainier View decision was also incorrect. For the first time, HUD won a lawsuit on a national level which confirmed that it has the right to limit rents that materially exceed comparable unassisted units through the use of market surveys.

Due to the Supreme Court's ruling, the Ninth Circuit Court of Appeals vacated its opinion on June 25, 1993, and the US District Court for the Western District of Washington vacated its earlier court orders on October 8, 1993. In its vacated injunctions, the court concluded that HUD "shall be allowed

to recover payments made pursuant to [the court orders] with interest through the use of set-offs against future payments to plaintiffs.” The court concluded that the Alpine Ridge plaintiffs should pay HUD interest from the date on which they received the payments, with the general objective of restoring HUD to the financial position it occupied before the judgments.

HUD is collecting Section 8 overpayments.

As a result of the vacated injunctions, HUD Headquarters developed and distributed to the field a methodology for recovering the past court-ordered payments. Seven HUD field offices were affected by the courts’ rulings on Alpine Ridge and are responsible for calculating and collecting the overpayments. By office, the number of projects identified for repayment purposes are:

<u>Northwest/Alaska</u>		<u>Pacific/Hawaii</u>		<u>Rocky Mountains</u>	
Seattle	20	Los Angeles	11	Denver	15
Anchorage	2	Sacramento	6		
		San Francisco	5		
		Phoenix	1		

Based on each field office’s initial calculations, the Alpine Ridge plaintiffs for these 60 projects received about \$9.2 million in overpayments.

Audit Objectives

The objectives of our audit were to:

1. Understand the history of litigation and the process used to obtain recovery of overpayments made to Alpine Ridge plaintiffs;
2. Evaluate the Seattle Office of Housing's calculations of the overpayments to collect from the plaintiffs; and
3. Determine whether the Seattle Office of Housing is collecting what is authorized under the court order.

Audit Objectives, Scope and Methodology

To accomplish our objectives, we reviewed correspondence, legal documents, reports, and other documentation on the Alpine Ridge litigation. We interviewed Housing staff responsible for performing the calculations and HUD staff in other Offices of Housing affected by Alpine Ridge litigation. We reviewed and used information in Housing files to

recalculate amounts due. This audit report is limited to our field work (recalculations) in the Seattle Office of Housing.

Audit Period

Our audit covered the period January 1, 1987, to April 30, 1996. It focused on the court decisions for Alpine Ridge, which began in 1990. We performed our field work between March and July 1996.

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

HOUSING HAS CALCULATED AND IS COLLECTING OVERPAYMENTS FROM PLAINTIFFS

We reviewed the Seattle Office of Housing's (Housing's) calculations of overpayments due to HUD from Section 8 owners involved in litigation against HUD (*Alpine Ridge, et. al. v. HUD*). We did this by comparing Housing's calculation process to Headquarters instructions and the court order allowing HUD to collect past overpayments. Our recalculations of the total amount due and Housing's calculations differed for 17 of the 20 total projects. We discussed the significant differences for 15 of these 17 projects with Housing staff and agreed on changes. (The differences for the other two projects totaled \$1,236 and were not significant.) The differences, both positive and negative, total about \$370,000.

In determining the amount due under the court order, Housing followed Headquarters instructions which were silent on interest. However, the Director of Housing also required owners to follow additional repayment terms in exchange for waiving interest that HUD was entitled to collect. Housing used the ability to charge interest to encourage owners to accept repayment terms not provided for in the court order. The Director of Housing believed waiving the interest in favor of accelerated repayment terms was in the best interest of the Government. Still, interest will be charged if owners do not accept the revised repayment terms.

Housing also pursued overpayments resulting from owners who billed at higher rates while the Alpine Ridge lawsuit was pending. These overpayments not subject to the court order were included in Housing's calculations of the amount due.

Our review found differences in calculations.

