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Audit Report Number	2009-FW-1016
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TO: Scott G. Davis, Director, Disaster Recovery & Special Issues Division, DGBD

FROM: *//signed//*
Gerald R. Kirkland
Regional Inspector General for Audit, Fort Worth Region, 6AGA

SUBJECT: The Texas Department of Housing and Community Affairs's Disaster Recovery Action Plan Needs Improvement

HIGHLIGHTS

What We Audited and Why

We audited the U. S. Department of Housing and Urban Development (HUD) Community Development Block Grant (CDBG), Supplemental I and II Disaster Recovery program funds, administered by the Texas Department of Housing and Community Affairs (TDHCA). Specifically, we wanted to determine whether TDHCA administered the floodplain management program as required by federal, state, and local policies and whether it protected HUD's CDBG investments in properties reconstructed or rehabilitated with Disaster Recovery program funds against future potential losses. The audit was initiated as part of the Office of Inspector General's (OIG) commitment to HUD to implement oversight of the Disaster Recovery funds to prevent fraud, waste, and abuse.

What We Found

TDHCA generally administered the program funds in accordance with applicable federal, state, and local floodplain regulations and policies. However, its action plan did not require homeowner's insurance on properties reconstructed or rehabilitated with Supplemental I funds, and its grants required only 3 years of homeowner's insurance for homes reconstructed or rehabilitated with

Supplemental II funds. Due to the lack of or limited insurance, HUD's CDBG Disaster Recovery funds invested in the homes provided to the disaster victims are at risk of loss. Of a sample of 59 Supplemental I funded homes tested, 38 were later damaged by another hurricane or storm. Of the 38 homes, 23 did not have insurance. Based on a projection of the sample results, at least 133 of 453 reconstructed or rehabilitated homes, or homes awaiting reconstruction, lacked insurance and were damaged or are at risk of being damaged by another storm. If TDHCA changes and improves its action plan and policies, an estimated \$ 60.2 million of program funds could be saved.

What We Recommend

We recommend that HUD's Director of Disaster Recovery Assistance & Special Issues Division request TDHCA to (1) modify its action plan to provide homeowner's insurance for a period equitable to the amount of funds invested, request the homeowner to obtain homeowner's insurance as a prerequisite to obtaining assistance for a period equitable to the amount of funds invested, or prohibit the homeowner from receiving future Disaster Recovery assistance if an insurance policy is not maintained on a newly reconstructed or rehabilitated home.

Auditee's Response

We provided a copy of the draft report to TDHCA on August 21, 2009. We held an exit conference with TDHCA and HUD on September 8, 2009. Based on TDHCA's comments, we made tone changes and provided a revised draft on September 14, 2009. We requested and received TDHCA's written comments to the revised draft report on September 21, 2009. TDHCA did not agree with the finding. The complete text of TDHCA's response, along with our evaluation of that response can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

The 2005 hurricane season was one of the most extreme in recorded history to hit the Gulf Coast region. Hurricanes Katrina and Rita caused extensive damage to homes from excessive wind and rain damage. Since the 2005 hurricane season, the region has suffered eight additional hurricanes or tropical storms, including Hurricane Ike that caused extensive damage costing \$30 billion to the eastern Texas coastline.

To aid in the recovery from the 2005 storms, Congress authorized two supplemental funding appropriations. Supplemental I, Public Law 109-148, authorized \$11.5 billion, and Supplemental II, Public Law 109-234, authorized \$5.2 billion in funding. Of the \$16.7 billion authorized, the State of Texas (State) received \$503 million through the U. S. Department of Department of Housing and Urban Development’s (HUD) Community Development Block Grant program (CDBG) to address areas most impacted by Hurricanes Rita and Katrina.

The Texas governor selected the Texas Department of Housing and Community Affairs (TDHCA) as the lead agency to administer the CDBG Disaster Recovery funds. TDHCA, established in 1991, is the State’s primary agency for providing essential public services to and meeting the housing needs of extremely low- to moderate-income individuals and families.

TDHCA's method of allocation used data from the Federal Emergency Management Agency (FEMA), the Texas Department of Insurance, census poverty data, and public input. The method of allocation distributed \$261.3 million to the individual assistance program under Supplementals I and II, which was designed to rehabilitate or reconstruct the homes of the disaster victims affected by Hurricane Rita. Funds for all homeowners projected to be assisted with Supplemental I funds have been budgeted and approved. The reconstruction or rehabilitation of homes using the Supplemental II funds, in earnest, began in 2009. As of March 2009, the contractor had completed a few homes and is required to complete all homes by the end of the contract in January 2011. The following table provides information regarding projects and funds used and anticipated to be used for homeowners to recover from Hurricane Rita.

