



EXHIBIT A

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-5000

OFFICE OF PUBLIC AND INDIAN HOUSING

MAR 07 2019

Ms. Barbara T. Smith
Acting Executive Director
San Francisco Housing Authority
1815 Egbert Avenue
San Francisco, CA 94124-2519

Dear Ms. Smith:

Pursuant to my delegated authority, I have determined that the Housing Authority of the City and County of San Francisco (SFHA) is in default of both its Housing Choice Voucher (HCV) Consolidated Annual Contributions Contract (ACC-Section 8) and its Low Rent Public Housing (LRPH) Consolidated Annual Contributions Contract (ACC-LRPH) executed by and between SFHA and the U.S. Department of Housing and Urban Development (HUD) on August 12, 1998, and April 29, 1996, respectively (collectively, ACCs). HUD has determined that SFHA is in substantial default of both its ACCs as a result of material breaches of Paragraphs 10 and 14 of the ACC-Section 8 and Paragraph 5 of the ACC-LRPH. Each breach serves as an independent basis for default and will be discussed in turn.

First, HUD has determined that SFHA is in material breach of Paragraphs 14(a) and (b) of ACC-Section 8, which require SFHA to: (a) maintain complete and accurate books of accounts and records for the HCV program, kept in accordance with HUD requirements, and permit a speedy and effective audit; and (b) furnish HUD such financial and program reports, records, statements and documents . . . in such form and accompanied by such supporting data as required by HUD.^{1,2} HUD makes the foregoing default determination due to SFHA's material breach of Paragraphs 14(a) and (b) of the ACC-Section 8 based on the following:

- i. HUD's Quality Assurance Division (QAD) conducted a Financial Management Review (FMR) and Management and Operations Review (MOR) of SFHA through three on-site visits conducted in October and November 2018 and extensive remote review and analysis of additional supporting documentation. The QAD team specifically sought to determine SFHA's Unrestricted Net Position (UNP) for 2018 and its Restricted Net Position (RNP) for 2016, 2017 and 2018, and to assess SFHA's overall management and operation of the HCV Program, among other objectives. HUD delivered the results of QAD's 2018 review on February 22, 2019, Financial Management Review QAD-FMRMOR-2019-CA0001 Housing Authority of the City and County of San Francisco (2019 QAD Report).

¹ See ACC-Section 8, ¶ 14(a) & (b).

² The requirements of Paragraph 14 of the ACC-Section 8 incorporate HUD's regulatory requirements at 24 C.F.R. § 981.158, which set forth a PHA's record keeping responsibility and obligation to disclose records and data to HUD.

Pursuant to 24 C.F.R. § 5.801(b), SFHA was required to submit financial information in the form and substance required by HUD in accordance with generally accepted accounting principles and HUD supplementary guidance. For the HCV Program, PIH Notices 2012-2 and 2017-10 require participating Public Housing Authorities (PHA) to submit monthly Voucher Management System (VMS) data and annual Financial Assessment Subsystem (FASS) electronic submissions. This data was required to be accurate as ensured by effective internal financial controls.³

In the 2019 QAD Report, Finding 2019-1, QAD found that SFHA “failed to maintain complete and accurate accounting records for the [HCV] program.”⁴ This failure is a repeat finding from QAD’s 2017 on-site review of SFHA and has been repeatedly identified as a source of material weakness in SFHA’s management of its HCV and LRPB Programs.⁵

The QAD team specifically found that “SFHA miscalculated and misreported RNP and UNP balances,”⁶ which fed inaccurate data into VMS and prevented both HUD and SFHA from gaining an accurate financial picture of SFHA’s financial position.⁷ These financial failures resulted in an unexpected HAP shortfall of approximately \$20 million in calendar year 2018.⁸ Overall, SFHA’s failure to “maintain adequate program and financial documentation constitutes a breach of Section 14[(a) of the ACC-Section 8].”⁹

- ii. Additionally, “[d]ue to the difficulties in locating necessary information, a speedy and effective review was not possible and required significant additional follow-up, and as of the date of this report, some issues remain unresolved and may not be resolvable given the lack of adequate and/or audible data.”¹⁰ The 2019 QAD Report specifically states that the team had “no trustworthy data upon which to base an unqualified opinion of SFHA’s financial position.”¹¹ SFHA’s operation of the HCV Program without the capability to “process, track and provide accurate, timely, internally consistent and readily accessible information financial activities” is impermissible

³ See Standards for Internal Control in the Federal Government, GAO-14-704G (Sept. 2014).

