Issue Date	February 18, 2009
Audit Report Number	2009-FW-1006

TO: Brian D. Montgomery
Assistant Secretary for Housing–Federal Housing Commissioner, H

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

SUBJECT: Enterprise Home Ownership Partners–Dallas, Inc., Dallas, Texas, Achieved Program Objectives but Did Not Fully Comply with Certain Requirements

HIGHLIGHTS

What We Audited and Why

As part of a nationwide internal audit of the U. S. Department of Housing and Urban Development's (HUD) asset control area program (program), we performed an external audit of Enterprise Home Ownership Partners–Dallas, Inc. (EHOP-Dallas). Our objective was to determine whether EHOP-Dallas administered the program in compliance with its agreement with HUD and the program objective to promote the revitalization, through expanded homeownership opportunities, of revitalization areas.

What We Found

EHOP-Dallas administered its program in an effective manner, increasing homeownership in revitalization areas and contributing to reducing blight in some neighborhoods. However, it did not comply with requirements when it (1) provided home buyers excess equity in the homes it resold, (2) did not resell all homes within the time limits established under the agreement, and (3) included ineligible expenses associated with theft and vandalism in net development costs.

What We Recommend

We recommend that the Assistant Secretary for Housing–Federal Housing Commissioner require EHOP-Dallas to calculate home-buyer enforcement notes as defined in the agreement and to exclude expenses associated with casualty losses in its calculations of net development costs. In addition, we recommend revising the agreement to address disposition of properties that the purchaser cannot sell within 18 months because of market conditions or other factors beyond its control.

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 provided a draft report to EHOP-Dallas on January 30, 2009, and asked for a written response by February 13, 2009. We held an exit conference to discuss the results of the audit on February 9, 2009. EHOP-Dallas provided its written response at the exit conference. EHOP-Dallas generally agreed with the findings and provided additional explanations for its actions. The complete text of EHOP-Dallas's response, along with our evaluation of that response, can be found in appendix A of this report.

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BACKGROUND AND OBJECTIVES

The purpose of the asset control area program (program) was to promote the revitalization, through expanded homeownership opportunities, of designated revitalization areas. The U. S. Department of Housing and Urban Development (HUD) sold single family homes in revitalization areas at a discount to units of local government and approved nonprofit organizations (purchaser); it did not offer discounts to approved for-profit organizations. The purchaser performed rehabilitation work on the homes and resold them to eligible buyers. An eligible buyer was an officer or teacher who was required to reside in the home for one year, or a family with a household income at or below 115 percent of median income which was required to reside in the home for three years. The resale price was the lesser of fair market value at the time of resale or 115 percent of the purchaser's net development costs.

HUD enforced the occupancy requirements with a home-buyer enforcement note which was a forgivable loan in the amount of the difference between market value at the time of resale and the resale price. If a home buyer did not meet the occupancy requirement, HUD required the home buyer to repay a prorated portion of the note based on the amount of time the buyer remained in the home.

HUD executed an asset control area agreement with Enterprise Home Ownership Partners–Dallas, Inc. (EHOP-Dallas), an approved nonprofit organization, on June 21, 2005. Enterprise Community Partners, Inc. was founded in 1982. It is a national nonprofit that provides expertise for affordable housing and sustainable communities. It created EHOP-Dallas to serve low- and moderate-income families by helping them achieve long-term homeownership. Its office is located at 100 North Central Expressway, Suite 1299, Dallas, Texas 75201.

HUD conveyed the first properties to EHOP-Dallas in October 2005. In total, HUD conveyed 199 properties to EHOP-Dallas under the two-year agreement. The original controlling agreement expired June 22, 2007, but continued to apply to unsold homes. At the time of this audit, EHOP-Dallas and HUD were negotiating the terms of a new agreement. HUD had not issued regulations for the program. As of October 8, 2008, EHOP-Dallas had rehabilitated all of the properties and resold 166 of them.

Our audit objective was to determine whether EHOP-Dallas administered the program in compliance with the agreement and the program objective to promote the revitalization, through expanded homeownership opportunities, of revitalization areas.

