



Office of Public and Indian Housing, Washington, DC

Public Housing Agencies' Declarations of Trust

**Office of Audit, Region 5
Chicago, IL**

**Audit Report Number: 2016-CH-0001
February 26, 2016**



To: Lourdes Castro Ramirez, Principal Deputy Assistant Secretary for Public and Indian Housing, P

From: Kelly Anderson, Regional Inspector General for Audit (Chicago Region), 5AGA

Subject: HUD Lacked Adequate Oversight of Public Housing Agencies' Compliance With Its Declaration of Trust Requirements

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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 oversight of public housing agencies' compliance with its declaration of trust requirements.

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: 2016-CH-0001

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HUD Lacked Adequate Oversight of Public Housing Agencies' Compliance With Its Declaration of Trust Requirements

Highlights

What We Audited and Why

We audited the U.S. Department of Housing and Urban Development's (HUD) oversight of public housing agencies' declarations of trust. The audit was part of the activities in our fiscal year 2015 annual audit plan. Our audit objective was to determine whether HUD had adequate oversight of public housing agencies' compliance with its declaration of trust requirements.

What We Found

HUD did not always ensure that public housing agencies maintained valid and sufficient declarations of trust for HUD-assisted properties. Specifically of the 115 projects reviewed, (1) 2 projects did not have declarations of trust and (2) 20 projects had declarations of trust with deficiencies that impaired their validity. Further, we were unable to determine whether the declarations of trust for 47 projects were sufficient. As a result, HUD's interests and investments were not always protected to prevent potential conveyances or encumbrances of public housing property without HUD approval. In addition, we estimate that HUD will provide more than \$509 million in operating subsidies over the next year for projects in which its interests are not protected.

What We Recommend

We recommend that HUD require the public housing agencies to (1) record new declarations of trust for 22 projects to ensure that HUD's interests are protected and (2) support that 47 projects have sufficient declarations of trust that cover all HUD-assisted properties. We also recommend that HUD (1) amend the declaration of trust form and (2) implement adequate procedures and controls to ensure that public housing agencies maintain valid and sufficient declarations of trust that are recorded in public records to prevent HUD-assisted properties from being conveyed or encumbered.

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Background and Objective

Public housing was established to provide decent and safe rental housing for eligible low-income families, the elderly, and persons with disabilities. Public housing comes in all sizes and types, from scattered single-family houses to highrise apartments. Nationwide, there are approximately 1.2 million families residing in public housing developments that are owned and operated by about 3,300 local public housing agencies. Each year, the U.S. Department of Housing and Urban Development (HUD) provides approximately \$4 billion in operating subsidies to assist public housing agencies in running their public housing programs. Additionally, HUD awards approximately \$2 billion to public housing agencies annually for the development, modernization, and maintenance of public housing properties.

The United States Housing Act of 1937, as amended, requires that public housing properties that receive funding under the Act be operated as public housing for a set amount of time based on the type and use of assistance received. Public housing agencies that receive HUD assistance are required to maintain a declaration of trust against all property in each development or project that benefits from the assistance. A declaration of trust is a legal instrument which grants HUD an interest in public housing property. It also provides public notice that the property was developed, maintained, or operated with Federal assistance and is, therefore, held in trust by the public housing agency for the benefit of HUD. The declaration of trust establishes that the property is to be operated as public housing in accordance with the terms and covenants of the consolidated annual contributions contract¹ and restricts the public housing agency from transferring, conveying, assigning, leasing, mortgaging, pledging, or otherwise encumbering the property without the expressed permission of HUD. This instrument serves as a protection mechanism for HUD's interests and investments in that it would allow HUD to invalidate the illegitimate conveyance or encumbrance of a property and grants HUD the interest necessary to seize and reassign a property in the event of a substantial default.

In August 2009, HUD issued Public and Indian Housing Notice 2009-28, which required all public housing agencies to be in full compliance with the declaration of trust requirements within 12 months of the beginning date of their next fiscal year. According to the notice, if HUD should determine that a public housing agency is not in compliance with its plan requirements and certifications, HUD may take whatever action it deems necessary and appropriate, including but not limited to the following actions:

¹ A consolidated annual contributions contract is a written contract between HUD and a public housing agency. Under the contract, HUD agrees to provide funding to the public housing agency to support its program, and the agency agrees to administer the program in accordance with HUD regulations and requirements and the terms of the contract.