⁴ See 2019-QAD Report, Finding No. 2019-1, p. 8.

⁵ See *id.*; see also PHARS Recovery Agreement and Action Plan executed by HUD, SFHA and the City and County of San Francisco effective July 1, 2017 (2017 PHARS Agreement); PHARS Recovery Agreement and Action Plan executed by HUD, SFHA and the City and County of San Francisco effective September 4, 2013 (2013 PHARS Agreement); and Financial Management Review QAD-FMR-2017-CA0001 Housing Authority of the City and County of San Francisco dated July 14, 2017 (2017 QAD Report).

⁶ QAD found that SFHA reported inaccurate RNP and UNP balances due to several concurrent and past data failures, including a lack of internal controls to reconcile financial data between the multiple systems used by SFHA to track HCV, HAP and LRPB funding and participation data. See 2019 QAD Report, Finding No. 2019-2, pp. 14-18.

⁷ See 2019 QAD Report, Finding No. 2019-2, pp. 14-18.

⁸ See *id.*, Finding No. 2019-7, p. 27.

⁹ See *id.*, Finding No. 2019-2, p. 18.

¹⁰ *Id.*, Finding No. 2019-1, p. 12.

¹¹ *Id.*, Finding No. 2019-1, p. 10.

under HUD regulations and the ACC-Section 8.¹² Accordingly, the “un-auditable” condition of SFHA’s financial records over the past several years constitutes a breach of Section 14(b) of the ACC-Section 8.

Second, HUD has determined that SFHA is in material breach of Paragraph 10 of the ACC-Section 8, which requires SFHA to comply with “the requirements of the [United States] Housing Act of 1937 and all HUD regulations and other requirements, including any amendments or changes in law or HUD requirements.”^{13,14} HUD makes the foregoing determination of default for material breach of Paragraph 10 of the ACC-Section 8 based on SFHA’s violations of the regulations at 24 C.F.R. §§ 982.158, 982.156, 5.801(b) and Part 985.

- i. The regulations at 24 C.F.R. § 982.158 are incorporated in Paragraphs 14(a) and (b) of the ACC-Section 8 and state: “The PHA must maintain complete and accurate accounts and other records for the program in accordance with HUD requirements, in a manner that permits a speedy and effective audit. The records must be in the form required by HUD, including requirements governing computerized or electronic forms of record-keeping. The PHA must comply with the financial reporting requirements in 24 CFR part 5, subpart H.” As described above, QAD found that SFHA “failed to maintain complete and accurate accounts and other records of the [HCV] program,” which prevented HUD from performing a “speedy and effective review.”¹⁵
- ii. Pursuant to 24 C.F.R. § 982.156, “[t]he PHA may only withdraw deposited program receipts for use in connection with the program in accordance with HUD requirements.” These HUD requirements are detailed in program notices, including without limitation Notice PIH 2014-5 (HA), which states in pertinent part that “HAP and/or HAP RNP shall not under any circumstances be used for any other purpose, such as to cover administrative expenses, be loaned, advanced or transferred . . . to other component units or other programs such as Low Rent Public Housing.” QAD found that SFHA had transferred HCV funds to an unrelated program, the Section 8 New Construction program, in FY 2012 in violation of the regulation.¹⁶
- iii. Pursuant to 24 C.F.R. Part 985 – Section 8 Management Program (SEMAP), SFHA must submit an annual SEMAP Certification, which allows HUD to assess its management capabilities and deficiencies. Failure by a PHA to correct identified SEMAP deficiencies or to prepare and implement a corrective action plan constitutes a default under the ACC.¹⁷ For FY 2017, SFHA received failing scores on three indicators, *viz.*, (i) Selection from the Wait List, (ii) HQS Enforcement, and (iii) Family Self Sufficiency, and was required to submit a corrective action plan to HUD

¹² *Id.*, Finding No. 2019-1, p. 13.

¹³ *See* ACC-Section 8, ¶ 10(a).

¹⁴ The requirements of Paragraph 10 of the ACC incorporate HUD’s regulatory requirements at 24 C.F.R. § 982.153, mandating that a “PHA must comply with the consolidated ACC, the application, HUD regulations and other requirements, and the PHA Administrative plan.” *See also* 24 C.F.R. §§ 982.52(a) and (b).

