



Office of Multifamily Housing Programs, Washington, DC

Implementation of Partial Payment of Claim Use Agreements



To: Robert Iber, Acting Director, Office of Asset Management and Portfolio Oversight, Office of Multifamily Housing Programs, HTN

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From: Tanya E. Schulze, Regional Inspector General for Audit, 9DGA

Subject: HUD Did Not Ensure Compliance With Partial Payment of Claim Use Agreement Restrictions

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of HUD's Office of Multifamily Housing Programs' implementation of partial payment of claim use agreements.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at <http://www.hudoig.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at 213-534-2471.



Audit Report Number: 2017-LA-0001

Date: October 27, 2016

HUD Did Not Ensure Compliance With Partial Payment of Claim Use Agreement Restrictions

Highlights

What We Audited and Why

We audited the U.S. Department of Housing and Urban Development (HUD), Office of Multifamily Housing Programs' implementation of use agreement restrictions for affordable set-aside units because it was included in our audit plan based on a prior audit, which determined that a multifamily project owner did not comply with project use agreement restrictions. The objective of the audit was to determine whether HUD ensured compliance with use agreement restrictions for affordable set-aside units as a condition of partial payment of claims (PPC).

What We Found

HUD did not ensure compliance with use agreement restrictions for affordable set-aside units as a condition of PPCs. This condition occurred because HUD did not have written procedures to ensure that staff used the Integrated Real Estate Management System (iREMS)¹ to track receipts of annual certifications from owners and to ensure that owners complied with project use agreement restrictions. As a result, HUD had no assurance that owners made available the affordable set-aside units required by the PPC use agreements.

What We Recommend

We recommend that the Acting Director for the Office of Asset Management and Portfolio Oversight, Office of Multifamily Housing Programs (1) develop and implement written procedures to track the required annual certifications using iREMS, (2) develop and implement written procedures to verify that properties comply with their PPC use agreement restrictions, and (3) obtain the missing annual certifications for two properties and record them in iREMS.

¹ The Integrated Real Estate Management System is the official source of data on the Office of Multifamily Housing Programs' portfolio of insured and assisted properties. It provides automated support to collect and maintain accurate data and enables program centers and hubs and Departmental Enforcement Center staff to perform servicing functions and implement enforcement actions when needed.

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Background and Objective

The U.S. Department of Housing and Urban Development (HUD) uses the partial payment of claim (PPC) approach to avoid a full insurance claim against the Federal Housing Administration (FHA) General Insurance Fund when an FHA-insured mortgage on a multifamily project goes into default due to circumstances beyond the owner's control. A PPC results in a smaller claim, but it may be warranted by the need to preserve housing that may be affordable and may or may not be subsidized. The claim amount is retained and recovered through a second mortgage, and the associated reduction in the project's first mortgage principal balance enables FHA to help stabilize the project for the long term. Thus, potential benefits of PPCs include preserving or providing affordable housing, stabilizing project operations, curing an existing default, and maximizing longer term returns to the FHA General Insurance Fund.

For HUD to offer a PPC, the lender and the owner must first voluntarily agree to accept the terms for a partial payment of the insurance claim, which includes entering into a HUD use agreement. If the property is already subject to a land use restriction agreement, the new HUD use agreement will mirror its requirements. For all other properties, the HUD use agreement will require (1) at least 30 percent of the units to be reserved for residents with incomes at or below 80 percent of adjusted median income at rents not to exceed 30 percent of 80 percent of adjusted median income or (2) current affordability provisions on the project to continue if they are more restrictive.

Our objective was to determine whether HUD ensured compliance with use agreement restrictions for affordable set-aside units as a condition of PPCs.

Results of Audit

Finding: HUD Did Not Ensure Compliance With Partial Payment of Claim Use Agreement Restrictions

HUD did not ensure compliance with PPC use agreement restrictions. Specifically, HUD did not always follow up with the owners to obtain the required annual certification of compliance. In addition, HUD did not perform reviews to verify that projects complied with use restrictions. These conditions occurred because HUD did not have written procedures to ensure staff used the Integrated Real Estate Management System (iREMS) for tracking receipts of owner annual certifications and to ensure that owners complied with project use agreement restrictions. As a result, HUD had no assurance that owners made available the affordable set-aside units required by the PPC use agreements.

HUD Did Not Always Receive Annual Certifications

We reviewed all seven multifamily properties nationwide that received a PPC in 2014 or 2015. As a condition of the PPC, the owners entered into a PPC use agreement, which designated a percentage of units as affordable.² The PPC use agreement required that these affordable set-aside units be rented to income-eligible families at rents not to exceed a certain level and required the owners to submit an annual certification of compliance with the occupancy restrictions.

Of the seven properties reviewed, four properties should have submitted an annual certification of compliance.³ Three of the four properties did not submit the required annual certifications of compliance, and HUD account executives and asset resolution specialists did not follow up with the owners to obtain them. For these three properties, an account executive obtained the certifications from one property owner for the past 2 years after we asked to see them. This condition occurred because account executives and asset resolution specialists did not consistently use iREMS to track the required annual owner certifications.

HUD Did Not Verify That Projects Complied With Use Restrictions

HUD did not verify that owners complied with project use restrictions. HUD account executives and asset resolution specialists stated that when they performed a management and occupancy review, they reviewed tenant files to ensure that income and rent restrictions were met. However, all seven properties had not had a management and occupancy review since the PPC closing because HUD did not consider these properties a priority as there were no financial or physical inspection red flags. This condition occurred because HUD did not have written procedures for verifying use restriction compliance.

