



Carmen-Marine Apartments, Chicago, IL

Resident Homeownership Program



To: Daniel J. Burke, Director of Multifamily Midwest Region, 5AHMLA

From: //signed//
Kelly Anderson, Regional Inspector General for Audit, 5AGA

Subject: The Cooperative and Management Agent Lacked Adequate Controls Over the Operation of Carmen-Marine Apartments, Chicago, IL

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of HUD's Resident Homeownership Program grant for Carmen-Marine Apartments.

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, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at <http://www.hudoig.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at 312-353-7832.



Audit Report Number: 2015-CH-1010

Date: September 30, 2015

The Cooperative and Management Agent Lacked Adequate Procedures and Controls Over the Operation of Carmen-Marine Apartments, Chicago, IL

Highlights

What We Audited and Why

We audited the U.S. Department of Housing and Urban Development's (HUD) Resident Homeownership Program grant for Carmen-Marine Apartments (project). The audit was part of the activities in our fiscal year 2015 annual audit plan. We selected the project based on a request from HUD's Chicago Multifamily Housing Hub. Our objective was to determine whether the Carmen-Marine Cooperative and management agent operated the project in accordance with HUD's requirements and the grant agreement.

What We Found

The Cooperative and management agent did not ensure that (1) the Cooperative always maintained a proper waiting list for rental units and appropriately selected households for initial membership sales, (2) sufficient documentation was maintained to support that the Cooperative's payments to HUD for initial membership sales were accurate, (3) sufficient documentation was maintained to support whether the City of Chicago should have received proceeds from subsequent membership sales, (4) housing was affordable for all members, (5) members maintained their units as their principal residence, (6) the Cooperative could support that it notified the Chicago Housing Authority that it received excessive Section 8 Housing Choice Voucher program housing assistance payments for units, and (7) the Cooperative submitted required reports to HUD. As a result, HUD and the Cooperative lacked assurance that the project was operated in accordance with HUD's requirements and the grant agreement, and the Cooperative is at risk of having to reimburse HUD nearly \$22.7 million in Program funds.

What We Recommend

We recommend that the Director of HUD's Multifamily Midwest Region (1) require the Cooperative to resolve the issues and implement adequate procedures and controls to address the weaknesses cited in this audit report and (2) make a preliminary determination as to whether the Cooperative is in default of the grant agreement.

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Background and Objective

During the 1960s and 1970s, the U.S. Department of Housing and Urban Development (HUD) worked with owners to finance thousands of housing projects under its Federal Housing Administration (FHA) mortgage insurance programs, including section 221(d)(3) of the National Housing Act. HUD insured loans for the projects under section 221(d)(3) for up to 40 years. However, it allowed owners to prepay the FHA-insured mortgage after 20 years and convert the projects to market-rate housing, providing a powerful incentive for owners to prepay the FHA-insured mortgage, particularly if the property had appreciated in value. This early prepayment option resulted in the loss of several hundred thousand affordable housing units. To prevent further loss of affordable housing units, Congress enacted the Low Income Housing Preservation and Resident Homeownership Act in 1990. The Act imposed a general prepayment limitation of federally insured mortgages and offered owners fair-market-value incentives to (1) extend low-income affordability standards for the remaining useful life of the projects or (2) transfer the projects to nonprofit organizations, tenant associations, or community-based organizations that would keep the housing units affordable for the remaining useful life of the projects. The incentives were available until 1996, when Congress restored the owners' right to prepay federally insured mortgages and removed all preservation funding under the Act.

In November 1966, HUD insured Carmen-Marine Apartments' (project) mortgage under section 221(d)(3) of the National Housing Act to provide rental housing for moderate-income households. The Carmen-Marine Tenants' Association, an Illinois nonprofit corporation, was organized in 1990 to ensure that the project remained as quality, affordable housing for low- and moderate-income households. The Association submitted a resident home-ownership plan to HUD in June 1993 to prevent the owner of the project from prepaying the HUD-insured mortgage and converting the building to market-rate use. In January 1994, HUD awarded the Association a grant of more than \$23.1 million under the Resident Homeownership Program under the Low Income Housing Preservation and Resident Homeownership Act. The Association was required to use the grant funds to acquire and rehabilitate the building and transfer ownership of the building to the Carmen-Marine Cooperative, which would then sell memberships in the Cooperative to tenants in occupied units.¹ The Association transferred ownership of the project to the Cooperative in December 1996. The project is a 300-unit multifamily cooperative project located in Chicago, IL. As of May 1, 2015, there were 292 units at the project that were to be occupied by Cooperative members and 8 rental units. HUD disbursed the more than \$23.1 million from January 1994 through March 1998.

¹ Tenants were not required to purchase memberships in the Cooperative. If the tenants did not become members, they could remain in their unit and were eligible to receive Section 8 Housing Choice Voucher program housing assistance from the Chicago Housing Authority.

Cagan Management Group, Inc., has been the management agent for the project since September 2006. The records are at the project located at 5030 North Marine Drive, Chicago, IL and at Cagan's office located at 3856 Oakton Street, Skokie, IL.

The Cooperative was required to return to HUD 50 percent of the proceeds from initial membership sales.² As of August 2015, the Cooperative had returned \$437,833 in proceeds to HUD. Further, initial members were required to enter into a 20-year nonrecourse promissory note payable to HUD for the difference between the fair market value of the unit and the purchase price of the membership. Upon the sale of a household's initial membership in the Cooperative, the promissory note became due.³ If a subsequent member purchased the membership during the 20-year note period for less than the current fair market value of the unit, that member was required to enter into a nonrecourse promissory note payable to HUD for the amount of the discount for the period remaining on the initial promissory note. Further, members were required to maintain their units at the project as their principal residence for as long as they owned a membership in the Cooperative. In addition, the Cooperative was required to ensure that members did not pay more than 35 percent of their adjusted gross monthly income toward membership fees. Some verylow-income households would be eligible to receive a subsidy from the Cooperative to ensure that members did not pay more than 35 percent of their monthly adjusted gross income toward membership fees.

Our objective was to determine whether the Cooperative and management agent operated the project in accordance with HUD's requirements and the grant agreement. Specifically, we wanted to determine whether (1) initial memberships in the Cooperative were sold in accordance with the grant agreement, (2) HUD received its full share of proceeds from initial membership sales, (3) the City of Chicago received its full share of the proceeds from subsequent membership sales, (4) membership fees did not exceed 35 percent of the members' monthly adjusted gross income, (5) members maintained their units as their principal residence, (6) the Cooperative received excessive housing assistance payments for units, and (7) the Cooperative submitted reports to HUD to demonstrate continued compliance with the Program.

² The Cooperative required a downpayment equal to the lesser of 2 months of the membership fees for the purchase of a membership to the Cooperative or 10 percent of the members' annual adjusted gross income. Members generally entered into a 40-year note payable to the Cooperative for the remaining balance due for the membership. The Cooperative was required to return to HUD 50 percent of the downpayments and principal portion of the note payments it received.

