



Issue Date January 6, 2012
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Audit Report Number 2012-BO-1001
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TO: Jennifer Gottlieb, Program Center Coordinator, Hartford Field Office, 1EPH

//signed//

FROM: John A. Dvorak, Regional Inspector General for Audit, Region 1, 1AGA

SUBJECT: The Housing Authority of the City of Hartford did not Properly Administer its \$2.5 Million Recovery Act Grant Construction Management Contract

## **HIGHLIGHTS**

### **What We Audited and Why**

We audited the Housing Authority of the City of Hartford's (the Authority's) administration of its American Recovery and Reinvestment Act grant that funded a construction management contract based on a hotline complaint. Our objective was to determine if the Authority solicited, evaluated, and administered the \$2.5 million grant funding and associated contract (the contract) properly and in accordance with federal requirements. We also visited a sample of sites to evaluate the impact the grant had on housing.

### **What We Found**

The Authority properly solicited and evaluated the construction management contract and generally improved housing conditions using its Recovery Act grant funds. However, it did not properly administer the management contract resulting in misuse of \$415,692 that should have been used for physical improvements to better housing.<sup>1</sup> This occurred in part because of the Authority's decision to use

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<sup>1</sup> \$415,692 = \$176,273 ineligible manager fees + \$45,246 ineligible profits + \$167,133 unnecessary/unreasonable work + \$27,040 ineligible clean-up costs.

more than \$250,000 in administrative fees that HUD provided to administer this construction manager contract for paying costs of administering its state housing units. The use of fees for other purposes was allowed by HUD rules. However, this use reduced the funding meant for improving housing buildings and structures, which was instead spent on management contract fees.<sup>2</sup> The Authority also paid profits that were not required by the contract, and for work that was unnecessary, unreasonable, or unsupported. The misuse of these funds had a real impact on housing improvements when only 38 of 102 boilers were replaced, and porches and a driveway included in the contract were not completed due to insufficient contract funds.

The Authority's warranty inspection also failed to identify numerous and obvious defective items which if uncorrected will shorten the lifespan of some improvements. Further, the Authority did not conduct employee interviews to verify contractor workers were paid the wage rates required by law.

During the audit we observed some minor conditions that we addressed in a separate letter to management.

### **What We Recommend**

We are recommending that the Director of HUD's Hartford Office of Public Housing require the Authority to; 1) repay more than \$415,000 in ineligible, unreasonable, and unsupported costs, and 2) establish and implement controls to ensure contract payments are limited to budgeted and approved amounts, change orders are approved prior to initiating work and their price is negotiated, warranty items are identified and corrected in a timely manner, and employee interviews are completed to verify contractor workers are paid the required wages.

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**

The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

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<sup>2</sup> \$176,273 = \$226,273 spent - \$50,000 approved.

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## **BACKGROUND AND OBJECTIVES**

The Housing Authority of the City of Hartford (Authority) is incorporated under the laws of the State of Connecticut and operates under a board of commissioners to provide safe and decent housing to low- and moderate-income families and elderly individuals. The Authority owns and operates more than 1,100 Federal public housing units under an annual contributions contract with the U.S. Department of Housing and Urban Development (HUD). It also manages more than 700 State housing units.

On February 17, 2009, President Obama signed the American Recovery and Reinvestment Act of 2009 (Recovery Act). This legislation included a \$4 billion appropriation of capital funds to carry out capital and management activities for public housing agencies, as authorized under Section 9 of the United States Housing Act of 1937. The Recovery Act requires that \$3 billion of these funds be distributed as formula funds and the remaining \$1 billion be distributed through a competitive process. On March 18, 2009, HUD awarded the Authority a formula grant of more than \$5 million.

The Authority allocated more than \$2.5 million in Recovery Act formula grant funds for site improvements at its Scattered Housing Sites II and III.<sup>3</sup> The improvements included new porches and overhangs, sidewalk repair, siding, fences, and boiler replacements.

We received a complaint indicating that the Authority and or its construction manager did not properly award and administer the contract. Our objective was to determine if the Authority solicited, evaluated, and administered the contract in accordance with federal requirements.

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<sup>3</sup> The Authority's contract number 1576-10

## RESULTS OF AUDIT

### Finding 1: The Authority Did Not Properly Administer its \$2.5 Million Recovery Act Construction Management Contract

The Authority generally improved housing conditions with the Recovery Act grant funding. However, it did not properly administer its \$2.5 million Recovery Act construction management contract (the contract). This occurred due to inadequate controls over tracking vendor fees and profits, spending within the approved budgeted amounts, and processing change orders. As a result, rather than using the funds to improve housing conditions, more than \$415,000 in Recovery Act funds were misspent on ineligible fees, profits, and unnecessary costs.

In addition the Authority; 1) did not identify defective warranty items due to inadequate oversight of its architect, which, if uncorrected, will shorten the life-span of improvements, 2) did not conduct employee interviews due to inadequate Davis Bacon procedures to verify workers were paid the wage rates required by law, and 3) its bid protest procedures required improvement to ensure prospective bid protests identify and correct mistakes and unfair procurement actions.

#### The Contract Improved Housing Conditions

The Authority hired a construction manager (manager) to complete \$2.5 million in exterior site improvements and 135 boiler replacements at twenty-one scattered housing unit sites. The manager was to receive \$226,000 (only \$50,000 was authorized by HUD) to solicit subcontractors in accordance with federal procurement requirements, award subcontracts, and oversee the work. The overall appearance and scope of work completed had a positive effect on the quality of housing provided to tenants.



