



Issue Date	April 8, 2009
Audit Report Number	2009-CH-1006

TO: Lucia M. Clausen, Director of Public Housing Hub, 5KPH

FROM:  Heath Wolfe, Regional Inspector General for Audit, 5AGA

SUBJECT: The Housing Authority of the City of Milwaukee, Wisconsin, Needs to Improve Its Procedures and Controls regarding Its Homeownership Programs

HIGHLIGHTS

What We Audited and Why

We audited the Housing Authority of the City of Milwaukee's (Authority) 5(h) and Section 32 homeownership programs (programs). We selected the Authority based on a risk analysis showing that it had high-risk program indicators. Our objectives were to determine whether the Authority properly accounted for and used its programs' proceeds in accordance with the U.S. Department of Housing and Urban Development's (HUD) requirements and properly administered its programs in accordance with the Authority's plans.

What We Found

The Authority did not adequately administer its programs with regard to whether program units were used by purchasers as their residences, sold to eligible purchasers, sold at their appraised value, and met HUD's recapture requirements. It also did not ensure that outstanding mortgage notes owed to it were recaptured. The Authority lacked adequate procedures and controls to ensure that HUD's regulations and its plans were followed in regard to the use of its 5(h) program units by purchasers as their residences and the recapture of outstanding mortgage notes owed to it. It failed to recover \$68,366 for two units that it sold that were

not used by the purchasers as their residences. Further, the Authority did not recover two outstanding mortgage amounts owed to it totaling \$23,399.

The Authority improperly sold a Section 32 program unit for \$114,500 to an individual who, five months before the sale, acquired a non-Authority property. It also sold six Section 32 program units for a total of \$150,000 below their appraised values. Further, the Authority did not require the appropriate restrictions and/or covenants for any of its 21 Section 32 program units sold.

We informed the Authority's executive director and the Director of HUD's Minneapolis Office of Public Housing of minor deficiency through a memorandum, dated March 31, 2009.

What We Recommend

We recommend that the Director of HUD's Minneapolis Office of Public Housing require the Authority to reimburse its applicable homeownership program from nonfederal funds for the improper use of more than \$356,000 in program funds and implement adequate procedures and controls to address the findings cited in this audit report to properly secure its interest in program units.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We provided our review results and supporting schedules to the Director of HUD's Minneapolis Office of Public Housing, the Coordinator of HUD's Milwaukee Office of Public Housing Program Center, and the Authority's executive director during the audit. We provided our discussion draft audit report to the Authority's executive director, its board chairman, and HUD's staff during the audit. We held an exit conference with the Authority's executive director on March 20, 2009.

We asked the executive director to provide written comments on our discussion draft audit report by March 26, 2009. The executive director provided written comments, dated March 26, 2009, and he agreed with our findings. The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report except for 18 pages of documentation that was not necessary for understanding the Authority's comments. A complete copy of the Authority's comments plus the documentation was provided to the Director of HUD's Minneapolis Office of Public Housing.

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BACKGROUND AND OBJECTIVES

The Housing Authority of the City of Milwaukee (Authority) was chartered in 1944 under Section 66 of the Wisconsin State Statutes. It is responsible for the construction, management, and provision of safe, affordable, and quality housing with services that enhance residents' self-sufficiency. The Authority is governed by a seven-member board of commissioners, which is appointed by the mayor and confirmed by the common council. The commissioners are appointed to staggered five-year terms. The Authority's executive director, appointed by the board of commissioners, is responsible for carrying out the mission and vision of the Authority and ensuring that the Authority's programs comply with the applicable federal, state, and local regulations, ordinances, and policies adopted by the board of commissioners. As of December 31, 2008, the Authority managed 4,364 public housing units and had 5,182 Section 8 vouchers.

The Authority sold 161 public housing units from June 1994 through June 2008 totaling more than \$9.4 million in net proceeds. Fifty-two of the units were acquired or constructed in conjunction with two of the Authority's HOPE VI redevelopment grants. These units contributed more than \$4 million in net proceeds. One hundred and nine of the units were the Authority's public housing scattered sites inventory. These units contributed more than \$5.3 million in net proceeds. All of the 161 public housing units were sold under the Authority's 5(h) or Section 32 homeownership program plans.

The Section 5(h) homeownership program offers housing authorities a flexible way to sell public housing units to low-income families. The 5(h) program helps low-income families purchase homes through an arrangement that benefits both the buyer and the public housing authority that sells the unit. It gives the buyer access to an affordable homeownership opportunity and the many tangible and intangible advantages of homeownership. Homeownership can be an important part of self-sufficiency for low-income families, providing a way of building wealth as well as increasing self-esteem and security. The program was authorized by Section 5(h) of the United States Housing Act of 1937. The Section 32 homeownership program replaced the 5(h) program and was established by the Quality Housing and Work Responsibility Act of 1998. It was patterned largely after the U.S. Department of Housing and Urban Development's (HUD) regulations that implemented the 5(h) program.