- Temporarily withhold cash payments pending correction of the deficiency,
- Disallow all or part of the cost of the activity or action not in compliance,
- Wholly or partly suspend or terminate the current award for the public housing agency's program,
- Require that some or all of the grant amounts be remitted to HUD,
- Condition a future grant and elect not to provide future grant funds to the public housing agency until appropriate actions are taken to ensure compliance,
- Withhold further awards for the program, or
- Take other remedies that may be legally available.

Our audit objective was to determine whether HUD had adequate oversight of public housing agencies' compliance with its declaration of trust requirements.

Results of Audit

Finding: HUD Lacked Adequate Oversight of Public Housing Agencies' Compliance With Its Declaration of Trust Requirements

HUD did not always ensure that public housing agencies maintained valid and sufficient declarations of trust for HUD-assisted properties. Specifically of the 115 projects reviewed, (1) 2 projects did not have declarations of trust and (2) 20 projects had declarations of trust with deficiencies that impaired their validity. Further, we were unable to determine whether the declarations of trust for 47 projects were sufficient. The deficiencies occurred because HUD lacked adequate procedures and controls to ensure that public housing agencies maintained valid and sufficient declarations of trust. It also did not provide adequate guidance to public housing agencies, independent auditors, and its own staff on monitoring for compliance with its declaration of trust requirements. As a result of these weaknesses, HUD's interests and investments were not always protected. In addition, we estimate that HUD will provide more than \$509 million in operating subsidies over the next year for projects in which its interests are not protected.

Public Housing Agencies Did Not Always Maintain Valid and Sufficient Declarations of Trust

We reviewed support for 115 statistically selected projects² administered by 82 public housing agencies³ to determine whether valid declarations of trust were recorded against the projects to protect HUD's interests and investments. Of the 115 projects, 2 did not have declarations of trust. Further, 20 projects had declarations of trust with 1 or more of the following deficiencies, which impaired their validity:

- 12 projects had declarations of trust that expired or will expire regardless of the period in which the project is required to be operated as public housing or the receipt of additional HUD funds,
- 8 projects had declarations of trust that were not in the form required by HUD,
- 2 projects had declarations of trust that did not contain legal descriptions, and
- 1 project had a declaration of trust that was not signed or executed by the public housing agency.

For 47 of the remaining 93 projects, we were unable to determine whether the declarations of trust were sufficient to protect HUD's interests.⁴ Specifically, (1) we were unable to determine whether all properties were protected by a declaration of trust for 40 projects, (2) the public

² Public housing agencies may administer multiple projects.

³ The methodology for the statistical sample is explained in the Scope and Methodology section of this audit report.

⁴ The 47 projects had 1 or more deficiencies.

housing agencies did not provide support that the declarations of trust were filed in public records for 5 projects, and (3) the public housing agencies did not provide complete declarations of trust for 4 projects.

HUD provided more than \$38.9 million in operating subsidies during fiscal years 2013 and 2014 for 22 projects that did not have valid declarations of trust. It also provided more than \$129 million in operating subsidies during fiscal years 2013 and 2014 for 47 projects for which we could not determine whether the declarations of trust were sufficient.

HUD provided more than \$167.9 million in operating subsidies to public housing agencies that lacked evidence of valid and sufficient declarations of trust.

We estimate that over the next year, HUD will provide more than \$509 million⁵ in operating subsidies to public housing agencies for projects that do not have valid declarations of trust. We also estimate that HUD will provide more than \$1.10 billion⁶ in operating subsidies for projects for which it lacks assurance that its interests and investments are protected.

HUD Lacked Adequate Procedures and Controls

The weaknesses described above occurred because HUD lacked adequate procedures and controls to ensure that public housing agencies maintained valid and sufficient declarations of trust. It also did not provide adequate guidance to public housing agencies, independent auditors, and its own staff on monitoring for compliance with its declaration of trust requirements.

