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INSPECTOR GENERAL
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UNITED STATES DEPARTMENT OF
HOUSING AND URBAN DEVELOPMENT

Previous Participation Flags in Multifamily's Active Partner Performance System

U.S. Department of Housing and Urban Development,
Office of Multifamily Housing Programs | 2023-KC-0002

February 14, 2023

Date: February 14, 2023

To: Ethan D. Handelman
Deputy Assistant Secretary, Office of Multifamily Housing Programs, HT

//signed//

From: Kilah S. White
Assistant Inspector General for Audit, GA

Subject: HUD Did Not Sufficiently Flag Unacceptable Physical Condition Scores To Assess Its Controlling Participants

Attached are the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of HUD's assessment of its Controlling Participants. HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act of 1978, as amended, requires that OIG post its reports on the OIG website. Accordingly, this report will be posted at <https://www.hudoig.gov>. If you have any questions or comments about this report, please do not hesitate to call Patrick Anthony, Audit Director, at (716) 646-7056.

Highlights

HUD DID NOT SUFFICIENTLY FLAG UNACCEPTABLE PHYSICAL CONDITIONS SCORES TO ASSESS ITS CONTROLLING PARTICIPANTS | 2023-KC-0002

What We Audited and Why

We audited the U.S. Department of Housing and Urban Development (HUD), Office of Multifamily Housing Programs' Section 8 controlling participants. During our initial review, we were unable to identify a universe of controlling participants with a history of poor physical inspection scores that were later approved for additional participation in multifamily business. Instead, we reviewed whether HUD properly flagged properties that received poor physical inspection scores. HUD uses flags in the APPS system as a way to assess risk associated with participants in Office of Multifamily Housing program projects. A flag does not automatically exclude an applicant from participation in HUD's programs; however, flags are considered risk factors that require appropriate mitigation, where possible.

Our audit objective was to determine whether HUD accurately identified the risks to assess its controlling participants. Specifically, we focused our review on the physical conditions of multifamily housing projects and HUD's use of Real Estate Assessment Center (REAC) scores in identifying potential risks associated with controlling participants.

What We Found

We found 13 properties with consecutive REAC scores below 60 that were missing the required flags in HUD's Active Partners Performance System (APPS) for unacceptable physical condition. This condition occurred because HUD did not have a quality control program to ensure that the account executives manually entered the flags into APPS and there was no automated process for flagging a property once it received the second consecutive below-60 REAC score. As a result, HUD relied on incomplete previous participation information to make decisions about future participation. Not having sufficient information to assess its controlling participants could potentially impact the health and safety of residents at multifamily properties.

What We Recommend

We recommend that the Deputy Assistant Secretary for Multifamily Housing (1) implement a quality control review to ensure that successive below-60 physical inspection score flags are entered into APPS and (2) update APPS to automatically flag a property that receives successive below-60 physical inspection scores.

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Background and Objective

The U.S. Department of Housing and Urban Development's (HUD) Office of Multifamily Housing Programs (Multifamily Housing) is responsible for the overall management, development, direction, and administration of HUD's multifamily housing programs. Within Multifamily Housing is the Office of Asset Management and Portfolio Oversight (OAMPO), which is responsible for oversight of multifamily project assets after their development, including coordinating with the Real Estate Assessment Center (REAC). OAMPO reviews all organization change submissions, which allows an organization to add or change controlling participants. Additionally, the HUD field office account executives are assigned to review all form HUD-2530, Previous Participation Certification, property submissions.

Any entity or individual that exercises financial or operational control of a covered project is considered to be a controlling participant and required to complete a previous participation review submission (see appendix B for more about covered projects and controlling participants). If a controlling participant is an entity, the submission must include the people who exercise the day-to-day financial or operational control for that entity. At least one person, such as a borrower, owner, management agent, or general contractor, must be identified as a controlling participant for each specified capacity.

Prospective entities and individuals that want to take an active role in HUD multifamily projects need to obtain approval by submitting form HUD-2530, disclosing (1) disclosure of all controlling participants to be involved in the proposed project, (2) a list of projects in which those controlling participants have previously participated or currently participate, (3) a detailed account of the controlling participant's involvement in the listed projects, and (4) assurances that the controlling participants have upheld their responsibilities while participating in those projects.

In October 2016, HUD issued new final regulations amending the process and simultaneously issued a guidance supplement clarifying the process by which HUD reviews previous involvement of participants that have decision-making authority over their projects.¹ Review of previous participation is one component of HUD's responsibility to assess financial and operational risk to projects in these programs.

HUD's Active Partners Performance System (APPS) is a web-based application that enables industry business partners to fill and submit a form HUD-2530 electronically. HUD Notice 2016-15 allowed applicants to use either APPS or a paper alternative, although HUD encourages participants to use APPS because it automates HUD's review process when seeking flags associated with an entity or individual.