## **The Authority Did Not Track Fees and Profits**

Grantees are required to maintain complete and accurate books and records;<sup>4</sup> however, the Authority's staff did not know and its records did not show the amount of fees and profits the manager received. We attributed this deficiency to inadequate accounting controls which included the manager's requests for payment<sup>5</sup> that identified only \$122,000 in construction fees on the "general conditions" line item with the remainder of the fees and profits imbedded in other line items.

## **We Identified \$415,692 in Questioned Costs**

With no clear accounting for fees and profits we obtained and audited the construction manager's records showing how the \$2.5 million was spent. The records showed that the manager received \$2,514,147, but only incurred \$2,098,455 in allowable contract costs. Thus, we questioned \$415,692 in contract costs.<sup>6</sup> See Appendix C and the following paragraphs further explanation.

## **Manager Fees Exceeded the Approved Amount**

The Authority exceeded the \$50,000 that HUD approved for construction manager services when it paid its manager more than \$226,000. This excess occurred primarily because the Authority used the more than \$250,000 in administrative fees that HUD provided to administer this federal contract for its state housing units. This nonfederal use was allowed by HUD's asset based accounting rules.<sup>7</sup> However, by using the \$250,000 for other purposes, sufficient administrative and construction manager grant funds were not available to pay the construction manager; and funds that HUD approved for buildings and structures were used to pay the manager. This had an impact on housing when 97 boilers were not replaced and several porches and a driveway included in the contract were not completed primarily due to insufficient contract funds.<sup>8</sup> Furthermore, the more than \$176,000 of the \$226,000 that exceeded the HUD approved amount was an ineligible grant cost that must be repaid to HUD.<sup>9</sup>

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<sup>4</sup> The Consolidated Annual Contributions Contract Between the Authority and the United States of America

<sup>5</sup> Periodic Requests for Payment, form HUD-51000

<sup>6</sup> \$415,692 questioned costs = \$2,514,147 paid - \$2,098,455 audited costs

<sup>7</sup> Grantees using HUD's Asset-based accounting rules grantees may use fees for any purpose after processing them through their central cost center

<sup>8</sup> 33 of the 135 boilers were not replaced based on a previous OIG audit that disallowed their replacement because they had more than 60 percent of their useful life remaining.

<sup>9</sup> \$176,273 = \$226,273 paid - \$50,000 approved

## **The Construction Manager Received Ineligible Profits**

Although the contract did not provide for profits, the Authority paid the manager more than \$45,000 in profits.<sup>10</sup> This occurred due to weak accounting controls. Specifically, the Authority did not require the manager to itemize all fees and profits on requests for payment. These profits were ineligible grant costs because the contract provided for no compensation beyond the \$226,000 manager fee.

## **Some Change Order Work was Unnecessary and Unreasonable**

The Authority approved more than \$72,000 to supervise and manage a preconstruction model.<sup>11</sup> The work was unnecessary because replacing siding, sidewalks, porches, and roofs was routine construction that did not require a model nor justify the additional costs. This error occurred in part because the Authority did not require nor approve a change order identifying the management costs prior to starting the work and thus, did not know what the model would cost. Furthermore, although the manager offered to waive preconstruction costs and change order prices were to be negotiated, the Authority did not ask for the waiver nor negotiate the costs.

The Authority also paid more than \$60,000 for a safety compliance officer to ensure contractors complied with safety standards.<sup>12</sup> We considered this an unnecessary cost because the contractor's are responsible for ensuring they comply with all local state and federal safety requirements.<sup>13</sup> We also considered it unreasonable to use limited Recovery Act Funds for these soft costs rather than for actual physical improvements to improve housing conditions.

The Authority also approved more than \$34,000 in manager costs for work at New Britain Avenue.<sup>14</sup> The costs were unreasonable because when combined with construction manager fees and the Authority's administrative fees the total soft costs for this change order were more than \$53,000, or 52 percent of \$102,000 cost.<sup>15</sup> We attributed this in part to the Authority's failure to negotiate change order fees.

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<sup>10</sup> \$45,246 = \$12,912 mockup profit and \$32,334

<sup>11</sup> \$72,950 Change Orders 41 and 42

<sup>12</sup> \$60,180

<sup>13</sup> General Conditions for Construction Contracts Form HUD-5370 Item 2(d)

<sup>14</sup> \$34,043 for Change Order 46 = \$13,600 for supervision + \$9,384 for principal office services + \$2,961 + \$8,098 change order fee.

<sup>15</sup> 52% = \$53,588/\$102,870

### **The Manager Double Counted Clean-up Costs**

The construction manager's cost accounting provided to us included more than \$27,000 in estimated general clean-up costs.<sup>16</sup> However, contractors are responsible and are compensated for clean-up costs under the contract's general conditions.<sup>17</sup> As such, the construction manager's listing of clean-up costs as a separate line item on its cost accounting was in effect a double counting of the costs and therefore; the \$27,040 in separate clean-up costs did not increase the amount of audited eligible contract costs and must be repaid to HUD.

### **Defective Warranty Items Were Not Identified**

The Authority relied on its Architect to perform a nine month inspection and two subsequent site visits to identify defective work items. However, the Authority did not ensure the inspections were conducted. After we alerted the Authority of several construction defects and warranty items, the Architect completed his first inspection two weeks before the warranty expired. A HUD inspection completed three days later showed that the Architect's warranty inspection failed to identify 58 obvious defective items.

The faulty warranty inspection may have occurred due to negligence and or because during construction the Architect certified that the work complied with the contract specifications and thus, may have had a conflict of interest in reporting obvious defects in the work.