RESULTS OF AUDIT

Finding EHOP-Dallas Achieved Program Objectives but Did Not Fully Comply with Requirements

Although EHOP-Dallas administered its program in an effective manner, it did not comply with three aspects of the program that require resolution. Specifically, EHOP-Dallas resold properties with home-buyer enforcement notes that exceeded the amount allowed under the agreement. In doing so, it essentially provided gift funds to the resale buyer, provided resale buyers with excess equity, and incurred losses on the properties. In addition, it did not resell 75 percent of homes within 12 months of acquisition or 100 percent of homes within 18 months as required. Further, rather than make claims against its insurance policy, EHOP-Dallas included the cost of replacement air conditioners and other ineligible expenses associated with vandalism in net development costs, thereby inflating costs that were passed on to the resale buyer.

EHOP-Dallas Provided Excessive Resale Home-Buyer Enforcement Notes

EHOP-Dallas routinely provided resale home-buyer enforcement notes that exceeded the amount required under the agreement.[1] The home-buyer enforcement note was forgiven if the resale buyer remained in the home for the required period. If the buyer moved out before the required period, the buyer was required to repay HUD a prorated portion of the note amount.

EHOP-Dallas increased the amounts of home-buyer enforcement notes as a form of subsidy to assist buyers who did not have enough money for a downpayment or who could not qualify for a mortgage at the resale price. EHOP-Dallas provided the additional subsidy from its own funds as a way to carry out the program. It also offered up to $20,000 home-buyer enforcement notes as a sales incentive to help move properties that were not otherwise selling.

Excessive home-buyer enforcement notes provided resale buyers with increased equity in homes. In some cases, EHOP-Dallas provided such funds when it spent more on the property than it was worth. This practice could result in a resale buyer being obligated to repay HUD more than the intended amount if the buyer did not reside in the home for the required period. EHOP-Dallas commented that it lost money on this program but wanted to honor its commitment to an underserved community.

EHOP-Dallas submitted documentation of its costs and related calculations to HUD for each property it acquired under the program. Through reviewing this

[1] Section 5.5(b) of the agreement required the resale home-buyer enforcement note to be in an amount equal to the difference between the resale price and the fair market value of the property at the time of resale.

documentation, HUD should have been aware of this practice, yet EHOP-Dallas said that HUD had not commented on it. HUD's primary monitoring objective was ensuring that EHOP-Dallas did not make excess profit upon resale. HUD's system for capturing cost and price data for the program concentrated on excess profit rather than the terms defined in the agreement, making it difficult for HUD to identify excessive home-buyer enforcement notes. Nonetheless, HUD's monitoring should ensure that participants operate according to the program requirements.

EHOP-Dallas should limit the home-buyer enforcement note to the required amount and classify separately additional subsidy that it provides.

EHOP-Dallas Exceeded Resale Time Limitations

HUD required EHOP-Dallas to resell 75 percent of homes within 12 months of acquisition and 100 percent of homes within 18 months.[2] As of October 8, 2008, EHOP-Dallas had resold 166 of the 199 properties it acquired under the program; it still had 33 properties in inventory, all of which exceeded the 12-month requirement and 22 of which exceeded the 18-month requirement. Of the 199 properties, 66 (33.2 percent) and 35 (17.6 percent) were held longer than the 12- and 18-month time limitations, respectively.

Because the agreement did not allow for alternative means of disposition, EHOP-Dallas continued to offer the completed properties for sale but also continued to incur holding costs, thereby increasing net development costs and the related development fee and decreasing the amount of equity that could be passed on to the resale buyer. EHOP-Dallas was unable to sell homes within established deadlines because (1) HUD did not approve demolition, (2) buyers were unable to obtain financing, or (3) other market conditions impacted sales.

HUD Did Not Approve Demolition

According to EHOP-Dallas, three of its properties should have been demolished. Conceptually, staff said it made no sense for EHOP-Dallas to rehabilitate the properties. Further, they believed that they could have demolished the properties and rebuilt them to provide a better useful life of the property. EHOP-Dallas requested HUD to approve demolition, but HUD did not approve the request. Eventually, EHOP-Dallas rehabilitated the properties at considerable expense with limited benefits. In one example, it exceeded the 18-month resale deadline because of the delays and extensive rehabilitation work. It incurred $90,319 in rehabilitation costs on a property it purchased for $1 from HUD in October 2005. The property appraised and sold for $87,500 in November 2007.

[2] Section 5.4 of the Asset Control Area agreement between HUD and EHOP-Dallas.

Prospective Buyers Were Unable to Obtain Financing

EHOP-Dallas stated that it had difficulty with prospective buyers being able to obtain financing. For example, it could not sell one of its condominiums that was under contract twice because lenders would not finance properties in that neighborhood. This situation led EHOP-Dallas to request and receive an amendment removing condominiums from the agreement.