Funding source	Type of assistance	Number Assisted	Amount of assistance
Supplemental I			
	Loan	31	\$ 2,345,421
	Grant	453	27,286,630
Supplemental II			
	Loan	329	19,834,415
	Grant	2,964 ¹	\$178,509,737 ²

¹ Our estimate of 2,964 grants is derived by dividing Supplemental II funds available of \$198,344,152 for housing assistance by the average grant amount of \$60,235 from Supplemental I and removing the estimated 10 percent of the projects that will be loans. ($\$198,344,152 / \$60,235 = 3,293$ projects); ($3,293 * .10 = 329$ loans); ($3,293 - 329 = 2,964$ grants)

² Ten percent of the funding is estimated to be loans; thus, it was removed from the total available for grants. ($\$198,344,152 - \$19,834,415 = \$178,509,737$)

TDHCA provides assistance to homeowners with loans or grants to reconstruct or rehabilitate their homes. A forgivable loan is used to fund the work for a home in a floodplain. The loans are forgiven if the homeowners maintain residency for 3 years. Additionally, the homeowners must maintain flood insurance at all times to be assisted in a flood plain. TDHCA will assess penalties and will be unable to provide federally assisted funding if the homeowners do not meet the requirements. TDHCA provides grants for homes that are not in a floodplain. Supplemental I grants do not have additional requirements, such as requiring insurance or residency. Supplemental II grants contain insurance and are effective up to 3 years based on the completion date of the improvements.

Our objectives were to determine whether TDHCA administered the floodplain program as required by federal, state, and local policy and whether it protected HUD's CDBG investments in properties reconstructed or rehabilitated with Disaster Recovery program funds against future potential losses.

RESULTS OF AUDIT

Finding: TDHCA's Disaster Recovery Action Plan Needs Improvement

TDHCA generally administered the program in accordance with applicable federal, state, and local floodplain management policies. However, its action plans did not require homeowner's insurance for Supplemental I and only 3 years insurance was required for Supplemental II for homes reconstructed or rehabilitated with program funds. Thus, HUD's CDBG Disaster Recovery funds invested in the homes provided to the disaster victims are at risk of loss. Of a sample of 59 Supplemental I homes tested, 38 were later damaged by another hurricane or storm.³ Of the 38 homes, 23 did not have insurance.⁴ Projecting the results of the statistical samples shows that at least 133 of the 453 Supplemental I homes lacked insurance and were damaged or are at risk of being damaged. This condition occurred because TDHCA designed its action plan to reconstruct or rehabilitate the maximum number of homes for disaster victims rather than require insurance for the homes for a period equitable to the amount of funds invested and the asset life of the home. As a result, an estimated \$60.2 million⁵ in HUD CDBG Disaster Recovery funds are at risk of loss. TDHCA needs to ensure CDBG funds are protected from future loss by protecting the homes with homeowner's insurance.

Uninsured Homes Were Damaged Again by Another Hurricane or Storm

Site visits at 59 statistically selected reconstructed or rehabilitated Supplemental I funded homes found that 38 of them were damaged again by Hurricane Ike or another storm. Of the 38 homes, 23 were not insured. Projecting this statistical sample shows that of the 453 homes that had been or will be repaired or replaced with Supplemental I funding, at least 249 homes had been damaged again, of which at least 133 were not insured. The estimates are based only on the homes that were damaged by Hurricane Ike or another storm. However, damages could also occur from other causes, such as fire.

The average grant awarded to repair or replace the homes was \$60,235. Using the average grant amount, we estimate that at a minimum, \$8 million is at risk of loss on at least 133 homes that were damaged but uninsured for Supplemental I.

For Supplemental I, TDHCA decided to forego providing insurance to homeowners that received a grant to minimize the cost per household. TDHCA based its decision

³ The 38 homes consist of 26 newly constructed homes and 12 existing homes awaiting reconstruction or rehabilitation.

⁴ The 23 uninsured homes consist of 15 newly constructed homes, 1 rehabilitation, and 7 existing homes waiting for assistance.

