The State of New Jersey, Trenton, NJ

Community Development Block Grant Disaster Recovery-Funded Sandy Homebuyer Assistance Program

Office of Audit, Region 3
Philadelphia, PA

Audit Report Number: 2017-PH-1005
August 14, 2017

To:	Stanley A. Gimont, Acting Deputy Assistant Secretary for Grant Programs, DGB
	//signed//
From:	David E. Kasperowicz, Regional Inspector General for Audit, Philadelphia Region, 3AGA
Subject:	The State of New Jersey Did Not Always Disburse Disaster Funds for Its Sandy Homebuyer Assistance Program To Assist Eligible Home Buyers

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of the State of New Jersey's Community Development Block Grant Disaster Recovery-Funded Sandy Homebuyer Assistance program.

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 website. 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 215-430-6734.

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The State of New Jersey Did Not Always Disburse Disaster Funds for Its Sandy Homebuyer Assistance Program To Assist Eligible Home Buyers

Highlights

What We Audited and Why

We audited the State of New Jersey's Community Development Block Grant Disaster Recovery-funded Sandy Homebuyer Assistance program. We conducted the audit because (1) it was the State's only home-buyer assistance program, (2) the State had spent a high percentage of its allocated funds, and (3) reviews performed by the State auditor and the State's disaster recovery integrity monitor identified potential issues. Our objective was to determine whether the State disbursed disaster funds for its Sandy Homebuyer Assistance program to assist eligible home buyers in accordance with applicable program requirements.

What We Found

The State did not always disburse disaster funds for its program to assist eligible home buyers in accordance with applicable program requirements. Of 65 home-buyer files reviewed, 12, with loans totaling $600,000, showed that the home buyers did not meet all program eligibility criteria and therefore, $558,000 of the $600,000 disbursed was ineligible. Based on our review, we projected that at least 39 of the 347 loans that the State issued, and more than $1.7 million of the nearly $16.4 million that it disbursed for the program, could be ineligible. This condition occurred because the State lacked procedures and its staff lacked training to ensure that home buyers complied with income eligibility and property ownership requirements. The State also disbursed $429,500 to nine home buyers in Atlantic County whose income exceeded the U.S. Department of Housing and Urban Development's (HUD) low- and moderate- income limits for 2013. This condition occurred because the State made a clerical error when it established HUD's 2013 income limits for Atlantic County. As a result, the State's use of nearly $1 million in program funds to assist 21 home buyers was ineligible because the home buyers did not meet all of the program eligibility requirements.

What We Recommend

We recommend that HUD direct the State to repay HUD from non-Federal funds for nearly $1 million disbursed to 21 ineligible home buyers.

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Background and Objective

On October 29, 2012, Hurricane Sandy made landfall near Atlantic City, NJ. The storm caused unprecedented damage to New Jersey's housing, business, infrastructure, health, social service, and environmental sectors. On October 30, 2012, President Obama declared all 21 New Jersey counties major disaster areas. The U.S. Department of Housing and Urban Development (HUD) identified the following nine counties as New Jersey's most impacted areas: Atlantic, Bergen, Cape May, Essex, Hudson, Middlesex, Monmouth, Ocean, and Union.

Through the Disaster Relief Appropriations Act of 2013,[1] Congress made available $16 billion in Community Development Block Grant funds for necessary expenses related to disaster relief, long-term recovery, restoration of infrastructure and housing, and economic revitalization. In accordance with the Robert T. Stafford Disaster Relief and Emergency Assistance Act of 1974, these disaster relief funds were to be used in the most impacted and distressed areas affected by Hurricane Sandy and other declared major disaster events that occurred during calendar years 2011, 2012, and 2013. From March 2013 to October 2014, HUD awarded the State more than $4.1 billion in disaster funds under the Act. The State established the Sandy Homebuyer Assistance program to assist low- and moderate-income home buyers in purchasing homes rather than attempting to find rental units in increasingly expensive leasing markets. The program was designed to provide eligible home buyers with up to $50,000 in an interest-free, forgivable loan to purchase a home in any of the nine counties designated as the areas most impacted by the storm. The loan is forgiven over a 5-year period, depreciating 20 percent each year until it is fully forgiven. The State designated its Housing and Mortgage Finance Agency as the entity to administer the program.

According to the State's program policy, home buyers were required to meet the following eligibility factors to qualify for a loan:

- The home buyer's residence at the time of application must be in one of the nine counties affected by the storm.
- The home buyer cannot own other real estate.
- The home buyer must have a minimum credit score of 620.
- The home buyer's income must meet HUD's low- and moderate- income limits.
- The home buyer cannot maintain more than $70,000 in liquid assets.
- The home buyer cannot receive duplicate benefits.
- The home buyer's property purchased with program funds must be within one of the nine counties affected by the storm, the home buyer's primary place of residence, and a single-family residential property.
- The home buyer must qualify for a first mortgage from an approved lender.

[1] Public Law 113-2, dated January 29, 2013

- The home buyer's housing cost-to-income (front-end) ratio must be between 28 and 36 percent after the application of program funding and debt-to-income (back-end) ratio must be no greater than 43 percent after the application of program funding.

As of February 2016, the State had disbursed nearly $16.4 million of the program's nearly $25 million to assist 347 home buyers. It did not issue any loans for the program after February 2016. During the audit, the program ended. On June 28, 2017, HUD approved the State's action plan amendment that included reallocating the remaining $5.9 million of funds from this program to the State's Fund for Restoration of Multifamily Housing program.

