



U.S. Department of Housing and Urban Development
Region 4, Office of Inspector General
Office of Audit, Box 42
Richard B. Russell Federal Building
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**MEMORANDUM NO.
2010-AT-1805**

May 19, 2010

MEMORANDUM FOR: Michael A. Williams, Director, Office of Public Housing,
Greensboro, NC, 4FPH

//signed//

FROM: James D. McKay, Regional Inspector General for Audit, Atlanta Region, 4AGA

SUBJECT: The Wilmington Housing Authority of Wilmington, NC, Misused Federal Funds
in the Purchase of Two Properties

INTRODUCTION

We performed a review of selected transactions at the Wilmington Housing Authority (Authority) in conjunction with our review of a citizen's hotline complaint. Among other concerns, the complainant alleged that the Authority misused U.S. Department of Housing and Urban Development (HUD) funds in conjunction with its purchase of Eastbrook Apartments in September 2005. Our objective was to determine whether the Authority misused HUD funds in its purchase of either Eastbrook Apartments or a tract of vacant land known locally as the "Winfield Smith" property. Our review revealed two instances in which the Authority, under its former management, misused HUD funds totaling \$267,914 for these properties.

We provided the draft memorandum to the Authority on May 7, 2010, and discussed the results with Authority officials at an exit conference on May 10, 2010. We received written comments on May 12, 2010. The Authority expressed agreement with the results and recommendations in both its written comments and during the exit conference. We have included the comments in appendix B.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

SCOPE AND METHODOLOGY

To accomplish our objective, we reviewed

- Federal land acquisition requirements at 24 CFR (Code of Federal Regulations) 941.303, HUD Notice 2003-10 (HA), Office of the Inspector General Audit Reports 2007-AT-1004 and 2007-AT-1011, and HUD's Greensboro Office of Public and Indian Housing's correspondence and files pertaining to the Authority.
- The Authority's documentation for the purchase of Eastbrook Apartments and a vacant tract of land known as the "Winfield Smith" property.
- The Authority's accounting policies, accounting records, and procedures manuals related to our objective.

We also interviewed the Authority's employees and HUD staff familiar with the Authority's operations.

We performed intermittent onsite audit work from January through March 2010 at the Authority's office located at 1524 16th Street, Wilmington, NC. The review was limited to the Authority's 2005 purchase of Eastbrook Apartments and 2004 purchase of the vacant tract of land. The land purchase came to our attention during the review as a result of a local newspaper article.

This review was not conducted in accordance with generally accepted government auditing standards. It was limited to our stated objective and should not be considered a detailed analysis of the Authority's internal controls or operations.

BACKGROUND

The Authority was formed December 9, 1940, pursuant to the North Carolina Housing Authorities Law. Its primary objective is to provide decent, safe, and sanitary housing in Wilmington, NC, and the surrounding area in compliance with HUD regulations. The Authority is governed by a nine-member board of commissioners appointed by the mayor of Wilmington. The Authority's records are located at 1524 16th Street, Wilmington, NC.

A citizen's complaint alleged that the Authority had misused an unspecified amount of HUD funds in the purchase of Eastbrook Apartments, a development it purchased from a private owner in September 2005. The Authority had a history of misusing HUD funds. In 2007, our office performed extensive audit work at the Authority and issued two reports (2007-AT-1004 and 2007-AT-1011). Among several other concerns, these reports detailed the Authority's misuse of \$744,916 in HUD public housing operating subsidies to pay expenses of other Federal and non-Federal programs and the inappropriate transfer of more than \$296,000 in HUD HOPE VI funds to an affiliate. The audits are closed with the exception of one recommendation (Recommendation 2A of 2007-AT-1011) requiring the Authority to repay HUD \$1.2 million in

home sales proceeds that the Authority allowed its affiliate to retain in violation of program requirements.

RESULTS OF REVIEW

Finding: The Authority Misused HUD Funds Totaling \$267,914 in the Purchase of Two Properties

The Authority misused \$209,938 in HUD Section 8 reserves to make mortgage payments on a non-HUD development, Eastbrook Apartments, and \$57,976 in HUD replacement housing factor funds to purchase vacant land. This violation occurred because the Authority's former management disregarded a HUD directive warning it not to use the Section 8 reserves for mortgage payments and HUD's requirements regarding the use of replacement housing factor funds. As a result, these funds were not available to assist the Authority's low-income residents as HUD intended.

The Authority Misused Section 8 Reserves

In September 2005, the Authority purchased Eastbrook Apartments, a 32-unit development housing a large number of Housing Choice Voucher program tenants. The complaint alleged that the Authority purchased the development using a \$1.4 million bank loan and misused HUD funds.

The Authority obtained a bank loan from Wachovia Bank to finance the more than \$1.3 million purchase price of Eastbrook. It also used \$7,619 in HUD Turnkey III funds to pay part of the closing costs, which was a permissible use of the funds under the Turnkey III use agreement with HUD. In addition, it inappropriately used \$209,000 in HUD Section 8 administrative fee reserves to make mortgage payments on the property. The misuse of HUD funds occurred despite a letter from HUD's Greensboro office denying the Authority's request to use the funds in that manner.