In other cases, EHOP-Dallas held open houses to attract potential buyers which generated interest among neighborhood residents who wanted to rent the homes rather than purchase them. EHOP-Dallas stated that it preferred not to enter the rental business but requested that HUD allow it to enter into lease-purchase arrangements on properties that it could not sell to eligible buyers.

Market Conditions Impacted Sales

There had been a decline in the local housing market over the past two years. The decline affected the number of homes sold and median sale prices. According to one report, local real estate agents sold 14 percent fewer homes in 2008 than in 2007 in addition to an 8 percent decline in 2007. Further, the local median sales price dropped to $140,580 in October 2008 from a high of $158,000 in June 2007. EHOP-Dallas attributed part of its difficulty in selling the properties in a timely manner to the housing market conditions.

HUD staff preferred that EHOP-Dallas not meet the resale deadlines rather than resell to ineligible buyers or those who could not afford the homes. HUD should consider revising the agreement to address the issue of unsalable properties.

EHOP-Dallas Included Ineligible Expenses in Net Development Costs

Of the 14 property files reviewed, five contained documentation of some type of casualty loss generally resulting from theft or vandalism. For example, in two cases, the initial rehabilitation contract included new central air conditioning units, which were later stolen. Net development costs on these properties included both the original units and the replacement units, with costs ranging from $1,600 to $3,500 each. EHOP-Dallas included both the original rehabilitation cost and the expenses associated with the theft in net development costs.

At another property, a water leak in an adjacent property caused damage to EHOP-Dallas's property. EHOP-Dallas made the necessary repairs and included the cost in net development costs instead of pursuing a claim against the owner of the neighboring property.

Only expenses specifically identified in the agreement as eligible could be included in the calculation of net development costs.[3] EHOP-Dallas appropriately included the cost of insurance premiums as eligible holding costs, yet chose not to submit insurance claims for the losses. Hazard insurance premiums were eligible expenses but the insurance deductibles and theft or casualty losses were not.

By including these ineligible expenses in net development costs, EHOP-Dallas passed the costs on to resale buyers and overstated its fees. However, its practice of regularly providing excess subsidy to resale buyers generally prevented it from realizing excess profit upon resale.

HUD staff expressed tolerance for including limited amounts of expenses associated with vandalism and insurance deductibles in net development costs. However, the agreement prohibited the inclusion of these expenses. EHOP-Dallas should not include expenses associated with casualty losses in its calculation of net development costs. If HUD wishes to allow these expenses, it should revise the agreement accordingly.

Conclusion

EHOP-Dallas managed the program well and achieved the program objectives. Despite its good faith efforts, EHOP-Dallas did not meet the resale deadlines established in the agreement and continued to incur holding costs on the properties it could not sell. It also provided excessive home-buyer enforcement notes to resale buyers and included ineligible expenses associated with casualty losses in net development costs. HUD should address these technical noncompliance issues with specific policy guidance.

Recommendations

We recommend that the Assistant Secretary for Housing–Federal Housing Commissioner

1A. Require EHOP-Dallas to calculate home-buyer enforcement notes as defined in the agreement and to classify and report separately any additional funds that it provides.

1B. Revise the agreement to allow for alternative disposition methods when participants are unable to resell rehabilitated properties to eligible buyers within a reasonable period.

1C. Require EHOP-Dallas to exclude expenses associated with casualty losses in its calculation of net development costs.

[3] Only costs specifically included in Exhibit 8 of the Asset Control Area agreement between HUD and EHOP-Dallas may be included in calculating net development costs.

SCOPE AND METHODOLOGY

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

We conducted the audit at EHOP-Dallas's offices in Dallas, Texas, and in our office in Fort Worth, Texas, from August 2008 to January 2009. The audit period was calendar years 2006 and 2007, which we modified to include the most current information related to whether resale timeframe requirements were met. To achieve the audit objective, we

- Obtained and reviewed relevant laws, draft regulations, HUD standard operating procedures, the program agreement, audit reports, and HUD monitoring review reports.
- Reviewed property and buyer records for a representative nonstatistical sample of properties that EHOP-Dallas rehabilitated and resold during the audit period. We reviewed supporting documentation for development costs, market value, and resale buyer eligibility.
- Inspected and photographed a nonstatistical sample of rehabilitated properties, including both unsold inventory and resold homes.
- Interviewed staff at EHOP-Dallas, the Fort Worth Office of Single Family Housing, the Denver Homeownership Center, and HUD headquarters.
- Obtained data showing acquisition and resale dates for the properties acquired under the agreement and aged the data to determine holding periods.
- Performed public records searches to identify any potential conflicts of interest.