HUD uses three tiers of flags in APPS to identify risks associated with previous participation:²

- Tier 1. Flags are an elevated risk to HUD.
- Tier 2. Flags are considered an ongoing risk to HUD.
- Tier 3. Flags are considered a single risk to HUD and are removed when the reason for the flag is resolved.

A property that has received a REAC score below 30 or two consecutive REAC scores below 60 or has shown a history of REAC scores below 60 or other repeated failures to maintain decent, safe, and sanitary conditions

¹ HUD Notice 2016-15, Processing Guide for Previous Participation Reviews of Prospective Multifamily Housing and Healthcare Programs' Participants

² Consecutive below-60 REAC scores are 1 of 29 flags that HUD considers when assessing controlling participants risk factors.



should receive a tier 2 flag in APPS for the unacceptable physical condition of a property. The flag can be removed when the property has received no REAC score below 60 for 5 years.

Our audit objective was to determine whether HUD accurately identified the risks to assess its controlling participants. Specifically, we focused our review on the physical condition of multifamily housing projects and HUD's use of REAC scores in identifying potential risks associated with controlling participants.

Results of Audit

FINDING: HUD DID NOT SUFFICIENTLY FLAG UNACCEPTABLE PHYSICAL CONDITION SCORES TO ASSESS ITS CONTROLLING PARTICIPANTS

HUD did not adequately enter the required flags into APPS for successive failing physical inspection scores. This condition occurred because HUD did not have a quality control program to ensure that the account executives manually entered the flags into APPS and there was no automated process for flagging a property once it received the second consecutive below-60 REAC score. As a result, HUD relied on incomplete previous participation information to make decisions about future participation. Not having sufficient information to assess its controlling participants could potentially impact the health and safety of residents at multifamily properties.

HUD Did Not Always Enter the Required Flags

HUD did not enter the required flags into APPS for successive failing REAC physical inspection scores in 13 of 21 properties reviewed. In 6 of the 13 instances, the property had more than 1 missing flag for the below-60 REAC score infraction. Repeated HUD guidance has reinforced that a property receiving consecutive REAC inspection scores below 60 must be flagged in APPS by the property account executive.³ REAC scores are documented in HUD's Integrated Real Estate Management System (iREMS), but there is no automated process by which a flag is placed into APPS when consecutive below-60 REAC scores are documented in iREMS. The flag process requires an account executive to log into APPS and manually enter the flag each time a property receives consecutive below-60 REAC scores.

Table 1. Sample items missing required flags

Sample item	Number of below-60 REAC scores January 1, 2016, through May 31, 2022	Number of missing flags in APPS
Sample item 1	5	4
Sample item 4	4	3
Sample item 5	4	3
Sample item 6	4	1
Sample item 7	4	3
Sample item 8	4	2
Sample item 9	4	3

³ HUD Notice 2011-24, Reissuance of Revised Protocol for Placing a Flag in [APPS] When a Property Receives a Physical Inspection Score Below 60 but Above 30, and HUD Notice 2018-08, Servicing of Projects That Do Not Meet HUD's Physical Condition Standards and Inspection Requirements (PCS&IR) or Fail to Certify That Exigent Health and Safety (EH&S) Deficiencies Have Been Resolved as Required

Sample item 10	4	1
Sample item 11	3	1
Sample item 12	2	1
Sample item 13	2	1
Sample item 17	2	1
Sample item 18	2	1

HUD Did Not Have a Quality Control Program or Automated Flagging System

The condition described above occurred because HUD did not have a quality control program to ensure that the account executives manually entered the flags into APPS each time successive below-60 REAC scores were entered into iREMS. Additionally, there was no automated process for flagging a property once it received the second consecutive below-60 REAC score. According to senior HUD officials, Multifamily Housing had included modernizing APPS as an information technology (IT) business need internally for several years but had not received funding because other IT requests from the Office of Housing and departmentwide were higher priorities. Multifamily Housing planned to continue to include APPS modernization in its budget requests.

HUD Relied on Incomplete Information

As a result of the condition described above, HUD relied on incomplete previous participation information to make decisions about future participation. Participants with tier 2 flags require approval from a production division director and asset management division director, but if a flag was missing from APPS, HUD lacked assurance that an approving official would know that a risk existed and appropriately mitigate it. Not having the information to evaluate the risk for all controlling participants could potentially impact the health and safety of residents at multifamily properties.

Recommendations

We recommend that the Deputy Assistant Secretary for Multifamily Housing

- 1A. Implement a quality control review to ensure that successive below-60 REAC inspection score flags are entered into APPS.
- 1B. Update APPS to automatically flag a property that receives successive below-60 REAC inspection scores.