Our objectives were to determine whether the Authority properly accounted for and used its 5(h) and Section 32 homeownership programs' proceeds in accordance with HUD's requirements and properly administered its programs in accordance with the Authority's plans. Its programs' proceeds were properly accounted for and used in accordance with HUD's requirements.

RESULTS OF AUDIT

Finding 1: The Authority Lacked Adequate Procedures and Controls regarding Its 5(h) Program

The Authority failed to recover \$68,366 for two units that it sold that were not used by the purchasers as their residences. It also did not recover two outstanding mortgage balances owed to it totaling \$23,399. These problems occurred because the Authority lacked adequate procedures and controls to ensure that HUD's regulations and its 5(h) homeownership program plan (see appendix C of this audit report) were followed with regard to the use of program units by purchasers as their residences and the recapture of outstanding mortgage notes owed to it. As a result, \$91,765 in program proceeds was not used to provide housing assistance to low-income families.

Two 5(h) Units Were Not Used as Purchasers' Residences

Section D.3.b in Part I of the Authority's 5(h) program plan for 2000 requires that purchasers agree to reside in the dwelling units for a period of at least five years from the date of conveyance. The Authority lacked adequate procedures and controls to verify that the residency requirements detailed in its plan were met. Additionally, its title company neglected to have each purchaser sign the residency agreement at the respective property's closing.

Using data mining software, we determined that there was a high probability that six of the Authority's 50 5(h) program units sold between December 2002 and July 2005 were not used by the homeowners as their residences. We were able to contact the purchasers and verified that two had not used program units as their residences as of November 2008. The two purchasers were leasing the units as of November 2008. One of the owners had received more than \$25,000 in housing assistance payments from Milwaukee County's Department of Health and Human Services-Housing Division's Section 8 Housing Choice Voucher program for leasing the 5(h) homeownership program unit since October 2004.

The Authority received more than \$122,000 in net proceeds for the two units sold on December 20, 2002, and July 15, 2004, respectively. Based upon its 5(h) program's five-year residency requirement, HUD should require that the Authority reimburse its 5(h) program \$68,366 for the net proceeds. The reimbursement amount was determined by calculating the percentage of time that each purchaser did not reside in the unit during the 5(h) program's required five-year residency requirement times the net sale proceeds received by the Authority, as shown in the following table.

Sale date	Net sale proceeds	Period purchaser did not reside in unit	Number of months	Reimbursement factor	Reimbursement amount (reimbursement factor times net sale proceeds)
December 20, 2002	\$63,286	August 2006 to December 2007	17 months	17 months/60 months (28.33 percent)	\$17,931
		October 2004 to December 2008		51 months/60 months (85 percent)	
July 15, 2004	59,335		51 months		50,435
Totals	\$122,621				\$68,366

According to the Authority's homeownership program manager, the Authority had not examined whether purchasers used units as their residences due to staff turnover and workload. The program manager said that he planned to discuss the recovery of the funds from the purchasers with the City of Milwaukee's attorney.

Mortgages Were Not Collected

Between December 27, 1995, and January 2, 2004, the Authority granted 83 noncash mortgages for purchasers of 5(h) program units. The 30-year mortgages, of up to \$25,000, were offered to households in cases where there was a gap between the bank approved mortgage amount and the appraised value of the program unit. For the purchasers who were granted the 30-year noncash mortgages, the Authority received net proceeds that were less than the appraised values of the units. The difference between the net proceeds and the appraised value of these units was covered by the 30-year noncash mortgages. The noncash mortgages were due when the units were resold.

According to HUD's regulations at 24 CFR (*Code of Federal Regulations*) 906.14(b), when the potential for windfall profit exists because the dwelling unit is sold to the initial purchaser for less than fair market value, without a commensurate limited or shared equity restriction, the initial purchaser will execute a promissory note payable to the public housing agency, along with a mortgage securing the obligation of the note. The mortgages signed by the purchasers indicated that the borrower would not transfer, sell, or convey any legal or equitable interest in the property without the prior written consent of the lender unless either the indebtedness secured by the mortgage was first paid in full or the interest conveyed was a mortgage or other security interest in the property, subordinate to the lien of the mortgage.

Ten of the purchasers who were granted mortgages resold their units, and the Authority collected the outstanding balances for eight mortgages. The two mortgages that the Authority did not collect had outstanding balances totaling \$23,399 at the time the units were resold. The Authority sold the two program units on December 27, 1995, and July 8, 1996, for \$76,000 and \$46,500 while

holding second and/or third mortgages for \$28,500 and \$9,405, respectively. The units were resold by the purchasers on April 28, 2005, and May 22, 2006, for \$152,900 and \$109,000, respectively.