In July 2014, the State's disaster recovery integrity monitor issued a report on the program that identified issues related to application intake and duplication of benefits. In April 2015, the State auditor issued an audit report on the program that identified issues related to income calculation errors.

Our objective was to determine whether the State disbursed disaster funds for its Sandy Homebuyer Assistance program to assist eligible home buyers in accordance with applicable program requirements.

Results of Audit

Finding: The State Did Not Always Disburse Disaster Funds for Its Program To Assist Eligible Home Buyers

The State did not always assist eligible home buyers in accordance with applicable program requirements. Of 65 home-buyer files reviewed in our statistical sample, 12 (18 percent), with loans totaling $600,000, showed that the home buyers did not meet all program eligibility requirements and therefore, $558,000 of the $600,000 disbursed was ineligible. Based on our review, we projected that at least 39 of the 347 loans that the State issued, and more than $1.7 million of the nearly $16.4 million that it disbursed for the program, could be ineligible. The State also disbursed $429,500 to nine home buyers in Atlantic County whose income exceeded HUD's low- and moderate-income limits for 2013. These conditions occurred because the State lacked procedures and its staff lacked training to ensure that home buyers complied with income eligibility and property ownership requirements and it made a clerical error when it established HUD's 2013 income limits for Atlantic County. As a result, the State's use of nearly $1 million in program funds to assist 21 home buyers was ineligible because the home buyers did not meet all of the program eligibility requirements.

The State Disbursed Program Funds to Ineligible Home Buyers

The State disbursed program funds to home buyers who did not meet all of the program eligibility requirements. The State's program policy required home buyers to meet the following eligibility factors to qualify for a loan: (1) income must meet HUD's low- and moderate-income limits, (2) home buyers' housing cost-to-income (front-end) ratio must be between 28 percent and 36 percent and debt-to-income (back-end) ratio must be no greater than 43 percent after the application of program funding, and (3) home buyers cannot own other real estate. Of the 65 home-buyer files reviewed, the State disbursed

- $200,000 to four home buyers whose income did not meet HUD's income limits. For two of the four home-buyer files, the State incorrectly calculated their income. After we recalculated the income, the home buyers' income exceeded the income limits. For the remaining two home-buyer files, the State approved the loans using an incorrect income limit to determine eligibility. When using the correct income limit, the home buyer's income exceeded the income limit. See appendix C for details.

- $208,000 to five home buyers who did not meet the State's underwriting eligibility ratios. For three of the five home buyers, the State incorrectly calculated the housing cost. After we recalculated the housing cost, two home buyers exceeded the front-end ratio requirement, and one home buyer did not meet the minimum front-end ratio requirement. For the home buyer who did not meet the minimum front-end ratio, only $8,000 of the $50,000 loan was ineligible. According to the program policy, if the front-end ratio was below 28 percent after the application of the maximum allowable program funding, the award amount should be decreased until the home buyer reached the 28 percent threshold. For another home buyer, the State incorrectly calculated the housing cost and income. After we recalculated the housing cost and income, the home buyer exceeded the front-end ratio requirement. For the remaining home buyer, the State approved a loan for which the home buyer exceeded the maximum back-end ratio requirement. The State's program policy stated that it would use the back-end ratio calculated by the approved lender to make eligibility determinations for its loans. See appendix D for details.

- $100,000 to two home buyers whose income did not meet HUD's income limits and did not meet the State's underwriting eligibility ratios. For the two home buyers, the State incorrectly calculated their income. After we recalculated their income and front-end ratio, the home buyers exceeded HUD's income limits and did not meet the minimum front-end ratio requirement. See appendix E for details.

- $50,000 to a home buyer who owned other real estate in addition to the property purchased using program funds.

These conditions occurred because the State lacked procedures and its staff lacked training to ensure that home buyers complied with income eligibility and property ownership requirements. As a result, the State's use of $558,000 in program funds was ineligible because the home buyers did not meet all of the program eligibility requirements. Based on our statistical analysis, we projected that at least 39 of the 347 loans that the State issued, and more than $1.7 million of the nearly $16.4 million that it disbursed for the program, could be ineligible.

The State Used Incorrect Income Limits To Determine Eligibility for Some Home Buyers

The State disbursed program funds to ineligible home buyers because it used incorrect income limits. The State disbursed $429,500 to nine home buyers in Atlantic County whose income exceeded HUD's 2013 income limits for the County. HUD sets the income limits for the nine counties in New Jersey most impacted by Hurricane Sandy. We noted a discrepancy between HUD's income limits and the income limits the State used to make its 2013 income eligibility determinations for applicants from Atlantic County. This discrepancy occurred because of a clerical error. The State used the incorrect income limits to make income eligibility determinations for 39 loans that it closed during the period October 31, 2013, through June 30, 2014. For 11 of the 39 loans, the home buyers' income exceeded HUD's income limits. As a result, the State made ineligible disbursements totaling $429,500 to nine home buyers[2] because they did not meet HUD's income limits. See appendix F for details.