³ The amount due was payable to the City of Chicago's HOME investment trust fund from the sales proceeds after deducting (1) amounts due for the purchase of the membership, (2) other amounts due in connection with the sale of the membership, and (3) the household's equity in the membership at the time of sale. Further, 6 years after the members entered into the notes with HUD, the amounts payable on the notes were reduced by 1/168th each month until the 20th year, when the notes are to be forgiven.

Results of Audit

Finding: The Cooperative and Management Agent Did Not Operate the Project in Accordance With HUD's Requirements

The Cooperative and management agent did not ensure that (1) the Cooperative always maintained a proper waiting list for rental units and appropriately selected households for initial membership sales, (2) sufficient documentation was maintained to support that the Cooperative's payments to HUD for initial membership sales were accurate, (3) sufficient documentation was maintained to support whether the City of Chicago should have received proceeds from subsequent membership sales, (4) housing was affordable for all members, (5) members maintained their units as their principal residence, (6) the Cooperative could support that it notified the Chicago Housing Authority that it received excessive Section 8 Housing Choice Voucher program housing assistance payments for units, and (7) the Cooperative submitted required reports to HUD. These weaknesses occurred because the Cooperative and management agent lacked adequate procedures and controls to ensure that the project was operated in accordance with HUD's requirements and the grant agreement.⁴ As a result, HUD and the Cooperative lacked assurance that the project was operated in accordance with HUD's requirements and the grant agreement and the Cooperative is at risk of having to reimburse HUD nearly \$22.7 million in Program funds.

Initial Membership Sales Not Administered in Accordance With the Grant Agreement

We reviewed the initial membership sales associated with eight units to determine whether initial memberships to the Cooperative were sold in accordance with the grant agreement. Contrary to the grant agreement, the Cooperative sold an initial membership for a unit after it was vacated by a rental household to a member of the Cooperative who was not selected from the required waiting list for rental units. Although the member moved from a one-bedroom unit to another one-bedroom unit, the vacated rental unit was larger than the member's old unit, and the member paid monthly membership fees associated with the old unit (\$309) rather than the new unit (\$323). The Cooperative and management agent also could not provide sufficient documentation to support that a household was appropriately selected from the waiting list for the initial sale of another unit after it was vacated by a rental household. Further, as of May 2015, the Cooperative did not maintain a waiting list for rental units that met the requirements of the resident home-ownership plan.

The Cooperative did not maintain an appropriate waiting list for rental units.

⁴ See appendix C of this audit report.

The president of the Cooperative's board of directors said that the Cooperative did not consider the size or condition of the units when it allowed the member to move into the vacated rental unit. Further, the former management agent for the project did not maintain documentation to support the individuals on the waiting list that the current management agent inherited. In addition, the Cooperative had not had a waiting list for rental units for the past 2 years since there were no vacant rental units at the project.

Lack of Sufficient Documentation To Support Payments to HUD From Initial Sales

We reviewed the Cooperative's fiscal years 2009 through 2013 payments to HUD to determine whether HUD received 50 percent of the proceeds from initial membership sales. The Cooperative and management agent could not provide sufficient documentation to support that the Cooperative made payments to HUD from the initial membership sales in accordance with HUD's regulations at 24 CFR (Code of Federal Regulations) 248.173(h) and article IV(l) of the grant agreement. The president of the board said that the former management agent for the Cooperative did not maintain adequate records of initial sales and the Cooperative did not always maintain records for initial members after they sold their memberships to subsequent members. In addition, the property manager for the Cooperative's management agent stated that the Cooperative did not have access to general ledgers, bank statements, canceled checks, or rent rolls before September 2006.

Since the Cooperative did not always maintain records for the initial members, we were unable to verify when the initial members became members of the Cooperative and whether the payments to HUD were accurate. Further, the Cooperative's annual calculation of funds due to HUD was based at least partially on estimates rather than actual amounts collected, and the Cooperative did not remit \$323 to HUD for 50 percent of the down-payment received for one unit. In addition, the Cooperative did not obtain a signature from a representative of HUD on the members' HUD notes.

Lack of Sufficient Documentation To Support Whether Funds Were Due to the City

We reviewed the subsequent membership sales associated with 13 units to determine whether the City received its full share of the proceeds from the sales. The Cooperative and management agent could not provide sufficient documentation to support whether net proceeds should have been paid to the City's HOME investment trust fund in accordance with regulations at 24 CFR 248.173(l) and article IV(p) of the grant agreement from the subsequent membership sales of all 13 units reviewed.⁵ The Cooperative and management agent could not provide sufficient documentation to support the initial members' equity in their memberships and the amount subsequent members paid for their memberships. The Cooperative and management agent also could not provide executed closing statements or membership price calculation charts for 4 sales and copies of the purchasers' checks for 12 sales. The administrative assistant for the Cooperative's management agent said that she did not make copies of the purchasers' checks.

⁵ Two of the memberships for the 13 units were sold twice to subsequent members. Therefore, there were 15 subsequent membership sales associated with the 13 units.

No Assurance That Housing Was Affordable for All Members

Contrary to paragraph 12 of HUD's use agreement with the Association, the Cooperative and management agent did not ensure that membership fees did not exceed 35 percent of the members' monthly adjusted gross income other than upon membership sales. Further, contrary to the resident home-ownership plan, the Cooperative did not grant membership to applicants if total monthly membership fees would exceed 35 percent of the households' monthly adjusted gross income. The Cooperative was to provide certain very low-income households a home-ownership fee subsidy to make up the difference between 35 percent of a very low-income household's monthly adjusted gross income and the regular monthly housing expense.⁶

In addition, since the Cooperative and management agent had not determined the members' household income after initial membership sales, the Cooperative would not be able to support that it sold initial memberships to the same proportion of very low-, low-, and moderate-income households as indicated in the resident income profile in paragraph 4.a. and required by paragraph 10.b. of the use agreement.

The treasurer of the board said that she was not aware that the resident home-ownership plan for the project stated that some very low-income members would be eligible to receive a home-ownership fee subsidy from the

Membership fees may have exceeded 35 percent of households' income.

Cooperative to prevent members from paying more than 35 percent of their monthly adjusted gross income for membership fees. The president of the board said that the Cooperative did not verify the members' income since it entered into a voluntary compliance agreement with HUD in January 2007, which stated that the members' income should not be verified. The agreement required the Cooperative to recertify the members' income. However, the agreement stated that all information reported by the members should be provided voluntarily and should not be verified. The agreement expired in January 2009. To ensure that the members do not pay more than 35 percent of their households' adjusted gross monthly income for membership fees and the Cooperative sells initial memberships to the appropriate proportion of very low-, low-, and moderate-income households, the Cooperative needs to verify the members' household income.

Members Not Living in Their Units at the Project

We reviewed the principal residency of 73 members associated with 36 units to determine whether the members maintained their units as their principal residence. The Cooperative and management agent did not ensure that members maintained their units at the project as their principal residence in accordance with regulations at 24 CFR 248.173(g)(4) and paragraph 7(a) of the Cooperative's occupancy agreement with members. We identified the following:

⁶ Households eligible to receive the subsidy must meet annual, base-adjusted gross income criteria ranging from \$7,302 to \$10,085, depending on the size of the unit.

