



U.S. DEPARTMENT OF
HOUSING AND URBAN DEVELOPMENT
OFFICE OF INSPECTOR GENERAL

March 17, 2016

MEMORANDUM NO:
2016-KC-0801

Memorandum

TO: Kathleen Zadareky
Deputy Assistant Secretary, Single Family Housing, HU

//signed//

FROM: Ronald J. Hosking
Regional Inspector General for Audit, Denver Region, 8AGA

SUBJECT: FHA Approved Nonprofits Purchasing Real Estate-Owned Homes

INTRODUCTION

We audited the U.S. Department of Housing and Urban Development's (HUD) rules and requirements pertaining to nonprofits purchasing real estate-owned (REO) homes during the exclusive listing period. Our objective was to determine whether HUD had adequate requirements to prevent nonprofits from acting as investors while purchasing REO homes during the exclusive listing period. We concluded that HUD did not have adequate requirements in place to prevent nonprofits from acting as investors while purchasing REO homes during the exclusive listing period. This deficiency gave nonprofit investors an unfair advantage over legitimate investors by giving them the first opportunity to purchase REO properties.

We conducted this audit based on information found during an audit of a nonprofit that purchased homes during the exclusive listing period (2015-DE-1801). In that audit, we reported that the nonprofit purchased REO homes during the exclusive listing period and then sold those homes to other than low-income buyers. We concluded that the nonprofit acted as an investor when it purchased the properties, giving it an unfair advantage over other investors. However, we also concluded that it did not violate HUD requirements because the requirements did not explicitly prohibit nonprofits from acting as investors during the exclusive listing period.

METHODOLOGY AND SCOPE

For the purpose of this audit, we relied on testing from our audit of the nonprofit and did not conduct additional testing. We based our conclusions on that testing and additional interviews and discussions. During this audit, we met with various HUD program officials to discuss the findings from the nonprofit audit and options for correcting the issue. We held additional

meetings over the course of the audit with HUD and HUD Office of Inspector General officials to clarify HUD's policy on nonprofits purchasing properties during the exclusive listing period.

BACKGROUND

The HUD Single Family Property Disposition Program is designed to dispose of REO properties in a manner that expands home-ownership opportunities, strengthens neighborhoods and communities, and ensures a maximum return to mortgage insurance funds. Under this program, nonprofit organizations are eligible to purchase REO properties. The following generally explains how different types of buyers may participate during the four listing periods of the program. The listing periods are shown in the chronological order by which HUD allows various buyers to participate in purchasing REO properties:

1. Lottery period: Any qualified potential owner-occupant may purchase insurable properties;
2. Exclusive period: Through the direct sales program, approved nonprofits may purchase properties at a discount of up to 30 percent for the purpose of reselling the property to low-income buyers. Nonprofits may purchase properties without a discount, but in that case, HUD regulations do not clearly restrict the resale to low-income buyers. Investors are otherwise not able to purchase properties during this period;
3. Extended period: Any potential buyer, including investors, may purchase properties;
4. Dollar period: When properties do not sell during the previous periods, they may be sold to government agencies for \$1.

Regulations at 24 CFR (Code of Federal Regulations) Part 291 contain a definition of "private nonprofit organizations," which includes specific eligibility requirements (24 CFR 291.5(b)), and includes nonprofit organizations in the definition of owner-occupants (24 CFR 291.202 (a)(2)), Part 291 also provides various processes for purchase. One process is the direct sales program (24 CFR 291.210), in which preapproved government agencies and nonprofit organizations may directly acquire REO properties at a discount. The regulations note that HUD may limit the number of direct sales to a given purchaser and there may be restrictions on resale to ensure expanded affordable housing opportunities. Part 291 also contains a separate competitive sales process (24 CFR 291.205), which does not provide a discount or reference postsale restrictions. The competitive process provides that priority will be given to government entities and nonprofit organizations over other owner-occupants. This process is also referred to as the exclusive listing period.

Regulations at 24 CFR 200.194 state that HUD maintains a roster of nonprofit organizations eligible to participate in certain Federal Housing Administration (FHA) activities. According to 24 CFR Chapter II, HUD recognizes a nonprofit as one that is on the approved roster and complies with any requirements stated in a specific applicable provision of the single-family regulations. Additionally, section 200.194 states that a nonprofit organization must submit an application that specifies the FHA activities it proposes to carry out.

HUD established guidelines for removal of a nonprofit organization from its approved FHA roster. According to HUD regulations at 24 CFR 200.195, HUD may remove an organization from the approved roster for failure to comply with applicable single-family regulations in Chapter II, mortgagee letters, or other written instructions or standards issued by HUD; failure to further all objectives described in the affordable housing program narrative; or misrepresentation or fraudulent statements.

RESULTS OF REVIEW

Federal regulations do not contain adequate clarification to prevent nonprofits from having an unfair advantage by acting as investors while purchasing REO homes without a discount during the exclusive listing period. Single Family Property Disposition Program regulations designate nonprofit agencies as owner-occupants, and the regulations do not specifically prohibit nonprofits from acting as investors. As a result, nonprofits may potentially benefit from their status and purchase homes during the exclusive listing period ahead of eligible investors.

Federal Regulations Do Not Contain Adequate Clarification

Nonprofits are required to resell properties to low-income buyers when they purchase those properties at a discount during the exclusive listing period. However, HUD does not have adequate clarification in 24 CFR 291.210 and 24 CFR 200.194 to prevent nonprofits from acting as investors while purchasing REO homes without a discount during the exclusive listing period and potentially selling to other than low-income buyers.

Nonprofit Agencies Are Designated as Owner-Occupants

HUD's Single Family Property Disposition Program labels nonprofit agencies as owner-occupants and has regulations stating what may be done with a home purchased with a discount. Specifically, the lack of clarification has made it possible for nonprofit agencies to take advantage of their owner-occupant designation and act as investors when purchasing a home without a discount. We met with HUD officials during this audit. They stated that this issue needed resolution and it concerned them that these actions affected the discount sales program.

Nonprofits Should Not Act as Investors During the Exclusive Listing Period

It was not HUD's intent for nonprofits to act as investors during the exclusive listing period, regardless of whether the nonprofit purchased the property with or without a discount. This practice gave nonprofit investors an unfair advantage over legitimate investors for the first opportunity to purchase REO properties. Program officials agreed during our audit that changes were needed to ensure that nonprofit agencies participating in its program would not be allowed to act as investors when purchasing homes during the exclusive listing period.

RECOMMENDATION

We recommend that the Deputy Assistant Secretary for Single Family Housing

- 1A. Develop and implement a policy or rule change that prevents nonprofit agencies from acting as investors for homes purchased during the exclusive listing period, regardless of whether the nonprofit purchased those homes at a discount.

Appendix A

Auditee Comments

The HUD Office of Single Family Housing chose not to provide comments to the report.