² If there was a land use restriction agreement in place with another entity, the PPC use agreement would mirror that agreement.

³ Three properties' annual certifications were not yet due because their PPCs closed in late 2015 (under 1 year).

Conclusion

HUD did not ensure compliance with PPC use agreement restrictions for affordable set-aside units. This condition occurred because HUD did not have written procedures for tracking owners' annual certifications of compliance using iREMS and to ensure that owners complied with PPC use agreement restrictions. As a result, HUD did not have assurance that owners made available the 766 affordable housing units required by the PPC use agreements.

Recommendations

We recommend that the Acting Director for the Office of Asset Management and Portfolio Oversight, Office of Multifamily Housing Programs

- 1A. Develop and implement written procedures to ensure that its staff obtains and tracks the required annual owner certifications using iREMS.
- 1B. Develop and implement written procedures to ensure that reviews are conducted to verify whether the properties complied with the use restrictions in the PPC use agreements.
- 1C. Obtain the missing annual owner certifications for the two properties (FHA numbers 085-11099 and 113-35284) and record them in iREMS.

Scope and Methodology

We performed our audit work at our office in San Francisco, CA, between June and September 2016. Our audit generally covered January 1, 2014, through December 31, 2015. We expanded our scope as necessary.

To accomplish our objective, we

- Interviewed HUD staff,
- Reviewed applicable HUD requirements,
- Reviewed HUD policies related to monitoring project compliance with use agreements for affordable set-aside units, and
- Reviewed HUD system data and project files.

Using the Online Property Integrated Information Suite, we identified nine properties nationwide that had a PPC during the period January 1, 2014, through December 31, 2015. However, this list included two properties serviced by the Office of Healthcare Programs, which is separate from the Office of Multifamily Housing Programs. Therefore, we selected and reviewed all of the remaining seven multifamily properties that had a PPC during that period.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Internal Controls

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

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

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Policies and procedures to ensure properties that received PPCs complied with use agreement restrictions for affordable set-aside units.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- HUD did not have written procedures to ensure properties that received PPCs complied with use agreement restrictions for affordable set-aside units (finding).

Appendixes

Appendix A

Auditee Comments

HUD declined the opportunity to provide written comments.

Appendix B

Criteria

Office of Management and Budget Circular A-123, Management’s Responsibility for Enterprise Risk Management and Internal Control, Section III, Establishing and Operating an Effective System of Internal Control

Management’s responsibility is to develop and maintain effective internal control that is consistent with its established risk appetite and risk tolerance levels. In addition, management is responsible for establishing and integrating internal control into its operations in a risk-based and cost beneficial manner, in order to provide reasonable assurance that the entity’s internal control over operations, reporting, and compliance is operating effectively.

HUD Handbook 4350.1, REV-2, Chapter 14, Partial Payment of Claims, Restructuring of HUD-Held Loans, and Modifications of FHA-Insured Loans, Section 2, Partial Payment of Claim

PPCs are used to avoid a full insurance claim against the FHA General Insurance Fund when an FHA-insured mortgage on a multifamily project goes into default due to circumstances determined to be beyond the Owner’s control. It results in a smaller claim but this may be warranted by the need to preserve housing that may be affordable, and may or may not be subsidized. A PPC is considered a “last resort” primarily to avoid a full insurance claim, and it is approved only after all other financial resources available to the project have been exhausted. The Owner must demonstrate that conditions contributing to the default that are within the Owner’s control have been resolved, that project operations and occupancy are stabilized, and that a PPC is likely to result in long term stability of the project.

Through the PPC process, HUD pays to the mortgagee a portion of the outstanding principal balance of the first mortgage, the PPC Claim amount. HUD simultaneously recasts the remaining first mortgage principal balance into a new first mortgage obligation. A new second mortgage obligation, the “PPC Note and Mortgage” (in the amount of the PPC Claim plus overdue interest on the old first mortgage) is also created in the transaction. The PPC Note obligates the Owner to pay 75% of the project’s annual surplus cash as repayment, and to enter into a 20-year HUD Use Agreement (see 14-6.C., 14-9.C., and 14-12.B.). In order for HUD to offer a PPC, the mortgagee and the Owner must first voluntarily agree to accept the terms for a partial payment of the insurance claim detailed in this Chapter, with the knowledge that any prepayment and lockout provisions in the mortgage are waived.

14-6. Mortgage Terms and Use Restriction

- C. Use Restriction. If the property is already subject to a Land Use Restriction Agreement (LURA), the new HUD Use Agreement will mirror its requirements. For all other properties, the HUD Use Agreement will require (i) at least 30 percent of the units to be reserved for residents with incomes at or below 80 percent of Adjusted Median Income (AMI), at rents not to exceed 30 percent of 80 percent of AMI, or (ii) current affordability provisions on the

project to continue, if more restrictive than in (i). These rents will be the initial basis for cash flow analysis. The new HUD Use Agreement will have a term of 20 years, which may exceed the remaining term of a prior LURA. As noted above, the HUD Use Agreement will reflect the requirements of the earlier LURA, and its requirements will remain in effect under the HUD Use Agreement even if the term of the original LURA lapses prior to the end of the new 20 year term.