Conclusion

The State did not always disburse disaster funds for its program to assist eligible home buyers in accordance with applicable program requirements. This condition occurred because the State lacked procedures and its staff lacked training to ensure that home buyers complied with income eligibility and property ownership requirements and it made a clerical error when it established HUD's 2013 income limits for Atlantic County. As a result, the State disbursed ineligible

[2] Two of the 11 loans were included in our statistical sample of 65 home-buyer files.

disaster funds totaling nearly $1 million to 21 home buyers who did not meet all of the program eligibility requirements.

Recommendation

We recommend that HUD's Deputy Assistant Secretary for Grant Programs direct the State to

1A. Repay HUD from non-Federal funds for the $987,500 disbursed to 21 home buyers who did not meet all of the program eligibility requirements.

Scope and Methodology

We conducted the audit from October 2016 through July 2017 at the State of New Jersey's Housing and Mortgage Finance Agency office located at 2 Dye Street, Trenton, NJ, and our office located in Philadelphia, PA. The audit covered the period March 2013 through September 2016.

To accomplish our objective, we reviewed

- Relevant background information.
- Applicable regulations, Federal Register notices, and the State's policies and procedures.
- The Disaster Relief Appropriations Act, Public Law 113-2.
- The State's Community Development Block Grant Disaster Recovery action plan and amendments.
- Funding agreements between HUD and the State.
- An audit report prepared by the State auditor.
- Integrity monitoring report prepared by the State's contractor.
- HUD's low- and moderate-income limits.

We performed public records searches. We conducted interviews with responsible employees of the State and HUD staff.

To achieve our audit objective, we relied in part on the State's computer-processed data. These data consisted of a listing of all loans closed within the program during the review period. Although we did not perform a detailed assessment of the reliability of the data, we performed a minimal level of testing and found the data to be adequate for our purposes. The testing entailed comparing loan information contained in the State's system to the home-buyer files.

The State disbursed nearly $16.4 million in program funds to 347 home buyers during the period August 2013 through February 2016. We statistically selected 65 loans valued at more than $3 million for review. We reviewed the home-buyer files for the 65 loans to determine whether the home buyers met all of the program eligibility requirements. The sample was designed using a stratified systematic sample to help control for potential differences across different counties for those households that received loans. We used statistical sampling because each sampled loan was selected without bias from the audit population, thereby allowing the results to be projected to the population. We found that a weighted average of 18.53 percent of all loans in our sample were ineligible. We estimate, with a one-sided confidence level of 95 percent, that at least 11.37 percent of all loans were ineligible. Extending this percentage to the universe of 347 loans yields at least 39 loans that would be ineligible. We also found that a weighted average of $8,617 per loan was ineligible. We estimate, with a one-sided confidence level of 95 percent, that at least $5,157 per loan was ineligible. Extending this percentage to the universe of 347 loans yields at least $1.7 million in loans that could be ineligible.

We compared HUD's low- and moderate-income limits for 2013, 2014, and 2015 for the nine counties that it designated as the most impacted in the State by Hurricane Sandy to the income limits that the State used to make income eligibility determinations for program applicants for those years. We identified a discrepancy with the 2013 income limits that the State used for Atlantic County. The State used the incorrect income limits to make income eligibility determinations for 39 loans that it closed during the period October 31, 2013, through June 30, 2014. Using the State's income data for the 39 home buyers, we determined that income for 11 of the 39 home buyers exceeded HUD's income limits. Since 2 of the 11 loans were included in our statistical sample, we reviewed the files for the other 9 loans to verify the home buyers' income.

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:

- Effectiveness and efficiency of operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Reliability of financial information – Policies and procedures that management has implemented to reasonably ensure that it obtains relevant and reliable information to adequately support program expenditures and discloses that information in the required reports.
- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that the use of resources is consistent with laws and regulations.

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:

- The State lacked adequate procedures, and its staff lacked adequate training to ensure that home buyers complied with income eligibility and property ownership requirements.

Appendixes

Appendix A

Schedule of Questioned Costs

Recommendation number	Ineligible 1/
1A	$987,500

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 and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

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July 17, 2017

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Re: HUD OIG Draft Audit Report of the Sandy Homebuyer Assistance Program

Dear Mr. Kasperowicz:

The State of New Jersey ("State") has reviewed the Department of Housing and Urban Development ("HUD"), Office of the Inspector General's ("OIG") audit report concerning the Community Development Block Grant – Disaster Recovery ("CDBG-DR") funded Sandy Homebuyer Assistance Program ("SHAP"). On behalf of the State of New Jersey Department of Community Affairs ("DCA") and the New Jersey Housing and Mortgage Finance Agency ("HMFA"), and, as discussed at the Exit Conference on Monday, July 10, 2017, we appreciate the opportunity to provide comments and clarifications to several of the findings that we deem to be factually inaccurate and/or legally unsupported. Through this letter submission, we seek to address certain issues raised by OIG in its draft audit report.

1. INTRODUCTION

When Superstorm Sandy made landfall in New Jersey in October 2012, the State suffered the worst natural disaster in its history. In the storm's aftermath, State workers labored tirelessly and under intense pressure to deliver relief to the citizens of New Jersey and to help the State recover from the storm. Hundreds of thousands of homes throughout the State were damaged or destroyed, and numerous residents were displaced from their homes in the aftermath of the storm.