The amount required to repair the items may not be material; however, the shortened lifespan of the defective items should they remain uncorrected was material. Based on HUD's inspection the Authority started to take action to correct the deficiencies. See Appendix D for more details.

### **The Authority Did Not Conduct Employee Interviews**

The Authority's contractor reviewed certified payrolls in accordance with HUD's requirements. However, employee interviews of contract employees were not conducted to verify the payroll's truthfulness. HUD does not require employee interviews for every contract; however, the Authority had not conducted any interviews for at least four years. If interviews are not conducted workers may

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<sup>16</sup> \$27,040

<sup>17</sup> General Conditions for Construction Contracts Form HUD-5370 Item 2(g)

not receive the required wage rates and contractors may defraud the government for wages not paid. Thus, during the audit the Authority agreed to start conducting interviews.

### **Bid Protest Procedures Required Improvement**

The Authority did not handle the bid protest in accordance with HUD's requirements when it did not include the appeal process in its solicitation, did not offer an appeal in its response to the bid protest, and designate an independent third party to render an impartial opinion.<sup>18</sup> This occurred primarily because the Authority did not have adequate formal bid protest procedures. If this deficiency not corrected future protesters may not receive due process and mistakes, irregularities, and unfair procurement actions may not be discovered and corrected.

### **Conclusions**

The Authority did not properly administer the contract due inadequate contract oversight, inadequate accounting and change order procedures and the Authority's failure to adequately oversee its architect . As a result, \$415,000 intended to improve housing conditions instead was misused for unnecessary and unreasonable change orders, excessive management fees, and ineligible construction manager profits. The misuse of these funds had a significant effect on housing conditions when 64 boilers(E.09 see comment 4) and two porches included in the contract were not installed. The Authority also needs to improve its warranty controls to ensure defects are identified and corrected in a timely manner or the lifespan of the improvements will be shortened and the Authority will have to use limited housing funds to correct the deficiencies that were the contractors' responsibility.

### **Recommendations**

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

- 1A. Repay HUD \$176,273 for ineligible construction manager fees paid to the construction manager.

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<sup>18</sup> HUD's bid protest procedures are stipulated in HUD HB 7460.8 Chapter 10, Section 10.4. and 24 CFR 85.36(b)12

- 1B. Repay HUD \$45,246 for ineligible profits paid to the construction manager.
- 1C. Improve accounting procedures for construction management contracts and ensure all fees and profits are clearly identified, classified, and paid in accordance with the contract.
- 1D. Improve budget and contract review procedures to ensure contracts and payments are limited to budgeted and approved amounts.
- 1E. Repay HUD \$133,090 (\$72,910 for unnecessary model costs and \$60,180 for unnecessary safety observer costs).
- 1F. Repay HUD the entire \$34,043 or the provide support for a portion thereof, for unreasonable management fees and soft costs for improvements at New Britain Avenue, Change Order 43.
- 1G. Establish and implement formal change order procedures to include ensuring change orders are initiated for all changes in the scope of work, approved by the contracting officer prior to initiating work, and the cost is negotiated.
- 1H. Repay HUD \$27,040 for ineligible general clean-up costs.
- 1I. Establish and implement formal procedures to ensure warranty inspections identify all material defects and corrective actions are taken in a timely manner.
- 1J. Establish and implement formal procedures for contractor employee interviews.
- 1K. Establish and implement formal bid protest procedures in accordance with federal requirements.

## SCOPE AND METHODOLOGY

We conducted our audit between June 2011 and November 2011. We completed our fieldwork at the Authority's office located at 180 Overlook Terrace, Hartford, CT, and its contracted construction manager's office. Our audit covered the period January 2010 through May 31, 2011, and was extended when necessary to meet our audit objectives.

To accomplish our audit objectives we,

- Limited our tests to the Authority's contact number 1576-10.
- Reviewed applicable Recovery Act and Capital Fund regulations, notices, and guidance, including  
  
The American Recovery and Reinvestment Act of 2009;  
24 CFR 85.36 Administrative Requirements For Grants And Cooperative Agreements;  
HUD Handbook 7460.8 rev-2 Procurement Handbook for Public Housing Agencies;  
The Authority's ARRA Procurement Policy.
- Interviewed key staff members at the Authority, the Construction Manager, and selected subcontractors.
- Evaluated and tested the procurement controls to evaluate their implementation and effectiveness.
- Evaluated the scope of work to determine what contract work wasn't completed, why it wasn't completed, and its monetary value.
- Reviewed all contract change orders to determine if they were eligible, necessary, reasonable, supported, and approved by the contracting officer prior to initiating work.
- Reviewed the terms of the contract and payments to the construction manager to determine the amount of fees and profits the manager was entitled to receive and was paid.
- Requested that the construction manager provide a cost accounting (accounting) for all contract costs and traced as sample of the costs to copies of bank checks, contracts, and invoices to verify the accuracy of the accounting.
- To test subcontractor costs we selected a nonrepresentative sample of checks from the accounting. We did not use a 100% or representative selection due to our ability to select a relatively small number of high dollar items, greater than \$10,000, to test a large percentage of the total payments. Our sample of 36 payments totaling \$1,686,901 was drawn from a universe of \$1,983,345; and thus, represented more than 85 percent of the total payments to subcontractors listed on the cost accounting. We believe this provided a reasonable basis to determine the accuracy and validity of allowable subcontractor costs.