On April 14, 1994, the former Director of the Planning and Procedures Division in HUD Headquarters issued instructions on the calculation and collection of overpayments. The memorandum instructed the Directors of Housing to calculate overpaid rents from July 1, 1991, to June 30, 1994, and add this to the lump sum payment ordered by the court (covering the period September 20, 1990, through June 30, 1991). Housing started implementing these instructions in 1995, notifying plaintiffs in December 1995 of the overpayments due HUD. We used these instructions and Housing's methodology to perform the calculations and found differences, both positive and negative, due to discrepancies in the data Housing used.

We discussed the differences with the Housing staff responsible for the calculations and agreed on revised

Headquarters instructions to the Office of Housing addressed calculation of overpayment, but not interest.

calculations. Housing officials have agreed to correct these differences and notify plaintiffs of the differences in the overpayments due. Housing is making about \$370,000 in adjustments.

The Office of Housing followed Headquarters instructions and did not pursue interest collection although allowed to do so by court order. Headquarters instructions were silent on how or whether to calculate or collect interest. However, the Director of Housing decided to use the court-allowed ability to charge interest as an incentive to encourage owners to follow repayment methods in addition to the method authorized by the court order.

In its decision of October 8, 1993, the U.S. District Court for the Western District of Washington (District Court) stated that HUD shall be allowed to recover (from the plaintiffs) overpayments with interest through the use of offsets against future payments to the plaintiffs. The District Court ordered this under the principle that HUD should be restored to the financial position which it occupied before the judgment.

In December 1995, Housing notified owners of the amounts due HUD. The notifications contained the following sentence:

"Please note that although the [court] order provides for an assessment of interest charges by HUD, the Department has decided to waive the interest provided that you adhere to the repayment terms cited herein."

The repayment terms cited included requirements to: pay HUD surplus cash and a portion of the Replacement Reserves account at fiscal year end; apply one-half of future rent increases to the debt; and offset future Section 8 payments.

Interest was allowed under the court order, but was not included in Headquarters instructions. Therefore, when the Director of Housing included the above statement, she required owners to follow additional repayment terms as a condition of the "interest waiver". As of August 31, 1996, the Seattle HUD office has collected \$867,769 in overpayments. This amount includes \$292,790 (or 34 percent) collected through the use of Section 8 offsets (the method authorized by

the court order) and \$574,979 (or 66 percent) collected through other methods.

Housing has pursued collection of overpayments made while the lawsuit was pending.

In the April 14, 1994 instructions on the calculation and collection of overpayments, the former Director of the Planning and Procedures Division did not address overpayments made prior to September 20, 1990. By strictly following these instructions, Housing would have not collected any overpayments prior to the original ruling.

In the Seattle Field Office, some owners disagreed with rents HUD set. These owners billed using rent levels higher than the rents approved by HUD from 1987 through 1990, and were allowed to do so. Due to instructions from the Office of General Counsel, Housing had sent letters to these owners, stating that, due to the pending Alpine Ridge litigation, they were authorized to continue billing for higher rents until notified that such action was no longer permitted.

In addition, on May 27, 1994, the same Director of the Planning and Procedures Division issued a memorandum to the Director of Housing in Seattle. He stated that, if Housing had allowed owners to bill at a higher rent while the lawsuit was pending, the higher rents would be assumed to be the entitled rents.

Beginning in September 1994, the Director of Housing started to discuss this issue with Headquarters. She questioned if HUD could reduce rents to the entitled level where owners billed at a higher rent than was approved on rent schedules and (unexecuted) HAP contracts.

In October 1995, after several meetings and e-mail correspondences, the Director of Housing notified Headquarters she was waiving the instructions in the May 27, 1994 memorandum. She stated the instructions in that memorandum were not regulatory, statutory, or required by the settlement agreement. With this action, Housing then started performing the calculations of overpayments to collect.

Conclusion

The Seattle Office of Housing's calculations of overpayments differed from our calculations, did not include interest as allowed by the court order, and included overpayments made while the lawsuit was pending. After discussing our

calculations, Housing agreed to adjustments totaling \$370,000. These calculations did not include interest which the Director of Housing provisionally waived to encourage faster repayments. However, Housing has indicated that they will impose interest if plaintiffs do not follow the specified repayment terms. We expect Housing to charge interest to any plaintiff that does not comply with the repayment terms specified.