In the wake of Sandy, the SHAP program served the crucial purpose of providing increased opportunity for Sandy-impacted low and moderate income individuals and families to purchase homes, rather than attempting to find rental units in increasingly expensive leasing markets in New Jersey's most storm-ravaged and distressed areas. SHAP is designed to boost the purchasing power of low and moderate-income households, primarily renters displaced by Sandy, as well as to stimulate the market for new and restored homes in the nine counties most affected by the storm. From the advent of SHAP, the State has worked tirelessly to ensure its successful implementation, disbursing 347 loans to home buyers.

Auditee Comments and OIG's Evaluation

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2. SUMMARY OF THE STATE'S POSITION

a. Eligibility Determinations

Comment 1

During the July 10, 2017 exit conference, OIG did not identify a specific standard with which it believes HMFA did not comply in making its eligibility determinations. Importantly, the State emphasizes that HMFA followed all program policies and procedures when making eligibility determinations, including calculating underwriting ratios and home buyer income. In Finding 1, the draft report erroneously asserts that, "[o]f 65 home-buyer files reviewed 12 (18 percent), with loans totaling $600,000, showed that the home buyers did not meet all program eligibility requirements." (Draft report, page 5). Based upon our detailed review of OIG's eligibility re-calculations, the State disagrees. The following provides the State's responses to specific files that were identified in the draft report.

Home Buyer Files Detailed on Page 15, Appendix D

The draft report is inaccurate to the extent it indicates that the State disbursed $250,000 to five home buyers who did not meet the State's underwriting eligibility ratios. It is the State's contention that four of the five home buyers fully satisfied the State's underwriting requirements.

Comment 2

Comment 3

Comment 4

Loan Number 132473 – OIG re-calculated the home buyer's front-end ratio to be 39%, thus, exceeding the allowable maximum front-end underwriting ratio of 36%. OIG, however, incorrectly included homeowner association ("HOA") fees to determine the home buyer's housing costs, as part of the front-end ratio calculation. Notably, at the time of SHAP's inception, HMFA policies and procedures did not include HOA fees in the front-end ratio calculation. Loan Number 132473 closed on November 13, 2013, and this loan was disbursed in compliance with HMFA's underwriting policy that was in effect at that time. Indeed, there was nothing in the SHAP Program Policy Manual to indicate that HOA Fees were to be included in the front-end ratio calculations. At the time of underwriting this loan, HMFA had reasonably determined that HOA fees would be captured in the back-end ratio to be provided by the bank, so it was unnecessary to include HOA fees in HMFA's underwriting process. Subsequent to closing this loan, on December 19, 2013, HMFA expressly modified the underwriting guidelines to include HOA fees as part of the front-end underwriting ratio calculation. In sum, HMFA appropriately excluded HOA fees from its calculation, and this file was correctly underwritten.

Comment 2

Comment 5

Loan Number 132274 – Similarly, this loan was properly underwritten by HMFA. OIG re-calculated the home buyer's front-end ratio to be 37%, thus, exceeding the allowable maximum front-end ratio of 36%. In re-calculating the home buyer's front-end ratio, OIG relied upon lender-prepared housing expense documentation to calculate the front-end ratio. But, at the time of underwriting, HMFA did not require utilization of the lender's documentation as part of the front-end ratio eligibility determination. HMFA instead utilized a standard manual calculation to determine applicant eligibility and amount of award, based on the information provided in the application. The lender information was only used to ensure the back-end ratio was at or below 43%. HMFA did not require applicants to provide updated information downstream in the process, so long as all information was accurate at the time of initial application submission. This is in accordance with widely accepted industry-standard underwriting procedures. Further, evaluating files based on the information provided at the time of initial application submission enabled HMFA to expediently review the large volume of applications submitted at the onset of the program, thereby providing crucial assistance to homebuyers on a timely basis. For these reasons, this file was correctly underwritten at the time of closing and was funded properly.

2

Auditee Comments and OIG's Evaluation

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Auditee Comments

Loan Number 132209 – OIG calculated the home buyer's front-end ratio to be 27%, thus, falling below the 28% minimum front-end ratio. In re-calculating the home buyer's front-end ratio, however, OIG relied upon the lender's documentation to calculate the front-end ratio. But, at the time of underwriting, HMFA's policies did not use or require the use of lender documentation to determine front-end ratio eligibility. For this reason, this file was correctly underwritten at the time of closing and was funded properly. What is more, even if we were to assume *arguendo* that the State's calculations were incorrect (which the State does not concede), the award amount should have been decreased until the applicant reached the 28% threshold, as opposed to concluding the applicant was wholly ineligible. This policy is expressly memorialized in the SHAP Program Policy Manual, which provides at page 7 that "[i]f Front-End is below 28% after the application of maximum allowable SHAP funding, the award amount will be decreased until applicant reaches the 28% threshold[.]" — Comment 6

Loan Number 132845 – HMFA correctly calculated this home buyer's housing cost. The State believes that OIG incorrectly included HOA fees to determine the home buyer's housing costs, as part of the front-end ratio calculation. As discussed previously, at the time of SHAP's inception, including the time of this loan's underwriting and closure, HMFA did not use HOA fees to calculate the front-end ratio. Furthermore, OIG calculated the front-end eligibility ratio here by comparing the home buyer's income to the housing cost provided by the lender. As discussed in detail above, at the time of this file's underwriting, HMFA did not use the lender's documents to determine front-end ratio eligibility. As a result, HMFA's underwriting decision was correct. — Comment 3

Home Buyer Files Detailed on Page 16, Appendix E

Second, the draft report is inaccurate to the extent it indicates that the State disbursed $100,000 to two home buyers whose income did not meet HUD's income limits and did not meet the State's underwriting ratios. It is the State's contention that one of the two home buyers fully satisfied the State's underwriting eligibility ratios.