We used data provided by EHOP-Dallas to determine its compliance with the resale time limitations. The data covered the period from October 4, 2005, through October 8, 2008. We tested the data for reliability[4] by tracing data elements to source documentation. We determined the data were sufficiently reliable as a basis for audit testing and reporting.

We selected a representative nonstatistical sample of 14 items for review of 140 properties closed during the audit period. Since the sample was randomly selected, we expect the results to be representative of EHOP-Dallas's operations. The resulting sample size allowed auditors to complete the assignment in the time allotted. We used a judgment sample for the property inspections by requesting EHOP-Dallas's construction manager to show us a variety of properties throughout its asset control area. We inspected and photographed three sold homes and eight inventory homes and viewed and photographed an additional 10 homes from the street.

[4] We assessed reliability using Government Accountability Office (GAO) guidelines in publication GAO-03-273G, Assessing the Reliability of Computer-Processed Data.

INTERNAL CONTROLS

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

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

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

Relevant Internal Controls

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

- Program operations – Policies and procedures that management implemented to reasonably ensure that its program met its objectives.

- Validity and reliability of data – Policies and procedures that management implemented to reasonably ensure that valid and reliable data were obtained, maintained, and fairly disclosed in reports.

- Compliance with laws and regulations – Policies and procedures that management implemented to reasonably ensure that its resource use was consistent with laws and regulations.

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

We did not identify any significant weaknesses in the controls we assessed.

APPENDIX

Appendix A

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

Enterprise
EHOP-DALLAS

100 N. Central Expressway
Suite 1299
Dallas, TX 75201
Tel 214.651.7789
Fax 214.651.7231

Mark McDermott
Chairman of the Board

Lorenzo S. Littles
President

Faith E Thomas
Secretary

Michael McNeely
Treasurer

William R. Frey
Board Member

Rafael Cestero
Board Member

February 3, 2009

Mr. Gerald R. Kirkland
Regional Inspector General
U.S. Department of Housing and Urban Development
819 Taylor Street, Suite 13A09
Fort Worth, TX 76102

RE: EHOP-Dallas, Inc. Asset Control Area Program ("ACA") Audit

Dear Mr. Kirkland:

Attached is EHOP-Dallas, Inc.'s ("EHOP") response to Findings of draft Audit Report Number 2009-FW-100X of the ACA program in Dallas.

Please let us know if you have any questions or wish to discuss these matters further.

Yours truly,

L. S. Littles

Lorenzo S. Littles
President

Attachment

Cc: Richard Pine

Enterprise
EHOP-DALLAS

RESPONSE TO OIG AUDIT REPORT NUMBER: 2009-FW-100X

Finding 1: EHOP-Dallas Achieved Program Objectives but Did Not Fully Comply with Requirements

Although EHOP-Dallas administered its program in an effective manner, it did not comply with three aspects that require resolution. Specifically, EHOP-Dallas resold properties with homebuyer enforcement notes that exceeded the amount allowed under the agreement[1]. In doing so, it essentially provided gift funds to the resale buyer, provided resale buyers with excess equity, and incurred losses on the properties. In addition, it did not resell 75 percent of homes within 12 months of acquisition or 100 percent of homes within 18 months as required. Further, rather than make claims against its insurance policy, EHOP-Dallas included the cost of replacement air conditioners and other ineligible expenses associated with vandalism in net development costs, thereby inflating costs that were passed on to the resale buyer.

EHOP-Dallas Provided Excessive Resale Home-Buyer Enforcement Notes

EHOP-Dallas routinely provided resale home-buyer enforcement notes that exceeded the amount required under the agreement. The home-buyer enforcement note was forgiven if the resale buyer remained in the home for the required period. If the buyer moved out before the required period, the buyer was required to repay HUD a prorated portion of the note amount.

EHOP-Dallas increased the amounts of home-buyer enforcement notes as a form of subsidy to assist buyers who did not have enough money for a downpayment or who could not qualify for a mortgage at the resale price. EHOP-Dallas provided the additional subsidy from its own funds as a way to carry out the program. It also offered up to $20,000 home-buyer enforcement notes as a sales incentive to help move properties that were not otherwise selling.