- We reviewed the Authority's procurement records to determine if the construction manager was properly solicited, evaluated, and selected.
- Selected and visited a nonrepresentative sample of work sites to verify work was completed and its general quality and condition. We used a non-representative selection rather than a 100% or representative selection because we wanted to spend no more than two audit days to inspect sites. Our sample of 6 of the Authority's property sites was drawn from a universe of 21 sites.
- Reviewed the warranty inspection report that HUD PIH Hartford, CT's Engineer completed after our site visits and notification that the sites had several material deficiencies. We relied on HUD's report which included written and photographic documentation of warranty deficiencies, to determine if the procedures and controls the Authority established and took were effective to identify and correct warranty items.
- Reviewed construction manager fees to determine if the Authority exceeded its authorized limit.

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 objectives.

# 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 objectives:

- Controls over experience and training
- Controls over formal written policies and procedures
- Controls over change order processing and accounting for fees and profits
- Controls over accepting bids, confidentiality of bids, and bid protests
- Controls over evaluating proposals and negotiations
- Controls over conflicts of interest and kick-backs
- Controls over warranty work
- Controls over wage rates

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 Deficiencies

Based on our review, we believe that the following items are significant deficiencies:

- The Authority did not track and account for fees and profits.
- The Authority's contract procedures did not ensure that Construction Manager Fees were within the budgeted and HUD approved amount.
- Change orders were not always completed for changes in work, not approved prior to starting work, and prices were not negotiated.
- The Authority did not conduct employee interviews to verify the truthfulness of certified payrolls and compliance with required wage rates.
- The Authority lacked procedures to ensure the quality of warranty inspections and to ensure they were conducted in accordance with the contract and HUD's requirements.
- The Authority didn't handle bid protests in accordance with HUD's requirements.

See finding 1 for details.

### **Separate Communication of Minor Deficiencies**

Minor internal control and compliance issues were reported to the auditee in a separate memorandum.

## APPENDIXES

### Appendix A

#### SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

Recommendation number	Ineligible 1/	Unreasonable or unnecessary 2/
1A	\$176,273	
1B	\$45,246	
1E		\$133,090
1F		\$34,043
1H	\$27,040	

- 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/ Unreasonable/unnecessary costs are those costs not generally recognized as ordinary, prudent, relevant, and/or necessary within established practices. Unreasonable costs exceed the costs that would be incurred by a prudent person in conducting a competitive business.

## Appendix B

# AUDITEE COMMENTS AND OIG'S EVALUATION

### Ref to OIG Evaluation

### Auditee Comments

December 28, 2011

Ms. Kristen Ekmalian  
HUD OIG, Assistant Regional Inspector  
1 Corporate Center  
Hartford, CT. 06103

Re: DRAFT Audit 2011-BO-0019 Housing Authority of the City of Hartford ("HACH") Limited Procurement Review of Recovery Act funded Construction Manager Contract # 1576-10 for Exterior Improvements and Site Improvements and Boiler Replacement at Scattered Sites II & III, Hartford, Connecticut, dated December 19, 2011.

Dear Ms. Ekmalian:

In accordance with your email instructions to me dated December 19, 2011 regarding the above-referenced draft audit report, I write to set forth HACH's formal written comments to the draft report for inclusion in their entirety in the final audit report that will be issued.<sup>1</sup> As you requested, I will indicate agreement or disagreement, as best as possible, with each specific issue contained in your draft report. I will also address each recommendation proposed by you, stating, as appropriate, how HACH will implement it, or why we believe the same is unnecessary or unjustified.

I want to first thank you for the time you have taken to meet with us during the course of the audit and share your proposed findings and audit recommendations. HACH acknowledges the important role that OIG plays in ensuring that tax payer funds are properly and effectively utilized for public housing. We hope that you, too, will recognize the important role HACH plays in providing safe and decent housing for low and moderate income families and elderly individuals throughout the greater Hartford area. As you duly point out, HACH owns and operates more than 1,000 federal public housing units and also manages more than 700 state housing units. We are quite proud of our work and substantial history of public housing achievements. The subject Scattered Housing Sites II and III project certainly belongs, we believe, within that fine history of successful public housing project achievements.

As OIG itself recognized in its previous "Finding Outlines," "overall the contracted work was completed, was in good condition, and of good quality." OIG also concludes that HACH "properly solicited and evaluated the construction management contract" for the underlying project at issue "and generally improved housing conditions using its Recovery Act grant funds." We certainly agree. Perhaps most critically, OIG must also recognize that the project was delivered on time and at the price guaranteed or

<sup>1</sup> It is my understanding, based upon your draft report, that the complete text of HACH's response will be incorporated as part of "Appendix B" to the final report.

{00427868.DOC Ver. 1}

THE HOUSING AUTHORITY OF THE CITY OF HARTFORD 180 OVERLOOK TERRACE, HARTFORD, CT 06106 (860) 723-8400

**Comment 1**

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fixed in the underlying construction manager's contract. This is a critical fact that should not be overlooked, particularly when considering OIG's overarching conclusion that HACH "did not properly administer the management contract." HACH respectfully, but quite adamantly, disagrees with this proposed conclusion and believes that the same arises from a material misunderstanding of the construction management contract at issue.

This was a fixed price contract, wherein the contractor, [REDACTED], acted as, among other things, a qualified construction manager at risk for the underlying project. This meant that [REDACTED] would act as a consultant to the owner in the preconstruction phase of the project, and as the equivalent of a general contractor during the construction phase. Under this type of contract, the construction manager accepts a commitment to deliver the project within a guaranteed or fixed maximum price, which obligates the construction manager to manage and control construction costs so as not to exceed the maximum contract price, which would be a financial hit to the construction manager at risk company [REDACTED]. Thus, the overall cost of the project to the owner is guaranteed, whereas the construction manager's fee is not.