Scope and Methodology

Our review period generally covered previous participation, REAC and APPS data from January 1, 2016, through April 30, 2022⁴. We conducted the audit from August 2021 through August 2022. We did not conduct onsite fieldwork for this audit.

To accomplish our objective, we

- interviewed HUD staff;
- reviewed applicable Federal regulations, HUD notices, and multifamily training material;
- reviewed REAC scores in iREMS; and
- reviewed controlling participant flags and available notes in APPS.

Initially, we attempted to identify a sample of controlling participants with a history of below-60 REAC scores that were later reviewed for additional multifamily business through the form HUD-2530 process. We used three different tables to identify a set of controlling participants that had gone through a form HUD-2530 review after receiving multiple 60-and-below REAC scores at other properties with which they were involved as controlling participants. Our data sets consisted of 6,832 properties with new financing from January 2016 through November 2021, REAC scores from 246,399 inspections, and 22,876 controlling participant identification numbers. We used Audit Command Language software to join the tables together and capture a universe of controlling participants with a history of 60-and-below REAC scores that later went through an additional form HUD-2530 review.

However, we were unable to capture a universe of controlling participants with a history of 60-and-below REAC scores that later went through a form HUD-2530 review because there were so many different variables involved in trying to identify controlling participants with a history of poor physical condition scores that later had a form HUD-2530 review. Controlling participants may join or leave a property at any time, each property may have multiple controlling participants, and properties may have a REAC inspection at any time during the year. We were unable to query APPS by controlling participants, REAC score, and date to determine whether they were later listed on an additional form HUD-2530.

Additionally, APPS does not contain the query capability to search across all controlling participants to identify a group of individuals that fit a historical search criterion. APPS also did not allow us to query controlling participants with a history of 60-and-below REAC scores that were later reviewed as part of a form HUD-2530 submission. APPS was built to provide a historical perspective on each applicant individually by Social Security number but not to query a group of controlling participants by a single aspect of their participation history.

During our review, we learned that the flags for two consecutive below-60 REAC scores required entry into APPS through a manual process. There were 414 multifamily properties that had at least 2 below-60 REAC scores from January 2016 through April of 2022. We selected a non-statistical sample of 21 of the 414 properties for review to determine whether the required flag was placed in APPS every time they

⁴ Although the rules changed in October 2016, and this timeframe straddles the rule change, all of the scores we looked at were governed by the new regulations, and accordingly, we used the new terminology from the new regulations.

received consecutive below-60 REAC scores. The results of our review can only be applied to the items we reviewed and cannot be projected to a larger universe.

To select the sample properties for review, we organized the 414 properties in descending order of the number of below-60 scores they had received during that period. For properties with the same number of below-60 scores, we further organized the sample by property identification number in ascending order. For our sample, we selected the first 11 properties that we verified had 2 or more consecutive below-60 REAC inspection scores during that period. Then, working from the bottom of the list, we pulled the last 10 properties that we verified had 2 or more consecutive below-60 REAC inspection scores.

Table 2. Sample Items

Sample item	Below-60 REAC Scores
Sample item 1	5
Sample item 2 through 10	4
Sample item 11	3
Sample item 12 through 21	2

Although we did not perform a detailed assessment of the reliability of the data, we determined that the computer-processed data were sufficiently reliable to be used in meeting our objective because the data in the sampled items were corroborated by documentary evidence available in iREMS.

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(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Appendixes

APPENDIX A - AUDITEE COMMENTS

We provided HUD a copy of the draft report for review on December 21, 2022, and we held an exit conference with staff from HUD’s Office of Multifamily Housing on January 13, 2023, to discuss the results of our audit. On January 23, 2023, the Director of Multifamily Housing informed us that HUD chose not to provide written comments for this report.

APPENDIX B - DEFINITIONS

Controlling Participants

Source: HUD Notice 2016-15 (pages 4-6) and defined at 24 CFR § 200.216

For purposes of Previous Participation review, unless excluded below or otherwise determined by HUD not to be a Controlling Participant, the following shall be considered to exercise financial or operational control over the listed entities and shall be considered Controlling Participants:

1. Entities and individuals owning, directly or indirectly, 25 percent or more of a Specified Capacity.
2. The controlling owners (entities and/or individuals) of the entity that controls the Specified Capacity, these include individuals or entities with the ability to direct the Specified Capacity to enter into agreements relating to the Triggering Event, including, without limitation, individuals or entities that own at least 25 percent of entities determined to control an entity that is a Specified Capacity.
3. Any officers and other equivalent executive management (including Executive Director and other similar capacities) of the Specified Capacity or Controlling Participant who are directly responsible to the board of directors (or equivalent oversight body) and who have the ability to prevent or resolve violations or circumstances giving rise to flags related to the Covered Project.
4. Managers or managing members of Limited Liability Companies (LLCs).
5. General partners of limited partnerships, including “administrative” general partners or other general partners if they exercise day-to-day control over the entity.
6. Partners in a general partnership.
7. Executive Director (or equivalent position) of a non-profit corporation.
8. With respect to non-profit Borrowers under the Section 242 program, the executive management (Chief Executive Officer, Chief Financial Officer, and Chief Operating Officer, or equivalents) of the Borrower and the members of the Board of Directors that HUD determines have control over the finances or operation of the hospital (typically the President, Vice President, Treasurer, and Chairman of the Finance Committee, or equivalents).
9. Members of a for-profit corporation’s Board of Directors who are also officers of the corporation.
10. Controlling stockholders of a corporation. A controlling stockholder is the holder of sufficient voting stock or shares in a corporation to prevail in any stockholders’ motion. In most cases, the controlling stockholder will be subject to the previous participation filing requirements of those owning at least 25 percent of a Specified Capacity or Controlling Participant. However, this listing is meant to trigger filing requirements for shareholders who may technically evade the 25 percent ownership filing requirement but exercise financial or operational control over the Specified Capacity.
11. Trustees of a trust.
12. For real estate investment trusts (REITs), the REIT itself, the chief executive officer (or equivalent position) and all company officers (except those officers determined by HUD not to exercise day-to-day control over the REIT, the Specified Capacity or the Covered Project) must file.
13. For insured projects, if applicable, the person (people) and/or entity (entities) to be listed on the Regulatory Agreement Non-Recourse Debt section.
14. Any other person or entity determined by HUD to exercise day-to-day, financial or operational control over a Specified Capacity. While it is unlikely, this may include any officers, directors or members of an executive management team who would otherwise not be required to make a

submission (even of shell entities or other entities that may fall into the exclusions below), if such person is exercising control over the Specified Capacity. This listing is meant to capture those rare individuals who structure their participation so as to technically circumvent HUD requirements but who de facto exercise control over the Specified Capacity. HUD believes that the individuals and entities described in the list above accurately account for the Controlling Participants in the vast majority of cases and that invoking an additional submission through this catch-all listing should be rare.

Triggering events Source: 24 CFR § 200.218

(a) Each of the following is a Triggering Event that may subject a Controlling Participant to Previous Participation review under § 200.220:

1. An application for Federal Housing Administration (FHA) mortgage insurance;
2. An application for funds provided by HUD pursuant to a program administered by HUD's Office of Housing, such as but not limited to supplemental loans;
3. A request to change any Controlling Participant for which HUD consent is required with respect to a Covered Project; or
4. A request for consent to an assignment of a housing assistance payment contract under Section 8 of the United States Housing Act of 1937 or of another contract pursuant to which a Controlling Participant will receive funds in connection with a Covered Project.

(b) The [Federal Housing] Commissioner may also require a review of a potential owner's Previous Participation in connection with a loan sale or other form of property disposition, including foreclosure sale. Notwithstanding anything contained in the regulations in this subpart to the contrary, any such review shall be in accordance with the terms, conditions, provisions and other requirements set forth by the Commissioner in connection with such loan sale or property disposition which may differ, in whole or in part, from the regulations in this subpart.

Covered projects Source: 24 CFR § 200.214

The following types of multifamily and healthcare projects are Covered Projects subject to the requirements of this subpart, provided however that single family projects are excluded from the definition of Covered Projects:

- (a) *FHA-insured projects.* A project financed or which is proposed to be financed with a mortgage insured under the National Housing Act, a project subject to a mortgage held by the [HUD] Secretary under the National Housing Act, or a project acquired by the Secretary under the National Housing Act.
- (b) *Housing for the elderly or persons with disabilities.* Housing for the elderly financed or to be financed with direct loans or capital advances under Section 202 of the Housing Act of 1959, as amended; and housing for persons with disabilities under Section 811 of the Cranston-Gonzalez National Affordable Housing Act.

- (c) *Risk share projects.* A project that is insured under Section 542(b) or 542(c) of the Housing and Community Development Act of 1992 (12 U.S.C. (United States Code) 17107 note).
- (d) *Projects subject to continuing HUD requirements.* A project that is subject to a use agreement or any other affordability restrictions pursuant to a program administered by HUD's Office of Housing.
- (e) *Subsidized projects.* Any project in which 20 percent or more of the units now receive or will receive a subsidy in the form of:
 - (1) Interest reduction payments under Section 236 of the National Housing Act (12 U.S.C. 1715z-1);
 - (2) Rental Assistance Payments under Section 236 of the National Housing Act (12 U.S.C. 1715z-1);
 - (3) Rent Supplement payments under Section 101 of the Housing and Urban Development Act of 1965 (12 U.S.C. 1701s); or
 - (4) Project-based housing assistance payment contracts under Section 8 of the United States Housing Act of 1937 (42 U.S.C. 1437f) administered by HUD's Office of Housing.