⁵ Supplemental I (\$8,011,255) + Supplemental II (\$52,223,745) = \$ 60,235,000, rounded to \$60.2 million.

on the premise that the cost saving would allow it to assist more families on its waiting list. TDHCA had calculated that its waiting list had already surpassed the amount of Disaster Recovery funds available. Further, TDHCA indicated that homeowner's insurance for grants was not a statutory requirement like mandatory flood insurance.

One Uninsured Property Sustained Severe Damage

TDHCA stated it took measures to minimize damage to homes by requiring the contractors to construct homes including the latest design and building techniques to alleviate damage caused by flooding or high winds; however, one homeowner's manufactured home, which cost more than \$47,000 to purchase and install, sustained severe damage caused by a tree blown down by Hurricane Ike in September 2008 (See Figures 1 and 2.) As of April 2009, the home was not repaired because the homeowner did not have private homeowner's insurance or personal funds to repair the damage.



Figure 1 Uninsured manufactured home damaged by Hurricane Ike⁶

⁶ Photograph provided by homeowner, Hankamer, Texas.



Figure 2 Interior view, current condition, shattered joists and rafters

The homeowner received financial assistance from FEMA for the damaged roof; however, according to the homeowner, the funds were not sufficient to repair all of the damage. The homeowner requested information on how to apply for federal aid to repair the roof damage caused by Hurricane Ike. Aside from the damage to this home, the majority of the damage to the other 37 inspected and affected homes was not as severe.

TDHCA Required Insurance for Supplemental II Homes

TDHCA also administered the CDBG Disaster Recovery program benefits under Supplemental II, which included the State's Homeowner Assistance program. That program will fund at least an additional 2,900 home reconstruction or rehabilitation projects at a cost of more than \$178.5 million. According to TDHCA officials, they took action to mitigate the risk for Supplemental II funded homes. In February 2009, when TDHCA began executing Supplemental II grant agreements, it required hazard or property insurance for reconstructed or rehabilitated homes. The grant agreements required homeowners to keep the improvements now existing or hereafter erected on the property insured against loss. However, the grant agreements did not specify a period for which the homeowners had to maintain the insurance. According to Affiliated Computer Services, Inc., (ACS) TDHCA's contractor, the insurance must remain in place for "perpetuity."

Supplemental II Funds Will be at Risk After 3 Years

Although TDHCA took actions to protect the Supplemental II funds, concerns exist as the grant agreements with the homeowners terminate 3 years from the

home reconstruction or rehabilitation completion date. Thus, after 3 years, TDHCA will lack a means to ensure the homeowner maintains insurance to protect the CDBG investment for the remaining useful asset life of the home or for a period equitable to the amount of CDBG funds invested. The potential for future damages appears high as information provided by ACS showed that 266 homes of Supplemental II applicants that requested assistance to rebuild after Hurricane Rita, were also damaged by Hurricane Ike. In addition, FEMA has paid more than \$1.4 million in benefits to these homeowners for damages caused by Hurricane Ike. Although all of the \$178.5 million of Supplemental II funding will be at risk 3 years after the homes' completion dates, it is more conservative to calculate a lower estimate of risk based on the assumption that a percentage of Supplemental II homes will continue to be insured, as shown by Supplemental I testing, it is more conservative to calculate a lower estimate of risk. Adopting that conservative approach and using the error rate from Supplemental I to make the estimation means that an estimated \$52.2 million in Supplemental II funds will be at risk if changes are not made.⁷

Disaster Victims Will Continue to Seek Aid to Repair Their Homes

Unless TDHCA corrects its Disaster Recovery action plan, disaster victims will continue to seek federal aid to repair or replace their homes that were already assisted. Uninsured homeowners with Hurricane Ike damage who meet FEMA assistance requirements are eligible for FEMA assistance and are allowed to apply for additional HUD CDBG Ike assistance. Some of the 23 homeowners that were affected by Hurricane Ike have already received FEMA assistance and are requesting and/or anticipating further federal aid for Hurricane Ike damage.