[REDACTED]'s guaranteed or fixed maximum contract price was \$2,514,147.00, which price included [REDACTED]'s fee of 9%, or \$226,273.23. Should construction costs have exceeded [REDACTED]'s estimates, then its 9% fee was at risk for covering the costs of the same. Should [REDACTED] have been able to deliver the project for less than it estimated incurring, then its profitability would increase. There was no contractual obligation for [REDACTED] to remit profits to HACH in the event that it was able to manage and control construction costs so as to increase its own profits.

A common understanding of the foregoing contract is of critical importance in appreciating HACH's response to and disagreement with your proposed conclusion that HACH did not properly administer that contract. To the extent that there may have been legitimate issues which arose from HACH's administration of the construction management contract, they were solely procedural in nature. There were no misspent funds. HACH did not "misuse" \$415,692 in Recovery Act grant funds as concluded in the draft report.

HACH will tighten-up and improve its internal procedures identified in the draft report, but it did not misuse Recovery Act funds and respectfully submits that it should not have to return funding for the project to HUD.

I. ISSUES

A. The Contract Improved Housing Conditions.

HACH agrees with this apparent first "issue" identified in OIG's draft report. As already noted and previously found by OIG, "overall the contracted work was completed, was in good condition, and of good quality." The work performed and delivered on time

Ref to OIG Evaluation

Auditee Comments

Comment 2

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and on budget indisputably improved housing conditions at the sites. Thus, while there are certain statements of fact contained under this "issue" heading in your draft report with which HACH disagrees (and which will be addressed subsequently where they arise more directly under other "issues"), HACH is in general agreement with this first "issue" identified in OIG's draft report. The contract dramatically improved housing conditions as Scattered Housing sites II and III.

B. The Authority Did Not Track Fees and Profits.

HACH disagrees with this apparent second "issue" identified in OIG's draft report and believes that the same is a "red herring" which arises from a fundamental misunderstanding of the construction manager at risk contract. By virtue of the very nature of the contract, the construction manager's profitability was entirely dependent upon its ability to deliver the project within the guaranteed or fixed maximum price. EBI's fee was fixed by contract. All payments made to [REDACTED] were in accordance with the terms and conditions of the contract and did not exceed the guaranteed price set forth therein. HACH disagrees, therefore, that there was any deficiency in its understanding of the contract, as suggested, or that it exercised "inadequate accounting controls" over the same.

Comment 3

C. OIG Identified \$415,692 in Questionable Costs.

HACH disagrees with this apparent third "issue" identified in OIG's draft report. [REDACTED] was paid the exact sum as set forth in its contract for the work; i.e., \$2,514,147, which exact sum is identified and confirmed by OIG in the draft report. HACH entirely disagrees with the underlying premise for this "issue," that only some lesser sum of money was "allowable" under the contract. We further note that [REDACTED] without objection, fully cooperated with OIG in connection with its audit, and voluntarily turned over its books and records to OIG for unfettered review. Clearly, neither HACH nor [REDACTED] ever believed or understood that anything more than the "allowable contract costs" were paid by HACH to [REDACTED]. This "issue" is discussed in greater detail below under the fourth "issue" identified in the draft report.

Comment 4

D. Manager Fees Exceeded the Approved Amount.

HACH disagrees with this apparent fourth "issue" identified in OIG's draft report. The report contains a proposed finding that the nine (9%) percent construction management fee stated in the CM at risk contract exceeded the \$50,000.00 HUD approved construction manager fee. If one accepts the underlying premise that there was a \$50,000 cap on [REDACTED]'s construction management fee, then HACH would have been in violation of the same as soon as it set pen to paper and executed the construction management contract. However, this was not the case.

As indicated earlier, under the construction manager at risk contract, [REDACTED] acted as a consultant to HACH in the preconstruction phase of the project, and as the equivalent of

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a general contractor during the construction phase. In our "Annual Statement/Performance and Evaluation Report" submitted to HUD in connection with this matter, we identified a "construction management fee" of \$50,000.00 for the subject project. The fee identified in the HUD form report, however, merely referred to that portion of [REDACTED]'s 9% fee allocated to pre-construction services to be performed by [REDACTED] and was never intended to modify or in any way undermine or cap the expressly agreed to overall 9% fee identified and agreed to in the construction management contract. The agreed upon fee for the entire project has always been and is 9% of the guaranteed maximum contract price of \$2,514,147.00, or \$226,273.23. The agreed upon 9% fee is what HACH paid [REDACTED]

Further, as is noted in OIG's draft report, HUD provided HACH "with more than \$250,000 in administrative fees" to administer the subject contract. It is inconsistent to conclude, therefore, that the contractually agreed to and stipulated 9% fee paid to [REDACTED] was excessive and/or was not authorized under the contract. It is also entirely misleading to state that the construction management fee "had an impact on housing when 97 boilers were not replaced" because of insufficient contract funds, when the reality is only 38 boilers were replaced because a previous OIG audit report disallowed replacing those boilers that had 60 percent of their useful life remaining. The number of boilers to be replaced was reduced when the original specifications for the contemplated replacements did not provide for the requisite efficiency rating required by HUD. The required increase in efficiency also increased the cost per boiler and, as a result, the number of boilers that could be afforded to be replaced was reduced. The management fee remained fixed by contract and the reduction in the number of boilers replaced was dictated in part by HUD expenditure limitations.

