

**TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS**  
**An Internal Audit of the Contract For Deed Conversion (CFDC) Program**  
**Audit Report # 17-003**

**Executive Summary**

The Office of Internal Audit (OIA) assessed the Contract For Deed Conversion (CFDC) Program's current compliance with the Texas Government Code (TGC), and the Texas Administrative Code (TAC). We also reviewed policies and procedures, as well as the CFDC Notice of Funding Availability, reports, and other documents

Based on the fieldwork performed, OIA concludes that the CFDC program functions are generally performed accurately and according to applicable rules.

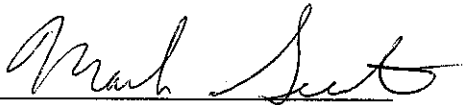
**Findings and Recommendations**

No Exceptions were noted

**Objective, Scope and Methodology**

Based upon our risk assessment and other factors, we selected the Contract For Deed Conversion program for detailed testing and analytical procedures. This audit was identified in the Fiscal Year 2017 Annual Audit Plan and included the objectives; (1) to evaluate and explain the CFDC Program and (2) to evaluate the administrative and internal control procedures related to the program

The current audit covered activities and processes in place during fiscal year 2016.



Mark Scott, CPA, CIA, CISA, CFE, MBA  
Director, Internal Audit

11/29/17  
Date Signed



TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

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Board Members of the Texas Department of Housing and Community Affairs ("TDHCA")

RE: REVIEW OF THE CONTRACT FOR DEED CONVERSION PROGRAM

Dear Board Members:

This report presents the results of the Office of Internal Audit ("OIA") "*Review of the Contract for Deed Conversion ("CFDC") Program.*" This audit was identified in the Fiscal Year 2017 Annual Audit Plan and was conducted in accordance with applicable audit standards. It included the objectives to evaluate and explain the *CFDC Program* and to evaluate the administrative and internal control procedures related to the program.

Our scope included a review of the Texas Government Code, and the Texas Administrative Code. We also reviewed policies, processes, and procedures, as well as the CFDC Notice of Funding Availability (NOFA), reports, and other related documents. Based upon our preliminary understanding of the CFDC Program we identified critical points and risk, to develop audit objectives and an audit plan including methodology.

The CFDC was selected for audit because the program was implemented after concern was expressed in the 2010 Sunset report on TDHCA. The program assists what is considered a vulnerable demographic group, which can be subject to predatory lending and other unscrupulous practices. The audit covered activities and processes in place during fiscal year 2016.

**BACKGROUND**

A Contract for Deed (CFD) is a contract in which the buyer pays for property by making monthly payments for a period of years. The buyer does not usually receive a deed to the property until all payments are made according to the contract. A CFD reduces credit restrictions and other impediments to home ownership. However, the households do not have the same level of protection in foreclosure proceedings as do home owners using traditional financing, and can be more vulnerable to fraud or unscrupulous sellers.



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In 2010, the Sunset Commission directed TDHCA to study the prevalence of CFD in colonias and report to the Legislature. TDHCA commissioned a study by the University of Texas. The UT study included several recommendations to TDHCA, which were generally towards making it easier for buyers under CFD arrangements to convert into a traditional deed.

TDHCA implemented the current Contract For Deed Conversion (CFDC) program in 2012 in response to the the study by the University of Texas, "The Contract for Deed Prevalence Project." The UT study noted that CFDs do not provide the same protections to the buyers as do traditional mortgages, and noted that they were often referred to as "poor man's mortgages." The report stated:

*A key element of most CFDs is the forfeiture clause – which provides that if a buyer defaults under the contracts, the seller can declare the contract terminated, regain possessions, and retain the buyer's prior payments as liquidated damages. Moreover, the homebuyer also typically loses the right to recover from any improvements made to the property. During the contract term, the buyer with a CFD is typically responsible for maintenance of the property and payment of the taxes and insurance, but this depends on contract terms, which are not always delineated. Typically (but not always in the case of non-developer transaction), CFDs include interest on the sales price, with rates significantly higher than conventional financing rates: 12% to 18% interest rates are common, although we came across rates as high as 20% during our field work for the project.*

The CFDC program was originally funded through the Housing Trust Fund (HTF). It was set up as a state grant award, to be distributed to administrators, who would carry out the program as TDHCA subrecipients in areas where CFD prevalence was highest. In July 2012, the TDHCA Board adopted an amendment to the "2012-2013 Housing Trust Fund Plan" to make \$500,000 available for a CFDC program serving Colonia residents earning up to 60% of the Area Median Family Income. The rules that the subrecipient administrators were required to follow were set out in the Notice of Funding availability (NOFA). In March 2013, HTF released the "CFDC Assistance Grant" NOFA to offer incentives to administrators wishing to convert CFDs, especially when utilizing Department HOME funds.

In June 2015, the 2016-2017 HTF Biennial Plan was approved providing an additional \$500,000 to the CFDC program, and in January 2017, the 2015 NOFA was re-released in the amount of \$310,500 extending reservation of funds until December 31, 2017

We tested compliance by administrators of the CFDC program. The criteria for audit testing were laid out in the NOFA for the program and the TAC 10, Chapter 23. The conversion program provides funding to assist households with the administrative work required to convert Contracts for Deed. TDHCA utilizes subrecipients to carry out the conversions.

### Testing

The CFDC program's general requirements were laid out in TAC 10, Chapter 23(E) Rule§ 23.51. The program was set up using subrecipients to carry out the program, and therefore the entities utilized were either local governments or non-profits subject to the Single Audit Act. We tested for compliance with that act along with the following requirements:

- Minimum of 3 years working history with:
  - Colonia real estate issues or
  - Mortgage loan origination or
  - TX Colonia housing construction activities
- Summary of skills and experiences for key staff in the areas of:
  - Mortgage lending
  - Construction management

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- Real Estate laws
- HOME CFD Governing Board resolution
- HOME CFD has proof of at least \$40k in cash reserves to facilitate administration of the program.

Our testing noted no instances of non-compliance.

The need for the CFDC program was lessened by improved education and subsequent legislation. In 2015 H.B 311 established that, on recording, an executory contract conveys legal title to a purchaser.

OIA extends our sincere appreciation to management and staff of the CFDC Program for their cooperation and assistance during the course of this audit.

Sincerely,



Mark Scott, CPA, CIA, CISA, CFE, MBA  
Internal Audit Director

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