Auditee Comments

Housing agreed with the finding and noted they have already begun to collect repayments and several owners have repaid their debts in full. They also noted they have notified at least one owner that they reserve the right to charge interest if the owner does not comply with the repayment agreement terms.

OIG Evaluation of
Auditee Comments

We noted that Housing told **all** owners that interest would be waived provided that the owners adhered to the repayment terms. These repayment terms included specific actions. For example, as part of the repayment terms, some owners were to pay surplus cash to HUD by March 30, 1996. We believe these are the repayment terms Housing should be evaluating compliance with when deciding whether to charge interest.

Recommendation

We recommend that you:

- 1A. Charge interest for any plaintiff that has not complied with repayment terms in the December 1995 notification.
- 1B. Provide evidence that the adjustments in the calculations have been completed and communicated to owners.

HOUSING OVERPAID HOUSING ASSISTANCE WHEN IT APPLIED A LOCAL FACTOR TWICE RATHER THAN ONCE, AS APPROVED

The Office of Housing applied a local Annual Adjustment Factor (AAF) for a two-year period. This application did not comply with the former Regional Administrator's initial approval, which specified a twelve-month period. Housing staff stated they did this due to an appeal from a project owner and in accordance with guidance from HUD Headquarters. As a result, about 61 project owners in the Seattle Primary Metropolitan Statistical Area (PMSA) received the benefit of a twice-applied high local AAF. These owners received up to \$3.7 million in excessive Housing Assistance Payments (HAPs). The rents at these projects continue to reflect the application of the high local AAF and HUD continues to pay about \$57,500 in excessive HAPs per month. This misapplication occurred because, in response to an owner's appeal, Housing obtained guidance from HUD Headquarters staff not involved in the original decision and did not consult the local staff who were involved.

HUD requirements allow for adjusting AAFs.

HUD regulations at 24 CFR 888.202 require annual publication of AAFs in the Federal Register. These AAFs are used to adjust contract rents at certain multifamily projects. The anniversary date for publishing AAFs is November 8. If AAFs are published after this date, they can be applied retroactively to November 8. The Federal Register publishing AAFs on November 22, 1989, states that the AAF established for an area may result in rents that are substantially lower than rents for comparable unassisted units. If this occurs, a housing authority or private owner may apply to the HUD Field Office for consideration of a revised AAF for the area, as provided by 24 CFR 888.204.

According to 24 CFR 888.204, if the application of the normal AAF results in rents substantially lower than rents for comparable unassisted units, and it is shown to HUD that the costs of operating comparable unassisted housing has increased at a greater rate than the AAF, the HUD Field Office will consider establishing separate or revised AAFs for the area. Per Section 888.202, the Field Office will publish a notice appropriate to the limited scope of the revised factors. These revised factors are to remain in effect until superseded by the subsequent annual publication of AAFs in the Federal Register.

Local AAFs were requested and approved.

On July 18, 1990, the Executive Director of the Housing Authority of Snohomish County requested an increased AAF for the Seattle PMSA. He requested the increases on behalf of the housing authorities in King and Snohomish Counties. The former Regional Administrator, with input from the Regional Economist, approved these local AAFs on August 2, 1990, effective September 1, 1990. These revised AAFs were to remain in effect until the next annual publication of AAFs in the Federal Register in November 1990.

The 1990 published AAFs were lower than the local AAFs approved by the former Regional Administrator. Since these rates still did not reflect rental market conditions, the same Executive Director requested application of the local AAFs previously approved and effective September 1, 1990. On January 23, 1991, the former Regional Administrator again approved local AAFs. In the notice, however, he stated that:

“So that the same AAFs remain in effect for only a twelve-month period, these revised AAFs are effective through August 31, 1991. Thereafter, the AAFs published in the Federal Register on December 18, 1990, will be in effect.”

This approval specifically stated the local AAFs would be effective for one year (September 1, 1990 through August 31, 1991).

An owner appealed Housing's application of the local AAF.