HUD's primary method of oversight to ensure that public housing agencies comply with its requirements for a declaration of trust is through the single audit.⁷ Therefore, it added suggested audit procedures for monitoring public housing agencies' compliance with its declaration of trust requirements to the Office of Management and Budget Circular A-133 Compliance Supplement. However, the supplement does not provide procedures or instructions for assessing whether a declaration of trust is valid and sufficient to ensure that HUD's interests are protected. Further, since the audit procedures are suggestions, independent public auditors are allowed to exercise judgment regarding the audit procedures performed.

⁵ This estimate is based on a projection of the audit universe and is explained in the Scope and Methodology section of this report.

⁶ This estimate is based on a projection of the audit universe and is explained in the Scope and Methodology section of this report.

⁷ All non-Federal entities that expend \$500,000 or more of Federal awards in a year are required to obtain an annual audit in accordance with the Single Audit Act Amendments of 1996, Office of Management and Budget Circular A-133, the Office of Management and Budget Circular A-133 Compliance Supplement, and Government Auditing Standards. A single audit is a comprehensive audit of an entity's programs and operations conducted by an independent auditor. Amongst the items evaluated during the single audit is the entity's compliance with laws and Federal requirements for the programs and funds administered.

In August 2009, HUD issued Public and Indian Housing Notice 2009-28, which required public housing agencies to ensure that current declarations of trust were recorded against HUD-assisted properties. However, the notice failed to provide the agencies with information on how to assess whether their declarations of trust were valid and sufficient.

HUD also did not provide guidance to its own staff on monitoring public housing agencies for compliance with its declaration of trust requirements. For instance, HUD did not include the review of the declarations of trust as a requirement in the monitoring activities conducted by its field offices because of its reliance on the Single Audit Act. In our discussions with the field offices, we determined that some program offices reviewed public housing agencies' declarations of trust. However, the reviews were not consistent among the program offices and in some instances, determined only whether a public housing agency maintained a copy of the declaration of trust rather than ensuring that the declaration of trust (1) was valid, (2) included all public housing property, and (3) was recorded in public records.

The current versions of the declaration of trust, forms HUD-52190-A and HUD-52190-B, require only a legal description of public housing property. However, HUD's system⁸ and records generally did not contain legal descriptions of public housing property, only the physical address. As a result, property information required by the declaration of trust does not always correspond with the information available in HUD's system and records. Therefore, HUD staff was not always able to reconcile the declarations of trust to the projects to ensure that all HUD-assisted properties were included on a declaration of trust unless they obtained additional information and support from the public housing agencies. This additional information and support would generally involve the work of a third-party contractor, via a land survey, to determine what properties were included as part of the legal description.

The current forms of declarations of trust automatically renew based on the receipt of additional funding. However, those same forms also automatically expire at the end of the period in which a project is required to be operated as public housing. Therefore, if there was a dispute over whether a declaration of trust was legally valid and sufficiently protected all HUD-assisted properties, HUD could bear the burden of having to prove that the declaration of trust was still effective. Further, since the trusts could terminate without HUD's approval or release, public housing agencies could potentially pledge or encumber project assets without HUD's knowledge or approval. Additionally, the instruction pages of HUD's declaration of trust forms did not reflect the current practices of HUD. The instructions stated that HUD's counsel should prepare and transfer the declaration of trust to the public housing agency for execution and recording. However, all 13 of the HUD Office of General Counsel offices we surveyed stated that the declaration of trust was prepared by the public housing agency and its counsel, not HUD.

⁸ HUD's Inventory Management System/Public and Indian Housing Information Center System is the core system of the Office of Public and Indian Housing. It collects and maintains inventory information on the portfolio of public housing units and is used to calculate and distribute funds to public housing agencies.

Conclusion

HUD did not always ensure that public housing agencies maintained valid and sufficient declarations of trust for HUD-assisted properties. As a result, HUD interests and investments were not always protected. Further, we estimate that HUD will provide more than \$509 million in operating subsidy funding over the next year for projects in which its interests are not protected, and there is a risk of loss of a significant amount of public housing assets. We also estimate that HUD will provide more than \$1.10 billion in operating subsidy funding to projects for which it lacks assurance that its interests and investments are protected by sufficient declarations of trust.