According to the Authority's homeownership program manager, the Authority secured the mortgages by registering limited warranty deeds and mortgage notes with the Milwaukee County (County) Registrar's office. When the borrower attempted to resell the program unit, the limited warranty deed and mortgage note would show up as items of record that would need to be satisfied before the title was transferred. The borrower's title company would notify the Authority of the sale and inquire as to the amount owed on the mortgage. At the time the two program units in question were sold by the Authority, the City of Milwaukee's (City) attorney was responsible for processing property closings. The attorney did not register the limited warranty deeds and mortgage notes with the County's office. Therefore, the Authority was not notified when the program units were resold. The Authority's homeownership program manager said that he planned to discuss the collection of the outstanding mortgages with the City attorney.

Conclusion

The Authority did not ensure that program units were used by purchasers as their residences and failed to recapture outstanding mortgages owed to it. As previously mentioned, two program units were not used by purchasers as their residences, and the Authority did not recover \$23,399 in funds owed to it.

Recommendations

We recommend that the Director of HUD's Minneapolis Office of Public Housing require the Authority to

- 1A. Reimburse its 5(h) homeownership program \$68,366 from nonfederal funds for two program units cited in this finding that were not used as the purchasers' residence.
- 1B. Reimburse its 5(h) homeownership program \$23,399 from nonfederal funds for the two unrecovred mortgage notes cited in this finding.
- 1C. Implement adequate procedures and controls to ensure that that its 5(h) homeownership plan's requirements and HUD's regulations are followed to include determining whether purchasers are residing in the program units and outstanding mortgage notes are recovered when due.

Finding 2: The Authority Lacked Adequate Procedures and Controls regarding Its Section 32 Homeownership Program

The Authority improperly sold a program unit for \$114,500 to an individual who, five months before the sale, acquired a non-Authority property. It also sold six program units for a total of \$150,000 below their appraised values. Further, the Authority did not require the appropriate deed restrictions and/or covenants for any of its 21 Section 32 program units sold. The problems occurred because the Authority lacked adequate procedures and controls to ensure that its Section 32 program units were sold to program-eligible purchasers, were sold at their appraised value, and met HUD's recapture requirements. As a result, these sales did not fully achieve all of the intended benefits of the Authority's program.

Prior Homeownership Checks Were Not Documented

The Authority sold 21 Section 32 program units from August 17, 2006, to June 3, 2008, and received net proceeds of nearly \$1.4 million.

The Authority's Section 32 program plan requires that program eligibility be limited to first-time homebuyers or those who have not owned a home in the past three years. The Authority did not maintain documentation to support that the purchasers of its 21 Section 32 program units met this requirement. On January 30, 2008, it sold a program unit for \$114,500 to a purchaser who had acquired a non-Authority property located in Milwaukee in August 2007.

The Authority's homeownership program manager said that the Authority conducted checks to determine whether program applicants had previously owned property. The Authority used the City's Department of Neighborhood Services' Website to check the property ownership status of program applicants. However, it only documented the checks if an applicant had previously owned a property. The homeownership program manager said that the Authority performed a check on the individual who acquired a non-Authority property before the program unit purchase. At the time the check was performed, this individual had not yet acquired the non-Authority property. However, the Authority could not provide documentation to support that the individual was eligible for the program.

Units Were Sold Below Their Appraised Values

The Authority sold 6 of its 21 Section 32 program units at sale prices totaling \$150,000 below their appraised values contrary to its plan requirements. The appraisals were performed by an independent appraisal company and noted any adverse conditions during the inspection of the properties and that these conditions

were considered in the analysis of the property values. All of the units were vacant and boarded up at the time of the appraisal and were in varying degrees of disrepair. This disrepair included minor damage to tile floors, peeling interior paint, damaged windows, and damaged and/or missing siding.

According to the Authority's homeownership program manager, the Authority considered rehabilitating the six units and then selling them. However, it determined that it was not economically feasible to rehabilitate the units. Therefore, the Authority offered the six units to the clients of nonprofit organizations. The decision not to rehabilitate the units was based on costs, appraised value, location, and the real estate market. The Authority performed informal scopes of work to estimate the rehabilitation costs for the six units. Since the estimated rehabilitation cost exceeded the appraised value, the Authority decided to sell the units at a discount below their appraised value. However, the Authority's plan required the units to be sold at their appraised value. The following table shows the sale date, appraised value, sale price, and loss to the Authority's Section 32 homeownership program for the six units.

Date of sale	Appraised value	Sale price	Loss to program
March 1, 2007	\$50,000	\$2,000	\$48,000
March 1, 2007	35,000	1,000	34,000
February 29, 2008	66,000	40,000	26,000
March 14, 2008	36,000	30,000	6,000
March 28, 2008	64,000	48,000	16,000
May 21, 2008	26,000	6,000	20,000
Totals	\$277,000	\$127,000	\$150,000

The six program units were sold to individuals who were referred to the Authority by two nonprofit organizations. The organizations assisted the individuals in rehabilitating the units.

