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Audit Report Number 2011-NY-1013
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TO: Balu Thumar, Acting Director, New Jersey Office of Public Housing, 2FPH

FROM: *Edgar Moore*  
Edgar Moore, Regional Inspector General for Audit, New York/New Jersey  
Region, 2AGA

SUBJECT: Long Branch Housing Authority, Long Branch, NJ, Generally Complied With  
Capital Fund Program Regulations

## **HIGHLIGHTS**

### **What We Audited and Why**

We audited the Housing Authority of the City of Long Branch's administration of its Public Housing Capital Fund Program (CFP) and Capital Fund Financing Program (CFFP). We selected the Authority after our internal review of the U.S. Department of Housing and Urban Development's (HUD) oversight of energy performance contracting<sup>1</sup> disclosed that Authority officials may have used CFP funds to repay a loan for energy performance contract work. The objectives of this audit were to determine whether Authority officials obligated and disbursed CFP and CFFP funds in accordance with HUD regulations and maintained a financial management system that complied with program requirements.

### **What We Found**

Authority officials generally obligated and disbursed CFP and CFFP funds in accordance with HUD regulations and maintained a financial management system that complied with program requirements. However, they received add-on subsidy incentive payments from HUD, to which they were not entitled, to repay an energy performance contract loan, because they had already used CFP funds

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<sup>1</sup> Report no. 2011-NY-0001, issued 02/01/2011

for the repayment, and did not use proceeds from the sale of Authority land for activities as initially approved by HUD. We attribute these issues to Authority officials' unfamiliarity with HUD regulations. Consequently the Authority received approximately \$1.1 million and was scheduled to receive more than \$1.4 million in additional add-on subsidy incentive payments, to which it was not entitled, and used \$5 million to fund activities that, while allowable by HUD regulations, were not for the purposes HUD had initially approved.

### **What We Recommend**

We recommend that the Acting Director of the New Jersey Office of Public Housing instruct Authority officials to repay the \$1.1 million add-on subsidy incentive and strengthen controls to ensure that HUD is informed in a timely manner of any changes to HUD's approved use of Authority funds. In addition, we recommend that action be taken to deobligate the more than \$1.4 million in obligated add-on subsidy incentive to which the Authority would have been entitled.

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.

### **Auditee's Response**

We discussed the results of the review during the audit and at an exit conference held on August 9, 2011. On August 17, 2011, Authority officials provided their written comments as requested and generally agreed with the draft report findings. The complete text of the Authority'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**

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The Housing Authority of the City of Long Branch is a nonprofit corporation established in 1938 after the passage of the Federal Housing Act of 1937 to provide housing for qualified individuals. The Authority is governed by a seven-member board of commissioners, which appoints the executive director, who manages the day-to-day operation of the Authority.

The Authority is responsible for the development, maintenance, and management of public housing for low- and moderate-income families residing in Long Branch, NJ. It administers 486 low-rent and 695 Section 8 units and manages the financial operations of a for-profit and a nonprofit limited partnership. The Authority receives operating subsidies, Public Housing Capital Fund Program (CFP), Capital Fund Financing Program (CFFP), and HOPE VI program funding from HUD. It received an average of \$1 million annually through CFP in fiscal years 2007 through 2010, approximately \$4 million under CFFP in 2005, and \$20 million in HOPE VI grants in 2006.

CFP funds are used for repairs, major replacements, upgrading, and other nonroutine maintenance work to maintain the Authority's units in a clean, safe, and good condition. CFFP funds, used to make capital improvements, are obtained through private sources, such as a bond or conventional bank loan for which the Authority borrows and pledges a portion of its future annual CFP funds, subject to the availability of appropriations, to make debt service payments. The HOPE VI program, developed to eradicate severely distressed public housing, provides funds to make physical improvements and management improvements and to provide social and community services to address public housing resident needs.

The objectives of this audit were to determine whether Authority officials obligated and disbursed CFP and CFFP funds in accordance with HUD regulations and maintained a financial management system that complied with program requirements.

## RESULTS OF AUDIT

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### Finding: Authority Officials Generally Complied With CFP Regulations

Authority officials generally obligated and disbursed CFP and CFFP funds in accordance with HUD regulations and maintained a financial management system that complied with program requirements. However, they received add-on subsidy incentives from HUD, to which they were not entitled, to repay an energy performance contract loan, because they had already used CFP funds for the repayment, and did not use proceeds from the sale of Authority land for activities approved by HUD. Consequently, the Authority received approximately \$1.1 million in add-on subsidy incentives, to which it was not entitled, and used \$5 million to fund activities that, while allowable by regulation, were not for the purposes HUD had initially approved.