- Six members did not maintain their units as their principal residence,⁷
- Six members were deceased, and
- One member held membership certificates and executed occupancy agreements for two separate units.

In addition, the Cooperative did not execute membership certificates, occupancy agreements, Cooperative notes, and HUD notes associated with two units.⁸

The treasurer of the board said that it was her understanding that a member could move out of a unit and remain a member as long as one of the other members associated with the same unit maintained the unit as a principal residence. However, after reviewing paragraph 7(a) of the occupancy agreement, she agreed that all members must maintain their units as their principal residence.

Lack of Documentation To Support Authority Was Notified To Stop Section 8 Payments

We reviewed the Section 8 Housing Choice Voucher program housing assistance payments associated with 17 units to determine whether the Cooperative received payments from the Chicago Housing Authority for rental units when members were paying membership fees for the units or after individuals had passed away. Contrary to regulations at 24 CFR 982.311(a), the grant agreement, and paragraph 8 of the housing assistance payments contracts, the Cooperative lacked documentation for seven rental units to support that it informed the Authority in a timely manner that payments should have been stopped. The Cooperative received more than \$34,000 in additional payments from the Authority for the seven rental units. The payments included the following:

- Nearly \$21,000 over 38 months when an individual, other than the household member for whom the Cooperative received housing assistance payments, had become a member of the Cooperative and was paying membership fees for the unit;
- Nearly \$12,000 for four units after the households became members and were paying membership fees for the units; and
- More than \$2,000 for two units after the individuals passed away.

Although the administrative assistant stated that it was not the Cooperative's responsibility to contact the Authority to stop the housing assistance payments, she said that one of the management agent's staff members verbally informed the Authority of the situations. For a unit in which the individual passed away in December 2007, the property manager informed staff of

⁷ One of the six members notified the Cooperative that she had moved out, but the Cooperative did not remove the member from the membership certificate.

⁸ As a result of our audit, the Cooperative executed a membership certificate, an occupancy agreement, a Cooperative note, and a HUD note associated with one of the units and executed a membership certificate for the other unit.

the management agent in January 2008 that the unit should be empty by the end of the month, they could stop payments from the Authority by February or March 2008, and they should notify the Authority after the Cooperative received the next payment. The Cooperative received payments for the unit through April 2008.

The property manager of the Cooperative's management agent said the Authority recaptured overpayments by withholding payments for other households in the project that received housing assistance. The Authority provided a schedule to show that it recaptured nearly \$15,000 of the overpayments associated with four of the seven units.⁹ However, the Cooperative could not provide sufficient documentation to support that it reimbursed the Authority \$19,866 of the overpayments it received for five units.

Reports Not Submitted to HUD

Contrary to article VIII(d) of the grant agreement, the Cooperative did not submit reports to HUD to demonstrate continued compliance with the Program. The reports included but were not limited to (1) semiannual reports on vacancies, (2) semiannual reports of nonpurchasing tenants, (3) monthly reports on the status of resales, (4) monthly reports on the status of sales activity, and (5) reports on changes in closing costs to the initial members. The president of the Cooperative's board of directors said that the Cooperative may have submitted reports to HUD after the grant was awarded but stopped submitting the reports when the original management agent for the project was replaced.

Conclusion

The weaknesses described above occurred because the Cooperative and management agent lacked adequate procedures and controls to ensure that the project was operated in accordance with HUD's requirements and the grant agreement. As a result, HUD and the Cooperative lacked assurance that the project was operated in accordance with HUD's requirements and the grant agreement, and the Cooperative is at risk of having to reimburse HUD nearly \$22.7 million in Program funds as allowed by the grant agreement. In addition, the Director of HUD's Multifamily Midwest Region stated that based on the results of our review, he believed that the Cooperative was in default of its grant and use agreements with HUD.

Recommendations

We recommend that the Director of HUD's Multifamily Midwest Region require the Cooperative to

- 1A. Develop and maintain a waiting list for rental units that meets the requirements of the resident home-ownership plan.
- 1B. Provide sufficient documentation to support that HUD had received 50 percent of the proceeds from initial membership sales as of June 2015. If the Cooperative cannot do this, it should pay HUD half of the principal on the Cooperative notes

⁹ The Authority recaptured all of the overpayments for two units and recaptured only part of the overpayments for another two units. Therefore, the Authority did not recapture overpayments associated with five (7 – 2) units.

for all memberships less the amount the Cooperative paid HUD for initial membership sales.

- 1C. Have a representative of HUD at the closing for membership sales to sign the HUD note and include as part of the closing a certification in which the Cooperative and seller certify that they did not receive and the buyer certifies that it did not pay more for the membership than is listed on the membership price calculation chart.
- 1D. Verify the current household income for all members to determine whether the members are paying more than 35 percent of their households' adjusted gross monthly income for membership fees. For any members that are paying more than 35 percent of their households' adjusted gross monthly income for membership fees, it should determine the amount the household overpaid and reimburse the household that amount.
- 1E. Remove individuals, who did not maintain their units at the project as their principal residence or are deceased, from the membership certificates, occupancy agreements, Cooperative notes, and HUD notes.
- 1F. Execute an occupancy agreement, Cooperative note, and HUD note associated with the remaining unit.
- 1G. Support or reimburse the Chicago Housing Authority from non-Federal funds for the \$19,866 in excessive Section 8 Housing Choice Voucher program housing assistance payments that it received for five rental units.
- 1H. Implement adequate procedures and controls to address the weaknesses cited in this audit report to prevent the Cooperative from the possible repayment of the remaining \$22,666,717 in Program funds, which HUD disbursed for the project (\$23,104,550 in Program funds disbursed for the project – \$437,833 in proceeds from initial membership sales the Cooperative returned to HUD).

We also recommend that the Director of HUD's Multifamily Midwest Region

- 1I. Make a preliminary determination as to whether the Cooperative is in default of the grant agreement. If it is preliminarily determined that the Cooperative is in default, provide the Cooperative notice of the determination and propose corrective or remedial actions to address the default.

Scope and Methodology

We performed our onsite audit work from November 2014 through July 2015 at the project located at 5030 North Marine Drive, Chicago, IL. The audit covered the period January 1994 through October 2014 and was expanded as necessary.

To accomplish our objective, we reviewed

- Applicable laws, regulations at 24 CFR Parts 248 and 982, and HUD's files for the project and grant and use agreements with the Association.
- The project's audited financial statements from 1998 through 2014, financial records, resident home-ownership plan, management agent agreement, and unit files.
- Cagan Management Group, Inc.'s policies and procedures and organizational chart.
- Data in HUD's Public and Indian Housing Information Center, Enterprise Income Verification System, and Single Family Insurance System.

In addition, we interviewed members of the Cooperative, employees of Cagan Management Group, Inc., and HUD staff.