Moreover, as of November 2008, Texas estimated that it needs more than \$3 billion for uninsured housing cost as a result of Hurricane Ike. Based on our sample, almost 29 percent of the disaster victims affected by Hurricane Rita were hurricane victims again. Local government officials stated that the disaster victims that were assisted for Hurricane Rita are requesting information on how to apply for funding when it becomes available to repair the damages to their new homes caused by Hurricane Ike. TDHCA's decision not to require homeowner's insurance for Supplemental I or not insuring homes under Supplemental II for a period equitable to its cost has put at risk a substantial portion of the funds provided under Supplementals I and II and created a condition whereby federal tax dollars may again be used to assist the same homeowners. Since the Supplemental I funds have been budgeted and expended, any additional assistance from HUD will need to be provided from another source of funds.

⁷ See Appendix C Sampling Methodology and Results.

Conclusion

TDHCA generally administered the program funds in accordance with applicable federal, state, and local floodplain regulations and policies; however, based on the sample tested, several of the Supplemental I homeowners did not have homeowner's insurance to protect their homes from loss. Additionally, homes will be at risk after the initial insurance period terminates for homes reconstructed and/or rehabilitated with Supplemental II funds. TDHCA needs to ensure that the investments in the homes are protected with insurance. Otherwise, a portion of the funding is at risk of loss. If TDHCA requires the homes to be insured against damages caused by hazards, wind storms, or rain storms, an estimated \$60.2 million could be put to better use and protected from loss.

Recommendation

We recommend that HUD's Director of Disaster Recovery Assistance & Special Issues Division request TDHCA to

- 1A. Modify its action plan to either provide homeowner's insurance for a reasonable period to all newly reconstructed or repaired homes for a period equitable to the amount of funds invested and the life of the asset, or request the homeowner to obtain homeowner's insurance as a prerequisite to obtaining assistance for a period equitable to the amount of funds invested and the life of the asset, or prohibit the homeowner from being able to receive future Disaster Recovery assistance if an insurance policy is not maintained on a newly reconstructed or repaired home, which will result in \$60.2 million in funds to be put to better use.

SCOPE AND METHODOLOGY

We performed our audit fieldwork from January through May 2009 at the TDHCA's office located in Austin, Texas; the Affiliated Computer Services, Inc. (ACS), office in San Antonio, Texas; and the Council of Government's (Councils)⁸ offices located in Beaumont, Houston, and Jasper, Texas. The audit generally covered the period January 10, 2007, through April 3, 2009. To accomplish our objectives, we

- Gained an understanding of the CDBG program requirements by reviewing applicable HUD regulations, waivers, notices, and legislation for the Disaster Recovery Supplementals I and II provided to Texas.
- Reviewed TDHCA's annual action plans.
- Reviewed TDHCA's, Council's, and ACS's policies and procedures to gain an understanding of the organizations' floodplain management and environmental assessment requirements and homeowner's insurance coverage.
- Reviewed the Council's and ACS's files for homes in flood zones and conducted site visits to the homes that were completed.
- Interviewed personnel from TDHCA, the Councils, and ACS.
- Reviewed TDHCA's Supplemental I data from its Housing Contracting System to obtain a statistical sample of applications for homes not in a flood zone.
- Reviewed flood zone maps and other data obtained from FEMA related to Hurricane Ike damage to the homes in the sample.
- Conducted file reviews, site visits, and interviews of applicants for the 59 randomly selected housing applications and summarized the results.
- Reviewed ACS's Supplemental II data from its Worltrac System to obtain information on the number of applications and the number of homes that were damaged by Hurricane Ike.

The universe consisted of the electronic data received from TDHCA's housing contracting system that contained 453 approved applications for a total funding of \$27,286,630. A file review conducted on the applications verified that the data obtained from TDHCA was generally reliable. A representative statistical sampling method was used because each sampling unit is selected without bias from the universe and the conclusions reached about the universe can be based on mathematically defensible projections from the sample. Using this method, a random sample of 59 applications funded by TDHCA's Supplemental I funds was selected for review

A detailed file review was performed on all 59 applications in the statistical sample to determine whether the properties were properly identified as not being in a flood zone. The file documentation supported the Councils' results that the homes were not located in flood zones. A site visit was conducted to verify and determine whether any of the 59 applicants' homes was damaged by Hurricane Ike or a recent storm and whether the homes were insured. We projected

⁸ The Council of Government is a voluntary association of local governments whose purpose is to solve area wide problems for their region. Texas is divided into 24 regional councils of which 4 were affected by Hurricane Rita.

the results of our sample to the population of 453 homes. We then estimated the risk of loss to Supplemental I and Supplemental II funds (see Appendix C for the complete sampling methodology and results).