When the former Authority management decided to purchase Eastbrook, it determined that the property could be sustained using its cash flow. However, in 2007, less than 2 years after the purchase, a potentially hazardous mold infestation became apparent, and the Authority had to relocate all of the tenants. Since Eastbrook's cash flow was curtailed and the Authority could not continue funding its mortgage payments as originally planned, in October 2007, it requested HUD's permission to use pre-2004 Section 8 administrative fee reserves for the payments.¹ However, before that request, in May 2007, the Authority had already made an interfund transfer of \$119,163 from its Section 8 administrative fee reserve to Eastbrook to pay the mortgage. Before the Authority received a response to its request from HUD, it made a second interfund transfer of \$ 90,775 to Eastbrook. In November 2007, unaware that the Authority had already used the Section 8 funds, HUD denied the requested use of the funds. HUD's letter explained

¹ HUD's regulations provided that pre-2004 Section 8 administrative fee reserves could be used for "other housing purposes permitted by state and local laws," while administrative fee reserves accumulated after 2004 could only be used in the Section 8 voucher program.

the denial by stating that the units were unoccupied and would not pass HUD's Section 8 housing quality standards inspections.

Despite HUD's decision denying the use of the Section 8 funds for Eastbrook mortgage payments, as of January 13, 2010, the Authority had not repaid the funds. The Authority's director of finance stated that she was directed by the former executive director to use the Section 8 reserves for the mortgage payments. She also stated that the former executive director did not inform her that HUD had denied the Authority's request to use the funds for that purpose.

The Authority Misused Replacement Housing Factor Funds

In 2004, the Authority purchased a parcel of vacant land, known locally as the "Winfield Smith" property, using \$57,976 in HUD replacement housing factor funds as a down payment. HUD provided these funds to the Authority in 2001 for the purpose of replacing public housing units. As of March 2010, the Authority had not built housing on the property. Its purchase of vacant land using replacement housing factor funds and the lack of development violated several HUD requirements.

The regulations (24 CFR 941.303) required that public housing authorities submit a site acquisition plan and have HUD approval for any land purchases. The Authority made the purchase without providing the site acquisition plan or requesting HUD approval. In 2003, HUD issued Notice 2003-10 (HA) containing additional requirements. The notice required that housing authorities provide HUD with a replacement housing factor plan and a development plan. The Authority did not provide HUD with either of the required plans until November 2009.

Since the Authority failed to provide HUD the required documentation and used the funds to make the land purchase without HUD's knowledge or consent, its use of replacement housing factor funds was ineligible. In November 2009, the Authority submitted a request to use replacement housing factor funds to pay off the remaining mortgage balance on the land. When HUD received that request, it requested a site acquisition plan, which the Authority provided in February 2010. HUD reviewed the plan and rejected the Authority's request because its plan did not provide for new public housing units.

Conclusion

Our review showed that the Authority disregarded the applicable program requirements as well as HUD's instructions and used \$267,914 in Federal funds in violation of the regulations.

RECOMMENDATIONS

We recommend that the Director of HUD's Greensboro Office of Public Housing require the Authority to

- 1A. Repay its Section 8 administrative fee reserves \$209,938 from non-Federal funds.
- 1B. Repay its capital fund account \$57,976 from non-Federal funds.
- 1C. Provide HUD evidence that it has implemented effective controls to better ensure the proper use of HUD funds.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

<u>Recommendation number</u>	<u>Ineligible 1/</u>
1A	\$209,938
1B	\$57,976
Total	<u>\$267,914</u>

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.

Appendix B

AUDITEE COMMENTS



1524 South 16th Street Wilmington, NC 28401 • V 910.341.7700 • F 910.341.7760 • TDD 910.341.7740 • <http://wha.net>

May 12, 2010

Mr. James D. McKay
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Region 4 Office of Inspector General
Office of Audit, Box 42
Richard B. Russell Federal Building
75 Spring Street, SW, Room 330
Atlanta, GA 30303-3388

Dear Mr. McKay:

Thank you for providing us a report of your review of transactions related to the acquisitions of the Eastbrook Apartments and the "Winfield Smith" property.

We have no objection to the contents of the report and do not dispute the finding. We are in the process of preparing a plan to satisfy each of the recommendations. As you are well aware, these transactions occurred several years ago and long before my tenure as the Chief Executive Officer. Be assured that adequate internal controls are now in place, the most significant of which is a recently adopted and revised Accounting Policies and Procedures manual, to ensure proper use of federal funds.

We appreciate the professionalism of those involved in the review. If you have any questions, or require any additional information, please don't hesitate to ask. We look forward to the release of the final report.

Sincerely,

A handwritten signature in blue ink, appearing to read "Michael J. Krause", is written over a light blue horizontal line.

Michael J. Krause
Chief Executive Officer

c: Michael A. Williams
Constance H. Wojtek
David Butcher

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