Loan Number 133023 – HMFA correctly approved this loan. As an initial matter, the State believes that OIG erroneously included merit pay in its income calculation, without verifiable evidence to demonstrate that the home buyer had received merit pay in prior years or would continue to do so in the future. Merit pay is not guaranteed, and, thus, should have been excluded from the income calculation. Subtracting out merit pay, the home buyer's income is $47,093, which, as described below, falls within the applicable HUD income limit. — Comment 7

In addition, the State believes that the draft report applied the incorrect income chart when evaluating this file. The home buyer's application was completed in September 2013, and HMFA performed its income calculation on March 19, 2014. The State believes that OIG mistakenly relied upon the 2014 income chart, which was not effective until April 2014. Applying the chart that was effective as of March 19, 2014, the correct applicable HUD income limit was $51,400. Consequently, the home buyer's income of $47,093 falls within the HUD-established limit. — Comment 8

Furthermore, the home buyer satisfied the minimum front-end eligibility ratio. The homebuyer's annual income of $47,093 is equivalent to $3,924.42 monthly. When this monthly figure is compared to the homebuyer's $1,127.82 in housing costs, it results in a front-end ratio of 29%, which is above the minimum front-end ratio threshold of 28%. As a result, this home buyer satisfied the State's underwriting eligibility requirements, and this loan was properly funded. — Comment 9

3

Auditee Comments and OIG's Evaluation

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Auditee Comments

Home Buyer who Owned Additional Real Estate – Finding 1, Page 6, Paragraph 2

The State appreciates the opportunity to address the instance of the home buyer identified in the draft report as owning real estate other than the property purchased using program funds. The State emphasizes that HMFA's rigorous due diligence did not uncover any evidence that the home buyer owned other real estate at the time of the eligibility determination and loan disbursement. HMFA complied with all applicable policies and procedures in evaluating the home buyer's application. In fact, prior to disbursement, HMFA fully reviewed the home buyer's credit report, and there was no open or recent mortgage listed. HMFA also reviewed the home buyer's tax returns, and the home buyer did not claim mortgage interest, nor did the tax returns list any property as an asset. Finally, the home buyer did not disclose any real estate assets in the affidavit that was required to be signed and notarized with the SHAP application. The State believes that OIG obtained the relevant information regarding this home buyer's real estate holdings by performing a search using the Accurant system. Importantly, Accurant was not a system to which HMFA had access while making eligibility determinations. Nor was use of Accurant required by any federal or State regulation or by any program policies or procedures. Based on the information that OIG has provided, the State will proactively make the appropriate referral to the Sandy Fraud Task Force.

Comment 10

b. Atlantic County Income Limits

On page 6, Finding 1, the draft report concluded that the "State disbursed $429,500 to nine home buyers in Atlantic County whose income exceeded HUD's 2013 income limits for the County." OIG further indicated that the home buyer's income exceeded the HUD-established income limits for eleven out of 39 Atlantic County loans that closed between October 31, 2013 and June 30, 2014.

While the State acknowledges the inadvertent clerical error in the Atlantic County income limits chart, the State emphasizes that this was an isolated occurrence. The State proactively reviewed the income limit charts for the other eight counties and confirmed that Atlantic County is the sole instance of such an error. Furthermore, the acknowledged exceedances of the HUD-determined limits were largely ***de minimis***. To illustrate, in one instance, the home buyer's annual income exceeded the applicable HUD income limit by $91.00, and, in another instance, the home buyer's annual income exceeded the HUD income limit by $522. Notwithstanding this error, these Atlantic County loans cited furthered the crucial programmatic purpose of providing vital assistance to Sandy-impacted citizens to purchase homes, especially given that these applicants may have been otherwise unable to do so.

Comment 11

c. The Draft Report's Error Rate Extrapolation is Inaccurate

OIG conducted an extrapolation based on its sampling to estimate the number of loans that could be ineligible out of the overall population. OIG's underlying methodology does not withstand scrutiny, however, as it contains several unjustified choices and assumptions. For the reasons detailed at length above, the basis for questioning the eligibility of five of the twelve files cited in the draft report does not withstand examination. Therefore, OIG applies an unjustifiably high error rate as the basis for its extrapolation across the SHAP program.

Comment 12

Furthermore, out of the remaining seven files OIG is questioning, two of those files are being questioned due to the inadvertent, isolated clerical error in the Atlantic County income limits charts. (Draft Report, page 5, paragraph 3). OIG has identified the entire scope of the impacted Atlantic County files (Draft Report, page 17, Appendix F); therefore, it would be inappropriate to use the Atlantic County as the basis to extrapolate a greater error rate across the total universe of files. This is especially true given that this was unquestionably a one-time clerical error.