Excessive home-buyer enforcement notes provided resale buyers with increased equity in homes. In some cases, EHOP-Dallas provided such funds when it spent more on the property than it was worth. This practice could result in a resale buyer being obligated to repay HUD more than the intended amount if the buyer did not reside in the home for the required period. EHOP-Dallas commented that it lost money on this program but wanted to honor its commitment to an underserved community. If EHOP-Dallas ensured that home-buyer enforcement notes did not exceed the required amounts, it could reduce its losses from operating the program.

EHOP-Dallas submitted documentation of its costs and related calculations to HUD for each property it acquired under the program. Through reviewing this documentation, HUD should have been aware of this practice, yet EHOP-Dallas said that HUD had not commented on it. HUD's primary monitoring objective was ensuring that EHOP-Dallas did not make excess profit upon resale. HUD's system for capturing cost and price data for the program concentrated on excess profit rather than the terms defined in the

[1] Section 5.5(b) of the agreement required the resale homebuyer enforcement note to be in an amount equal to the difference between the resale price and the fair market value of the property at the time of resale.

agreement, making it difficult for HUD to identify excessive home-buyer enforcement notes. Nonetheless, HUD's monitoring should ensure that participants operate according to the program requirements.

EHOP-Dallas should limit the home-buyer enforcement note to the required amount and classify separately additional subsidy that it provides.

RESPONSE:

Comment 1

EHOP did provide Homebuyer Enforcement Notes ("HBEN") that exceeded the amount required under the agreement. The ACA Agreement states in Section 5.4(a) that "The Homebuyer Enforcement Note shall be in an amount equal to the difference between the Resale Price and the Fair Market Value of the property at time of resale." EHOP did not intentionally disregard the terms of the agreement, but used its best judgment to subsidize properties in order to sell them.

There is an inherent conflict between the goals of the program, the stipulations in the contract and market place realities. An independent property owner who can not sell a home typically reduces the price until the home sells. The results of the price reduction are two-fold. First, the owner is able to sell his property at a price the market will support based on his constraints of time on the market verses his need to sell. This adjustment generally takes place regardless of the fair market value of the property. Second, the transaction below the fair market value re-establishes the fair market value of future sales at a lower level. Due to the constraints of the contract EHOP was not able to reduce the sales price of a home below fair market value leaving only an option to subsidize the home through increasing the HBEN as an incentive to buyers and to increase affordability. Increasing the note put neither the homebuyer nor HUD at a disadvantage. The cost of the increase was solely born by EHOP with the benefits of possible repayment accruing to HUD. The lien born by the buyer neither put them in a better of worse position. If the buyer did not fulfill the terms of the lien they could repay HUD out of the proceeds from sale of the home. If the buyer fulfilled the terms of the lien they would receive the benefits of the increased equity in the property.

The decision to increase the HBEN did lead directly to additional losses for EHOP. The decision was a conscious management decision that was made in an effort to serve the community, but also to reduce the costs associated with inventory that would not sell. Stating that EHOP would not have lost as much on the program if it did not increase the HBENs does not take into account the cost of holding properties for an extended period of time or the opportunity costs of not being able to do additional development because of inventory build-up.

EHOP will request a contract amendment from HUD to allow the increase of the HBEN or the decrease of the sales price as a strategy to provide additional subsidy to improve the affordability and salability of properties.

EHOP-Dallas Exceeded Resale Time Limitations

HUD required EHOP-Dallas to resell 75 percent of homes within 12 months of acquisition and 100 percent of homes within 18 months[2]. As of October 8, 2008, EHOP-Dallas had

[2] Section 5.4 of the Asset Control Area agreement between HUD and EHOP-Dallas.

resold 166 of the 199 properties it acquired under the program: it still had 33 properties in inventory, all of which exceeded the 12-month requirement and 22 of which exceeded the 18-month requirement. Of the 199 properties 66 (33.2 percent) and 35 (17.6 percent) were held longer than the 12 and [8-month time limitations, respectively.

Because the agreement did not allow for alternative means of disposition, EHOP-Dallas continued to offer the completed properties for sale but also continued to incur holding costs, thereby increasing net development costs and the related development fee and decreasing the amount of equity that could be passed on to the resale buyer. EHOP-Dallas was unable to sell homes within established deadlines because (1) demolition was not an approved activity, (2) buyers were unable to obtain financing, or (3) other market conditions impacted marketability.