An electronic database of applications was obtained from ACS. A reliability assessment of the computer data provided by ACS was limited to the number of homes completed in the flood plain and was determined to be generally reliable. All additional electronic data was used for background information, and no assessment of the data's reliability was conducted. Although no detailed review of Supplemental II grants was performed,⁹ it is expected that 2,964 households will be assisted with \$178.5 million in Supplemental II funds. Although all of the \$178.5 million of Supplemental II funding will be at risk 3 years after the homes' completion dates, to be more conservative, we calculated a lower estimate of risk based on the assumption that a percentage of Supplemental II homes will continue be insured, as shown by Supplemental I testing, even though insurance will not be an enforceable requirement. Adopting that conservative approach and using the error rate from Supplemental I, we calculated the estimation of risk of loss for Supplemental II (see Appendix C for the complete sampling methodology and results).

The audit was conducted 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

⁹ At the time of our review, only 4 homes were complete and 28 under construction for Supplemental II.

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are achieved:

- Program operations,
- Relevance and reliability of information,
- Compliance with applicable laws and regulations, and
- Safeguarding of assets and resources.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Floodplain management policies and procedures,
- Flood insurance purchase policies,
- Homeowner's insurance purchase policies

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weaknesses

Based on our review, we believe that the following items are significant weaknesses:

- TDHCA lacked policies and procedures to ensure that homeowners had insurance to protect federal funding from loss due to future hurricanes, storms, or other hazards (see finding).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

Recommendation number	Funds to be put to better use <u>1/</u>
1A	\$60,235,000

1/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. In this instance, the amount represents the estimated costs that HUD can avoid if it requires homeowner's insurance to be maintained on homes that are repaired or replaced with Supplemental I and II funds. The estimate does not reflect any offsetting costs that may be incurred in providing homeowner's insurance.


Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

Comment 1


TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS
www.tdhca.state.tx.us

Rick Perry
GOVERNOR

Michael Gerber
EXECUTIVE DIRECTOR

BOARD MEMBERS
C. Kent Comine, *Chair*
Gloria Ray, *Vice Chair*
Leslie Bingham Escareño
Tomas Cardenas, P.E.
Tom H. Gann
Juan S. Muñoz, Ph.D.

September 21, 2009


Mr. Gerald Kirkland
Regional Inspector General for Audit
HUD Office of Inspector General, Region VI
819 Taylor Street, Suite 13A09
Fort Worth, TX 76102

Dear Mr. Kirkland:

Please find attached the Texas Department of Housing and Community Affairs' response to the recently revised draft audit numbered 2009-FW-101X. The Department continues to disagree with the underlying assumptions of the audit and the conclusions drawn. It is also clear to us that there is significant disagreement between HUD's Office of Inspector General and the HUD division implementing this program.

We encourage you to resolve these differences at HUD and provide clear guidance to the Department as to what is expected so that we may continue to administer our Disaster Recovery programs in full compliance with HUD rules and guidelines.

Sincerely,



Michael Gerber
Executive Director

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♻️ Printed on recycled paper.

Auditee's Response

Comment 1

TDHCA currently requires recipients of benefits to execute an agreement in which they commit to maintain insurance to cover damage to the premises, including flood insurance if in a flood plain. TDHCA does not believe that it is appropriate to use CDBG disaster recovery funds to pay for insurance coverage without a thorough cost-benefit analysis. Such an analysis, performed at the Federal level, should measure the impact of providing insurance for all recipients when the need for housing far exceeds the funding available. In addition, consideration should be given to the difference in future vulnerability to storm damage between older housing and replacement housing designed to withstand such storms. Finally, consideration should be given to the possibility of using other methodologies to ensure that future CDBG disaster funds are not used to pay for losses that could have been avoided or financially minimized.

If an average insurance policy is \$1,200 per year, the annual cost of insuring the estimated 2900 beneficiaries under Rita Round II would be nearly \$3.5 million. Currently, the program only allows for payment of the initial period of insurance, i.e., the first year. Regardless of that requirement, over the reasonable life of these homes, assumed at 30 years, the cost would be in the range of \$105,000,000. The probability of \$105,000,000 in losses to these new homes and/or repaired homes is not easy to estimate; however, the condition of the new stock as compared with that which was replaced is a material factor in the potential longevity of the structures and the ability to withstand future storms. As a general rule, the greatest risk of destruction was in areas immediately adjacent to the coast and, therefore, at risk of surge, flooding, high winds, fallen trees, as well as damage from airborne objects and water-born debris. A survey of the most severely damaged areas indicates widespread damage to homes as a result of structural collapse and as a longer term result of mold and decay. Although still standing, many of these homes were in largely deserted neighborhoods and are owned by persons without the ability to procure immediate water and mold remediation assistance or structural repair to prevent further exposure to the elements.