¹⁵ *See* 2019 QAD Report, Finding 2019-1, pp. 8, 12.

¹⁶ *See id.*, Finding 2019-6, pp. 24-25.

¹⁷ *See* 24 C.F.R. § 985.109.

Family Self Sufficiency, and was required to submit a corrective action plan to HUD to address these deficiencies on or before March 30, 2018.¹⁸ SFHA failed to submit a corrective action plan for these deficiencies, and again received failing scores on Selection from the Wait List and HQS Enforcement for FY 2018.¹⁹ SFHA's failure to first submit a corrective action plan, and continued deficient performance violates Section 985.106, and pursuant to Section 985.109 may constitute a default under the ACC.

Third, HUD has determined that SFHA is in default of its ACCs because it is in material breach of Paragraph 5 of the ACC-LRPH, which requires SFHA to "develop and operate all projects covered by this ACC in compliance with all the provisions of this ACC and all applicable statutes, executive orders, and regulations issued by HUD, as they shall be amended from time to time, including but not limited to those regulations promulgated by HUD at Title 24 of the Code of Federal Regulations, which are hereby incorporated into this ACC by reference as fully set forth here. . . ."²⁰ HUD makes the foregoing determination of default for material breach of Paragraph 5 of the ACC-LRPH based on the following:

- i. Pursuant to the United States Housing Act of 1937, HUD instituted the Public Housing Assessment System (PHAS) to evaluate public housing authorities' annual financial, physical and management performance. Due to failing PHAS performance scores for Fiscal Year 2011, HUD designated SFHA a "Troubled" PHA and required SFHA and the City and County of San Francisco (the City) to enter into the 2013 Public Housing Authority Recovery and Sustainability Initiative (PHARS) Agreement. Due to continued performance deficiencies in 2017, the parties entered into the revised 2017 PHARS Agreement.
- ii. According to the 2017 PHARS Agreement, SFHA did not achieve a passing Financial Assessment Subsystem (FASS) score due to failing ratings on three financial indicators related to financial solvency. SFHA did not achieve acceptable ratings for its Quick Ratio, Months Expendable Net Assets Ratio and Debt Service Coverage Ratio and was required to improve its FASS score and "sustain an acceptable level of performance in managing and operating SFHA's financial systems processes, controls, integrity and capacity." SFHA has failed to improve performance on these three key financial measures since 2017 in violation of HUD regulations at 24 C.F.R. § 903.73.

For all the foregoing breaches, violations and findings, HUD has determined that SFHA is in default of its ACC-Section 8 and ACC-LRPH. In accordance with 42 U.S.C. § 1437d(j)(3)(A)(iv)(v), after a finding of default, HUD has the authority to not only "take possession of all or part of the public housing agency" but to "require the agency to make other arrangements acceptable to the Secretary and in the best interests of the public housing residents and families assisted under section 1437f of this title [42 U.S.C.

¹⁸ See SEMAP Scoring Letter from HUD Office of Public Housing Director Gerard Windt to SFHA Executive Director Barbara Smith, dated January 24, 2018 (FY17 SEMAP Notice).

¹⁹ See the FY18 SEMAP Notice.

²⁰ See ACC-LRPH, § 5.

agency or the programs of the agency.” To this end, San Francisco Mayor London Breed informed HUD by letter dated October 26, 2018, that SFHA and the City are actively working to remedy the findings, regulatory violations and breaches of the ACCs by preparing the City to “accept and assume all responsibilities for SFHA’s essential functions” and remediate prior record deficiencies and administer the program.²¹ Therefore, having determined that it is in the best interest of SFHA residents and assisted families, HUD is exercising its discretion to allow SFHA the opportunity to cure its defaults and come into compliance with the program requirements through the City’s assumption of SFHA’s “essential functions.”