Comment 12

4

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Comment 13

Comment 12

Further supporting that the extrapolated error rate is inaccurately high is the April 2015 State auditor report of the SHAP Program, which was expressly referenced in the draft report at page 4. In that audit, the State auditor reviewed a much larger statistical sample of 246 files, and only found an incorrect payment rate of 1% of the sample's dollar value. As a result, it is clear that the extrapolated error rate in the draft report is inaccurate. Accordingly, the State respectfully requests that OIG delete the extrapolation and the associated figures from the draft report.

d. The State's Training and Procedures were Robust to Ensure that Home Buyers Complied with Income Eligibility and Property Ownership Requirements

Comment 14

Comment 15

Comment 16

In the draft report, OIG concludes that the State lacked procedures and its staff lacked training to ensure that home buyers complied with the income eligibility and property ownership requirements. (Draft Report, page 5). The draft report, however, overlooks that SHAP underwriting was performed by experienced in-house HMFA Single Family Department underwriting and affordable housing income qualification staff. At the onset of SHAP, the underwriting personnel possessed a minimum of three years of mortgage underwriting and/or state and federal affordable housing income qualification experience. Furthermore, the SHAP program underwriting policies and requirements, including income calculation procedures, reflect long-established and widely-accepted industry standards. What is more, Chapter 5 of the HUD Occupancy Handbook was relied upon for guidance throughout the underwriting process. As a result, the State's training and procedures were robust and ensured that home buyers complied with all applicable requirements.

3. CONCLUSION

Thank you for your kind consideration of our positions. We continue to appreciate your help and cooperation in this matter. As always, we look forward to continuing our close partnership with you as we address these important disaster recovery issues.

Very truly yours,

Kimberly A. Cahall
Director, Superstorm Sandy Compliance Unit

c: Sam Viavattine, DCA (via electronic mail)
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OIG Evaluation of Auditee Comments

Comment 1 The State asserted that we did not identify a specific standard with which we believed the State did not comply in making its eligibility determinations. It also asserted that it followed all program policies and procedures when making eligibility determinations, including calculating underwriting ratios and home buyer income. We disagree. During the exit conference, we stated that we used the State's program policies and procedures when making eligibility determinations including calculating underwriting ratios and home buyer income. The State did not always follow its program policies and procedures when making eligibility determinations. As shown in the report, the State's use of nearly $1 million in program funds to assist 21 home buyers was ineligible because the home buyers did not meet all of the program eligibility requirements.

Comment 2 The State claimed that we incorrectly included homeowner association fees to determine the home buyer's housing costs as part of the front-end ratio calculation. It also claimed that at the time of the program's inception, the policies and procedures did not include homeowner association fees in the front-end calculation. In addition, it claimed that we relied upon lender-prepared housing expense documentation to calculate the front-end ratio, which at the time of underwriting, the State did not require utilization of the lender's documentation as part of the front-end ratio eligibility determination. We disagree. We correctly used the Uniform Underwriting Transmittal Summary, which included homeowner association fees as a housing cost, to calculate the front-end ratio to make eligibility determinations. According to the program policy, the State was required to review the lender's Uniform Underwriting Transmittal Summary and re-evaluate the applicant's eligibility prior to closing to ensure continued compliance with the front-end ratio requirement. Further, since the program's inception, the State's program procedures manual required the State to review and adjust the interest rate, downpayment amounts, homeowners insurance figures, and homeowner association fee amounts on the State's underwriting Excel spreadsheet to ensure continued compliance with the front-end ratio requirement.

Comment 3 The State contended that it had reasonably determined that homeowner association fees would be captured in the back-end ratio to be provided by the bank, so it was unnecessary to include homeowner association fees in the State's underwriting process. Although we agree that homeowner association fees were captured in the back-end ratio, the homeowner association fees should have also been captured in the State's underwriting process. The program policy required the State to review the lender's Uniform Underwriting Transmittal Summary and re-evaluate the applicant's eligibility prior to closing to ensure continued compliance with the front-end ratio requirement. Further, the State's program procedures manual required the State to review and adjust the interest rate, downpayment amounts, homeowners insurance figures, and homeowner association fee amounts on the State's underwriting Excel spreadsheet to ensure continued compliance with the front-end ratio requirement. The Uniform Underwriting Transmittal Summary included homeowner association fees as part of the home buyer's housing cost and it used the fees to calculate the front-end ratio. Moreover, the inclusion of homeowner association fees to a home buyer's housing cost was in accordance with widely accepted industry-standard underwriting procedures. The State's Housing and Mortgage Finance Agency's website included a guide for home buyers which showed that homeowner association fees were included as part of a home buyer's housing cost. Therefore, we used the housing cost from the Uniform Underwriting Transmittal to calculate the front-end ratio to make eligibility determinations.

Comment 4 The State claimed that on December 19, 2013, it expressly modified its underwriting guidelines to include homeowner association fees as part of the front-end underwriting ratio calculation. We are aware that the State changed its guidelines and began including homeowner association fees in its front-end ratio calculations. However, according to the State's program procedures manual, it should have utilized the lender's Uniform Underwriting Transmittal Summary prior to closing to review and adjust the homeowner association fee amount on its underwriting Excel spreadsheet to ensure continued compliance with the front-end ratio requirement. The State's program procedures manual was effective at the inception of the program. Those procedures should have been followed when underwriting every loan, including loans underwritten prior to December 19, 2013. Therefore, the State inappropriately excluded homeowner association fees and did not properly underwrite the loan.