More often than not, these homes were older homes in less than optimal condition to begin with. They were generally not elevated to be secure from flood damage.

Comment 2

As these homes are replaced with assistance from the CDBG disaster recovery program, they are replaced with new, sound homes, constructed according to building standards that require compliance with the International Residential Code, which prescribes higher quality construction and mitigation against environmental forces and standards which employ effective wind resistant construction methods as well as elevation when a home is located in a flood plain. It is anticipated that the new homes will be far more resistant to reasonably foreseeable damage than prior homes. This is supported by the level of damage noted in this report for replaced housing impacted by Hurricane Ike. Only one home in the sample sustained severe damage while the rest of the inspected and affected homes sustained less severe damage. Due to these higher construction standards and mitigation activities, TDHCA contends the projection of the amount of damage likely to occur and the amount of program funds at risk or that could be saved if recipients were required to carry insurance are over-estimated.

Comment 1

While not a regulatory requirement, TDHCA intends to continue requiring homeowners to execute an agreement that requires maintenance of insurance, including notification that if the property is damaged, the homeowner may not be eligible for future benefits if they failed to maintain insurance. However, there is no requirement regarding the length of time that a program recipient must insure their property, other than for flooding, in order to receive assistance in the event of another disaster. The Department has imposed more requirements to safeguard these funds than are stipulated by regulation.

Auditee's Response

Comment 1

TDHCA has carried out the program in compliance with HUD's program guidance and is well within the bounds of the "maximum feasible deference" provisions of CDBG disaster recovery funding in making the decision to maximize expenditures on actual recovery rather than diverting these funds to insurance. To the extent that HUD provides additional program guidance in this area, TDHCA will follow HUD's program guidance.

Comment 3

The OIG audit recommendations, suggesting that TDHCA consider amending its program to provide, as one of three alternatives, homeowner's insurance for a reasonable period to all newly constructed or repaired homes for a period equitable to the amount of funds invested and the life of the asset raises issues which TDHCA believes are far better addressed at a HUD program guidance policy level. If CDBG disaster funds are used to provide insurance, the costs could potentially be quite large. The average annual multiplier of \$1,200 becomes \$36,000 in a model using a 30 year asset life. Dedicating such a large amount of funding to insurance would materially affect the ability of CDBG disaster recovery funding to serve those most in need. A state agency is simply not going to have access to the actuarial and other data necessary to make an informed decision about such a policy. Due to the enormity and complexity of this undertaking, not to mention the lack of definition of such concepts as "a period equitable to the amount of funds invested" and "asset life of the home," TDHCA is not in a position to do anything other than to continue to require homeowners to provide insurance and to address the issue of insurance when developing criteria for receipt of benefits under any future CDBG disaster recovery funding.

Comment 2

The Department has several concerns with the methodology utilized to determine the estimated amount of funds at risk of loss. While the report states that the calculation used to estimate the savings of \$60,235,000 to the program is not meant to be a statistical projection but rather an attempt to provide a conservative and reasonable dollar estimate for the risk of loss, TDHCA believes that a more in-depth analysis, one which TDHCA is not equipped to perform, should be conducted at the Federal level. The report notes that a representative statistical sample was used, and indicates that the sample was randomly selected from the population of homes in Supplemental I, and summarizes that the conclusions reached about the universe for Supplemental I are based on mathematically defensible projections from the sample. However, the only thing that can be concluded statistically from the sample of Supplemental I is the number of uninsured homes. The amount of damage was not determined for the selected sample, and the report clearly indicates that only one of the damaged homes from the sample sustained severe damage. In spite of this, the projection of this sample across both Supplemental I and Supplemental II utilizes an amount that indicates near to total loss for each structure. Since the calculation uses the average grant award amount to estimate the minimum amount at risk across both populations, the assumption is that an average of \$60,000 in damages will occur to each newly constructed home. These homes were all reconstructed to building standards which utilize construction methods to mitigate against future storm damage. TDHCA believes that these factors are indicative of the actuarial risk being significantly lower.

