



**U.S. Department of Housing and Urban Development**  
Office of Inspector General for Audit, Region V  
Ralph H. Metcalfe Federal Building  
77 West Jackson Boulevard, Suite 2646  
Chicago, Illinois 60604-3507

Phone (312) 353-7832 Fax (312) 353-8866  
Internet <http://www.hud.gov/offices/oig/>

**MEMORANDUM NO:**  
2009-CH-0801

September 14, 2009

**MEMORANDUM FOR:** Anthony P. Scardino, Acting Deputy Chief Financial Officer, F

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

**SUBJECT:** Evaluation of the Final Front-End Risk Assessment of the Green Retrofit Program for Multifamily Housing

### **INTRODUCTION**

We reviewed the front-end risk assessment (assessment) of the Green Retrofit Program (program) for Multifamily Housing for the U.S. Department of Housing and Urban Development (HUD). Our objective was to determine whether the assessment complied with the Office of Management and Budget's guidance for the American Recovery and Reinvestment Act of 2009 (Recovery Act); the Recovery Act's Updated Implementing Guidance; and HUD's streamlined assessment process. There are no recommendations in this memorandum.

### **METHODOLOGY AND SCOPE**

Using the Office of Management and Budget's Implementation Guidance for the Recovery Act and HUD's Recovery Act streamlined assessment process and its Department Management Control Program handbook, we evaluated the following factors against the final assessment for the program to ensure that the following major program objectives were sufficiently emphasized:

- Legislative,
- Organizational structure and staffing,
- Program objectives and performance measures,
- Program structure and administration,
- Coverage by written and other procedures,
- Systems,
- Funding/funds control and organizational checks and balances,
- Management attitude,
- Reporting and documentation,
- Monitoring, and
- Special concerns and impacts.

We performed our review from June through August 2009 at our Columbus, Ohio, audit office. For this memorandum, our review was not conducted in accordance with generally accepted government auditing standards. Under the Recovery Act, inspectors general are expected to be proactive and focus on prevention; thus, this memorandum is significantly reduced in scope.

## **BACKGROUND**

The Recovery Act appropriated \$250 million to the program. Competitive grants and loans will be administered by HUD's Office of Affordable Housing Preservation (Office) for eligible property owners (owner) of properties receiving project-based assistance pursuant to Section 202 of the Housing Act of 1959 (12 U.S.C. (*United States Code*) 17012), Section 811 of the Cranston-Gonzalez National Affordable Housing Act (42 U.S.C. 8013), or Section 8 of the United States Housing Act of 1937 as amended (42 U.S.C. 1437f). The purpose of the grants and loans is (1) for owners to make green retrofit investments in the property, (2) to ensure the maintenance and preservation of the property, (3) the continued operation and maintenance of energy efficiency technologies, and (4) the timely expenditure of funds. Physical and financial analyses of the properties will be conducted to determine the amount of each grant or loan. The terms of the grants or loans will include continued affordability agreements. Grant and loan funds must be spent by the receiving owner within two years.

The Office is the successor organization to the Office of Multifamily Housing Assistance Restructuring. It was established by Congress in 1997 to restructure the debt on the aging portfolio of privately owned affordable housing stock with Federal Housing Administration (FHA)-insured mortgages and subsidized rents in a program called the Mark-to-Market program. The same organizational team that has led efforts in the Mark-to-Market program will provide the staffing for the program.

The new funding under the Recovery Act will require an ongoing evaluation and analysis of risk and continued monitoring to work toward achieving the goals of the legislation. In applying the Recovery Act implementing guidance regarding risk management, HUD will incorporate elements of its assessment process. The streamlined assessment process will build upon the analysis and work that is underway to implement the Recovery Act provisions, maximizing the use of documents and materials available and supplementing, as needed, to ensure that internal controls are in place.

## **RESULTS OF REVIEW**

Our review of the final assessment for the program determined that it generally complied with the Office of Management and Budget's guidance for the Recovery Act, the Recovery Act's Updated Implementing Guidance, and HUD's streamlined assessment process. Of the 11 factors evaluated in the assessment, none was found to be high risk, four were assessed as medium risk, and seven were assessed as low risk. The assessment's risk assessment chart adequately addressed planned actions for the four factors assessed as medium risk. Overall, the factors identified above had the major program objectives sufficiently emphasized in the assessment and resulted in the following:

- **Legislative:** HUD was given legislative authority through Title XII of the Recovery Act that included authority for HUD to make loans, make grants, and take a variety of other actions to facilitate utility-saving investments and other investments that produce

environmental benefits in certain existing HUD-assisted multifamily housing, subject to agreement between HUD and the owner. The legislative timelines are clearly defined as the HUD Secretary must take steps necessary to ensure that owners receiving funding for energy and green retrofit investments under this heading shall expend such funding within two years of the date they receive the funding. To ensure that owners complete the agreed-upon retrofits and expend funds as scheduled, the Office will use rehabilitation escrow administrators to monitor and track owners' progress toward completion of the scheduled work for each property. In addition, the Office will offer time-based incentives for owners to complete all of the scheduled physical rehabilitation and retrofits successfully and in a timely manner.

