



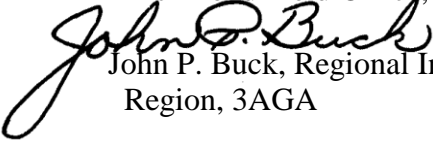
U.S. Department of Housing and Urban Development
Wanamaker Building, Suite 1005
100 Penn Square East
Philadelphia, PA 19107-3380

Regional Inspector General for Audit

MEMORANDUM NO:
2010-PH-0801

January 12, 2010

MEMORANDUM FOR: Charlie Famuliner, Director, Multifamily Program Center,
Richmond Field Office, 3FHML

FROM: 
John P. Buck, Regional Inspector General for Audit, Philadelphia
Region, 3AGA

SUBJECT: HUD's Regulatory Agreement with the Yorkville Cooperative
Does Not Protect HUD's Interest

INTRODUCTION

We performed this review at your request due to concerns regarding the appropriateness of the U.S. Department of Housing and Urban Development's (HUD) current regulatory agreement with the Yorkville Cooperative (Cooperative). Our objective was to determine if HUD entered into the appropriate regulatory agreement with the Cooperative for its Section 221(d)(3) program.

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

METHODOLOGY AND SCOPE

The scope of our review was limited strictly to addressing concerns regarding the appropriateness of HUD's current regulatory agreement with the Cooperative. To accomplish this objective, we

- Reviewed HUD Handbooks 4350.1, 4370.2, REV-1 and other HUD policies and procedures governing HUD's 221(d)(3) properties.
- Reviewed HUD's 1979 regulatory agreement with the Cooperative.
- Interviewed Cooperative officials and officials from HUD's Richmond, VA, Multifamily field office.

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- Reviewed the Cooperative’s 2007 and 2008 audited financial statements.
- Reviewed the Cooperative’s independent public accountant’s workpapers used to prepare the 2007 and 2008 audited financial statements.
- Reviewed audit workpapers supporting our recently issued external audit report on the Yorkville Cooperative (Audit Report Number 2010-PH-1003).

We performed our review from September 2009 through December 2009 at HUD’s Richmond, VA, Multifamily field office located at 600 East Broad Street, Richmond, VA, and at the Cooperative’s office located at 3146 Draper Drive, Fairfax, VA. The audit generally covered the period January 2006 through March 2009, but was expanded when necessary to include other periods.

Our objective was to determine if HUD entered into the appropriate regulatory agreement with the Cooperative for its Section 221(d)(3) program.

BACKGROUND

The U.S. Department of Housing and Urban Development (HUD) entered into a regulatory agreement with the Yorkville Cooperative (Cooperative) in 1979 for HUD’s Section 221(d)(3) insured multifamily program. The Section 221(d)(3) program insures mortgage loans to facilitate the new construction or substantial rehabilitation of multifamily rental or cooperative housing for moderate-income families, the elderly, and the handicapped. Section 221(d)(3) mortgages are for nonprofit sponsors or cooperatives up to 100 percent of the HUD/Federal Housing Administration (FHA) estimated replacement cost of the project.

The regulatory agreement also provided the Cooperative the use of housing assistance payments contracts for its units. The Cooperative executed a Section 8 contract with HUD for 237 units. Currently, 229 units are occupied, and eight are vacant. During our audit period, HUD authorized the Cooperative the following financial assistance for its program:

Fiscal year	Authorized funds	Disbursed funds
2006	\$1,405,123	\$1,405,123
2007	\$2,427,715	\$2,427,715
2008	\$2,823,100	\$2,786,679
2009	\$2,956,624	\$854,372
2009	\$394,775	\$394,775
Totals	\$10,007,337	\$7,868,664

Our objective was to determine if the HUD entered into the appropriate Regulatory Agreement with the Cooperative for its Section 221(d)(3) program.

RESULTS OF REVIEW

Current Regulatory Agreement Is Not Appropriate

HUD and the Cooperative did not enter into an appropriate regulatory agreement for participants of the Section 221(d)(3) program. The regulatory agreement executed in 1979 was intended for entities participating in the Multifamily Insurance program but it did not include specific regulatory requirements needed for entities participating in the program as cooperatives. The agreement failed to include necessary requirements pertaining to the general operating reserve account.

When the Cooperative signed its regulatory agreement in 1979, HUD's Washington, DC, field office was responsible for administering FHA multifamily functions and servicing loans for entities located in Fairfax, VA. In January 1997, oversight of the Cooperative's participation in the 221(d)(3) program transferred to the Richmond, VA, Multifamily Program Center. Due to the transfer in HUD oversight and the length of time that transpired since the regulatory agreement was signed, HUD officials could not explain why an incorrect regulatory agreement was executed.