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#### **Obligation and Expenditure of CFP and CFFP Funds Generally Complied With Regulations**

Authority officials generally complied with regulations at 24 CFR (Code of Federal Regulations) Part 905 for obligating and expending CFP and CFFP funds and maintained a financial management system that complied with CFP and CFFP requirements. Specifically, Authority officials properly obligated the Authority's \$1.1 million in 2008 CFP funds, which we reviewed, and expended for eligible activities \$1.2 million, or 57 percent, of the \$2.1 million in CFP funds drawn down during the audit period (also reviewed). In addition, during the period May 1, 2005, through February 18, 2009, Authority officials complied with regulations when expending \$1.7 million of more than \$4 million in CFFP funds reviewed. Further, all CFP and CFFP fund expenditures reviewed were supported by proper procurement and accounting documentation.

#### **Ineligible Add-On Subsidy Incentives Were Received**

Authority officials requested and received more than \$1 million in add-on subsidy incentives, to which the Authority was not entitled, for use in repaying an energy performance contract loan. In accordance with Section 154 of the Energy Policy Act of 2005, HUD encouraged public housing authorities to realize energy savings through energy performance contracting,<sup>2</sup> and regulations at 24 CFR

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<sup>2</sup> Energy performance contracting is an innovative financing technique that uses cost savings realized from reduced energy consumption to repay the cost of energy conservation measures. Generally, an authority executes an energy

905.10 allow CFP and CFFP funds to be used for capital improvements, which can include various costs for energy efficiency improvements. Accordingly, Authority officials used more than \$1.7 million from a \$4 million CFFP bond financing and \$21,192 in CFP funds to pay for approximately \$1.8 million spent on eligible energy improvements made as part of an energy performance contract executed in 2005. Further, under CFFP, a portion of the Authority's future annual CFP funds were pledged to make debt service payments for the bond.

Regulations at 24 CFR 990.185(a) provide that a public housing authority may qualify for an add-on subsidy incentive if the authority undertakes energy conservation measures that are financed by an entity other than HUD. Consequently, Authority officials requested an add-on subsidy incentive, which HUD approved on April 28, 2005, providing the Authority \$210,587 annually for the 5-year period from 2006 through 2010. However, since the activities undertaken for which the incentive was provided were financed through HUD sources (CFP and CFFP funds), the Authority was not entitled to receive the add-on incentive. This condition occurred because Authority officials were not familiar with HUD regulations prohibiting the receipt of an add-on subsidy if a loan for energy conservation measures was repaid from HUD-funded sources. As result, the Authority received more than \$1 million, to which it was not entitled, and was scheduled to receive \$210,587 in add-on subsidies for the next 7 years (more than \$1.4 million).

### **Land Sale Proceeds Were Not Used as Initially Approved**

Authority officials did not use \$5.1 million realized from the sale of the Authority's land for the purposes initially proposed to and approved by the HUD Special Applications Center in 2004. Rather, other sources of funds were used for these purposes, and approximately \$3 million of the land sale proceeds was used in 2010 for other HUD field office approved projects. While funds used from the land sale were applied to HUD-funded eligible activities, the proceeds were not used as initially approved by HUD, and HUD was not informed of or requested to approve the changes. Further, Authority officials requested approval from HUD to use the remaining \$2.1 million after we inquired about the status of these funds.

In January 2004, Authority officials received approval from the HUD Special Application Center to demolish one of its projects with 46 low-rent units and dispose of adjoining contaminated land. The land was approved to be disposed of through a sale for \$5.1 million to the local utility company that had been judged responsible for the land's contamination. In conjunction with the demolition and sale, the Special Applications Center approved the request to build 46 replacement low-income housing units and a community center with the \$5.1

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service agreement with an energy service company that guarantees that energy use will be reduced by a set amount after installation of energy conservation measures.

million. However, contrary to HUD's approval, Authority officials deposited the \$5.1 million into the Authority's business activity unrestricted account, which was used to leverage other sources of funds for other eligible activities.

According to HUD procedures, an authority cannot change the intended use of sale proceeds without the prior written consent of HUD. Further, Authority officials did not comply with regulations at 24 CFR 970.35(a)(3), which require an authority to inform its HUD field office of the use of net proceeds by providing a financial statement reporting on how the funds were expended by item and amount, and the field office was requested, by the Special Applications Center to verify that the funds were used as approved and the Authority's records adequately supported this assertion.

In January 2004, Authority officials applied for a HOPE VI grant for redevelopment of three projects including the project approved for demolition and disposition. The HOPE VI grant for redevelopment was approved in February 2006, and the HOPE VI funds were used to build the community center. Rather than using the proceeds as approved, officials used CFP, Replacement Housing Factor funds, tax credits, and \$646,121 from the business activity unrestricted account to build a 40-unit mixed finance project consisting of 29 Section 8 and 11 tax credit units. This account consisted of the \$5.1 million from the land sale, accrued interest of \$200,000, and \$750,000 from proceeds of the land lease to the developer.

