



**U.S. Department of Housing and Urban  
Development  
Washington, DC**

**Office of Multifamily Housing  
Section 236 Program**



Issue Date: December 11, 2012

Audit Report Number: 2013-PH-0001

TO: Marie D. Head, Deputy Assistant Secretary for Multifamily Housing Programs,  
HT  
Mary Ann Henderson, Director, Baltimore Multifamily Hub, 3BHMLAS  
//signed//

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

SUBJECT: HUD's Region 3 Multifamily Housing Offices Generally Ensured That Section  
236 Rent and Excess Income Requirements Were Met

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 Region 3 Offices of Multifamily Housing's monitoring of HUD's Section 236 properties to ensure that rents and excess income were properly identified and remitted to HUD.

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 8L, 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 215-430-6729.



December 11, 2012

## HUD's Region 3 Multifamily Housing Offices Generally Ensured That Section 236 Rent and Excess Income Requirements Were Met

# Highlights

Audit Report 2013-PH-0001

### What We Audited and Why

We audited HUD's Region 3 Offices of Multifamily Housing to determine whether HUD ensured that rents and excess income for Section 236 properties were properly identified and remitted to HUD. We performed this audit based on our audit plan and problems identified during an external audit of a Section 236 property located in Washington, DC.<sup>1</sup>

### What We Found

HUD's Region 3 Offices of Multifamily Housing generally ensured that Section 236 properties established basic and market rents and remitted excess income to HUD as required. However, the Washington, DC, program center did not ensure 6 of its 16 Section 236 properties' rents and excess income were properly identified.

### What We Recommend

We recommend that the Director of HUD's Baltimore Multifamily hub direct the Washington, DC, program center to (1) review excess income calculations totaling \$19,121 to determine whether the income is adequately supported, and resubmit excess income from non-Federal funds as required; (2) require two Section 236 properties to repay from non-Federal funds excess income totaling \$55,091 that was retained without HUD's approval; (3) require two Section 236 properties to submit monthly excess income reports as required; and (4) follow its procedures to ensure adequate oversight of Section 236 rents and excess income.

<sup>1</sup> HUD OIG audit report number 2012-PH-1005, Second Northwest Cooperative Homes Association, Washington, DC, Did Not Identify Rents and Remit Excess Income to HUD

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## BACKGROUND AND OBJECTIVE

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The Section 236 program, established by the Housing and Urban Development Act of 1968, combined Federal mortgage insurance with interest reduction payments to the lender for the production of low-cost rental housing. Under this program, the U.S. Department of Housing and Urban Development (HUD) provided interest subsidies to lower a project’s mortgage interest rate to as low as 1 percent. This program no longer provides insurance or subsidies for new mortgage loans, but existing Section 236 properties continue to operate under the program. The interest reduction payment results in lower operating costs and subsequently a reduced rent structure.

The program’s basic rent is the rent that the owner must collect to cover the property’s operating costs, given the mortgage interest reduction payments made to the property. The program’s market rent represents the rents needed to cover operating costs if the mortgage interest were not subsidized. Members occupying program units are required to pay rents based on annual income. At a minimum, members must pay at least basic rent for the program units but cannot pay rent that exceeds the established market rents. Members paying less than the Section 236 market rent are considered assisted members. If members pay rents that are above the basic rent amount, HUD defines the additional rent as excess income. Program participants are required to resubmit the excess income to HUD monthly.

As of April 2012, there were 140 Section 236 properties located within Region 3 Offices of Multifamily Housing (the Philadelphia and Baltimore hubs and their four program centers). The hubs and program centers are responsible for asset management and loan servicing responsibilities in monitoring and assisting owners and managing agents to maintain projects in good physical and financial condition. The table below shows the number of Section 236 properties under the jurisdiction of the respective HUD offices.

<b>Region 3 Office of Multifamily Housing</b>	<b>Office type<sup>2</sup></b>	<b>Number of Section 236 properties</b>	<b>Number of units</b>
Pittsburgh, PA	Program center	49	5,292
Philadelphia, PA	Hub	28	3,034
Richmond, VA	Program center	26	3,138
Washington, DC	Program center	16	2,262
Baltimore, MD	Hub	14	2,108
Charleston, WV	Program center	7	864
<b>Total Section 236 properties</b>		<b>140</b>	<b>16,698</b>

<sup>2</sup> Within the Region 3 jurisdiction, there are two hubs and four program centers. In addition to monitoring its own properties, the Philadelphia hub provides oversight to the Charleston and Pittsburgh program centers, and the Baltimore hub provides oversight to the Richmond and Washington, DC, program centers.