RESPONSE:

Comment 2

Under the ACA Agreement holding costs are an eligible expense. While costs incurred over an extended holding period technically increase the amount of development fee EHOP can contractually charge, the reality is that the longer EHOP holds properties the more it loses. Most long held properties do not provide sufficient revenue to generate a development fee much less one that approaches the 15% limit. There is a distinct disincentive to holding properties because of the substantial costs associated with property management and oversight, and the opportunity costs associated with an extended credit line. The potential increase in development fees does not offset the costs of holding properties for extended periods. An additional disincentive is that as equity diminishes many properties become harder and harder to sell and require subsidization by EHOP leading to direct losses.

EHOP has made every effort to sell its homes within the contractually stipulated time periods. Buyers inability to obtain financing and the changing market dynamics that have reduced the availability of credit have played a major role in EHOP's ability to sell its homes. EHOP will continue to market its properties with the goal to sell them as quickly as possible to clients meeting the program guidelines. EHOP will also continue to explore potential alternate disposition strategies with HUD.

HUD Did Not Approve Demolition

According to EHOP-Dallas, three of its properties should have been demolished. Conceptually, staff said it made no sense for EHOP-Dallas to rehabilitate the properties. Further, they believed that they could have demolished the properties and rebuilt them to provide a better useful life of the property. EHOP-Dallas requested HUD to approve demolition, but HUD did not respond. Eventually, EHOP-Dallas rehabilitated the properties at considerable expense with limited benefits. In one example it exceeded the 8-month resale deadline because of the delays and extensive rehabilitation work. It incurred $90,319 in rehabilitation costs on a property it purchased for $1 from HUD in October 2005. The property appraised and sold for $87,500 in November 2007.

Prospective Buyers Were Unable to Obtain Financing

EHOP-Dallas stated that it had difficulty with prospective buyers being able to obtain financing. For example, it could not sell one of its condominiums that was under contract twice because lenders would not finance properties in that neighborhood. This situation led EHOP-Dallas to request and receive an amendment removing condominiums from the agreement.

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In other cases, EHOP-Dallas held open houses to attract potential buyers, which generated interest among neighborhood residents, who wanted to rent the homes rather than purchase them. EHOP-Dallas stated that it preferred not to enter the rental business but requested that HUD allow it to enter into lease-purchase arrangements on properties that it could not sell to eligible buyers.

Comment 3

RESPONSE:
While the inability of homebuyers to obtain financing significantly affected EHOP's sales of both condominiums and homes, there is a different causation for each property type.

Enterprise initially opted to acquire condominiums after discussions with local partners (lenders, counseling agencies and Realtors) that indicated there was sufficient demand in the marketplace for quality affordable units. Unfortunately, actual experience revealed that EHOP was able to meet the needs of some clients but that there was insufficient demand to sell the units in a timely manner. For this reason, EHOP requested removal of condominiums from the agreement. EHOP also found that while buyers wanted to purchase and could qualify, some units were not insurable and could not be financed. Low homeowner occupancy rates within the communities prevented both FHA and conventional financing. Two of these units are still in EHOP's inventory.

The majority of long held properties in EHOP's inventory are in neighborhoods where there is interest in the homes, but buyers who are willing to live in these neighborhoods can not qualify for a mortgage. Residents who were currently living in the neighborhoods were interested in purchasing but could not qualify for a mortgage and therefore wanted to rent the properties.

Market Conditions Impacted Marketability
There had been a decline in the local housing market over the past two years. The decline affected the number of homes sold and median sale prices. According to one report, local real estate agents sold 14 percent fewer homes in 2008 than in 2007 in addition to an 8 percent decline in 2007. Further, the local median sales price dropped to $140,580 in October 2008 from a high of $158,000 in June 2007. EHOP-Dallas attributed part of its difficulty in selling the properties in a timely manner to the housing market conditions.

HUD staff preferred that EHOP-Dallas not meet the resale deadlines rather than resell to ineligible buyers or those who could not afford the homes. HUD should consider revising the agreement to address the issue of unsalable properties.