In August 2008, HUD's Milwaukee Office of Public Housing Program Center became aware of the Authority's practice of selling Section 32 homeownership program units below their appraised value and directed it to no longer engage in this practice. The Authority sold no additional units below their appraised value after receiving HUD's directive.

No Deed Restrictions or Covenants Were Secured

Section M of the Authority's Section 32 homeownership program plan describes the antispeculation provisions, which ensure that it will reclaim 100 percent of any appreciation if a program unit is sold within the first year of ownership. That percentage will be reduced by 20 percent each year so that the owner can realize full

appreciation after five years of ownership provided that the outstanding mortgage has been satisfied, if applicable. The cost of any market improvements that resulted in an increased appraised value will be deducted from the appreciated amount and retained by the seller. HUD's regulations at 24 CFR 906.39(n) state that a homeownership program must include a deed restriction or covenant running with the property that will assure to HUD's satisfaction that the recapture requirements at 24 CFR 906.27 have been met.

The Authority did not properly secure the 21 program units sold with deed restrictions or covenants to ensure that HUD's requirements were met. It granted noncash mortgages for 10 program units, and limited warranty deeds were established. However, the deeds did not address the Authority's antispeculation provisions. For the remaining 11 program units, no deed restrictions or covenants were issued. HUD approved the Authority's plan to sell a total of 50 units using the Section 32 program.

According to the Authority's homeownership program manager, the Authority established a recapture policy because it was required by HUD's regulations. However, it did not implement the policy because if homeownership units were sold within five years, the market appreciation would have been minimal once the value of the home improvements was deducted. Also, the Authority did not want to prevent the homeowners from using any gains based upon market appreciation to purchase a larger and nicer home.

Conclusion

As previously mentioned, the Authority sold a program unit for a sale price of \$114,500 to a purchaser who concurrently owned a non-Authority property, six program units were sold for a total of \$150,000 below their appraised values, and the Authority did not properly secure the 21 program units sold with deed restrictions or covenants to ensure that its plan was followed and HUD's requirements were met.

Recommendations

We recommend that the Director of HUD's Minneapolis Office of Public Housing require the Authority to

- 2A. Provide documentation to support that the individual was program eligible at the time its Section 32 homeownership program unit was sold. If documentation cannot be provided, the Authority should reimburse its program \$114,500 from nonfederal funds for the sale of a program unit to an ineligible purchaser.

- 2B. Reimburse its Section 32 homeownership program \$150,000 from nonfederal funds for the program sale proceeds lost due to the sale of six units for less than their appraised market value.
- 2C. Implement adequate procedures and controls to ensure compliance with its plan and HUD's requirements for program applicants including the assurance that program applicants do not currently own or have not owned a home for the previous three years.
- 2D. Implement adequate procedures and controls regarding its Section 32 homeownership program units to ensure that they are properly secured to meet HUD's requirements and comply with the Authority's recapture provision identified in its program plan.

SCOPE AND METHODOLOGY

To accomplish our objectives, we reviewed

- Applicable laws and regulations, HUD's program requirements at 24 CFR Part 906, and the Authority's annual contributions contract with HUD.
- The Authority's 5(h) and Section 32 homeownership plans and implementing agreements; bank statements, check register; annual audited financial statements for 2005, 2006, and 2007; general ledgers; and homeownership files.
- HUD's files for the Authority.

We also interviewed HUD's staff, the Authority's employees, and staff members of the Dominican Center and Allied Churches Teaching Self-Empowerment.

Finding 2

We reviewed all 21 program units sold under the Authority's Section 32 program from August 17, 2006, to June 3, 2008. The sales of the program units were reviewed to determine whether the Authority properly secured the units according to its plan and HUD's requirements. We determined that the Authority did not properly secure the 21 units (100 percent) with the required deed restrictions or conveyances. It is authorized by its approved plan to sell a total of 50 units. Therefore, there were 29 units remaining to be sold.

We performed the audit work at the Authority's offices located at 809 North Broadway Avenue and 2363 North 50th Street, Milwaukee, Wisconsin, and HUD's Chicago regional and Milwaukee field offices. The audit covered the period January 1, 2007, through May 31, 2008. The period was adjusted as determined necessary.

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

INTERNAL CONTROLS

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

- Program operations,
- Relevance and reliability of information,
- Compliance with applicable laws and regulations, and
- Safeguarding of assets and resources.

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

Relevant Internal Controls

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

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

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet an organization's objectives.

Significant Weakness

Based on our review, we believe that the following item is a significant weakness:

- The Authority lacked adequate procedures and controls to ensure that its programs were administered in accordance with its 5(h) and Section 32 program plans and HUD's requirements (see findings 1 and 2).