Initially, Housing utilized this local factor for the twelve-month period, giving every Seattle PMSA project the benefit of the increased AAF. However, on May 17, 1993, a project owner wrote a letter to Housing asking them to reapply the higher local factors. He stated that when the former Regional Administrator published the revised factors for Seattle in August 1990, they were not applied retroactively to November 8, 1989, as required. Instead, HUD made the local AAFs effective as of September 1, 1990. According to the owner, revised factors are to be effective back to the previous November 8 (at the owner's option) for AAF projects.

Housing responded to the owner's appeal on June 14, 1993. Using guidance Housing stated they received from Headquarters, they applied the factors approved August 2,

1990, retroactively to rent increases between November 8, 1989, and December 18, 1990 (the next published AAFs). Housing then applied the factor approved January 23, 1991, to rent increases between December 18, 1990, and November 26, 1991 (the next published AAFs).

History of the 1990-91 Seattle PMSA local AAF	
To summarize, the following time periods show what AAFs were approved, the dates they were effective, and how they were applied:	
11/22/89:	HUD publishes AAFs, effective for rent increases after 11/22/89; AAFs could also be applied retroactively to 11/8/89.
7/18/90:	Executive Director requests increases in AAFs for Seattle PMSA.
8/2/90:	Regional Administrator approves increased local AAFs effective for rent increases between 9/1/90 and 11/8/90, when new AAFs are to be published. Note that these factors were effective initially for two months.
12/18/90:	HUD publishes AAFs, effective for rent increases after 12/18/90; AAFs could also be applied retroactively to 11/8/90.
1/7/91:	Executive Director again requests increases in AAFs for Seattle PMSA (which were the same as the ones approved on 8/2/90).
1/23/91:	Regional Administrator approves a continuation of the increased local AAFs. The local AAFs replaced those published on 12/18/90 and were effective to 8/31/91 (a total twelve month period).
11/26/91:	HUD publishes AAFs, effective for rent increases after 11/26/91; AAFs could also be applied retroactively to 11/8/91.
1993/94:	Housing adjusts rent increases from 1989-1991. Local AAF used for all rent increases between 11/8/89 and 11/26/91.

In effect, each project in the Seattle PMSA received the higher local AAFs twice. The regulations and the former Regional Administrator's approval only allowed application of the local AAFs once during a single twelve-month period.

HUD intended for the local factor to be effective for only 12 months.

The former Regional Economist who reviewed the Executive Director's requests stated he made sure to word the January 23, 1991, notice in such a way that the factors would be in effect for only a twelve-month period. He stated the intent was for each and every contract using AAFs to receive the local factors once. The reason the factors were not approved retroactively to begin with was that the factors were designed

for the Section 8 existing program for Public Housing, which has no provision for retroactive application. He stated that if Housing had approached him on whether they should apply the factors retroactively to November 8, 1989, he would have probably concurred, but then rescinded the notice dated January 23, 1991. According to the former Regional Economist, by making the local AAFs effective for two years, Housing raised the rents higher than they needed to, without a supporting study from the outside.

Housing staff were unable to locate the Headquarters guidance referred to in Housing's letters to project owners. According to the Housing staff, around this time Headquarters was not providing guidance in writing, so the guidance referred to may have been verbal.

Regardless of the existence of guidance, when Housing recalculated the rents using the local AAFs over a two-year period, it did so under no provisions in the regulations. The regulations on revising AAFs only state that HUD will establish a higher local AAF if two things occur. The rents from using the published AAFs must be substantially lower than rents charged for comparable unassisted units, and the costs of operating comparable housing must have increased at a greater rate than the AAF. However, Housing treated their original application of the local AAF adjustment as an administrative error, requiring a retroactive recalculation of rents. Therefore they did not do a comparison to comparable unassisted units.

HUD has paid up to \$3.7 million in excessive HAPs through December 31, 1995.