Further, in March, 2010, Authority officials used \$3 million from the business activity unrestricted account to purchase a former school with a plan to rehabilitate it and rebuild 100 affordable housing units for senior citizens. In the application to the HUD field office, Authority officials identified public housing funds as the source of funds. In addition, in 2009, Authority officials used \$400,000 to make a zero interest loan to fund startup and operating costs of its nonprofit subsidiary created to operate the community center. Upon our inquiry about use of the land sale proceeds contrary to that approved by HUD and the status of the remaining \$2.1 million, Authority officials requested HUD's approval to use those funds to build some home -ownership units, which had been approved in the HOPE VI redevelopment plan.

While the proceeds from the land sale were used for HUD-funded eligible activities, the proceeds were not used as initially approved by HUD's Special Applications Center, and HUD was not informed of or requested to approve the changes. We attribute this condition to Authority officials' unfamiliarity with HUD regulations and their misunderstanding of regulations at 24 CFR 970.19(f), which require that an authority demonstrate to the satisfaction of HUD that replacement units are provided in connection with the disposition of the property. Authority officials believed that since they had met HUD's requirement of approved housing replacement units, the Authority could classify the land sale proceeds as unrestricted and use them for other purposes.

## Conclusion

Authority officials generally complied with HUD regulations for the obligation and expenditure of CFP and CFFP funds and maintained an adequate financial management system. However, as a result of Authority officials' unfamiliarity with and misinterpretation of HUD regulations, the Authority erroneously received more than \$1 million in add-on subsidy incentive to repay a loan to finance energy conservation measures and did not use proceeds from its land sale in accordance with activities initially approved by HUD or inform HUD of the alternate use of these proceeds. Consequently, the Authority received more than \$1 million in add-on subsidy payments, to which it was not entitled, and HUD was not properly informed of the alternate use of \$5.1 million in Authority funds.

## Recommendations

We recommend that the Acting Director of the HUD New Jersey Office of Public Housing instruct Authority officials to

- 1A. Repay the \$1,052,935 add-on subsidy incentive the Authority received, to which it was not entitled, from 2006 through 2010.
- 1B. Ensure that the \$2.1 million in unused land sale proceeds requested for redevelopment of home-ownership units is used as approved by HUD.
- 1C. Strengthen controls to ensure that Authority officials use HUD funds in accordance with HUD-approved plans and comply with regulations at 24 CFR 970.35(a)(3) so that HUD is informed in a timely manner of any changes and project completion in accordance with regulations.

We also recommend that the Acting Director of HUD's New Jersey Office of Public Housing take action to

- 1D. Deobligate the \$1,474,109 in annual add-on subsidy incentive to which the Authority would have been entitled, thus ensuring that these funds are put to better use.



## SCOPE AND METHODOLOGY

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The review focused on whether the Authority obligated and expended capital funds in accordance with HUD requirements and had an adequate financial system in place. To accomplish the objectives, we

- Reviewed relevant HUD CFP and CFFP regulations at 24 CFR Part 905.
- Obtained an understanding of the Authority's management and financial controls over CFP and CFFP funds.
- Interviewed HUD New Jersey public housing field office personnel and reviewed appropriate records.
- Interviewed Authority officials and the Authority's independent public accountant.
- Reviewed reports from HUD's Line of Credit Control System and Office of Public and Indian Housing Inventory Management System and Information Center, Authority financial records, and independent public accountant's audit reports.
- Traced financial data reported to HUD to the Authority's records.
- Reviewed the obligation and expenditure of the fiscal year 2008 CFP funds, including Replacement Housing Factor funds.
- Selected a nonstatistical sample of 29 drawdowns, representing \$1.2 million, or 57 percent, of the \$2.1 million CFP funds drawdown through 134 requisitions during the audit period, July 2008 through June 2010. The sample was comprised of a random number of small, medium, and large drawdown amounts, and the results cannot be projected to the universe.
- Selected a nonstatistical sample of 10 drawdowns representing \$1.7 million, or 40 percent of the \$4.3 million of CFFP funds requisitioned during the period May 1, 2005, through February 18, 2009. The sample results cannot be projected to the universe.

The audit covered the period July 1, 2008, through June 30, 2010, and was extended as necessary. We performed the audit fieldwork from January through March 2011 at the Authority's office located at 2 Hope Lane, Long Branch, NJ.

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

# INTERNAL CONTROLS

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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.

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## Relevant Internal Controls

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

- Program operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Safeguarding resources – Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.
- Validity and reliability of data – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.

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 the 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 significant deficiency:

- Authority officials had not established adequate controls to ensure that the Authority only requested HUD funds to which it was entitled and expended funds in accordance with HUD-approved plans (see finding).