Separate Communication of Minor Deficiency

We informed the Authority's executive director and the Director of HUD's Minneapolis Office of Public Housing of minor deficiency through a memorandum, dated March 31, 2009.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/	Unsupported 2/
1A	\$68,366	
1B	23,399	
2A		<u>\$114,500</u>
2B	<u>150,000</u>	
Totals	<u>\$241,765</u>	<u>\$114,500</u>

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local policies or regulations.
- 2/ 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 AND OIG'S EVALUATION

<u>Ref to OIG Evaluation</u>	<u>Auditee Comments</u>
	<p>Mr. Ronald Farrell Assistant Regional Inspector General for Audit U.S. Department of HUD-Office of Inspector General 200 North High Street, Room 334 Columbus, Ohio, 43125</p> <p>March 26, 2009</p> <p>Re: DISCUSSION DRAFT AUDIT REPORT ON OIG'S AUDIT OF THE HOUSING AUTHORITY OF THE CITY OF MILWAUKEE'S 5(h) AND SECTION 32 HOMEOWNERSHIP PROGRAMS</p> <p>Dear Mr. Farrell,</p> <p>Thank you for the opportunity to respond to your March 12, 2009 discussion draft regarding the Housing Authority's 5(h) and Section 32 Homeownership Programs. Over the past 15 years, the Housing Authority has helped 445 families living in public housing or subsidized housing transition to homeownership. Fundamentally, the Housing Authority's homeownership program is an extension of its efforts to promote self-sufficiency among its residents and has been instrumental to the Housing Authority's Hope VI and neighborhood revitalization activities. These homeownership programs benefit the buyer, the Housing Authority, HUD, and the community.</p> <p>Enclosed are our responses to your findings. For the reasons stated below, we are respectfully asking you to reconsider your recommendation of repayment of \$356,000 in program funds, which you have described as "...funds to be put to better use..."</p>
Comment 1	Your calculation of net proceeds does not take into consideration our staff costs, city attorney fees, etc. If the Housing Authority's actual costs were taken into consideration, the net proceeds would be lower. Moreover, each homeownership sale "saves" HUD over \$7,500 annually in subsidy and utility costs, while creating new homeowners who are invested in the community.
Comment 2	The Housing Authority did not benefit from any of these transactions and should not be penalized for the purchasers' noncompliance with program regulations. The Housing Authority can and will be pursuing legal actions where appropriate, and the homeownership program will be reimbursed with any "proceeds" resulting from these actions.

Ref to OIG Evaluation**Auditee Comments**

We use our limited resources to provide assistance to families. Through the use of data mining software and additional contact with purchasers, you determined that two families, less than 2% of the families participating in the homeownership program, did not use their homes as their principal residences. The Housing Authority regularly revises or adjusts programs and procedures to provide the highest level of services to HUD, our families and the community. To this end, we are trying to balance reasonable oversight with the provision of services to promote homeownership opportunities in our community.

Two 5(h) Units Were Not Used as Purchasers' Residence:

The Housing Authority has, and will continue to, reassess and revise its homeownership policies and procedures to comply with regulatory changes. Purchasers are aware of the five-year residency requirement, and the Housing Authority's closing agent has been directed to include a separate, signed and Notarized residency agreement to the closing documents with a similar provision in the limited warranty deed. The Housing Authority will review the City of Milwaukee's Assessors database to determine whether there has been any change in the mailing address for the property tax bill for any purchases during the past five years in which the Housing Authority provided a second mortgage. Staff will check the assessor's database annually for the first five years of ownership as a means to determine potential changes in ownership. If there is a violation of residency, the Housing Authority will consider the legal remedy of calling the second mortgage due or referring to local law enforcement or HUD OIG for fraud investigation.

Mortgages Were Not Collected:

The audit brought to light that, in the mid-1990s, the City Attorney's Office failed to record the second mortgages on the two noted properties, resulting in subsequent sales without recapture.

In 1997, HACM retained National Title and Closing Services to perform title Searches and serve as closing agent for all its homeownership sales. Since that time, the second mortgages have been properly recorded. Nonetheless, we are in the processing of reviewing all of the 5(h) and Section 32 sales to ensure that each second and third mortgage was indeed recorded to secure HACM's interest.

Effective immediately, no sale file will be closed until sufficient Documentation is received and included in the file, ensuring that this oversight will not occur in the future.

Ref to OIG Evaluation**Auditee Comments****Comment 3**

In response to your recommendation:
Reimbursement of \$91,765 in nonfederal funds would only serve to diminish HACM's capacity to serve its current residents, and we respectfully ask for your reconsideration of this recommendation for reimbursement. It should be noted that the two units in question are no longer owned by the program participants. Both of these units were sold over five years ago, one without subsidy, making the residency requirement inapplicable. The Housing Authority will implement additional controls, as outlined above, to ensure compliance with the residency requirement and pursue appropriate action.