As of September 2006, there were 284 units at the project that were to be occupied by Cooperative members and 17 units for which the Cooperative received housing assistance payments from the Chicago Housing Authority.¹⁰ From September 2006 through October 2014, the Cooperative sold initial memberships for 8 of the 17 Section 8-assisted units. Therefore, as of October 2014, there were 292 (284 + 8) units that were to be occupied by Cooperative members and 8 rental units.

We initially selected 20 of the 292 member units for review. We selected nonstatistical samples of 15 units that we determined to be of high risk for (1) initial memberships to the Cooperative not being sold in accordance with the grant agreement (5 units) and (2) members not maintaining their units as their primary residence (10 units). We also selected a nonstatistical representative sample of 5 units for which we believed the initial members sold their membership to determine whether the City received its full share of the proceeds from subsequent membership sales. During the review of the initial membership sales, we found that the Cooperative inappropriately received housing assistance payments from the Chicago Housing Authority. During the review of primary residency, it appeared that two members associated with two units were deceased. We also found that the Cooperative and management agent did not ensure that membership fees

¹⁰ The Cooperative received Section 8 housing assistance for one unit that was required to be occupied by Cooperative members. Therefore, there were 284 units at the project that were to be occupied by Cooperative members and 16 rental units as of September 2006.

did not exceed 35 percent of the members' monthly adjusted gross income other than upon membership sales. Therefore, we selected (1) a nonstatistical sample of 12 additional units that we determined to be of high risk for members who were deceased or did not maintain their units as their primary residence and (2) the remaining 12 units for which the Cooperative received housing assistance payments from the Authority. We then reviewed all 44 (20 + 12 + 12) units to determine whether (1) initial memberships to the Cooperative were sold in accordance with the grant agreement (8 units), (2) the City received its full share of the proceeds from subsequent membership sales (13 units), (3) the Cooperative and management agent ensured that membership fees did not exceed 35 percent of the members' monthly adjusted gross income other than upon membership sales (36 units), (4) the members maintained their units as their principal residence, and (5) the Cooperative received housing assistance payments from the Authority for rental units when members were paying membership fees for the units or after individuals had passed away (17 units) as applicable.¹¹ We used nonstatistical samples since we knew enough about the population to identify a relatively small number of items of interest that were likely to be misstated or otherwise have high risk and we were not projecting the results to the population that we did not review.

We also selected the Cooperative's fiscal years 2009 through 2013 payments to HUD to determine whether HUD received its full share of proceeds from initial membership sales.

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.

¹¹ Although we selected 44 units for review, not all of the reviews applied to the 44 units. For example, members sold their membership interest associated with only 13 units.

Internal Controls

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.

Relevant Internal Controls

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

- Effectiveness and efficiency of operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Reliability of financial reporting – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.
- Compliance with applicable laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

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 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 a significant deficiency:

- The Coopertaive and management agent lacked adequate procedures and controls to ensure that the project was operated in accordance with HUD's requirements and the grant agreement (see finding).

Appendixes

Appendix A

Schedule of Questioned Costs and Funds To Be Put to Better Use

Recommendation number	Unsupported 1/	Funds to be put to better use 2/
1G	<u>\$19,866</u>	
1H		<u>\$22,666,717</u>
Totals	<u>\$19,866</u>	<u>\$22,666,717</u>

- 1/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.
- 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 instance, implementation of our recommendations will ensure that the Cooperative does not have to repay the remaining nearly \$22.7 million in Program funds HUD disbursed for the project.

Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

Comment 1

Comment 2

Comment 3
Comment 4
Comments 3, 5,
and 6

Comment 7

Comment 8

RESPONSE TO DRAFT AUDIT REPORT

Response Date: 9/21/2015

Carmen Marine Cooperative ("CMC") has received a draft of the U.S. Department of Housing and Urban Development ("HUD) Office of Inspector General's ("OIG") Draft Audit Report (the "Audit") and submits this written response. While CMC acknowledges and agrees that certain record keeping and reporting procedures can be improved, as noted in the Audit, CMC believes that it has at all times operated CMC consistent in all material respects with provisions of (i) the Low Income Housing and Preservation Act of 1990 (the "Act"); (ii) regulations implemented pursuant to the Act, found at 24 CFR 248.173 (the "Regulations"); (iii) the HUD approved Resident Homeownership Plan approved by HUD (the "RHP"); (iv) the Grant Agreement; and (v) the Use Agreement.

CMC's response will address OIG's seven general findings and each of its seven specific recommendations:

OIG Findings:

Initial Membership Sales Not Administered in Accordance With the Grant Agreement

The Audit finding concludes that "the Cooperative sold an initial membership for a unit after it was vacated by a rental household to a member of the Cooperative who was not selected from the required waiting list for rental units." CMC disagrees with this conclusion, but agrees that waiting list procedures could be improved and should be administered in a manner consistent with the Use Agreement. Historically, prospective buyers of units being sold/vacated were sold based on internal waiting lists created to relieve existing over-crowding situations. In addition, HUD (through its then representative, George Gilmore) supervised a lottery based waiting list. Current waiting lists for one, two and three bedroom waiting lists, all of which are posted at the building, are included in this response as Attachment A.

Lack of Sufficient Documentation to Support Payments to HUD From Initial Sales

From 1998 to 2004, CMC provided HUD provided with updates as to unit sales and copies of HUD related financing documentation in connection with the initial sales of units. At no time during this period did, nor thereafter has, HUD required or requested additional documentation to support the amount funded to HUD, other than amounts included in the annual audited financial statements. CMC does not have historic back-up documentation related to initial sales (e.g. copies of checks). It is worth noting that CMC can only confirm the amount it received from the buyer as a part of the closing process. CMC does not have the means to assure that buyers are not paying sellers additional funds outside of the closing process, although CMC does require an affidavit to that effect. CMC agrees that, on a prospective basis, it will provide HUD with copies of checks and closing statements to further document the price paid for units. CMC requests further guidance from HUD as to what additional documentation, if any, that HUD may request to substantiate annual HUD payments from CMC.

CMC Response to HUD Draft Audit
September 21, 2015

**Ref to OIG
Evaluation**

Auditee Comments

Comment 9

Comment 10

Comment 11

Comment 11

Comment 12

Comment 13
Comment 6

Comment 14
Comments 6,
14, and 15

Comment 16

Lack of Sufficient Documentation To Support Whether Funds Were Due to the City.

To the best knowledge of CMC and its management agent, units resold to date have been sold at a price not exceeding that which the original buyer is entitled to retain, plus the assumption of the outstanding respective balances of the HUD and Coop notes. Based on those purchase prices, no funds would be required to be remitted to the City of Chicago. Again, as stated above, CMC does not have the means to assure that buyers are not paying sellers additional funds outside of the closing process, although CMC does require an affidavit to that effect.