The Cooperative Established a General Operating Reserve Account

According to HUD Handbook 4350.1 REV-1, chapter 26, cooperatives insured under the Section 213 or 221(d)(3) programs are required to establish and maintain a general operating reserve fund. The purpose of the reserve is to provide the cooperative with a measure of financial stability. The fund may be used to finance the sale of memberships, to meet deficiencies arising from time to time as a result of delinquent payment by individual cooperators and other contingencies and to provide funds for repurchase of membership of withdrawing members. The reserve is to be maintained in a special account which can be in the form of a cash deposit or investment. Once the reserve equals 25 percent of annual carrying charges, funding of the reserve can be discontinued.

Although the Cooperative's regulatory agreement with HUD did not include a section pertaining to the establishment of a general operating reserve account, the Cooperative did in fact establish an account. The Cooperative funded the general operating reserve based on the terms and conditions outlined in HUD Handbook 4350.1, REV-1. The general operating reserve has a current balance of \$989,521. The current balance is greater than the required 25 percent of the annual carrying charges. The Cooperative ceased funding of the account in August 1999. The general operating reserve is currently escrowed with the U.S. Bank and the Fairfax County Redevelopment and Housing Authority is the trustee.

HUD Lacks Oversight of the General Operating Reserve Account

Without a regulatory agreement containing a section governing the reserve account, HUD lacks the ability to provide adequate oversight and control over the funds in the account. According to HUD Handbook 4370.2, HUD should exercise project control through the provisions of a regulatory agreement. The regulatory agreement sets forth specific requirements on the

establishment and maintenance of various funds, defines the requirements for tenant application and eligibility, and establishes the requirements of the project management and administration. Owners shall refer to the regulatory agreement and to other control documents for specific provisions, requirements, and restrictions applicable to the specific project.

The Cooperative's Current Regulatory Agreement Should Be Amended

The Cooperative's reserve account currently has a balance of \$989,521. Our recent external audit at the Cooperative identified significant internal control weaknesses and questioned costs. HUD currently has no oversight over how the Cooperative will use the funds in the reserve account. During our recent external audit at the Cooperative, HUD's legal counsel advised that a rider may be attached to the regulatory agreement to include requirements for the reserve account. Therefore, it is imperative for HUD to enter into an amended regulatory agreement with the Cooperative to ensure it has adequate control and oversight over these funds.

RECOMMENDATION

We recommend that the Director of HUD's Multifamily Program Center, Richmond field office

- 1A. Enter into an amended regulatory agreement with the Cooperative. The regulatory agreement should include a rider pertaining to the general operating reserve. This will ensure that the \$989,521 in reserve funds will only be used for eligible expenses.

AUDITEE'S RESPONSE

We provided our discussion draft audit memorandum to the Director of HUD's Multifamily Program Center, Richmond field office, on January 4, 2010. We held an exit conference on January 6, 2010. The Director concurred with our recommendation and provided written comments to our discussion draft audit memorandum on January 8, 2010. The complete text of HUD's response can be found in appendix B of this memorandum.

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

Appendix A

FUNDS TO BE PUT TO BETTER USE

Recommendation number	Funds to be put to better use 1/
1A	\$989,521

- 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 subsidy costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. The Cooperative's reserve account currently has a balance of \$989,521. By amending its regulatory agreement with the Cooperative HUD can ensure that these funds are used for purposes intended.

Appendix B

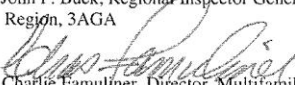
AUDITEE COMMENTS



U.S. Department of Housing and Urban Development
Richmond Office
600 E. Broad Street, 3rd Floor
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1-800-842-2610
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January 8, 2010

MEMORANDUM FOR: John P. Buck, Regional Inspector General for Audit, Philadelphia Region, 3AGA

FROM: 
Charlie Famuliner, Director, Multifamily Program Center,
Richmond Field Office, 3FHML

SUBJECT: HUD's Regulatory Agreement with the Yorkville Cooperative
Does Not Protect HUD's Interest REMS ID #: 800022168
FHA No. 000-35206

We are in agreement with the Internal Audit draft report issued on January 4, 2010 stating that the current regulatory agreement between HUD and Yorkville Cooperative is not appropriate. The regulatory agreement executed in 1979 did not include specific regulatory requirements needed for cooperative entities. The recorded Agreement failed to include necessary requirements pertaining to the general operating reserve account.

To correct this issue we plan to:

- By January 8, 2010 - have our legal department draft a modification of the regulatory agreement
- By March 12, 2010 - enter into an amended regulatory agreement with the Cooperative to include a rider pertaining to the general operating reserve to ensure that the \$989,521 in reserve funds will only be used for eligible expenses.

Should you have any questions, contact Jerryl Bennett at ext. 4842.

cc: Kimberly Harrison
Jerryl Bennett

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