Accordingly, while HACH accepts your math, *i.e.*, that \$226,273.23 exceeds \$50,000.00 by the sum of \$176,273.00, we must reject the underlying premise: there was no underlying \$50,000.00 cap on [REDACTED]'s fee. Therefore, we must likewise reject the proposed findings that HACH lacked adequate accounting controls to track [REDACTED]'s management or construction fee. HACH understood [REDACTED]'s fee to be the 9% included in the fixed contract price.

HACH, therefore, wholly disagrees with OIG's recommendation that it repay HUD \$176,273 for "ineligible" construction manager fees.

E. The Construction Manager Received Ineligible Profits.

HACH disagrees with this apparent fifth "issue" identified in OIG's draft report. This issue is premised upon the baseless notion that "the contract did not provide for profits." This was not an "at cost" contract. [REDACTED] certainly intended to profit as a result of its work. Indeed, the CM at risk contract by its very nature and design permitted [REDACTED] to profit without limitation to the extent that it could deliver the project within the guaranteed or fixed maximum price. The contract did not limit [REDACTED]'s profit, if any, to the agreed upon \$226,000 management fee. HACH, because it rejects any notion that it paid

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█████ ineligible profits, rejects much more so the notion that the payments "occurred due to weak accounting controls."

HACH rejects the proposed findings that it paid █████ additional ineligible profits in the amount of \$45,246.00. HACH paid █████ no more than the agreed to maximum fixed price set forth in the parties' contract. There was no contractual obligation for █████ to remit profits to HACH in the event that it was able to manage and control construction costs so as to increase its own profits.

F. Some Change Order Work was Unnecessary and Unreasonable.

HACH disagrees with this apparent sixth "issue" identified in OIG's draft report. Change order no. 41, which did not actually change the total fixed price agreed to in the CM at risk contract, is criticized—we believe unduly—because it involved a mock-up OIG finds "unnecessary because replacing siding, sidewalks, porches and roofs was routine construction that did not require a model." HACH disagrees with this assessment, which involves judgment by the construction team.

Section 1.06 of the Contract Specifications, entitled "Samples" and which are part of the underlying "contract documents," copy attached, expressly incorporated "full-size mock-ups" as requested by HACH. Mock-ups are of critical importance to any successful construction project, particularly one of the scope involved here, because they can serve as a baseline or model for what one should expect to see moving forward before actual construction begins. The cost for the subject mark-up, therefore, was built into and made a part of the fixed price contract. Its necessity duly rests with the judgment of the construction team and should not be the subject of criticism in an audit. All of the costs associated with this mock-up, as well as with change order no. 41 generally, were built into the underlying contract price. This change order did not change or increase the underlying contract price, but it merely provides detail or an explanation (perhaps in-artfully) of the underlying costs associated with fixed-price contract.

The same is true with regard to change order no. 42. For the same reasons that apply to change order no. 41, therefore, HACH cannot accept or agree that change order no. 42 resulted in "unnecessary and unreasonable change order costs," as proposed. Similarly, change order no. 43, which shows a \$27,638.00 credit in favor of HACH and which is criticized for the stated costs associated with safety compliance at New Britain Avenue, did not actually change the contract price but was merely used to track or explain underlying costs associated with the work which was always part of the underlying contract price. The same is true with regard to change order no. 46, which merely involved the allocation and expenditure of the contract contingency remaining after completion of the entire project, excluding New Britain Avenue.

You have also asserted that HACH did not negotiate change orders. That conclusion is not correct and we believe you have been provided with paperwork showing the credits back to HACH which were received as a result of such negotiations.

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In addition, change orders were negotiated as part of the Proposed Change Order process, which would not necessarily result in any documentation for you to review.

The project was delivered at the price guaranteed or fixed in [redacted]’s contract, i.e., for \$2,514,147.00. Thus, although there may have been 46 “change orders” over the course of the project, these change orders did not in fact change or modify the fixed maximum contract price. The change orders were used to track or breakout certain aspects of the work or to change line items, but did not increase the cost of the project. While this use of the “change order” process may not be what one typically encounters in construction projects, it underscores my primary point: to the extent that there are legitimate issues identified in the audit, they are procedural in nature and do not involve misspent funds. HACH can and certainly will tighten-up and improve its internal change order procedures, but it did not misuse Recovery Act funds and respectfully submits that it should not have to return funding for the project to HUD.

Comment 7

- The Manager’s Clean-Up Cost Were [sic] Ineligible.

HACH disagrees with this apparent seventh “issue” identified in OIG’s draft report. You question the \$27,040 allocated to general clean-up costs in [redacted]’s own voluntary accounting to OIG during the audit. The criticism appears to be that because these costs were not expressly “charged to the contract,” they were not “visible.” In reply, it must be noted that Section 1.02 of the “Project Closeout” specifications, copy attached, expressly included an exhaustive list of requisite cleanup and disposal obligations on the part of EBI. The cost of the same, therefore, necessarily was included in the guaranteed contract price and there was no need to further “charge [the same] to the contract.” (Indeed, had [redacted] sought to bill for clean-up costs as an extra charge under the contract, as you appear to require, then the charge would have in fact been ineligible for payment under the fixed price contract.) It is abundantly obvious that [redacted] incurred cleanup costs as part of its work under the contract and the same were always built into and made a part of its agreed upon contract price. There is no basis for OIG’s conclusion, therefore, that “the charge [which OIG requested [redacted] to create] was an ineligible contract cost.”