No Assurance That Housing Was Affordable For All Members

CMC disagrees with this conclusion as well as HUD's interpretation of the LIHPRHA affordability requirements. The "35% test" is found at 24 CFR 173(g)(2), which provides, in pertinent part, that a resident homeownership plan must demonstrate that: "*Prospective* (emphasis added) debt service payments, occupancy charges and utilities payable by the owners shall not exceed 35% of the monthly adjusted gross income of the owners." This was a one-time test demonstrated by the detailed data submitted on behalf of CMC in connection with the RHP approval process. There are no ongoing income certification requirements for coop unit purchasers and no HUD subsidies available for owners who may have a loss of income. In fact, one of the many disclosures to those who were Section 8 recipients at the time of the conversion process was the caution that giving up their Section 8 support would put them at risk in the future due to a loss of income. CMC does not agree that the 35% test is an ongoing affordability requirement of the LIHPRHA homeownership program and further believes that a sampling of any of other LIHPRHA homeownership projects would demonstrate that CMC is operating in a manner consistent with all other projects as it relates to this issue.

Members Not Living in Their Units at the Project

CMC agrees that LIHPRHA regulations require that initial owners occupy their units for 15 years. In addition, CMC's occupancy agreement requires principal residency by subsequent owners, although such requirement is not required under the LIHPRHA homeownership, nor was such requirement by subsequent owners under the approved RHP. Nonetheless, CMC does attempt to enforce this requirement within the limits of its resources. A sampling of efforts made by CMC's management agent to discover unit owners who have breached this provision is illustrated by file notes regarding several units which are attached hereto as **Attachment B**.

Lack of Documentation to Support the Authority (CHA) Was Notified to Stop Section 8 Payments

While CMC acknowledges that there were accounting and reporting issues with residents receiving the benefits of Section 8 support, CMC believes that those issues have now been resolved. Attached as **Attachment C** is recent correspondence from CHA regarding this matter. CMC will continue to work with CHA to assure that issues such as those that were identified do not recur.

Reports Not Submitted to HUD

To the best of its knowledge, CMC has submitted all reports required under the Grant Agreement. CMC notes that the Grant Agreement was the operative document during the rehabilitation and initial sale process. CMC believes that it fulfilled its grant reporting requirements as required during the four year term of the Grant Agreement. However, CMC is willing to discuss what further reporting requirements

**Ref to OIG
Evaluation**

Auditee Comments

Comment 16

that HUD and CMC determine are reasonable and appropriate to substantiate ongoing requirements with respect to CMC's homeownership program.

OIG RECOMMENDATIONS:

1A. Develop and maintain a waiting list for rental units that meets the requirements of the resident home-ownership plan.

Comments 3
and 5

AGREE: CMC has submitted its current waiting lists herewith and awaits any HUD comments or questions.

1B. Provide sufficient documentation to support that HUD had received 50 percent of the proceeds from initial membership sales as of June 2015. If the Cooperative cannot do this, it should pay HUD half of the principal on the Cooperative notes for all memberships less the amount the Cooperative paid HUD for initial membership sales.

Comment 17

AGREE (PROSPECTIVE BASIS ONLY): HUD has accepted documentation with respect to initial and subsequent unit sales since 1998, as well as annual audits showing annual payments to HUD, without any request for additional documentation or back up. To perform a forensic audit of its books, after these many years, during which there have been changes in management agent, onsite personnel, and board members, would be unreasonably burdensome. However, with respect to any future reporting, CMC is willing to provide HUD with any back-up documentation that it may reasonably request.

1C. Have a representative of HUD at the closing for membership sales to sign the HUD note and include as part of the closing a certification in which the Cooperative and seller certify that they did not receive and the buyer certifies that it did not pay more for the membership than is listed on the membership price calculation chart.

Comment 18

AGREE: While HUD has never requested to attend unit closings, CMC welcomes HUD attendance at closings provided HUD can provide CMC with a single point of contact for scheduling.

1D. Verify the current household income for all members to determine whether the members are paying more than 35 percent of their households' adjusted gross monthly income for membership fees. For any members that are paying more than 35 percent of their households' adjusted gross monthly income for membership fees, it should determine the amount the household overpaid and reimburse the household that amount.

Comment 11

DISAGREE: For the reasons stated above, CMC disagrees with this recommendation and reiterates strongly that such a requirement is inconsistent with the Act, the Regulations, and the approved RHP.

1E. Remove individuals, who did not maintain their units at the project as their principal residence or are deceased, from the membership certificates, occupancy agreements, Cooperative notes, and HUD notes.

Comment 19

AGREE: If this process is not yet complete, CMC will remedy deficient documentation.

**Ref to OIG
Evaluation**

Auditee Comments

Comment 20

Comments 14
and 15

Comment 21

IF. Execute an occupancy agreement, Cooperative note, and HUD note associated with the remaining unit.

AGREE: If this process is not yet complete, CMC will remedy deficient documentation.

IG. Support or reimburse the Authority from non-Federal funds for the \$19,866 in excessive housing assistance payments that it received for five rental units.

AGREE: As noted above, CMC believes it has resolved all outstanding accounting issues with CHA.

II. Make a preliminary determination as to whether the Cooperative is in default of the grant agreement. If it is preliminarily determined that the Cooperative is in default, provide the Cooperative notice of the determination and propose corrective or remedial actions to address the default.

CMC has used all reasonable and diligent efforts to comply in all material respects with all requirements applicable to its resident homeownership program since inception. Changes in management, legal advisors, on-site personnel, and board members may have contributed to errors that CMC is ready, willing and able to correct. CMC believes that any non-compliance issues were unintentional and inadvertent. Since being made aware of reporting and/or accounting deficiencies, CMC has remedied, and will continue to remedy, any unintentional oversights or non-compliance issues. CMC will work with HUD to establish any reasonable protocols that HUD may wish to establish to provide HUD with information needed to assure that Carmen Marine Cooperative continues to succeed as an example of resident homeownership for low and moderate income families.

CMC looks forward to working with HUD to bring a conclusion to this matter.

4

OIG Evaluation of Auditee Comments

Comment 1 The Cooperative stated that it believes that it has at all times operated the project consistent in all material respects with provisions of the (1) Low-Income Housing Preservation and Resident Homeownership Act of 1990, (2) regulations at 24 CFR 248.173, (3) the resident home-ownership plan for the project, (4) HUD's grant agreement with the Association, and (5) HUD's use agreement with the Association.

As discussed in the report, the Cooperative and management agent did not ensure that (1) the Cooperative always maintained a proper waiting list for rental units and appropriately selected households for initial membership sales, (2) sufficient documentation was maintained to that support the Cooperative's payments to HUD for initial membership sales were accurate, (3) sufficient documentation was maintained to support whether the City of Chicago should have received proceeds from subsequent membership sales, (4) housing was affordable for all members, (5) members maintained their units as their principal residence, (6) the Cooperative could support that it notified the Chicago Housing Authority that it received excessive Section 8 Housing Choice Voucher program housing assistance payments for units, and (7) the Cooperative submitted required reports to HUD. These weaknesses occurred because the Cooperative and management agent lacked adequate procedures and controls to ensure that the project was operated in accordance with HUD's requirements and the grant agreement. In addition, the Director of HUD's Multifamily Midwest Region stated that based on the results of our review, he believed that the Cooperative was in default of its grant and use agreements with HUD.