Our audit objective was to determine whether HUD's Region 3 Offices of Multifamily Housing ensured that rents and excess income for Section 236 properties were properly identified and remitted to HUD.

## RESULTS OF AUDIT

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### Finding: HUD's Region 3 Generally Ensured That Section 236 Rent and Excess Income Requirements Were Met

HUD's Region 3 Offices of Multifamily Housing generally ensured that its Section 236 properties established basic and market rents and remitted excess income to HUD as required. Five of the 6 Multifamily program offices reviewed ensured that all of their 124 properties followed HUD procedures for establishing appropriate rents and submitting monthly excess income reports to HUD. However, the Washington, DC, program center did not ensure that 6 of its 16 properties established appropriate rents and submitted monthly excess income reports (see appendix C). Specifically, two properties did not establish rents and four properties did not properly report excess income. This condition occurred because the program center did not always review Section 236 rents and excess income when conducting management reviews. Without adequate oversight, there is a risk that tenants are not paying appropriate rents and excess income amounts reported are inaccurate.

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#### **The Washington, DC, Program Center Did Not Ensure That Two Properties Established Appropriate Rents**

The Washington, DC, program center did not ensure that two properties established the appropriate rents as required. Specifically, Cedar Lane Apartments did not establish a market rent, and Hedin House did not establish a basic rent. The rent schedules reviewed indicated that both properties also received Section 8 housing assistance payments. Documentation reviewed showed that the Section 8 rents were established as required. HUD Handbook 4350.3, REV-1, paragraph 5-29(A)(1), requires Section 236 properties to establish HUD-approved basic rent and market rent. Basic rent is the minimum rent that all Section 236 tenants must pay. It represents the rent needed to cover the cost to operate the property after HUD has provided mortgage assistance to reduce the mortgage interest expense. The market rent represents the amount of rent the owner would have to charge if the mortgage were not subsidized. Tenants pay a percentage of their income toward rent but never pay less than the basic rent or more than the market rent for the property.

The program center was not aware that the properties had not established the required Section 236 rents. Although the properties did not establish rents as required, Cedar Lane Apartments reported and was approved to retain excess income totaling \$19,121, while Hedin House reported zero excess income. Since the required rents had not been established, there was no assurance that the

calculation to determine excess income was accurate. Thus, the excess income being reported is classified as unsupported until HUD approves the rents and calculation of excess income.

**The Washington, DC, Program Center Did Not Ensure That Four Properties Properly Reported Excess Income**

The Washington, DC, program center did not ensure that four properties followed excess income requirements. Foster House and Manor Towne Mutual Homes did not submit monthly excess income reports as required. Manor Towne Mutual Homes had not submitted monthly excess income reports since June 2009. HUD regulations at 24 CFR (Code of Federal Regulations) 236.60(a) define excess income as cash collected as rent from the residents by the borrower on a unit-by-unit basis that exceeds the HUD-approved unassisted basic rent. The regulations further require that excess income be returned to HUD monthly. The program center explained that both properties had a change in management agent. The newly appointed management agent was not aware of the monthly excess income requirements. The program center had begun to provide technical assistance to management to ensure that excess income requirements are met. However, the technical assistance to be provided should include assistance with the calculation and remittance of excess income.

For the remaining two properties, both properties retained excess income without HUD's approval. Northwest Cooperative Homes #15 retained excess income totaling \$54,658 for 6 months without HUD's approval. Further, the property was not eligible to retain excess income because it owed HUD \$693,312 in delinquent excess income. Another property, Brookland Manor, retained 1 month of excess income totaling \$433 without HUD's approval. HUD regulations at 24 CFR 236.60(c) state that the owner may apply to retain excess income and obtain HUD's approval to do so when needed. To be approved to retain excess income, the owner cannot be delinquent in submitting excess income. HUD was not aware of the retained excess income until our audit, but it informed us that it would comply with our recommendation to ensure that the ineligible funds are remitted to HUD as required.

**The Washington, DC, Program Center Did Not Follow HUD's Management Review Procedures**

The Washington, DC, program center did not follow its management review procedures. For Section 236 properties that also received housing assistance payments, a management review was performed by a contract administrator to



determine compliance with the housing assistance payments contract. For four of the six properties identified in this report, the contract administrator used form HUD-9834<sup>3</sup> when performing its review but was not required to ensure compliance with Section 236 requirements. HUD Handbook 4350.1, REV-1, paragraph 6-11(E), requires that HUD conduct a review to complete the sections of the management review not completed by the contractor to determine compliance with the regulatory agreement and other HUD requirements. HUD did not follow its own management review procedures as required.