Prior Homeownership Checks Were Not Documented:

Although the documentation was not included in the file, staff do standard background checks for eligibility, obtain signed affidavit from the applicant and reviews available ownership information through the City of Milwaukee Assessors' and Department of Neighborhood Services' websites for each of the participants. In these cases, the "no-matches" search results print-out was not included in the file.

Units Were Sold Below Their Appraised Values:

In considering units for homeownership, HACM takes into account location, the amount of rehab required, and the homes' marketability.

The six units referenced in the finding were units that had repairs exceeding estimated appraised value and units for which there was no buyer interest.

Comment 4

Because a Community Based Organization (CBO) was able to combine its funding resources and the buyers' sweat equity, the rehab and sale of the homes became economically feasible under the CBO's programming. HACM decided to sell these units under appraised value, and before repairs were made, in order to save the houses from demolition and as a contribution for the benefit of the neighborhood which the CBO represented. The buyers were eligible under the Section 32 plan, and provided with required counseling services. The CBO coordinated the rehab work, and the units were code compliant before they were occupied.

Ref to OIG Evaluation**Auditee Comments**

HACM was remiss in that it didn't plan for this type of community partnership in its homeownership proposal. However, this has been discussed with the Field Office, and it is understood that future sales of this nature will be done through approved disposition and public bid.

No Deed Restriction or Covenants Were Secured

HACM agrees with and fully supports the anti-speculation intentions outlined in HUD's Section 32 program guidelines. Over the past two decades, too many Neighborhoods have seen a rise in property flipping and inflated housing prices, adding to the current distressed economic climate. It was with the goal of promoting long-term homeownership, neighborhood stability, and fair housing prices that HACM designed its anti-speculation policy for its homeownership program.

After the approval of the Section 32 program, it became evident that the anti-speculation policy was, for all practical purposes, superfluous. The homes sold under the Section 32 program are fully rehabbed before sale, and are sold at appraised value, eliminating the opportunity to 'flip' the property after buying at depressed prices and making improvements. Eligible buyers are low to moderate income families, and lack the financial ability to make significant improvements to properties that would net any substantial appreciation.

Comment 5

The above factors, along with a topped out housing market, proved that property speculation among eligible buyers did not pose considerable concern; that the program design itself protects against inflated re-sales of HACM houses; and that executing the anti-speculation policy would be onerous and unproductive.

HACM's philosophy embraces the promotion of self-sufficiency; one way being through homeownership. A homeownership unit sale that increases the program buyer's wealth through property equity and long term appreciation is considered a successful outcome.

Responses to Recommendations for Finding 2:

The Housing Authority respectfully requests reconsideration of the reimbursement of \$114,500 from nonfederal funds because staff did check the applicant's program eligibility; however, the documentation was not included in the file. The applicant referenced in the finding applied to the homeownership program in February 2007. Staff checked for prior ownership, and found none, but failed to place a copy of the "no matches" print out in the

Comment 6

Ref to OIG Evaluation**Auditee Comments**

File. The fact that no prior ownership information was available can be substantiated by her credit report, obtained in November, 2007, months after the purchase of the unreported owned property. Supporting documentation, including the November 2007 credit report, has been forward for investigation and is not included in this response. It is the Housing Authority's position that due diligence was indeed done on the case cited above and that it was the buyer who knowingly and deliberately defrauded the program. The City Attorney will work with HUD OIG to undertake the appropriate legal action. Housing Authority staff will continue to make reasonable efforts to ensure that the homes sold under its Section 32 program are sold only to those who meet the program definition of a first time buyer. Because due diligence was done in this case, by all parties, the Housing Authority should not be penalized by reimbursing the program \$114,500 from nonfederal funds. Also, reimbursement or return of the fraudulently obtained unit may well be accomplished via legal action.

The Housing Authority respectfully requests reconsideration of the reimbursement of \$150,000 from nonfederal funds. Because the units were sold to advance the goals of the homeownership program, for the benefit of HUD, the Housing Authority, and the community, and because this constitutes a first time policy infringement, we believe reimbursement of \$150,000 in nonfederal funds would be punitive and diminish the Housing Authority's capacity to serve its current residents.

The Housing Authority will continue to use reasonable efforts to ensure that the homes sold under its Section 32 program are sold only to applicants who meet the program definition of first time home buyer.

The Housing Authority will periodically review, assess, and amend its homeownership programs, policies, and controls to ensure that they meet HUD's requirements and comply with the Housing Authority's approved plan. As a result of this audit, the Housing Authority will be submitting a revised homeownership plan for consideration by its Board of Commissioners, and subsequent review and approval by HUD.