Recommendations

We recommend that the Principal Deputy Assistant Secretary for Public and Indian Housing to require the public housing agencies to

- 1A. Record new declarations of trust for the 22 projects to ensure that HUD's interests are protected for the period in which the public housing agencies are required to operate the projects as public housing.
- 1B. Support that the 47 projects have sufficient declarations of trust that cover all HUD-assisted properties to protect HUD's interest and prevent encumbrances. If the public housing agencies cannot support that valid declarations of trust were recorded for all HUD-assisted properties, HUD should require the agencies to record declarations of trust or apply appropriate sanctions against the agencies that do not comply with HUD regulations.

We recommend that the Principal Deputy Assistant Secretary for Public and Indian Housing

- 1C. Amend the declaration of trust forms and instructions to (1) include a second identifier for each property, such as physical addresses, so that HUD may verify the effectiveness of the declaration of trust with the information maintained in its systems; (2) allow for the declaration of trust to terminate only upon release from HUD; and (3) reflect the actual preparation process used.
- 1D. Implement adequate procedures and controls to ensure that public housing agencies maintain valid declarations of trust that are recorded in public records to prevent more than \$509 million in annual operating subsidy funds from being provided to projects in which HUD's interests and investments are not protected. Such procedures and controls should include but not be limited to (1) issuing additional guidance regarding declarations of trust to assist HUD's field office staff, public housing agencies, and independent auditors in clarifying HUD's requirements and appropriately evaluating the declarations of trust and (2) amending the A-133 Compliance Supplement to require auditors to review an entire project at a time and include steps for determining whether all property of the project is included on declarations of trust and whether the declarations of trust were properly recorded in public records.

Scope and Methodology

We performed our audit work from February through September 2015 at the HUD Office of Inspector General's (OIG) offices located in Chicago, IL, and Detroit, MI, and at other locations as appropriate. The audit covered the period October 1, 2012, through September 30, 2014, but was expanded as necessary.

To accomplish our objective, we reviewed

- Applicable laws, HUD regulations, and program requirements, including 42 U.S.C. (United States Code) 1437g; the United States Housing Act of 1937 as amended; HUD's program requirements at 24 CFR (Code of Federal Regulations) Parts 902, 905, 941, and 968; Public and Indian Housing Notices 2009-28, 2010-44, and 2011-61; HUD Handbooks 7460.5 and 7460.7; HUD Guidebook 7460.7, REV-2; Office of Management and Budget Circulars A-133 and the Compliance Supplement; and HUD forms HUD-52190-A – Declaration of Trust for Development Grant Projects, HUD-52190-B – Declaration of Trust for Modernization Grant Projects, and HUD-53012-A – Consolidated Annual Contributions Contract.
- Public housing agencies' property records, such as declarations of trust, warranty deeds, property reports, and title insurance reports.
- Information about public housing agencies and their public housing properties in HUD's various systems, such as (1) Inventory Management System/Public and Indian Housing Information Center, (2) Line of Credit Control System, (3) Financial Assessment Subsystem, and (4) HUD's Central Accounting and Program System.

We also interviewed HUD staff and conducted surveys of a random selection of management officials and staff from HUD's Offices of Public and Indian Housing and General Counsel.

Statistical Sample

We statistically selected a stratified, optimized, random sample of 115 asset management projects from a universe consisting of 7,358 projects that received operating subsidies in fiscal year 2014 and reviewed declaration of trust support for compliance with HUD's requirements. The 115 projects were administered by 82 different public housing agencies. Using data from HUD's Central Accounting and Program System,⁹ we identified a universe of 7,358 housing and asset management projects that received operating funds during fiscal year 2014 to provide low-rent housing. We confined our definition of operating funds to disbursements issued under the

⁹ HUD's Central Accounting and Program System provides an integrated general ledger and core accounting for its grant, subsidy, and loan programs.

fund code “0163OP.” We averaged the funds received over a 2-year period to estimate annual funding for each project. Totaling the average funding for all projects yielded an annual expenditure of \$3.76 billion per year.

In compiling this universe, we excluded six projects as statistical outliers since they received large amounts that might have distorted our projection results. These six large excluded projects received \$419 million over 1 year, and this additional amount was not included in the universe we used for our final projections. To accurately project the total funds disbursed to facilities without a valid declaration of trust, we stratified the universe by amounts paid, breaking it into seven strata as outlined in the sample design table below. To keep a reliable, tight projection of the dollar amounts going to assets that were not covered, we used an optimized Neyman sample design. In this manner, additional sampling accuracy was applied to the high-dollar strata.