## APPENDIXES

### Appendix A

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

<u>Recommendation</u> <u>number</u>	<u>Ineligible 1/</u>	<u>Funds Put To</u> <u>Better Use 2/</u>
1A	\$1,052,935	
1D	_____	\$1,474,109
Total	<u>\$1,052,935</u>	<u>\$1,474,109</u>

- 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.
- 2/ 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 case, if the more than \$1.4 million in obligated add-on subsidy incentives scheduled to be received is deobligated and returned to the program, we can be assured that these funds will be put to better use.

# Appendix B


## AUDITEE COMMENTS AND OIG'S EVALUATION

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### Ref to OIG Evaluation

### Auditee Comments

**HOUSING AUTHORITY OF THE CITY OF LONG BRANCH**  
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Tyrone Garrett, JD, P.H.M.,  
Executive Director

August 15, 2011

Mr. Edgar Moore  
Regional Inspector General for Audit  
U.S. Department of Housing and Urban Development  
Office of Inspector General  
26 Federal Plaza, Room 3430  
New York, NY 10278-0068

Re: Audit Report of 2011

Dear Mr. Moore:

Listed below are the responses to the IG's audit report of August 15, 2011.

**Finding 1:** Ineligible add-on subsidy incentives were received.

The Authority concurs with the finding and will work with the HUD New Jersey Field Office to set up a repayment agreement of \$1,052,935.

**Finding 2:** Land sale proceeds were not used as initially approved.

Although "leveraging" the proceeds was not explicitly stated by SAC in its initial demolition/disposition approval, it is the Authority's interpretation that is was not precluded in their language either. Sale proceeds from Seaview Manor were clearly noted as a source of funding for subsequent demolition /disposition applications and not solely for Seaview Manor but also Grant Court and Garfield Court. In addition, the use of the Seaview Manor proceeds were identified as a source of funding in the 2003,2004, and 2005 HOPE VI applications in both the narrative and budget pro-formas.

Throughout the redevelopment process, the Authority only sought to maximize the utilization of the sale proceeds in a manner that would meet the end of benefiting the distressed community in the most effective possible way. In fact, the Authority has, as of this date, constructed (238) units of housing

*Integrity...Action...Accountability...Performance...*

**Comment 1**

**Comment 2**

**Comment 3**

**Ref to OIG Evaluation**

**Auditee Comments**

**Comment 3**

and built a Community Center, which exceeded the original plan of (46) units using the same \$5.1 million. The remaining \$2.1 million is being leveraged to closeout the HOPE VI with a homeownership phase.

**Comment 4**

The sale proceeds from Seaview Manor were placed in the redevelopment account under the control of the Authority which is annually audited and is reported in the Authority's financial statements.

**Comment 1**

The Authority will classify the sales proceeds and interest earned from the redevelopment account in the Business Activity restricted reserve category in its 2011 financial statements. In the future, the Authority will get approval from HUD New Jersey Field Office as well as Special Application Center for the use of the remaining proceeds.

In conclusion, the Gregory School currently has a pending Phase II application at the National Parks Service for historical status. This will allow us to rehabilitate the existing building and construct an addition with historic tax credits, the Federal Home Loan Bank of New York grant and the New Jersey State Low Income Tax Credit Program this fall.

Respectfully submitted,



Tyrone Garrett J. D.  
Executive Director

### **OIG Evaluation of Auditee Comments**

- Comment 1** Authority officials have agreed to take action responsive to the recommendation.
- Comment 2** Authority officials maintain that the Special Applications Center's approval for the use of the \$5.1 million land sale proceeds did not preclude leveraging these funds to accomplish other eligible activity. However, the approval letter explicitly stated that the proceeds generated from the land disposition were to be used to build 46 low-income housing units and a community center, and once HUD approves a disposition application and an authority's stated intended use for net proceeds, the use of those proceeds can not be changed without the prior written consent of HUD.
- Comment 3** The report does not dispute the HUD funding eligible accomplishments Authority officials achieved through the leveraging of its various funding sources. The report notes that various other sources of funding were used to construct the 46 housing units approved by HUD, and that \$3.1 million of those proceeds were used in March 2010 to purchase the Gregory School, and HUD approval for the use of the remaining funds was recently requested.
- Comment 4** Authority officials stated that the sale proceeds from Seaview Manor were placed in the redevelopment account under the control of the Authority, which was annually audited and was reported in the Authority's financial statements. The land sale proceeds and the Section 8 certificate operating reserve funds were also deposited into this account, which was identified in the Authority's financial statements as the business activity account. Based upon the transactions reviewed, all funds were used for HUD eligible activity; however, the funds should have been reported as being restricted to HUD eligible activity.