Ref to OIG Evaluation**Auditee Comments**

Over the past 15 years, the Housing Authority has received thousands of inquiries and applications from Milwaukee families interested in pursuing the dream of home ownership. Over 700 applications were received in the past two years alone. Facing debt issues and lack of credit, 161 hopeful homeowners were able to purchase an affordable, fully rehabbed home because the Housing Authority, in partnership with HUD, provided counseling services, professional guidance, and forgivable second mortgage subsidies. Milwaukee's homeownership program has helped stabilize neighborhoods, reduce crime and blight, and promote self-sufficiency.

Comment 7

Although the findings did uncover several administrative lapses during the 15-year execution of the Section 5(h) and 32 programs, the Housing Authority is taking corrective action to ensure mortgages are recorded, homebuyers use the property as their residence, and all activity is consistent with our approved plan. Additionally, we will request amendments to the plan that are in line with the current market conditions while maintaining the program's appeal to potential buyers. The Housing Authority is proud of its accomplishments and hopes to continue creating new homeowners for another 15 years, or more.

Sincerely,



Tony Pérez
Secretary-Executive Director

OIG Evaluation of Auditee Comments

- Comment 1** We questioned the applicable amounts that the Authority received from the sale for each respective property cited in the findings and were supported by its financial records.
- Comment 2** Any funds that the Authority may receive through its corrective actions could be used as a source of nonfederal funds to reimburse its program for the findings in this report.
- Comment 3** Section D.3.b in part I of the Authority's 5(h) program plan for 2000 requires that purchasers agree to reside in the dwelling units for a period of at least five years from the date of conveyance.
- Comment 4** The Authority's Section 32 homeownership plan requires it to sell homeownership units at the appraised value. When it was not feasible to sell the units at their appraised value, the Authority had the option to remove the units from its Section 32 homeownership program and dispose of them using Section 18 of the Housing Act.
- Comment 5** HUD's regulations at 24 CFR 906.39(n) state that a homeownership program must include a deed restriction or covenant running with the property that will assure to HUD's satisfaction that the recapture requirements at 24 CFR 906.27 have been met.
- Comment 6** The credit report generated by the applicant's lender identified the unreported property as a possible address. Further, section 7.1 of the Authority's Section 32 Implementing Agreement states that the Authority shall be responsible for the maintenance of books, accounts, reports, files, records, and other documents relating to all activities.
- Comment 7** The actions taken, in process, and proposed by the Authority, if fully implemented, should improve its programs operations.

Appendix C

FEDERAL REQUIREMENTS AND THE AUTHORITY'S PROGRAM IMPLEMENTING AGREEMENTS

Finding 1

HUD's regulations at 24 CFR 906.14(a) state that if a dwelling is sold to the initial purchaser for less than fair market value, the homeownership plan shall provide for appropriate measures to preclude realization by the initial purchaser of a windfall profit on resale. "Windfall profit" means all or a portion of the resale proceeds attributable to the purchase price discount (the fair market value at date of purchase from the public housing agency less the below-market purchase price), as determined by one of the methods described in paragraphs (b) through (d) of this section. (b) Promissory note method – where there is potential for a windfall profit because the dwelling unit is sold to the initial purchaser for less than fair market value, without a commensurate limited or shared equity restriction, the initial purchaser shall execute a promissory note, payable to the public housing agency, along with a mortgage securing the obligation of the note, on the following terms and conditions: (1) The principal amount of indebtedness shall be the lesser of (i) the purchase price discount, as determined by the definition in paragraph (a) of this section and stated in the note as a dollar amount, or (ii) the net resale profit, in an amount to be determined upon resale by a formula stated in the note. That formula shall define net resale profit as the amount by which the gross resale price exceeds the sum of (A) the discounted purchase price, (B) reasonable sale costs charged to the initial purchaser upon resale, and (C) any increase in the value of the property that is attributable to improvements paid for or performed by the initial purchaser during tenure as homeowner. (2) At the option of the public housing agency, the note may provide for automatic reduction of the principal amount over a specified period of ownership while the property is used as the purchaser's family residence, resulting in total forgiveness of the indebtedness over a period of not less than five years from the date of conveyance, in annual increments of not more than 20 percent. This does not require a public housing agency's plan to provide for any such reduction at all, or preclude it from specifying terms that are less generous to the purchaser than those stated in the foregoing sentence. (3) To preclude collusive resale that would circumvent the intent of this section, the public housing agency shall (by an appropriate form of title restriction) condition the initial purchaser's right to resell upon approval by the public housing agency, to be based solely on the public housing agency's determination that the resale price represents fair market value or a lesser amount that will result in payment to the public housing agency, under the note, of the full amount of the purchase price discount (subject to any accrued reduction, if provided for by the homeownership plan pursuant to paragraph (b)(2) of this section). If so determined, the public housing agency shall be obligated to approve the resale.