Comment 5 The State contended that it only used the lender information to ensure that the back-end ratio was at or below 43 percent. It also claimed that it did not require applicants to provide updated information downstream in the process, so long as all information was accurate at the time of initial application submission. We acknowledge that the State used the lender information in accordance with its program policies and procedures manuals to ensure that the home buyer met the back-end ratio requirement. We also acknowledge that the State did not require applicants to provide updated information. However, the program policy required the State to review the lender's Uniform Underwriting Transmittal Summary and re-evaluate the applicant's eligibility prior to closing to ensure continued compliance with the front-end ratio requirement. Further, the State's program procedures manual required the State to review and adjust the interest rate, downpayment amounts, homeowners' insurance figures, and homeowner association fee amounts on the State's underwriting Excel spreadsheet to ensure continued compliance with the front-end ratio requirement. Therefore, because the State did not use the Uniform Underwriting Transmittal Summary to review and adjust the front-end ratio, it did not properly underwrite the loan.

Comment 6 The State asserted that if it were to assume that its calculation was incorrect, which it did not concede, the award amount should have been decreased until the applicant reached the 28 percent threshold, as opposed to concluding the loan was wholly ineligible. After a subsequent review of our workpapers, we determined that an adjustment was needed. The State disbursed $50,000 to this home buyer. We reduced the award amount until the home buyer's front-end ratio increased to 28 percent. The State should have disbursed only $42,000 to this home buyer. Therefore, $8,000 of the State's disbursement to the home buyer was ineligible. We adjusted the final report to reflect this change.

Comment 7 The State claimed that we erroneously included merit pay (a performance bonus) in our income calculation, without verifiable evidence to demonstrate that the home buyer had received merit pay in prior years or would continue to do so in the future. We disagree. The program policy and procedures did not identify a method to calculate a home buyer's income that included merit pay. Therefore, we calculated the income based on the State's normal practice that we observed during the audit and through discussions with the program staff. In similar loan files, the State included bonuses in the home buyers' income calculation. Moreover, for this loan, the State included the merit pay in its income calculation. It was only after we questioned the State's income calculation because it had not included a salary increase that the State first asserted that we should not have included the merit pay in our income calculation (which would put the home buyer's income within the income limit).

Comment 8 The State contended that the auditors applied the incorrect income chart when evaluating this file. We disagree. We used HUD's low- and moderate-income limit chart for 2014 because those limits were effective at the time of the income calculation. The State performed its income calculation on March 19, 2014. According to a HUD official responsible for overseeing the State's disaster grant, the 2014 income limit chart was effective as of December 18, 2013. In addition, the program policy stated that the State received the 2014 income limit chart on December 18, 2013. The applicable 2014 income limit for Monmouth County was $48,850. Based on our income calculation, the home buyer's income was $49,548 which exceeded HUD's income limit.

Comment 9 The State asserted that the home buyer satisfied the minimum front-end eligibility ratio. We disagree. Based on our income calculation, the home buyer did not satisfy the minimum front-end eligibility ratio. The home buyer's annual income of $49,548, which included the merit pay, totaled $4,129 per month. When calculating the front-end ratio using the monthly income and the home buyer's housing costs of $1,127, it resulted in a front-end ratio of 27 percent which was below the minimum front-end ratio of 28 percent. The program policy required that home buyer's front-end ratio must be between 28 percent and 36 percent after the applying program funds.

Comment 10 The State contended that Accurint[3] was not a system to which it had access while making eligibility determinations. It further contended that using Accurint was not required by any Federal or State regulation or by any program policies or procedures to assist in making eligibility determinations. We agree that using Accurint was not required by any Federal or State regulation or by any program policies or procedures to assist in making eligibility determinations. However, the program policy required that home buyers could not own other real estate. During the audit, we performed an Accurint search on the 65 home buyers in our statistical sample and found that 1 home buyer owned other real estate. We also performed a search of the New Jersey property tax records that verified that this home buyer owned other real estate in addition to the property purchased using program funds.

Comment 11 The State claimed that the exceedances of the HUD-determined limits in the Atlantic County income limit chart for 2013 were largely negligible. We disagree. As stated in the program policy, home buyers were required to meet HUD's low- and moderate-income limits. During the audit, we compared the home buyer's income to HUD's low- and moderate-income limits for Atlantic County for 2013 to make income eligibility determinations. Home buyers were not eligible if their income exceeded the income limits, regardless of the amount that exceeded the limit. As shown in the report, the State disbursed $429,500 to nine home buyers that exceeded HUD's 2013 income limits in Atlantic County.

Comment 12 The State asserted that the basis for questioning the eligibility of 5 of the 12 loans cited in the draft report did not withstand examination and because of that, we applied an unjustifiably high error rate as a basis for an extrapolation across the program. It also asserted that the extrapolated error rate in the report was inaccurate. It further asserted that it would be inappropriate to use the Atlantic County files as the basis to extrapolate a greater error rate across the total universe of files. We disagree. As discussed in the report, 12 loans totaling $600,000, showed that the home buyers did not meet all program eligibility requirements and therefore, $558,000 of the $600,000 disbursed was ineligible. Our sample of 65 home-buyer files was selected statistically without bias. The extrapolation was based on the audit results for the 12 ineligible home buyers. We adjusted the extrapolation based on the $42,000 adjustment we made for the home buyer discussed in Comment 6 above. We found a weighted average of 18.53 percent of all loans in our sample were ineligible. We estimate, with a one-sided confidence level of 95 percent, that at least 11.37 percent of all loans were ineligible. Extending this percentage to the universe of 347 loans yields at least $1.7 million in loans that could be ineligible.