Risk rating: Low

- **Organizational structure and staffing:** The same organizational team that has led efforts in the Mark-to-Market program will provide the staffing for the program. The principal change is in the increased staffing for participating administrative entities' coordination and its reporting directly to the Associate Deputy Assistant Secretary. It is not likely that there will be procurement activity for this contract since the financial advisory contractor is already in place as are the three participating administrative entity contracts. If external postclosing portfolio management services are ultimately determined to be needed, the Office will look to existing contractors on the HUD small procurement schedule for such services. As the Mark-to-Market program nears its conclusion, transaction flow has declined significantly. As a result, Office staff has sufficient capacity to effectively manage the program concurrently with the Mark-to-Market program activities.

Risk rating: Low

- **Program objectives and performance measures:** The program objectives as outlined in the Recovery Act are stated in precise, measurable terms. The Office is specifically directed
  - “To make competitive grants or loans;
  - To owners receiving project-based assistance under:
    - i. Section 202 of the Housing Act of 1959 (12 U.S.C. 17012),
    - ii. Section 811 of the Cranston-Gonzales National Affordable Housing Act (42 U.S.C. 8013); or
    - iii. Section 8 of the United States Housing Act of 1937 as amended (42 U.S.C.1437f);
  - For utility-saving retrofits and other retrofits that produce environmental benefits;
  - With funds to be expended within two years of the date funding was received.”

In addition to experience gained through the Mark-to-Market Green Initiative, the Office is well positioned to evaluate green performance measures as a result of specialized training completed by its staff and contractors. Due to this training, the Office staff and contractors are highly educated in matters of energy retrofits and green investments and will use their knowledge to evaluate green products, components, and activities for their appropriateness as “energy retrofit and green investment” compliant and for the likelihood that each can be delivered and installed on site within the required timeframes.

Specific performance metrics that will be collected and reported include

- The number of affordable housing units rehabilitated through the program,
- The number of units receiving energy conservation/green improvements, and
- Tracking the number of green jobs created or retained each quarter through program activity.

HUD will collect quarterly recipient reports from grantees to measure results. The Office will provide grantees with reporting instructions. A methodology has been established to define green jobs using already defined green standards from Leadership in Energy and Environmental Design and other organizations and Energy Star certification for reporting correctly. The measurement data collected will be made available on the HUD.gov/Recovery Web site.

Risk rating: Low

- **Program structure and program administration:** HUD established four major activities that must be performed to attain the objectives of the program. They are
  - Acceptance and processing of applications,
  - Underwriting and determination of grants and/or loans to owners,
  - Rehabilitation escrow administration with incremental disbursement of funds after completion of green retrofit items, and
  - Final closeout of each account.

Under the program, owners of eligible projects may be offered either a program grant or loan of up to \$15,000 per unit for an individual eligible project to be used to finance green retrofits that will reduce ongoing utility consumption, benefit resident health, and/or benefit the environment. Program grants and loans are expected to average \$10,000 per unit across all eligible projects that are funded. Program grants and loans will be placed into rehabilitation escrow deposit accounts, and funds will be released only upon receipt of appropriate on-site inspections, documentation, and owner certifications.

The Recovery Act mandates that the grants or loans under the program be provided through the policies, procedures, contracts, and transactional infrastructure of the authorized programs administered by the Office. The Office has recent experience in underwriting green retrofits that are incorporated into Mark-to-Market restructurings through the Mark-to-Market Green Initiative. The Office launched the Green Initiative in 2007 to assist projects going through the Mark-to-Market process in undertaking rehabilitation in a way that promotes energy savings and efficiency and provides an improved, healthier environment for tenants. In 2008, the Office's senior management and key staff received Leadership in Energy and Environmental Design professional accreditation, which consisted of training in new construction and major renovation of buildings that are energy efficient and which provide an improved environment for inhabitants.