Comment 2 The Cooperative disagrees that it sold a membership unit to a household that was not selected from the required waiting list. However, contrary to the grant agreement, the Cooperative sold an initial membership for a unit after it was vacated by a rental household to a member of the Cooperative who was not selected from the required waiting list for rental units. Although the member moved from a one-bedroom unit to another one-bedroom unit, the vacated rental unit was larger than the member's old unit, and the member paid monthly membership fees associated with the old unit (\$309) rather than the new unit (\$323).

Comment 3 The Cooperative stated that historically it had sold vacated rental units based on an internal waiting list that was created to relieve overcrowding. However, the resident home-ownership plan states that any rental units vacated by current households, either during the conversion period or after the conversion to home ownership, must be marketed and households must be selected in accordance with the affirmative fair housing marketing and tenant selection plan in tab 15 of the resident home-ownership plan. The marketing and tenant selection plan in tab 15 states that the Association will market units using a waiting list and lease units to

very low-, low-, and moderate-income households as defined in the resident home-ownership plan. To market units, the Cooperative would advertise in at least three local newspapers and post notices regarding unit availability in prominent places in the community.

- Comment 4 The Cooperative stated that HUD supervised the creation of a lottery-based waiting list. The Cooperative and its former management agent did not provide documentation to support the individuals that were on this lottery-based waiting list. The president of the Cooperative's board of directors said that the lottery-based waiting list had been exhausted and that the Cooperative had not had a waiting list for rental units for the past 2 years since there were no vacant rental units at the project.
- Comment 5 The Cooperative stated that the current waiting lists for one-, two-, and three-bedroom units are included in its response as attachment A. However, the current waiting lists for one-, two-, and three-bedroom units are internal waiting lists.
- Comment 6 We did not include in appendix B the attachments that the Cooperative provided since the attachments were not necessary to understand the Cooperative's comments. We provided the Director of HUD's Multifamily Midwest Region with a complete copy of the Cooperative's written comments plus the attachments.
- Comment 7 The Cooperative stated that HUD had not required or requested documentation to support the amount of proceeds due to HUD from initial membership sales.
- Regulations at 24 CFR 248.173(h) state that the entity that transfers ownership interests in or shares representing units to eligible households must return 50 percent of the proceeds from the initial sale to HUD for use under 24 CFR 248.157 and 248.161, subject to the availability of appropriations. The entity must keep and make available to HUD all records necessary to accurately calculate payments due to HUD. Further, article VIII(d) of the grant agreement states that the Association or Cooperative must submit reports to HUD to demonstrate continued compliance with the requirements of the Program. The areas of the resident home-ownership plan that currently require reports include but are not limited to semiannual reports or surveys of nonpurchasing tenants and monthly reports on the status of sales activity until all units have been initially sold.
- Comment 8 The Cooperative stated that it does not have access to historical documentation related to the Cooperative's initial membership sales. In the future, the Cooperative will submit copies of closing statements and checks to HUD to support the amount members paid for their memberships. The Cooperative requested guidance from HUD for any additional documentation it may require to support the amount of proceeds due to HUD from initial membership sales.

The Cooperative should work with HUD's Chicago Multifamily Housing Hub to resolve recommendation 1B and 1H as applicable.

Comment 9 The Cooperative stated that to the best of the Cooperative's and its management agent's knowledge, memberships had not been sold for more than the members' equity in their memberships. Therefore, there were no net proceeds that the Cooperative was required to have paid to the City's HOME investment trust fund.

However, the Cooperative and management agent could not provide sufficient documentation to support whether net proceeds should have been paid to the City's HOME investment trust fund from the subsequent membership sales of all 13 units reviewed. The Cooperative and management agent could not provide sufficient documentation to support the initial members' equity in their memberships and the amount subsequent members paid for their memberships.

Comment 10 The Cooperative stated that it requires affidavits that purchasers are not paying sellers additional funds outside the closing process for membership sales. However, the Cooperative has not provided affidavits to this effect.

Comment 11 The Cooperative stated that it disagrees that it did not ensure that housing was affordable for all members and that it was required to ensure that membership fees did not exceed 35 percent of the members' monthly adjusted gross income other than upon membership sales. Regulations at 24 CFR 248.173(g)(2) state that prospective debt service payments, occupancy charges, and utilities payable by owners must not exceed 35 percent of the monthly adjusted gross income of the owners.

Regulations at 24 CFR 248.173(g)(2) do not limit the determination that membership fees did not exceed 35 percent of the members' monthly adjusted gross income to only at the time of membership sales. Paragraph 12 of the use agreement states that monthly carrying charges, including principal, interest, utility charges, taxes, property insurance, and home-ownership fees, for all members must not exceed 35 percent of the members' monthly adjusted gross income. Further, paragraph 4.a. of the use agreement states that as long as any unit in the project continues to be operated as rental housing, the Association, to the extent practicable, must maintain 60, 23, and 17 percent of the rental units in the project as affordable to very low-income households, low-income households, and moderate-income households, respectively. Paragraph 10.b. states that the Association, to the extent practicable, must sell membership in the project to the same proportion of very low-, low-, and moderate-income households as indicated in the resident income profile in paragraph 4.a. of the use agreement. In addition, HUD's Chicago Multifamily Housing Hub's position is that the Cooperative was required to continue to ensure that membership fees did not exceed 35 percent of the members' monthly adjusted gross income after membership sales.

Therefore, contrary to paragraph 12 of the use agreement, the Cooperative and management agent did not ensure that membership fees did not exceed 35 percent

of the members' monthly adjusted gross income other than upon membership sales. Further, the Cooperative would not be able to support that it sold initial memberships to the same proportion of very low-, low-, and moderate-income households as indicated in the resident income profile in paragraph 4.a. and required by paragraph 10.b. of the use agreement.

- Comment 12 The Cooperative stated that its occupancy agreement requires subsequent members to maintain their units at the project as their principal residence. However, the resident home-ownership plan does not require subsequent members to maintain their units at the project as their principal residence.

Paragraph 7(a) of the Cooperative's occupancy agreements with members states that the members agree to occupy the unit at all times as a principal residence until the date on which the members sell their membership in the Cooperative. Further, the resident home-ownership plan states that all initial and subsequent homeowners will be required to certify to the Cooperative that the units will be used as their principal residence.

- Comment 13 The Cooperative stated that it tries to ensure that members maintain their units at the project as their principal residence. The Cooperative should work with HUD's Chicago Multifamily Housing Hub to resolve recommendations 1E and 1H as applicable.

- Comment 14 The Cooperative stated that it believes that the issue of the Cooperative's receiving overpayments of Section 8 Housing Choice Voucher program housing assistance from the Chicago Housing Authority has been resolved. It stated that attachment C contained correspondence from the Authority regarding the matter.

The Cooperative did not provide sufficient documentation to support that it reimbursed the Authority \$19,866 for the overpaid housing assistance it received for five units. Attachment C included two documents that appeared to be letters from the Authority to the Cooperative containing housing assistance payments statements for the Cooperative. The statements appeared to show that the Authority recaptured \$1,190 of the nearly \$20,000. However, the letters were not on the Authority's letterhead or signed by a representative of the Authority.