## Conclusion

The Washington, DC, program center did not always ensure that Section 236 properties established basic and market rents and remitted excess income to HUD as required. The management reviews performed did not always include a review to ensure compliance with Section 236 program requirements. Without proper oversight, there is a risk that excess income that has been reported to HUD is inaccurate or will not be remitted.

## Recommendations

We recommend that the Director of HUD's Baltimore Multifamily hub direct the Washington, DC, program center to

- 1A. Require Cedar Lane Apartments and Hedin House to establish appropriate rents, review excess income calculations totaling \$19,121 to determine whether the income is adequately supported, and resubmit excess income to HUD from non-Federal funds as required.
- 1B. Require Northwest Cooperative Homes #15 and Brookland Manor to repay from non-Federal funds excess income totaling \$55,091 that was retained without HUD's approval.
- 1C. Require Foster House and Manor Towne Mutual Homes to submit monthly excess income reports as required.
- 1D. Follow its procedures to ensure adequate oversight of Section 236 rents and excess income. During its management reviews, the program center should review rents and excess income requirements to ensure compliance with Section 236 requirements.

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<sup>3</sup>Form HUD-9834 is the form used when performing management reviews for multifamily housing projects. HUD staff or its project-based contract administrators completes the questions on the form to evaluate the project's compliance with HUD multifamily program requirements.

## SCOPE AND METHODOLOGY

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We conducted the audit from March to October 2012 in HUD's Washington, DC, program center and our offices located in Richmond, VA, and Baltimore, MD. The audit covered the period April 2011 through April 2012 and was expanded as necessary to include other periods. To achieve our audit objective, we relied in part on computer-processed data. The data included rent schedules, excess income reports, and other computer-generated data. Although we did not perform a detailed assessment of the reliability of the data, we did perform a minimal level of testing and found the data to be adequate for our purposes. To accomplish our objective, we

- Interviewed HUD's Office of Multifamily Housing staff responsible for monitoring Section 236 properties;
- Reviewed 24 CFR Part 236 and other HUD requirements and handbooks; and
- Reviewed rent schedules, excess income documentation, and management review reports for 140 Section 236 properties within Region 3.

To verify that HUD ensured that rents and excess income were properly identified and remitted as required, for the 140 Section 236 properties within our region, we reviewed 140 rent schedules and 1,264 monthly excess income reports for the period April 2011 to April 2012. We also reviewed the most recent management occupancy review for each property.

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.

# INTERNAL CONTROLS

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Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

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

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

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## Relevant Internal Controls

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

- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that the program meets its objectives.

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 Washington, DC, program center did not ensure that six properties followed Section 236 requirements.

## APPENDIXES

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### Appendix A

#### SCHEDULE OF QUESTIONED COSTS

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Recommendation number	Ineligible 1/	Unsupported 2/
1A		\$19,121
1B	\$55,091	

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.
- 2/ 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.

## Appendix B

# AUDITEE COMMENTS

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U.S. Department of Housing and Urban Development

Baltimore Office  
City Crescent Building  
10 South Howard Street, 5th Floor  
Baltimore, MD 21201-2528

December 4, 2012

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

FROM: *Mary Ann Henderson*  
Mary Ann Henderson, Director, Baltimore Multifamily Hub, 3BHMLAS

SUBJECT: HUD's Region 3 Multifamily Housing Offices Generally Ensured that Section 236  
Rent and Excess Income Requirements Were Met

This office is in receipt of the draft audit report concerning the Section 236 Rent and Excess Income Requirements discussed with Marie Head, Deputy Assistant Secretary (DAS) for Multifamily Housing in November 2012. We have reviewed the draft and agree with its conclusions. We have also reviewed the recommendations that have been made and agree with them. This includes the revision 1D, provided to us by Kim Harrison via email on December 3, 2012, attached. We also understand that the report will be directed to the DAS and to me for response.

The Baltimore HUB will work with the DC Multifamily Program Center to assure that corrective actions are taken to monitor the excess income reports and make sure that all requirements are met. If you have further questions, or comments, please do not hesitate to contact me at 410-209-6545.

Cc: Marie Head, Multifamily DAS  
Kimberly Harrison, OIG  
Clinton Bradley, Housing Policy and Participation Standards  
Melanie Marston, Director, DC Multifamily Program Center

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## Appendix C

### SECTION 236 PROPERTIES NOT MONITORED

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<b>Property name</b>	<b>Appropriate rents not established</b>	<b>Monthly excess income report not submitted</b>	<b>Excess income retained without HUD's approval</b>
Hedin House	X		
Cedar Lane Apartments	X		
Foster House		X	
Manor Towne Mutual Homes		X	
Northwest Cooperative Homes #15			X
Brookland Manor			X