Risk rating: Low

- **Coverage by written and other procedures:** HUD’s Housing Notice H 09-02, issued on May 13, 2009, provides detailed, specific, and comprehensive written instructions for procedures to be followed by grant applicants, recipients, and beneficiaries as well as Office staff. As the need for clarification or further guidance arises, the Office may publish and communicate to all stakeholders in any or all of the following ways:
  - The Internet: The program Web site will provide guidance to grant applicants, recipients, and beneficiaries as well as Office staff and other stakeholders.
  - Training seminars: The Office plans to convene a two-day training seminar in the summer of 2009 for Office staff, participating administrative entities, and other stakeholders. The training will cover specific program requirements related to underwriting, approval guidelines, and the closing process. The Office will conduct other training seminars as needed and upon request from participating administrative entities or HUD staff.
  - Conference calls: A standing time slot will be maintained for conference calls, which will be held biweekly for the first six months of the program. The calls will include Office staff, participating administrative entities, and other HUD staff to discuss policy, procedural issues, and questions arising from the specific circumstances of individual assets going through the Green Retrofit Program. Conference calls will continue on an as-needed basis after the first six months.
  - Monthly production meetings: Monthly production meetings are held with participating administrative entities and the Office to discuss the status of each asset and identify any weakness and/or roadblock to performance. These meetings are already in place for Mark-to-Market and the Mark-to-Market Green Initiative process. The discussion of program assets can be incorporated into these preexisting meetings with little to no difficulty.

Risk rating: Low

- **Systems:** The Office’s management information system, referred to as the “MIS System,” officially identified as “HUD System F24B (Mark-to-Market),” located within HUD’s secure systems Web application suite, will be used to track and document significant milestones from receipt of the owner’s application through closing of the transaction. The existing rehabilitation escrow database will be used to track the creation of each program rehabilitation escrow account from inception through completion of work. These systems will work with the Office’s infrastructure to provide the necessary information to report on the recovery.gov Web site as well as any other reporting required by the Office of Management and Budget.

Relatively minor enhancements will be needed to tailor the management information system, used for tracking and managing the Mark-to-Market transaction progress and process, to the program-specific milestones and transactional outcomes. Raw data elements, milestone tracking, and reporting requirements for the program will be similar to Mark-to-Market use. The logic behind both program and Mark-to-Market data collection and reporting will be similar, since both are used to track a real estate underwriting and closing process.

The Office is working with various groups within HUD to develop a system to track, monitor, and control the disbursement of Recovery Act funds. The planned phase I

changes to the Mark-to-Market system have been completed. The Office is beginning phase II to determine and plan changes that are needed for program activities. Meetings are scheduled to take place beginning in June 2009 to facilitate this coordination. The goal is to have all system changes in place for the next Multifamily Housing Systems scheduled release, anticipated to occur by October 30, 2009.

Risk rating: Medium

- **Funding/funds control and organizational checks and balances:** The Recovery Act appropriated \$250 million for grants or loans for energy retrofit and green investments for eligible assisted housing to be administered by the Office. The Office's program shall be collectively known as the Green Retrofit Program. The Office will have three separate program funds control plans reflecting the distinct commitment and funding processes for each type of funding.
  - The participating administrative entities' funds control plan, 5 percent of program funding, has been approved by HUD. This plan was drafted and approved first because the participating administrative entities' funds will be committed and obligated by HUD much earlier in the program. The participating administrative entities' funds will be used by HUD to contract for the necessary underwriting analyses required for HUD to determine whether and in what amount to fund program grants or loans.
  - Funding for staffing, training, technical assistance, technology, research, and evaluation activities, 1 percent of program funding, will be addressed in the Office of Housing's salaries and expenses funds control plan and HUD's working capital plan.
  - Plans for the balance of the funds, going for grants and loans, are being developed. No grants or loans will be committed or obligated before approval of appropriate funds control plans.

Risk rating: Medium

- **Management attitude:** Office management has taken steps to establish a control environment that sets a positive and supportive attitude toward internal control consciousness. The Office's Green Retrofit Program Quality Control Team, including one management-level staff member and four experienced line staff members, was recently selected and assigned the task of reviewing HUD's Housing Notice H 09-02 and ensuring that all written guidance and programmatic decisions established for the program are consistent both with the notice and across the documentation. This will be an ongoing responsibility as additional or supplemental guidance is published.

Based on the controls that have been developed by Office staff, management demonstrates a clear grasp of the importance of and commitment to the establishment of the program and its goals. Office management is committed to conducting business with the highest standard of ethics. Office staff maintains ethics educational requirements as established by HUD.