About 61 projects in King and Snohomish Counties received the benefit of a relatively high local AAF in two years rather than the one year intended. We determined that, through December 31, 1995, HUD paid up to \$3.7 million in increased HAPs for the 61 projects due to this decision and is continuing to pay about \$57,500 a month in increased HAPs. In our calculation, we compared HUD's recalculated rent levels for each project to the rent levels with the local AAF applied once. The differences in these rent levels totaled \$3.7 million. Note that the \$3.7 million is the maximum amount that could have been paid. The actual amount will be less due to vacancies and other adjustments. We did not determine if the owner submitted vouchers for and HUD paid less than the amount calculated for each project.

Example of retroactive application of AAF.

For example, at **Pilchuck II**, Housing initially used the normal AAF published November 22, 1989 (1.046), to process the May 22, 1990, rent increase. They then used the local factor (1.101) for the May 22, 1991, rent increase. In 1994, Housing retroactively recalculated the rents, applying the local factor to both the May 22, 1990, and May 22, 1991, rents. This resulted in the following differences, extended through 1995:

As a result of the retroactive calculation, HUD paid the project \$39,493 in August 1995 to adjust for the difference in the rent levels between May 22, 1990, and May 22, 1994. In addition, between May 22, 1994, and December 31, 1995, HUD paid \$15,614 in higher HAPs due to the twice-applied local factor. As of December 31, 1995, **Pilchuck II** had received a total of \$55,107 in overpayments and was receiving \$27 per unit per month more than it would if the local factor were only applied once, as intended. Note that the maximum amount **Pilchuck II** could have received before vacancies or other adjustments would be \$55,251.

Conclusion

Using guidance that Housing said they received from Headquarters, Housing took action that resulted in multifamily projects in the Seattle PMSA receiving excessive HAPs. Housing took this action without input from the Regional Economist who was involved in approving the local AAFs. Unless corrected, Housing will have provided and will continue to provide these owners an unintended windfall, at a time when HUD is focusing on finding ways to keep the funds spent on HAPs under control.

Auditee Comments and OIG Evaluation

Housing agreed with the finding and Recommendations 2A and 2B. However, they recommended changes to Recommendation 2C and disagreed with Recommendation 2D. We made changes to Recommendation 2C and removed Recommendation 2D.

Recommendations

We recommend that you:

- 2A. Review the rent levels for the owners in the Seattle PMSA receiving AAFs and determine the amount overpaid.
- 2B. Adjust the rent levels to where they would be if the local AAF had been applied only between September 1, 1990, and August 31, 1991.
- 2C. Collect the overpaid HAPs from the project owners that received the overpayments.

HOUSING HAS NOT ATTEMPTED TO COLLECT OVERPAYMENTS ON AN ALPINE RIDGE PROJECT THAT WAS SOLD

The Seattle Office of Housing (Housing) has not attempted to collect overpayments on a project that was sold during the Alpine Ridge litigation although it has a statutory obligation to do so. Through discussions with Headquarters, Housing decided to not pursue collection because the project was sold to a public housing authority (a non-profit entity) which was not a party to the Alpine Ridge lawsuit. As a result, HUD has not collected \$21,651 in overpayments from either the previous or current owner.

Agencies should attempt to collect claims.

Section 3711(a)(1) of Title 31, US Code, provides that each agency “shall try to collect a claim of the United States Government for money or property arising out of activities of, or referred to, the agency.” This law and 24 CFR 17 do not distinguish between profit and non-profit debtors.

An Alpine Ridge plaintiff sold its project.

Effective January 1993, an Alpine Ridge plaintiff, Craigmont Associates (the owner of Craigmont Apartments), sold its interest in the project and assigned its HAP contract with HUD to the Snohomish County Housing Authority (Housing Authority). In its disclosures to the Housing Authority, Craigmont Associates did not disclose that it was a party to *Alpine Ridge, et. al. v. HUD*, even though this case was going through the appeal process. Through the purchase, the Housing Authority assumed liabilities of the project, but did not become a plaintiff to the lawsuit.