Comment 13 The State contended that the State auditor reviewed a much larger statistical sample of 246 files and found only an incorrect payment rate of 1 percent of the

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[3] Accurint is a widely accepted locate and research tool available to government, law enforcement, and commercial customers.

sample's dollar value. We disagree. The State auditor reported that it reviewed 53 files from a universe of 246 files representing assisted home buyers. Of the 53 files reviewed, 6 files contained income calculation errors. This resulted in two incorrect payments totaling $27,000, 1 percent of the sample's total dollar value. We performed our audit in accordance with generally accepted government auditing standards and found that 12 of 65 files contained income calculation errors, use of incorrect income limits, housing cost calculation errors, and a home buyer that owned other property. As a result, we report that $558,000 of the $600,000 disbursed to these home buyers was ineligible. This represented 18 percent of the sample's total dollar value.

Comment 14 The State asserted that the draft report overlooked that the program underwriting was performed by experienced in-house State Single Family Department underwriting and affordable housing income qualification staff. Although the program underwriting may have been performed by experienced in-house staff, some mistakes were made. We found that the State did not always disburse disaster funds for its program to assist eligible home buyers in accordance with applicable program requirements.

Comment 15 The State claimed that the program underwriting policies and requirements, including income calculation procedures, reflected long-established and widely-accepted industry standards. We agree that the program underwriting policies and requirements generally reflected long-established and widely-accepted industry standards. However, the State lacked procedures to ensure that it disbursed funds to only eligible home buyers in accordance with applicable program requirements. For example, the program policy required that home buyers could not own other real estate. However, as discussed in the report, we found an applicant who owned other real estate. This information resided in the State's property tax records. Further, the program policies and procedures were not adequate to ensure that home buyers met all eligibility requirements. As discussed in the report, we found that the State did not always correctly calculate home buyers' income when making eligibility determinations.

Comment 16 The State contended that its training and procedures were robust and ensured that home buyers complied with all applicable requirements. However, as discussed in this report, the State did not always disburse disaster funds for its program to assist eligible home buyers in accordance with applicable program requirements and this occurred because the State lacked procedures, its staff lacked training, and a clerical error occurred.

Appendix C

Summary of Home Buyers Who Exceeded HUD's Income Limits

Home-Buyer Files With Incorrect Income Calculations

No.	Loan number	Income limit year	County	Applicable HUD income limit	State calculated income	HUD OIG calculated income
1	133707	2014	Middlesex	$56,300	$50,120	$58,283
2	133777	2014	Atlantic	38,150	37,209	38,825

Home-Buyer Files Where the State Used Incorrect Income Limits

No.	Loan number	State calculated income	Income limit used by the State	State's income determination	Correct applicable HUD income limit	HUD OIG income determination using correct applicable HUD income limit
1	132646	$39,040	$47,050	Eligible	$38,400	Ineligible
2	132929	40,171	47,050	Eligible	38,150	Ineligible

Appendix D

Summary of Home Buyers Who Did Not Meet the State's Underwriting Eligibility Ratios

Home Buyers Who Did Not Meet the Front-End Eligibility Ratio

No.	Loan number	Minimum front-end ratio allowed	Maximum front-end ratio allowed	State calculated front-end ratio	HUD OIG calculated front-end ratio
1	132473	28%	36%	36%	39%
2	132845	28%	36%	32%	38%
3	132274	28%	36%	32%	37%
4	132209	28%	36%	30%	27%

Home Buyers Who Did Not Meet the Back-End Eligibility Ratio

No.	Loan number	Maximum back-end ratio allowed	Lender calculated back-end ratio used by the State
1	132342	43%	55%

Appendix E

Summary of Home Buyers Who Exceeded HUD's Income Limits and Did Not Meet the State's Underwriting Eligibility Ratios

Home Buyers Who Exceeded HUD's Income Limits

No.	Loan number	Income limit year	County	Applicable HUD income limit	State calculated income	HUD OIG calculated income
1	132543	2013	Union	$57,050	$50,965	$64,603
2	133023	2014	Monmouth	48,850	41,325	49,548

Home Buyers Who Did Not Meet the Minimum Front-End Eligibility Ratio

No.	Loan number	Minimum front-end ratio allowed	State calculated front-end ratio	HUD OIG calculated front-end ratio
1	132543	28%	29%	23%
2	133023	28%	33%	27%

Appendix F

Summary of Home Buyers Who Exceeded HUD's 2013 Income Limits in Atlantic County

No.	Loan number	State calculated income	Income limit used by the State	State's income determination	Correct applicable HUD income limit	HUD OIG income determination using correct applicable HUD income limit
1	132388	$59,829	$60,450	Eligible	$49,050	Ineligible
2	133013	47,482	53,750	Eligible	43,600	Ineligible
3	133055	46,800	47,050	Eligible	38,150	Ineligible
4	132535	46,078	47,050	Eligible	38,400	Ineligible
5	132505	43,691	53,750	Eligible	43,600	Ineligible
6	132604	43,040	47,050	Eligible	38,400	Ineligible
7	132650	42,535	47,050	Eligible	38,150	Ineligible
8	132601	38,672	47,050	Eligible	38,400	Ineligible
9	132649	38,410	47,050	Eligible	38,400	Ineligible