- Comment 15 The Cooperative stated that it will continue to work with the Chicago Housing Authority to ensure that the issues identified in the audit report do not recur. The Cooperative should work with HUD's Chicago Multifamily Housing Hub to resolve recommendation 1H as applicable.

- Comment 16 The Cooperative stated that it believes that it has submitted all of the reports required under the grant agreement, which was the operative document during the rehabilitation of the project and the initial membership sales process, and that the Cooperative has fulfilled its grant reporting requirements. However, it is willing to discuss further reporting requirements to substantiate the Cooperative's ongoing requirements with respect to the Program.

Contrary to article VIII(d) of the grant agreement, the Cooperative did not submit reports to HUD to demonstrate continued compliance with the Program. The reports included but were not limited to (1) semiannual reports on vacancies, (2) semiannual reports of nonpurchasing tenants, (3) monthly reports on the status of resales, (4) monthly reports on the status of sales activity, and (5) reports on changes in closing costs to the initial members. The grant agreement had not been closed out as of September 2015. The president of the Cooperative's board of directors said that the Cooperative may have submitted reports to HUD after the grant was awarded but stopped submitting the reports when the original management agent for the project was replaced. The Cooperative should work with HUD's Chicago Multifamily Housing Hub to resolve recommendation 1H as applicable.

- Comment 17 The Cooperative stated that HUD has accepted documentation for initial and subsequent membership sales since 1998, including annual audits showing the amount of proceeds due to HUD from initial membership sales, without requesting additional documentation. To request the Cooperative to provide historic financial information is unreasonably burdensome.

Regulations at 24 CFR 248.173(h) state that the entity that transfers ownership interests in or shares representing units to eligible households must return 50 percent of the proceeds from the initial sale to HUD for use under 24 CFR 248.157 and 248.161, subject to the availability of appropriations. The entity must keep and make available to HUD all records necessary to accurately calculate payments due to HUD. The Cooperative should work with HUD's Chicago Multifamily Housing Hub to resolve recommendation 1B.

- Comment 18 The Cooperative stated that it welcomes a representative of HUD at the closings for membership sales if HUD can provide a single point of contact for scheduling. The Cooperative should work with HUD's Chicago Multifamily Housing Hub to resolve recommendations 1C and 1H as applicable.

- Comment 19 The Cooperative stated that it will remove the individuals who did not maintain their units at the project as their principal residence or are deceased from the membership certificates, occupancy agreements, Cooperative notes, and HUD notes if it has not already addressed the matter. The Cooperative should work with HUD's Chicago Multifamily Housing Hub to resolve recommendation 1E.

- Comment 20 The Cooperative stated that it will execute an occupancy agreement, Cooperative note, and HUD note associated with the remaining unit if it has not already addressed the matter. The Cooperative should work with HUD's Chicago Multifamily Housing Hub to resolve recommendation 1F.

- Comment 21 The Cooperative stated that it will work with HUD to establish any reasonable protocols that HUD may want to establish to provide HUD with information needed to ensure that the Cooperative continues to succeed as an example of resident home-ownership for low- and moderate-income households. The

Cooperative should work with HUD's Chicago Multifamily Housing Hub to resolve recommendation 1H.

Appendix C

Applicable Requirements

Section 226(b)(5)(a)(i) of the Low-Income Housing Preservation and Resident Homeownership Act of 1990 states that a homeowner under a home-ownership program may transfer the homeowner's ownership interest in or membership representing the unit, except that a program may establish restrictions on the resale of units under the program.

Regulations at 24 CFR 248.173(g)(4) state that HUD must require that the form of home ownership impose the appropriate conditions to ensure that each initial member occupies the unit it acquires for at least the initial 15 years of ownership, unless the resident council determines that the initial member is required to move outside the market area due to a change in employment or an emergency situation. Section 248.173(h) states that the entity that transfers ownership interests in or shares representing units to eligible households must return 50 percent of the proceeds from the initial sale to HUD for use under 24 CFR 248.157 and 248.161, subject to the availability of appropriations. The entity must keep and make available to HUD all records necessary to accurately calculate payments due to HUD.

Regulations at 24 CFR 248.173(i)(3) state that at closing, the initial homeowner must execute a nonrecourse promissory note for a term of 20 years equal to the difference between the fair market value of the unit and the purchase price, payable to HUD, together with a mortgage securing the obligation of the note. Section 248.173(i)(3)(i) states that with respect to a sale by an initial homeowner, the note must require payment upon sale by the initial homeowner, to the extent that proceeds of the sale remain after paying off other outstanding debt incurred in connection with the purchase of the property; paying any other amounts due in connection with the sale, including closing costs and transfer taxes; and paying the household the amount of its equity in the property, computed in accordance with 24 CFR 248.173(k). Section 248.173(i)(3)(ii) states that with respect to a sale by an initial homeowner during the first 6 years after acquisition, the household may retain only the amount computed under 24 CFR 248.173(k). Any excess is distributed as provided in 24 CFR 248.173(l). Section 248.173(i)(3)(iii) states that with respect to a sale by an initial homeowner 6 to 20 years after acquisition, the amount payable under the note must be reduced by 1/168th of the original principal amount of the note for each full month of ownership by the household after the end of the sixth year. The homeowner may retain all other proceeds of the sale.

Regulations at 24 CFR 248.173(j) state that when a subsequent purchaser during the 20-year period, measured by the term of the initial promissory note, purchases the property for less than the then current fair market value, the purchaser must also execute at closing such a promissory note and mortgage for the amount of the discount. The term of the promissory note must be the period remaining in the original 20-year period. Section 248.173(k) states that the amount of equity an initial homeowner has in the property is determined by computing the sum of (1) the contribution to equity paid by the household, if any, including any downpayment and any amount paid toward principal on a mortgage loan during the period of ownership; (2) the value of any improvements installed at the expense of the household during the household's tenure as

owner, as determined by the resident council based on evidence of amounts spent on the improvements, including the cost of material and labor; and (3) the appreciated value, determined by applying the consumer price index against the contribution to equity under 24 CFR 248.173(k)(1) and (2), excluding the value of any sweat equity or volunteer labor used to make improvements to the unit. Section 248.173(l) states that any net sales proceeds that may not be retained by the member under the Program approved under 24 CFR 248.173 must be paid to the HOME investment trust fund for the unit of general local government in which the project is located.

Regulations at 24 CFR 982.311(a) state that housing assistance is paid to the owner in accordance with the terms of the housing assistance payments contract. Housing assistance may be paid to the owner only during the lease term and while the household resides in the unit. Section 982.311(c)(2) states that housing assistance payments terminate when the housing assistance payments contract terminates.