Sample design				
Stratum	Lower boundary (operating subsidy in dollars)	Number in universe	Sample size	Sampling weights
0-10pct	0	735	2	367.500
10-30pct	42,195	1,472	4	368.000
30-50pct	130,457	1,472	8	184.000
50-70pct	254,605	1,471	15	98.067
70-90pct	447,876	1,472	29	50.759
90-99pct	990,884	593	30	19.767
99-100pct	3,500,000	143	27	5.296

Using this stratification scheme, we tested the performance of several counts and sample designs using replicated sampling. A sample count of 115 was found to be sufficient. A sample of 115 projects was statistically selected from these strata using the surveyselect procedure in SAS®. These samples were used for two separate types of projections: (1) dollars spent on projects that were not protected by a valid declaration of trust and (2) dollars spent on projects for which we could not determine whether the declaration of trust was sufficient to protect HUD’s interests.

The audit team acquired records from the public housing agencies and evaluated any declarations of trust to determine whether they were sufficient to protect HUD’s interests.¹⁰ We found that 22 of the 115 projects did not have sufficient declarations of trust and that 2 of the projects recorded declarations of trust during the audit after our request for documentation. The average amount of operating funds provided to projects without valid declarations of trust was estimated and

¹⁰ Of the 115 projects that were reviewed, 5 were classified as mixed-finance projects. For those projects, we determined whether they had a declaration of restrictive covenants that was sufficient to protect HUD’s interests. We did not identify any mixed-finance projects as part of the 22 projects that lacked valid declarations of trust.

projected across the entire universe of projects. Because all randomly selected samples are subject to “the luck of the draw”, we calculated a margin of error for each dollar estimate and made a final projection on that basis. This calculation was done by computing the mean and standard error of the dollar amounts. Variances were calculated using a Taylor series. We used the traditional formulas for estimating the lower bounds (LCL) of dollar amounts as noted below:

$$Amount_{LCL} = N(\mu - t_{\alpha/2} SE_{\$})$$

Amount_{LCL} = total audit finding amount after deducting a margin of error.

N = number of sampling units in the universe.

μ = average value of the error per unit.

$SE_{\$}$ = standard error associated with dollar amounts.

$t_{\alpha/2}$ = student's - t for projecting a one-sided confidence interval for a sample of this design.

Applied to the 7,358 projects in our universe, we can say, with a one-sided confidence interval of 95 percent, that at least \$509 million in operating subsidy assistance will be paid by HUD for projects that do not have declarations of trust sufficient to protect HUD's interests and investments ((99704 - 1.659 x 18370) x N ≈ 69228 x 7,358 ≈ \$509,000,000).

Additionally, we found that we could not determine whether the declarations of trust were sufficient to protect HUD's interests for 47 projects.¹¹ The average amount of operating funds provided for agencies for which we could not determine the sufficiency of declarations of trust was estimated and projected across the entire universe of projects. Applied to the 7,358 projects in our universe, we can say, with a one-sided confidence interval of 95 percent, that at least \$1.10 billion in operating subsidy assistance will be paid by HUD for projects in which HUD lacked assurance that its interests and investments were sufficiently protected ((187252 - 1.659 x 22066) x N ≈ 150642 x 7,358 ≈ \$1,100,000,000).

To achieve our audit objective, we relied in part on information maintained in HUD's Central Accounting and Program System and HUD's Inventory Management System/Public and Indian Housing Information Center. Although we did not perform a detailed assessment of the reliability of the data, we performed a minimal level of testing and found the data to be adequately reliable for our purposes.

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 We based the projection on only 45 of the projects because the 2 projects that recorded declarations of trust during the audit were included in the projection of projects that did not have valid declarations of trust.

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.
- 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:

- HUD lacked adequate procedures and controls to ensure that public housing agencies maintained valid and sufficient declarations of trust (finding).

Appendices

Appendix A

Schedule of Funds To Be Put to Better Use

Recommendation number	Funds to be put to better use 1/
1D	\$509,000,000

- 1/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an 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, if HUD implements our recommendation, it will avoid providing funding for projects that do not have valid declarations of trust to protect its interests and investments. Our estimate reflects only the initial year of this benefit.

Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments


U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-5000
PRINCIPAL DEPUTY ASSISTANT SECRETARY
FOR PUBLIC AND INDIAN HOUSING

FEB 23 2016

MEMORANDUM FOR: Kelly Anderson, Assistant Inspector General for Audits
Office of Inspector General, 5AGA
[Handwritten signature]

FROM: Jemine A. Bryon, General Deputy Assistant Secretary, Public and Indian Housing, P

SUBJECT: Comments to Draft Audit Report – HUD Lacked Adequate Oversight of Public Housing Agencies' Compliance With Its Declaration of Trust Requirements

Thank you for the opportunity to comment on the draft finding and recommendations contained in the above-mentioned audit report of the Office of Inspector General (OIG). The Office of Public and Indian Housing (PIH) is committed to full and effective compliance with statutory and regulatory requirements for public housing properties.

PIH has reviewed the draft audit report and provides the following responses to OIG recommendations.

Recommendation 1A. Record new declarations of trust for the 22 projects to ensure that HUD's interests are protected for the period in which the public housing agencies are required to operate the projects as public housing.

PIH Response to Rec. 1A. PIH concurs with this recommendation to the extent that all 22 of the projects listed in the draft report lacked valid or sufficient declarations of trust. PIH will work with the HUD Office of General Counsel (OGC) to verify that the 22 projects record new declarations of trust, as appropriate.

Recommendation 1B. Support that the 47 projects have sufficient declarations of trust that cover all HUD-assisted properties to protect HUD's interest and prevent encumbrances. If the public housing agencies cannot support that valid declarations of trust were recorded for all HUD-assisted properties, HUD should require the agencies to record declarations of trust or apply appropriate sanctions against the agencies that do not comply with HUD regulations.

PIH Response to Rec. 1B. PIH will work with OGC to verify that the 47 projects are protected by declarations of trust. If any deficiencies are found, PIH will work with OGC and the PHAs involved to record new declarations of trust if necessary.

www.hud.gov espanol.hud.gov

Comment 1

Comment 1

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

Comment 2

2

Recommendation 1C. Amend the declaration of trust forms and instructions to (1) include a second identifier for each property, such as physical addresses, so that HUD may verify the effectiveness of the declaration of trust with the information maintained in its systems; (2) allow for the declaration of trust to terminate only upon release from HUD; and (3) reflect the actual preparation process used.

PIH Response to Rec. 1C. Generally, PIH concurs with this recommendation to amend the forms and instructions to improve upon the quality and effectiveness of these documents. However, PIH will defer to OGC in all legal matters involved in the development of revised declarations of trust forms and instructions. Any revisions to these documents would only apply to declarations of trusts that are recorded after the forms and instructions are approved by the Office of Management and Budget (OMB). PIH will rely on OGC's recommendations regarding second identifiers, termination and actual preparation process.

Recommendation 1D. Implement adequate procedures and controls to ensure that public housing agencies maintain valid declarations of trust that are recorded in public records to prevent more than \$509 million in annual operating subsidy funds from being provided to projects in which HUD's interests and investments are not protected. Such procedures and controls should include but not be limited to (1) issuing additional guidance regarding declarations of trust to assist HUD's field office staff, public housing agencies, and independent certified public accountants in clarifying HUD's requirements and appropriately evaluating the declarations of trust and (2) amending the A-133 Compliance Supplement to require auditors to review an entire project at a time and include steps for determining whether all property of the project is included on declarations of trust and whether the declarations of trust were properly recorded in public records.

Comment 2

PIH Response to Rec. 1D. PIH concurs with this recommendation and will develop additional guidance for internal and external stakeholders. However, we will review and offer alternatives for procedures and controls other than that identified in the Recommendation 1D(2) because it is not yet clear whether independent certified public accountants have the necessary skills to perform additional review, and how much time would be added to their process. A-133 currently provides that Auditors request a list of all PHA property, sample by development number, and verify if DOI's are recorded in public records. We will evaluate options to improve upon current procedures. It should be noted that any changes to the A-133 Compliance Supplement must be submitted to and accepted by OMB.