The statistics determined by sampling Supplemental I were extrapolated to Supplemental II. These two populations do not have identical demographic attributes, and consequently, the sample from Supplemental I can not mathematically be appropriately extrapolated to Supplemental II.

Also, the sample used to determine the rate of uninsured homes includes seven existing homes that had yet to be assisted. It is unlikely that those seven homes would be able to qualify for or obtain insurance based on the existing damage; therefore, using these numbers in the calculation

Auditee's Response

as evidence to support the level of uninsured homeowners in the population adversely impacts and inflates the overall calculation of homes at risk by as much as 30%.

Comment 2

Although the report claims that the estimate of the risk of loss is conservative and reasonable, all of the calculations and assumptions listed above cause TDHCA to question this assertion. To pursue a calculation of funds at risk, a more accurate depiction would be to determine the likelihood that uninsured homes would be impacted by a future storm or hazard event and the probable level of damage sustained to a newly constructed home by that event. Incorporating probability factors would more fairly determine the amount of funds at risk or funds to be put to better use. Regardless of how TDHCA reacts to the analysis and recommendations based on this particular sample, TDHCA strongly believes that thorough analysis and development of policy guidance in this arena by HUD is timely and appropriate.

Comment 3

In conclusion, TDHCA is not convinced that the State of Texas providing 30 years of insurance to all homeowners whose homes were reconstructed with CDBG disaster recovery funds would be more beneficial than providing homes to as many affected homeowners as possible and requiring them to maintain insurance on their home for the period of the loan or grant. The risk of a major hurricane striking anywhere on the Texas Gulf Coast is approximately 30%. The cost of providing insurance would mean that as many as 50% fewer homeowners could be served. Without sufficient actuarial data and appropriate testing and statistical sampling, TDHCA is unable to make this decision. As a result, TDHCA will follow HUD's program guidance regarding this issue. In the meantime, TDHCA will continue its practice of requiring homeowners to execute an agreement that requires them to maintain insurance, and if the property is damaged, the homeowner may not be eligible for future benefits if they failed to maintain insurance.

OIG Evaluation of Auditee Comments

- Comment 1** TDHCA disagreed with the underlying assumptions of the audit and the conclusions drawn. It stated that it currently required recipients of benefits to execute an agreement in which they commit to maintain insurance to cover damage to the premises, including flood insurance if in a flood plain. TDHCA indicated it would not change its program until HUD issued additional program guidance as it stated that there is no requirement regarding the length of time a program recipient must insure their property and that its program was within the bounds of CDBG “maximum feasible deference” provisions. We affirm our conclusion that without insurance for a period equitable to the amount of funds invested or the asset life of the home, the funds will be at risk of loss. TDHCA’s response did not clearly address that it did not require insurance for the 453 homes assisted by Supplemental I nor does it address how it will ensure that homes under Supplemental II will be protected when the grant agreements expire after 3 years. TDHCA is correct that there is no requirement for insurance to be provided and that it has maximum feasible deference to create its program. However, according to the Office of Management and Budget’s Circular A-87, Cost Principles for State and Local Governments, TDHCA was required to establish principles and standards to promote effective program delivery and efficiency. The application of the principles in the Circular is based on the fundamental premises that governmental units are responsible for the efficient and effective administration of Federal awards through the application of sound management practices. Thus, we disagree that it does not need to change its program.
- Comment 2** TDHCA had several concerns with the methodology used to determine the estimated amount of funds at risk of loss. TDHCA made several arguments including the replacement housing is better built, only one home sustained severe damage, the risk of damage was projected from Supplemental I to Supplemental II, and the likelihood of damage by a future storm was low. We affirm our projection of damaged homes and our conservative estimation of risk. We were limited to testing Supplemental I homes and estimating Supplemental II risk as only four Supplemental II funded homes located in a flood zone had been completed when we started our audit. The basic premise, though, will exist for Supplemental II funding after 3 years; homes that do not have insurance are at risk of loss from future storms. Further, as the homes we inspected had been damaged by Hurricane Rita and then damaged by Hurricane Ike or another storm, we disagree with TDHCA’s contention that we did not properly calculate risk or that the better built homes will not suffer damage.
- Comment 3** TDHCA indicated that providing insurance would be too costly, limit the amount of CDBG assistance being provided, and could only be provided for the first year with CDBG funds. Our recommendation provided options other than using CDBG funds that addressed these concerns, including having the homeowner provide the insurance or limiting future assistance if insurance is not obtained.