To cure the current defaults, SFHA and the City must agree to and complete the following:

1. SFHA and the City must submit to HUD for HUD’s review and approval a Memorandum of Understanding (MOU) outlining a scheduled plan of action for the City’s assumption of all programmatic and financial functions of SFHA’s HCV and LRPB Programs, including but not limited to financial management, program management, wait list and admissions, inspections, eligibility determinations, and lease and grievances procedures. The MOU must also include plans for outsourcing financial and programmatic services for the HCV and LRPB programs to third party experts and implementing all corrective actions from the 2019 QAD Report. The MOU must be received by HUD on or before April 8, 2019, and addressed to:

Ms. Dominique Blom
 General Deputy Assistant Secretary
 Office of Public and Indian Housing
 U.S. Department of Housing and Urban Development
 451 7th Street, SW, Room 4100
 Washington, DC 20410-0001

with a copy to:

Mr. Gerard Windt
 Director, Office of Public Housing
 San Francisco Regional Office
 U.S. Department of Housing and Urban Development
 One Sansome Street, Suite 1200
 San Francisco, CA 94104-4430

2. HUD reserves the right, pursuant to the U.S. Housing Act of 1937 42 U.S.C. § 1437d(j)(3), Paragraph 15 of the ACC-Section 8 and Section 17(e) of the ACC-LRPB, to seek any appropriate remedy, including without limitation taking possession of any or all SFHA properties, SFHA’s rights or interests in connection with the programs, including funds held by a depository, program receipts, and rights or interests under SFHA’s HAP contracts.

²¹ See 42 U.S.C. § 1437d(3)(A) (2018); ACC-Section 8, ¶ 15(a); and ACC-LRPB, § 17(e).

3. Failure to meet any of the scheduled deadlines, unless otherwise agreed to in advance by HUD in writing, shall terminate SFHA's opportunity to cure its default, and HUD will reinstate the default.
4. HUD's exercise of its option to allow SFHA to cure its default does not preclude HUD from mandating that SFHA cure any breach or default of either ACC or finding related to SFHA's HCV (Section 8) Program or Low Rent Public Housing Program (Section 9) as HUD deems appropriate.²²

SFHA has thirty (30) days from the date of this notice to appeal this determination of default or any of the supported findings on the basis that they are not substantially accurate or have been resolved. Should HUD not receive a written response from SFHA within 30 days, HUD will assume that SFHA agrees with the above findings and determination and accepts them as facts.

Should you have any questions, please contact Gerard Windt, Director of Public Housing in HUD's San Francisco office, at 415-489-6444.

Sincerely,



Dominique Blom
General Deputy Assistant Secretary
for Public and Indian Housing

cc: The Honorable London N. Breed, Mayor of the City of San Francisco

²² "HUD's exercise or non-exercise of any right or remedy under the Consolidated ACCs is not a waiver of HUD's right to exercise that or any other right or remedy at any time." See ACC-Section 8, ¶ 15(b); see also ACC-LRP, ¶ 17.

EXHIBITS

- Exhibit 1. HCV Consolidated Annual Contributions Contract executed by and between SFHA and HUD on August 12, 1998 (ACC-Section 8).
- Exhibit 2. Low Rent Public Housing Consolidated Annual Contributions Contract executed by and between SFHA and HUD on April 29, 1996 (ACC-LRPH).
- Exhibit 3. Financial Management Review QAD-FMRMOR-2019-CA0001 Housing Authority of the City and County of San Francisco, dated February 22, 2019 (2019 QAD Report).
- Exhibit 4. Financial Management Review QAD-FMR-2017-CA0001 Housing Authority of the City and County of San Francisco, dated July 14, 2017 (2017 QAD Report).
- Exhibit 5. SEMAP Scoring Letter from HUD Office of Public Housing Director Gerard Windt to SFHA Executive Director Barbara Smith, dated January 29, 2019 (FY18 SEMAP Notice).
- Exhibit 6. SEMAP Scoring Letter from HUD Office of Public Housing Director Gerard Windt to SFHA Executive Director Barbara Smith, dated January 24, 2018 (FY17 SEMAP Notice).
- Exhibit 7. PHARS Recovery Agreement and Action Plan executed among HUD, SFHA and the City and County of San Francisco, effective July 1, 2017 (2017 PHARS Agreement).
- Exhibit 8. PHARS Recovery Agreement and Action Plan executed among HUD, SFHA and the City and County of San Francisco, effective September 4, 2013 (2013 PHARS Agreement).
- Exhibit 9. Approval and Disapproval of PHARS Deliverables, dated May 22, 2018.
- Exhibit 10. Letter from Mayor London Breed to General Deputy Secretary Dominique Blom, dated October 16, 2018 (SFHA Shortfall Letter).
- Exhibit 11. Response from General Deputy Secretary Dominique Blom to SFHA Acting Executive Director Barbara Smith (HUD Shortfall Response).
- Exhibit 12. SFHA Fiscal Year 2017 Independent Public Accountant Audit (IPA Audit).