Comment 3

While PIH agrees with the OIG that there is a need to improve upon procedures and controls relating to recordation of declarations of trusts, PIH disagrees with the OIG statement that HUD's interests and investments in public housing are not protected. The United States Housing Act of 1937¹ created statutory conditions protecting public housing when Capital Funds or Operating Funds are used on public housing for

¹ See Section 9(d)(3) and 9(e)(3) 42 USC 1437g(d)(3) and (e)(3), respectively.

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

3

development, modernization or operations. The Annual Contributions Contract between PHAs and HUD (HUD 53012A (7/93)) is a grant agreement which further supports this statutory protection.

Thank you for your consideration of our responses to the OIG draft report.

OIG Evaluation of Auditee Comments

- Comment 1** HUD generally agreed with our recommendations. We will work with HUD to resolve the issues in the audit resolution process.
- Comment 2** We appreciate HUD's acknowledgement of the issues and its plans to take necessary actions to address the issues cited in the audit report. As HUD may offer alternative solutions to address these issues, any planned actions will be evaluated during the audit resolution process.
- Comment 3** We agree that there are statutory restrictions and a contractual agreement that prohibit the conveyance or encumbrance of public housing property; however, we disagree that these alone are sufficient to protect HUD's interests. On multiple occasions, public housing agencies, without valid or sufficient declarations of trust, have encumbered properties without HUD's knowledge or permission in violation of the statute. Section 8 of the consolidated annual contributions contract (form HUD-53012A) requires the public housing agency to record a declaration of trust against HUD-assisted properties to prevent conveyances or encumbrances. It also states that such instrument and all amendments should be duly recorded or filed for record wherever necessary to give the public notice of their contents and to protect the rights and interests of HUD and of any bondholders. Therefore, a valid and properly recorded declaration of trust protects HUD's interest and investment by notifying the public that a property must be operated in accordance with all public housing Federal requirements, including the requirement to not convey or otherwise encumber a property unless it is expressly authorized by Federal law or HUD.

Appendix C

Federal Requirements

The United States Code at 42 U.S.C. 1437g (d)(3)(a) states, that except as otherwise provided in this chapter, any public housing developed using amounts provided under this subsection, or under section 1437l of this title as in effect before the effective date under section 503(a) of the Quality Housing and Work Responsibility Act of 1998, must be operated under the terms and conditions applicable to public housing during the 40-year period that begins on the date on which the project (or stage of the project) becomes available for occupancy.

The United States Code at 42 U.S.C. 1437g(d)(3)(b) states, that except as otherwise provided in this chapter, any public housing or portion thereof that is modernized using amounts provided under this subsection or under section 1437l of this title (as in effect before the effective date under section 503(a) of the Quality Housing and Work Responsibility Act of 1998) should be maintained and operated under the terms and conditions applicable to public housing during the 20-year period that begins on the latest date on which modernization is completed.

The United States Code at 42 U.S.C. 1437g (e)(3) states, no portion of any public housing project operated using amounts provided under this subsection, or under this section as in effect before the effective date under section 503(a) of the Quality Housing and Work Responsibility Act of 1998, may be disposed of before the expiration of the 10-year period beginning upon the conclusion of the fiscal year for which such amounts were provided, except as otherwise provided in this chapter.

Regulations at 24 CFR 905.304(a) state that the public housing agency must operate all public housing projects in accordance with the Public Housing Capital Fund annual contributions contract, as amended, and applicable HUD regulations, for the statutorily prescribed period. These periods should be evidenced by a recorded declaration of trust on all public housing property. If the public housing agency uses capital funds to develop public housing or to modernize existing public housing, the capital fund annual contributions contract term and the covenant to operate those projects are as follows:

- (1) *Development activities.* Each public housing project developed using capital funds should establish a restricted use covenant, either in the declaration of trust or as a declaration of restrictive covenants, to operate under the terms and conditions applicable to public housing for a 40-year period that begins on the date on which the project becomes available for occupancy, as determined by HUD.
- (2) *Modernization activities.* For public housing agencies that receive Capital Fund assistance, the execution of each new Capital Fund annual contributions contract amendment establishes an additional 20-year period that begins on the latest date on which modernization is completed, except that the additional 20-year period does not apply to a project that receives Capital Fund assistance only for management improvements.

(3) *Operating Fund.* Any public housing project developed that receives Public Housing Operating Fund assistance must have a covenant to operate under requirements applicable to public housing for a 10-year period beginning upon the conclusion of the fiscal year for which such amounts were provided.