Consistent communication between management and staff is a key factor in ensuring that established policies and procedures are followed on a regular basis. Regular calls and

meetings also provide a mechanism whereby departures from established policies and procedures can be discussed. Changes in established policies and procedures may be initiated by a need to consider an exception or a waiver or when considering new ideas or initiatives. The Office has reports generated by various tracking systems (examples include multiple reports from HUD System F24B, REMS (multiple reports), closing reports, production management reports, postclosing portfolio management reports, rehabilitation escrow aging reports, and assumption/subordination reports) that managers use to track work progress of subordinate staff and the underlying transactions in conjunction with regularly scheduled work tracking meetings. Additionally, the Office has a regular series of calls and meetings as well as ad hoc calls and meetings to monitor progress and discuss ongoing and new issues.

Risk rating: Low

- **Reporting and documentation:** HUD's Housing Notice H 09-02 for the program provides participants with information about program policies, procedures, and reporting requirements. The Office will be able to distribute additional guidance electronically to all program participants as needed through the resource desk, a Web-based clearinghouse for information. Program-specific information, documents, directives, and alerts are communicated in this manner for Mark-to-Market issues, and the resource desk will be able to serve a similar function for the program. In addition, the resource desk is an avenue by which stakeholders can raise questions regarding program policies and processes. Office systems are also being modified to produce reports that will track the use of program funds according to the statutory requirements for loans and grants (94 percent of the total appropriated); appropriate underwriting and oversight (5 percent of the total appropriated); and training, technical assistance, technology, monitoring, research, and evaluation activities (1 percent of the total appropriated). Office systems also are being developed to track the applications for funding by category as established in HUD's Housing Notice H 09-02. The Office will need to track applicants by project category (for example, Section 202 projects and Section 811 projects) and by HUD region.

While documentation and reporting will build on current Office systems, the need to expand the capabilities of some of these systems to provide separate reporting for the program and the need to create applications unique to the program make this activity a medium-risk activity. This risk is mitigated by the planned action of creating the systems to track and provide management with reports on activities and on compliance with all program requirements. Managers and staff will be accountable for meeting program goals, and this accountability will become part of the performance review process. The Office uses reports generated by tracking systems for managers to review work progress in conjunction with regularly scheduled workload tracking meetings. Additionally, the Office conducts regular calls and meetings and ad hoc calls and meetings to monitor progress and discuss ongoing and new issues.

Risk rating: Medium

- **Monitoring:** Oversight and monitoring for the program use the Office data systems, which are being expanded to include program activities. Approximately 300 properties are expected to participate in the program. This program size will allow monitoring

systems to track all participants and provide regular reporting and exceptions reporting to Office staff for all properties on an ongoing basis. To address the accountability objective of ensuring that funds are used for authorized purposes and to mitigate the risk of fraud, waste, error and abuse, the Office will use its contract with its participating administrative entities to provide ongoing monitoring of the quality of work submitted by each participating administrative entity and of program outcomes generated by each participating administrative entity. Also, the rehabilitation escrow deposit agreement (agreement) provides for periodic monitoring of the work performed by the owner. Funds will not be released from the rehabilitation escrow until after the rehabilitation escrow administrator has received and accepted the report from an on-site inspection, confirming that each respective improvement was completed as specified in the agreement, and has reviewed the funds reimbursement request and all required owner documentation and certifications. Several practices have been established to assist the Office in monitoring participating administrative entities' performance. The office will expand the monitoring of the participating administrative entities to include monitoring the progress of properties participating in the program.

Risk rating: Medium

- **Special concerns and impacts:** The program is going to receive scrutiny based on its origin as a part of the Recovery Act, a much debated and high-profile effort by the administration to revive the American economy. The statute underlines the urgency of the task by creating extremely tight timeframes for delivering money to participants that can be quickly turned into jobs. The Office is singularly well suited among HUD offices to oversee this program based on its performance in the Mark-to-Market program.

HUD stated that The Mark-to-Market program and the Office have withstood many reviews of its program and outcomes by HUD's Office of Inspector General, The U. S. Government Accountability Office, and voluntary internal audits. The Office has routinely engaged a third-party audit firm to confirm compliance with the documentation requirements of the Mark-to-Market Operating Procedures Guide. These audits have always shown that participating administrative entities are in substantial compliance.

Risk rating: Low

### **RECOMMENDATION**

Based on the results of this review, this memorandum report contains no recommendations.

### **AUDITEE'S RESPONSE**

We provided our discussion draft audit memorandum to HUD's Acting Deputy Chief Financial Officer on September 2, 2009. HUD declined our offer for an exit conference and to provide written comments on the discussion draft audit memorandum.