EHOP-Dallas Included Ineligible Expenses in Net Development Costs
Of the 14 property files reviewed, five contained documentation of some type of casualty loss generally resulting from (theft or vandalism. For example, in two cases, the initial rehabilitation contract included new central air conditioning units, which were later stolen. Net development costs on these properties included both the original units and the replacement units, with costs ranging from $1,600 to $3,500 each. EHOP-Dallas included both the original rehabilitation cost and the expenses associated with the theft in net development costs.

At another property, a water leak in an adjacent property caused damage to EHOP-Dallas's property. EHOP-Dallas made the necessary repairs and included the cost in net development costs instead of pursuing a claim against the owner of the neighboring properly.

Comment 4

Only expenses specifically identified in the agreement as eligible could be included in the calculation of net development costs[3], EHOP-Dallas appropriately included the cost of insurance premiums as eligible holding costs, yet chose not to submit insurance claims for the losses. Hazard insurance premiums were eligible expenses but the insurance deductibles and theft or casually losses were not.

By including these ineligible expenses in net development costs, EHOP-Dallas passed the costs on to resale buyers and overstated its fees. However, its practice of regularly providing excess subsidy to resale buyers generally prevented it from realizing excess profit upon resale.

HUD staff expressed tolerance for including limited amounts of expenses associated with vandalism and insurance deductibles in net development costs. However, the agreement prohibited the inclusion of these expenses. EHOP-Dallas should not include expenses associated with casualty losses in its calculation of net development costs. If HUD wishes to allow these expenses, it should revise the agreement accordingly.

RESPONSE:
EHOP treated the costs associated with theft and vandalism as an eligible rehabilitation cost under Exhibit 8 of the Agreement. The intent of including the costs was not to increase development fees, but to reflect accurately the total cost for repairs to the property. Since the incremental increase in development fees associated with an increase in cost due to theft or vandalism does not cover the overhead costs associated with the management of the repair, there was no incentive for EHOP to use theft or vandalism as a means to increase fees. EHOP implemented and refined processes and procedures that would reduce the potential for theft and vandalism to reduce its costs and reduce the development costs associated with a property. For example, EHOP removed the installation of the HVAC system and kitchen appliances from the rehabilitation contractor's scope of work and directly installed the items at the time of closing to the homebuyer. This significantly reduced the potential for theft and vandalism. EHOP projected that, when considering both the deductible costs associated with an insurance claim and the increased cost of insurance associated with a high level of claims, it made financial sense to only file claims on catastrophic occurrences. Pursuant to the guidelines set forth in Exhibit 8, EHOP acted prudently in seeking to minimize theft and vandalism and to preserve the properties' value for potential buyers.

Conclusion
EHOP-Dallas managed the program well and achieved the program objectives. Despite its good faith efforts, EHOP-Dallas did not meet the resale deadlines established in the agreement and continued to incur holding costs on the properties it could not sell. It also provided excessive home-buyer enforcement notes to resale buyers and included ineligible expenses associated with casualty losses in net development costs. HUD should address these technical noncompliance issues with specific policy guidance.

Recommendations
We recommend that the Assistant Secretary for Housing-Federal Housing Commissioner

[3] Only costs specifically included in Exhibit 8 of the Asset Control Area agreement between HUD and EHOP-Dallas may be included in calculating net development costs.

1 A. Require EHOP-Dallas to calculate home-buyer enforcement notes as defined in the agreement and to classify and report separately any additional funds that it provides.

1B. Revise the agreement to allow for alternative disposition methods when participants are unable to resell rehabilitated properties to eligible buyers within a reasonable period.

1C. Require EHOP-Dallas to exclude expenses associated with casualty losses in its calculation of net development costs.

OIG Evaluation of Auditee Comments

Comment 1 EHOP-Dallas agreed with the facts disclosed in the report but provided additional comments to explain the conditions reported. We acknowledge EHOP-Dallas's additional comments.

We modified language in the report in response to EHOP-Dallas's comments concerning the cost of holding properties for an extended period of time and the opportunity costs of not being able to do additional development because of inventory build-up.

Comment 2 EHOP-Dallas provided additional comments to explain the conditions reported. We acknowledge that EHOP-Dallas made good faith efforts to sell its homes within the contractually stipulated time periods.

Comment 3 EHOP-Dallas provided additional comments to explain the conditions reported. We acknowledge EHOP-Dallas's additional comments.

Comment 4 We maintain our position that only expenses identified as eligible could be included in the calculation of net development costs. Casualty losses were not eligible expenses.

We acknowledge EHOP's refined processes and procedures.