In HUD's grant agreement with the Association, the Association agrees to carry out its grant activities under the grant agreement in compliance with the regulations, the terms of the resident home-ownership plan, and any other applicable laws and regulations. Article IV(k) of the grant agreement states that all initial members must certify that their unit will be used as their principal residence. Initial members must also agree to occupy their unit for at least 15 years from the date of purchase unless the Cooperative determines that an initial member is required to move outside the market area due to changes in employment or for emergency reasons. The Cooperative may impose longer occupancy terms in its agreement with each initial and subsequent member if it deems it necessary. Article IV(l) states that at the time of the sales of membership shares to the initial members, the Cooperative must remit to HUD 50 percent of all proceeds from the sales of the shares. If cash is received from the initial member because the member receives a loan for the purchase price, 50 percent of the cash received must be remitted to HUD. If the Cooperative provides the loan to the member, the Cooperative must remit to HUD 50 percent of the principal paid by the member as it is paid to the Cooperative. If the initial owner transfers the shares to another purchaser who assumes the initial member's remaining debt, 50 percent of the principal amount collected will continue to be remitted to HUD.

Article IV(p) of the grant agreement states that if the initial member sells his or her membership in the Cooperative within the first 6 years after acquisition, the member may retain only amounts allowed by 24 CFR 248.173(k). If the initial member sells his or her membership 6 to 20 years after acquisition, the member may retain all proceeds in excess of amounts payable on the promissory note to HUD allowed by 24 CFR 248.173(i)(3), except as otherwise provided for in the formula specified in exhibit 16 of the resident home-ownership plan.

Article VIII(d) of the grant agreement states that the Association or Cooperative must submit reports to HUD to demonstrate continued compliance with the requirements of the Program. The areas of the resident home-ownership plan that currently require reports include but are not limited to (1) semiannual report on vacancies, (2) semiannual report or survey of nonpurchasing tenants, (3) monthly reports on the status of resales, (4) monthly reports on the status of sales activity until all units have been initially sold, and (5) reports on changes in closing costs to the

initial members as needed. Article X states that a default under the grant agreement will consist of any (1) material noncompliance with the Act; the regulations; the resident home-ownership plan; or any other Federal, State, or local law as determined by HUD or (2) other material breach of the grant agreement. If HUD determines preliminary that the Association or Cooperative is in default, HUD will give the Association or Cooperative notice of a determination of default and the corrective or remedial action proposed by HUD. The Association or Cooperative must have the opportunity to demonstrate, within the time prescribed by HUD, that it is not in default or that the proposed corrective or remedial action is inappropriate before HUD implements the corrective or remedial action. When HUD determines that corrective or remedial actions by the Association or Cooperative have not been undertaken as instructed or will not be effective to correct the default and prevent further default, HUD may take the following additional corrective and remedial actions under the agreement: (1) demand repayment of all Program funds disbursed, including funds held in escrow accounts funded by the grant agreement; (2) initiate litigation or other legal proceedings designed to require compliance with the Act, the regulations, the resident home-ownership plan, the grant agreement, or any other authorities; (3) require the Association to transfer all of its rights and interest in the project to HUD; or (4) take any other remedial action legally available. No delay or omission by HUD in exercising any right or remedy under the grant agreement will impair HUD's ability to exercise such right or remedy or constitute a waiver of or consent in any default by the Association or Cooperative.

Article XII(a) of the grant agreement states that the Association or Cooperative, in performing the terms, provisions, and requirements of the grant agreement, must also follow the provisions and terms of HUD's use agreement with the Association and the resident home-ownership plan for the project, which are incorporated into the grant agreement.

Paragraph 4.a. of HUD's use agreement with the Association states that during the conversion period and for as long as any unit in the project continues to be operated as rental housing after conversion, the Association must, to the extent practicable, maintain 60, 23, and 17 percent of the rental units in the project as affordable to very low-income households, low-income households, and moderate-income households, respectively. Paragraph 10.b. states that the Association, to the extent practicable, must sell membership in the project to the same proportion of very low-, low-, and moderate-income households as indicated in the resident income profile in paragraph 4.a. of the use agreement. Paragraph 12 states that monthly carrying charges, including principal, interest, utility charges, taxes, property insurance, and home-ownership fees, for all members must not exceed 35 percent of the members' monthly adjusted gross income.

The resident home-ownership plan for the project states that any rental units vacated by current households either during the conversion period or after the conversion to home ownership must be marketed and households must be selected in accordance with the affirmative fair housing marketing and tenant selection plan in tab 15 of the resident home-ownership plan. Prices and financing terms available from the Cooperative will be established so that an initial homeowner's expenses will not exceed 35 percent of the homeowner's adjusted monthly income. Tab 9 of the resident home-ownership plan states that the homeowners in the Cooperative will not pay more than 35 percent of their adjusted monthly income for housing. To achieve the goal of offering ownership opportunities to the greatest number of building residents while maintaining the 35 percent of income housing expense cap, some very low-income building residents will be

eligible to receive a home-ownership fee subsidy. The home-ownership fee subsidy will make up the difference between 35 percent of a very low-income household's adjusted monthly income and the regular monthly housing expense. Households eligible to receive the subsidy must meet annual, base-adjusted gross income criteria ranging from \$7,302 to \$10,085 depending on the size of the unit. The marketing and tenant selection plan in tab 15 states that the Association will market units using a waiting list and lease units to very low-, low-, and moderate-income households as defined in the resident home-ownership plan.

Paragraph 4.b. of the Chicago Housing Authority's housing assistance payments contracts with the Cooperative states that the contracts terminate automatically (1) if the leases are terminated by the Cooperative or the tenants or (2) if the households move from the contract units. In paragraph 8 of the contracts, the Cooperative certified (1) that except for the rent to the Cooperative, the Cooperative had not received and would not receive any payments or other consideration for rental of the contract units during the contracts terms; (2) the households did not own or have any interest in the contract units; and (3) to the best of the Cooperative's knowledge, the members of the households resided in the contract units and the units were the households' only residence.

Paragraph 7(a) of the Cooperative's occupancy agreements with members states that the members agree to occupy the unit at all times as a primary residence until the date on which the members sell their membership in the Cooperative.

Appendix D

Schedule of Deficiencies

Unit reference number	Initial membership sales	Subsequent membership sales	Members' income	Principal residence	Section 8 payments
1			X		
2		X	X		
3			X		
4			X	X	
5		X	X		
6			X		
7			X	X	
8			X	X	
9		X	X	X	
10			X	X	
11					
12			X	X	
13			X	X	X
14					
15			X		
16		X	X	X	
17		X	X		
18			X		
19					X
20			X	X	
21		X	X		
22					X
23		X	X	X	
24					
25			X		
26	X		X		X
27			X		
28			X	X	
29		X	X		
30					
31	X	X	X		X
32			X		
33		X	X		
34					
35			X		

Unit reference number	Initial membership sales	Subsequent membership sales	Members' income	Principal residence	Section 8 payments
36					
37			X	X	
38					
39		X	X	X	
40					X
41		X	X	X	
42			X	X	
43			X		X
44		X			
Totals	<u>2</u>	<u>13</u>	<u>33</u>	<u>15</u>	<u>7</u>

* The blue fields represent when the review did not apply. During the audit, we provided the Cooperative schedules that detailed the results of our reviews.