Comment 8

H. Defective Warranty Items Were Not Identified.

HACH disagrees with this apparent seventh “issue” identified in OIG’s draft report, which involves findings requiring discretion and judgment on the part of the project architect, and believes that the same is not entirely warranted.

HACH’s contract with the project architect, [redacted] ([redacted]), contains specific provisions regarding warranty inspections specifically designed to ensure that warranty inspections and corrective actions are taken in a timely manner and in accordance with HUD’s requirements. In section 1.21 of the architect’s contract, entitled “A/E’s Service During the Construction and Guarantee Phase,” copy attached, the project architect must “[m]ake periodic visits to the site to substantiate the progress and quality of the work and to determine if the work is proceeding in accordance

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with the contract documents. On the basis of on-site observations, he/she shall endeavor to guard the HA against defects and deficiencies in the work." In addition, "[a]fter completion of construction," the architect must "make visits to the site prior to the expiration of the guarantee period specified in the Main Construction Contract to inspect for evidence of faulty materials and faulty workmanship." The architect is obligated to "make one [such] visit nine months after completion" and "two additional visits" within twelve months after completion of construction. The express purpose of these visits is for "the A/E to endeavor... to guard the HA and Government against defects and deficiencies in the work." Further, the A/E must "immediately notify the contractor and the HA while on site of any deficiencies and shall submit within seven (7) days of the visit a written report to the HA which shall describe all observed defects and deficiencies which are, in the A/E's opinion, covered by the guarantees provided for in the contract documents ..." (Underscoring added to emphasize the inherently debatable nature of "defect" and "deficiency" claims.) A copy of each such report must be filed with both "the HA and HUD."

These express contractual mandates are designed to ensure warranty inspections and corrective actions are taken in a timely manner and in accordance with HUD's requirements. HACH is legally entitled to rely upon the same, as well as the expert judgment and opinions of the project architect. [REDACTED] has, to our understanding, acted in accordance with its contractual requirements and has provided HUD with a copy of its warrantee inspection report. Although your office may have disagreement with [REDACTED]'s findings, HACH cannot fairly be held accountable for the opinions of its architect or for OIG's own disagreement with those opinions. HACH honored its warranty obligations by having a contract in place requiring timely expert inspections, and thereby satisfied its duties to HUD regarding warranty inspections.

HACH will act to ensure that future warranty inspections are timely performed for future projects by its retained experts.

I. The Authority Did Not Conduct Employee Interviews.

This apparent eighth "issue" identified in the OIG draft report involves internal procedures at HACH, specifically those regarding employee interviews to verify hours worked and wages paid. As noted in your report, Federal Department of Labor regulations require investigations to be made of all contracts "with such frequency as may be necessary" to assure compliance with the Davis Bacon Act. HUD's own Davis Bacon "streamlining" procedures do not require on-site employee interviews to verify the accuracy and truthfulness of certified payrolls for each job or contract. HUD instead encourages targeting interviews to projects, contracts or employers where violations are suspected. HACH contracts with a third party expert to serve as its Davis Bacon compliance officer. As you note, this "contractor reviewed certified payrolls in accordance with HUD's requirements." HACH had no independent reason to suspect the presence of wage violations with this project. Further, it is HACH's understanding and belief that its third party compliance officer also had no reason to suspect wage violations

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based upon his review of the certified payroll records for the subject project. There is also no basis to believe that violations were suspected at any other projects occurring within the last "four years," as vaguely referenced in the draft report. There is no basis to conclude, therefore, as your report appears to imply, that employee interviews were required for the subject project.

Notwithstanding the foregoing, HACH will modify the scope of its third party compliance officer contract to ensure employee interviews are conducted where violations are suspected in accordance with HUD's streamlining procedure requirements.

J. Bid Protest Procedures Require Improvement.

HACH agrees with this "ninth" issue identified in OIG's draft report. HACH's procurement policy does establish bid protest procedures. This was HACH's first bid protest and, as the result of the same, it was discovered that those procedures may not have fully complied with the requirements for a bid protest set forth by HUD. Fortunately, the bid protest at issue was ultimately resolved. In any event, the proposed findings under this particular issue, which are entirely procedural in nature, will be accepted and the recommended corrections implemented. HACH will establish and implement formal bid protest procedures in accordance with HUD's requirements.

Comment 11

II. RECOMMENDATIONS

1A. Rejected as unjustified on the grounds discussed above.

1B. Rejected as unjustified on the grounds discussed above.

1C. Rejected as unjustified for the subject contract on the grounds discussed above. HACH will certainly abide by the recommendation (as it believes it always has) when and where applicable in the future.

1D. Rejected as unjustified for the subject contract on the grounds discussed above. HACH will certainly abide by the recommendation (as it believes it always has) when and where applicable in the future.

1E. Rejected as unjustified on the grounds discussed above.

1F. Rejected as unjustified on the grounds discussed above.

1G. Rejected as unjustified for the subject contract on the grounds discussed above. HACH will certainly abide by the recommendation (as it believes it always has) when and where applicable in the future.

1H. Rejected as unjustified on the grounds discussed above.

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Ref to OIG Evaluation

Auditee Comments

Comment 12

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I.J. Accepted; HACH will modify the scope of its third party compliance officer contract to ensure employee interviews are conducted where violations are suspected in accordance with HUD's streamlining procedure requirements.

IK. Accepted; HACH will establish and implement formal bid protest procedures in accordance with HUD's requirements.