When the District Court vacated its earlier court orders, it gave HUD the authority to collect past overpayments to plaintiffs through offsets against Section 8 payments. After HUD notified the Housing Authority of this decision, the Housing Authority’s Interim Executive Director wrote an appeal letter on June 29, 1994. The Interim Executive Director stated that the Housing Authority should not be responsible for retroactive charges to the previous owner. In March 1995, Housing calculated that HUD was due \$21,651 from overpayments on Craigmont Apartments. However, Housing did not request repayment from the Housing Authority, since, through discussions with Headquarters, they decided to not pursue collection of overpayments from a non-

HUD was not required to leave rents at the court-ordered level.

profit owner when a profit-motivated owner initially received them.

The Housing Authority was not an Alpine Ridge plaintiff. Since the Housing Authority was not a plaintiff, HUD does not have the authority or ability to collect funds *under the court order*, which states “defendants shall be allowed to recover [over]payments...through the use of set-offs against future payments to **plaintiffs** [emphasis added].” Since the previous court orders which required HUD to raise rents were specific to the plaintiff, when Craigmont Associates sold Craigmont Apartments, HUD became free from abiding by these outstanding court orders. We believe that, as of January 1993, Housing was free to adjust rents to the levels they would have been without the previous court orders. Housing did not do so. Instead, they left rents at the higher court-ordered levels, providing the Housing Authority the benefits of an Alpine Ridge plaintiff even though it was not. Therefore, starting in January 1993, a debt was created (non-Alpine Ridge) due to these overpayments and Housing should attempt collection.

Even though it is no longer making Housing Assistance Payments (HAPs) to Craigmont Associates, Housing still has the responsibility to attempt collection of overpayments from the former owner. Since this cannot be done through offsets to future payments, HUD should use other available remedies in order to comply with Section 3711 (a)(1).

Since Housing decided not to pursue collection from either Craigmont Associates or the Housing Authority, HUD has not received \$21,651 from past overpayments. A portion of these funds was paid under the Alpine Ridge lawsuit and a portion was paid because Housing allowed the Housing Authority to assume the position of the Alpine Ridge plaintiff. We did not determine the portion of the overpayments that HUD paid each owner.

Auditee Comments

Housing agreed with the finding and noted they would attempt collection of the overpayments for the project that was sold. They also noted that collection may prove to be difficult, but they will use the procedures outlined in the Claims Collection Act.

Recommendations

We recommend that you:

- 3A. Determine the portion of the \$21,651 in overpayments made to both Craigmont Associates and the Housing Authority.
- 3B. Initiate collection proceedings against Craigmont Associates for the amounts overpaid.
- 3C. Collect the amount overpaid the Housing Authority due to leaving rents at the higher court-ordered levels after the project was sold.

(THIS PAGE INTENTIONALLY LEFT BLANK)

Auditee Comments

Distribution

Secretary's Representative, OAS (2)
Comptroller, Pacific/Hawaii, 9AF
Director of Housing, Northwest/Alaska, 0AH (4)
Director, Accounting Division, 0AFF
Assistant to the Secretary for Field Management, SC, (Room 7106)
Assistant to the Deputy Secretary for Field Management, SDF (Room 7106)
Audit Liaison, Housing, HFM (Room 2108) (5)
Acquisitions Librarian, Library, ARS (Room 8141)
Deputy Assistant Secretary for Multifamily Housing Programs, HM (Room 6106)
Chief Financial Officer, F (Room 10164) (2)
Deputy Chief Financial Officer, FF (Room 10166) (2)
Associate General Counsel, Office of Assisted Housing and Community Development, CD (Room 8162)

Associate Director US GAO (2)
Union Plaza, Building 2, Suite 150
820 1st Street NE
Washington, DC 20002
Attn: Jacquelyn Williams-Bridgers

Inspector General, G (Room 8256)
Deputy Inspector General, G1
Counsel to the Inspector General, GC (Room 8260)
Assistant Inspector General for Audit, GA (Rm. 8286)
Deputy Assistant Inspector General for Audit, GA (Rm. 8286)
Director, Financial Audits Division, GAF (Room 8182)
Director, Research and Planning Division, GAP (Room 8180)
Central Records, GF (Room 8266) (2)
Semi-annual Report Coordinator, GFM (Room 8254)
DIGAs, 10 other Districts (10)
cc:Mail to Morris Grissom, OIGPOST2 (for Internet)