HUD's regulations at 24 CFR 906.3 state that a public housing agency may sell all or a portion of a public housing development to eligible residents for purposes of homeownership according to a homeownership plan approved by HUD under this part.

HUD's regulations at 24 CFR 906.13 state that a homeownership plan shall include appropriate protections against any risks of fraud or abuse that are presented by the particular plan, such as extended use of the dwelling by the purchaser as rental property.

The Authority's Section 5(h) homeownership plan requires that the applicants/purchasers agree to continue to reside in the dwelling unit for a period of at least five years from the date of conveyance.

Section 6.3 of the Authority's implementing agreement states that the Authority shall comply with, implement, and enforce all provisions of the homeownership plan.

Finding 2

HUD's regulations at 24 CFR 906.1(a) state that a public housing agency may only transfer public housing units for homeownership under a homeownership program approved by HUD under this part.

HUD's regulations at 24 CFR 906.15(b) state that the dwelling unit sold to an eligible family must be used as the principal residence of the family.

HUD's regulations at 24 CFR 906.15(d) state that a public housing agency may establish requirements or limitations for families to purchase housing under a homeownership program, including but not limited to requirements or limitations regarding (1) employment or participation in employment counseling or training activities, (2) criminal activity, (3) participation in homeownership counseling programs, and (4) evidence of regular income.

HUD's regulations at 24 CFR 906.27(a) state when the family has owned a unit under this part, the following rules apply: (1) in this section, the term gain from appreciation means the financial gain on resale attributable solely to the home's appreciation in value over time, and not attributable to government-provided assistance or any below-market financing provided under 24 CFR 906.29; (2) in this section, the term net proceeds means the financial gain on resale received by the seller after satisfying all amounts owing under mortgages, paying closing costs, and receiving an amount equal to the downpayment (made from the seller's own funds) and principal payments on the mortgages; (3) a public housing agency must have a policy that provides for the recapture of net proceeds in an amount that the public housing agency considers appropriate under the guidelines of this section; (4) a public housing agency must have a policy that provides for the recapture of the following amounts, if a family resells a homeownership unit it purchased under this part during the five-year period beginning upon purchase of the dwelling unit: (i) all or a portion of the gain from appreciation and (ii) all or a portion of the assistance provided (which includes below-market financing, but which does not include Section 8(y) assistance used for mortgage payments under this part) under the homeownership program to the family to the extent there are net proceeds, considering the factors the public housing agency establishes under paragraphs (b)(1) to (7) of this section. (b) The public housing agency's program under this part may provide for consideration of any factors the public housing agency considers appropriate in determining how much of the gain from appreciation and assistance to recapture, including but not limited to the following: (1) the aggregate amount of assistance provided under the

homeownership program to the family, (2) the contribution of equity by the purchasing family, (3) the period of time elapsed between purchase by the homebuyer under the homeownership program and resale by homebuyer, (4) the reason for resale, (5) any improvements made by the family purchasing under the homeownership program, (6) any appreciation in the value of the property, and (7) any other factors that the public housing agency considers appropriate in making the recapture determination under this section. The public housing agency must enforce its recapture policy through an appropriate form of title restriction.

HUD regulations at 24 CFR 906.39(n) state that a homeownership program must include a deed restriction or covenant running with the land that will assure to HUD's satisfaction that the requirements of 24 CFR 906.27 and 906.15(b) are met.

Section 15(A) of the Annual Contribution Contract between HUD and the Authority states that the housing authority must maintain complete and accurate books of account for the projects of the housing authority in such a manner as to permit the preparation of statements and reports in accordance with HUD requirements, and to permit timely and effective audit.

The Authority's Section 32 homeownership plan requires that eligibility be limited to first-time homebuyers or those who have not owned a home in the past three years.

The plan indicates that antispeculation provisions ensure that the Authority will reclaim 100 percent of any appreciation within the first year of ownership. That percentage will be reduced by 20 percent each year so that the owner can realize full appreciation after five years of ownership (provided the outstanding mortgage has been satisfied). The cost of any market improvements that resulted in increased appraised value will be deducted from the appreciated amount and retained by the seller.

The plan indicates that the Authority will sell homeownership units at the appraised value to eligible participants using a fee-simple method of sale. The Authority's policy is to sell units at appraised value based on a third-party, independent, professional appraisal obtained at least 30 days before the proposed sale date.

Section 6.1 of the Authority's implementing agreement states that the Authority covenants and agrees that after the execution of this agreement, it shall comply with all applicable provisions of the regulations, including without limitation, those provisions with respect to the physical condition of the property to be sold and compliance with local code requirements and requirements for elimination of lead-based paint hazards, under 24 CFR 906.7(a), nonpurchasing residents under 24 CFR 906.23 and limitations on resale profits under 24 CFR 906.27.

Section 6.2 of the Authority's implementing agreement states that the Authority shall comply with the implementing agreement and enforce all provisions of the homeownership plan.