Appendix C

SAMPLING METHODOLOGY AND RESULTS

Purpose of the sampling

The sampling objective was to determine whether the homes were; located in flood zones, damaged by Hurricane Ike or a recent storm, and insured. The sample was based on the number of approved applications not in flood zones and in TDHCA's housing contract system as of January 21, 2009. In support of the objectives, an attribute sampling plan was implemented that allows statistical projections on affected homes and properties.

Definition of the audit population and tests performed

The universe contained 453 applications approved for total funding of \$27,286,630, with an average grant amount of \$60,235. The average grant amount was determined by dividing total funding by the number of applications. ($\$27,286,630 \div 453 = \$60,235$). Grant amounts ranged from a high \$99,388 to a low of \$9,219.

The approved funding was used to finance the reconstruction or rehabilitation of 453 homes that were not located in a flood zone. Accordingly, we made random selections of these 453 homes to perform a detailed file review to compare and verify the electronic data and to verify the home's non-flood zone status. In addition, a site visit to each of the homes was conducted to verify if any of the applicant's homes were damaged by Hurricane Ike or a recent storm and to determine if the homes were insured. A sampling error was documented for each home that did not have documentation to support its flood plain designation; and/or showed evidence of hurricane damage verified by a homeowners' interview and/or FEMA financial assistance documentation; and/or did not have homeowner's insurance verified by homeowner's interview and/or FEMA financial assistance documentation.

Sample design

Using attribute sampling methodology, we determined that a sample size of 59 applications was sufficient using a 90 percent confidence level, expected error rate of 50 percent, and a desired sampling precision level of 10 percent. Accordingly we randomly sampled 59 applications funded by the TDHCA's Supplemental I funds.

Statistical projections of the sampled data

The file documentation supported the Councils' results that the homes were not located in flood zones. However, the site visits to each of the 59 homes showed that 38 of 59 (64 percent) homes were damaged by Hurricane Ike or a recent storm. In addition, 23 of the 38 (61 percent) applicants did not have homeowner's insurance to repair the damage.

Applying an attribute sampling evaluation methodology to the number of damaged and uninsured homes, we estimate that at least 133 homes were damaged by a hurricane or storm and did not have insurance to repair the damage.

Estimated cost savings/loss of Supplemental I and II funds

While our statistical sampling methodology was not designed to estimate the dollar value associated with items failing our attribute tests, to quantify a conservative and reasonable estimate for the risk of loss for Supplemental I funds, we used the conservative lower confidence level projection of 133 and the average grant amount of \$60,235 as a basis for calculating a reasonable dollar estimate. Accordingly, we estimated that at least \$8,011,255 (133 X \$60,235) of the Supplemental I funds are at risk of loss.

To similarly quantify a conservative and reasonable estimate for the risk of loss for Supplemental II funding, we expected that a corresponding number of households to be assisted with \$178.5 million in Supplemental II funds will be damaged again and uninsured. The fact that 266 applicants' homes were damaged again by Hurricane Ike while waiting to be assisted with Hurricane Rita Supplemental II funds supports our argument. In addition, although all of the \$178.5 million of Supplemental II funding will be at risk 3 years after the homes' completion dates, to be more conservative, we calculated a lower estimate of risk based on the assumption that a percentage of Supplemental II homes will continue be insured, as shown by Supplemental I testing, even though insurance will not be an enforceable requirement. Therefore, using the lower confidence level as a conservative estimate for the potential number of errors in Supplemental II, we estimated that an additional \$52,223,745 in extended Disaster Recovery grant funds is at risk of loss as follows.

- $\$178,509,737 \div \$60,235$ average grant amount from Supplemental I = 2,964 grants.
- 29.27 percent lower confidence level X 2,964 grants = 867 grants at risk.
- 867 grants X \$60,235 average grant amount from Supplemental I = \$52,223,745.

This calculation is not meant to be a statistical projection but is an attempt to provide a conservative and reasonable dollar estimate for the risk of loss.

In total, we estimated that HUD can save an estimated \$ 60,235,000 (\$8,011,255 + \$52,223,745) by requiring homeowner's insurance to be maintained on homes repaired or replaced with Supplemental funds. The estimate is presented solely to demonstrate the amount of funds that could be put to better use if HUD implements our recommendations.