Regulations at 24 CFR 905.318 state that immediately upon taking title to a property, the public housing agency or owner entity should record the deed and a declaration of trust or in the case of mixed finance, a declaration of restrictive covenants in the form and in the manner and order prescribed by HUD. The public housing agency must at all times maintain a recorded declaration of trust or declaration of restrictive covenants in the form and in the manner and order prescribed by HUD on all public housing projects covering the term required by this part.

Regulations at 24 CFR 905.505(c)(1) state that any public housing that is developed using amounts under this part (including proceeds from financing authorized under this part) should be operated under the terms and conditions applicable to public housing during the 40-year period that begins on the date on which the project becomes available for occupancy, except as otherwise provided in the Housing Act of 1937.

Regulations at 24 CFR 905.505(c)(2) state that any public housing or portion of public housing that is modernized using amounts under this part (including proceeds from financing authorized under this part) must be maintained and operated during the 20-year period that begins on the latest date on which the modernization is completed, except as otherwise provided in the Housing Act of 1937.

Regulations at 24 CFR 905.505(c)(3) state that public housing subject to the use conditions described in paragraph (c) of this section or to any other provision of law mandating the operation of housing as public housing for a specific length of time should be maintained and operated as required until the latest such expiration date.

Regulations at 24 CFR 905.505(c)(4) state that all public housing rental projects must show evidence satisfactory to HUD of an effective declaration of trust being recorded in first position, meeting the requirements of paragraph (c) of this section, and covering the term of the financing.

Regulations at 24 CFR 941.401(c)(2) state that the public housing agency should record promptly the deed and declaration of trust in the form prescribed by HUD and HUD may require the public housing agency to submit evidence of such recordation.

Regulations at 24 CFR 968.210(d) state that as HUD may require, the public housing agency must execute and file for record a declaration of trust, as provided under the annual contributions contract, to protect the rights and interests of HUD throughout the 20-year period during which the public housing agency is obligated to operate its developments in accordance with the annual contributions contract, the Housing Act of 1937, and HUD regulations and requirements.

Public and Indian Housing Notice 2009-28 states that within 12 months of the date of public housing agencies' next fiscal year, they must ensure that current (unexpired) declarations of trust

are recorded against all of their public housing property. HUD considers public housing agencies to be in full compliance with these requirements when declarations of trust with legal descriptions are recorded against all of their public housing property.

Public and Indian Housing Notice 2009-28 states that if HUD should determine that a public housing agency is not in compliance with its public housing agency plan requirements and certifications, it may take whatever action it deems necessary and appropriate, including but not limited to the following actions: (a) temporarily withhold cash payments pending correction of the deficiency by the public housing agency, (b) disallow all or part of the cost of the activity or action not in compliance, (c) wholly or partly suspend or terminate the current award for the public housing agency's program, (d) require that some or all of the grant amounts be remitted to HUD, (e) condition a future grant and elect not to provide future grant funds to the public housing agency until appropriate actions are taken to ensure compliance, (f) withhold further awards for the program, or (g) take other remedies that may be legally available.

Public and Indian Housing Notice 2009-28 states the form of declaration of trust that a public housing agency should execute and record against public housing property depends on the funding from HUD. Public housing agencies must record the appropriate form of declaration of trust for their property. In most instances, the public housing agency will record the form HUD-52190-A for Capital Fund development grant projects or the form HUD-52190-B for Capital Fund modernization grant projects.

Public and Indian Housing Notice 2011-61 made Public and Indian Housing Notice 2009-28 permanent until it is amended, revoked, or superseded.

Section 8 of the consolidated annual contributions contract (form HUD-53012A) states that promptly upon the acquisition of the site of any project, the housing authority should execute and deliver an instrument, confirming and further evidencing, among other things, the covenant of the housing authority not to covey or encumber the project except as expressly authorized in this annual contributions contract. Such instrument and all amendments should be duly recorded or filed for record wherever necessary to give the public notice of their contents and to protect the rights and interests of HUD and of any bondholders. The housing authority should furnish HUD with appropriate evidence of such recording or filing. From time to time, as additional real property is acquired by the housing authority in connection with projects, the housing authority should promptly amend such instrument to incorporate all such real property and should record the instrument as amended.