III. CONCLUSION

The contracted work was completed, was in good condition, and of good quality. The project was delivered on time and at the price fixed in [redacted]'s contract. To the extent that there are legitimate criticisms of HACH's management of or paperwork concerning the project, they are procedural in nature and do not involve misspent or misused funds. There was no financial misfeasance by HACH of any nature with regard to the subject project. HACH will improve its internal procedures, where applicable, as identified above. HACH did not misuse Recovery Act funds and respectfully submits that it should not have to return any funding for the project to HUD.

Sincerely yours,



Alan E. Green  
Executive Director

## OIG Evaluation of Auditee Comments

**Comment 1** The findings and recommendations identified in this report are based on the audit evidence found during the audit and are therefore reportable. The fixed price contract indicates the construction manager was to act a consultant during the preconstruction phase: however, the contract had no language or requirements that stated the construction manager was to act as "the equivalent of a general contractor" during construction. Under the unambiguous terms of the contract, the contractor was to be paid the contract sum of \$2,514,147 (subject to change orders) which included within its total a construction fee of nine percent. The contractor was not entitled to profit in addition to the approved fee under the Recovery Act.

The contract was not a Guaranteed Maximum Price contract. A Guaranteed Maximum Price contract would have established a maximum price for a specific scope of work. However, the Authority did not execute an American Institute of Architects contract to establish the guaranteed maximum price. The contract's scope was continually revised by additions and deletions to the work throughout the contract period although not all deletions were executed through change orders. Therefore, comparing this contract to a Guaranteed Maximum Price contract was not factually correct nor a valid basis for explaining the legal requirements for this contract.

**Comment 2** During the audit and in the Authority's response nothing was provided to evidence it tracked fees and profits. We attribute the failure to account for costs to a lack of adequate accounting controls and oversight of the contract, which was the prime responsibility of the Authority.

**Comment 3** The Authority was incorrect in its claim that only allowable costs were incurred and in its understanding of federal contracting requirements for use of Recovery Act funds. Also, we disagree that the Authority use of funds was appropriate and had the Authority used these funds for dwellings and structures that HUD approved, more new porches and boilers would have been installed and more housing improvements made. We therefore the Authority needs to repay HUD \$415,692 for failing to use the funds as approved.

**Comment 4** The Authority was in violation of the requirements of the Recovery Act and HUD requirements when it agreed to pay more than HUD approved for management fees. HUD clearly approved only \$50,000 of the grant for "construction manager fees" on HUD form 50075.1.<sup>19</sup> However, the Authority could have used other funds such as a portion of the \$250,000 in administrative funds HUD provided<sup>20</sup> to pay its construction manager fees as provided in the contract; however, these funds were instead used for its state housing units. Therefore, costs paid totaling \$176,273 exceeded the \$50,000 allowed under the grant require repayment.

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<sup>19</sup> budget line item 1410

<sup>20</sup> budget line item 1430

We acknowledge that 33 boilers were not replaced due to a prior OIG audit that recommended not replacing boilers when they had 60 percent or more of their useful life remaining. Thus, to clarify the report we added the word “primarily” and added footnote 8 to disclose why 33 of the boilers were not replaced. The Authority is also correct that the OIG recommended that the specified boilers efficiency be increased from 80 to 85 percent in accordance with Recovery Act and other federal requirements. However, the Authority provided no denials or support for the additional costs and we considered the cost immaterial and thus, we did not adjust the report.

**Comment 5 See Comment 1**

Furthermore, during the audit and in the Authority’s response, it provided no credible evidence or contract language showing that the contract required or provided for profits above and beyond the negotiated \$226,273 management fee. Therefore, we maintain that profits paid to the contractor were not provided in the contract, and thus, must repay HUD.

Also based on our interviews with the construction manager, the Authority did not negotiate costs for the change orders we questioned.

**Comment 6** We do not agree change order issues were procedural in nature. The Authority is correct that the change orders for the unnecessary mock-up, a safety observer, and administrative charges for completing work New Britain Avenue did not raise the total cost of the contract. However, their costs were paid from contract funds and reduced the amount of contract funds available to complete the required scope of work included in the contract. This had a real effect when 64 boilers and porches included in the contract were not replaced or completed. We coordinated our evaluation of these change order costs with HUD and it was agreed these change orders were not necessary or valid<sup>33</sup> contract costs.

**Comment 7** The clean-up costs were included in the management fee and thus, charging them as separate line item in on the construction manager's cost accounting did not increase the amount of audited eligible contract costs. Thus, the paragraph was restated to reflect this. However, the other additional costs included in the construction manager’s accounting remain ineligible and require repayment.

**Comment 8** The grantees relied on contractors to provide professional services and expert advice; and the Authority's Architect contract if properly administered would have satisfied HUD's warranty requirements. However, Section 5 of the Authority's Annual Contributions Contract requires that grantees ensure its contractors and subcontractors comply with HUD's requirements. Thus, simply contracting for the work does not release the Authority from its responsibility to ensure compliance. The Authority did not ensure its contractor completed the

required inspections<sup>21</sup> nor ensured the quality of the inspections as evidenced by HUD's subsequent inspection and the photographs in the report. OIG is also concerned that the Authority's proposed corrective actions appears to rely on yet another contractor to verify compliance. Thus, we suggest that HUD ensure that the Authority's corrective actions include monitoring by the Authority itself to ensure its warranty contractors comply with HUD's requirements.

**Comment 9** The Authority generally accepted that employee interviews should be conducted and agreed to make procedural changes. However, we are concerned its new procurees do not appear to include the Authority overseeing its contractor to ensure employee interviews are routinely conducted or to monitor the effects thereof.<sup>22</sup> Thus, we strongly encourage HUD to ensure that the Authority actively oversees its contractor and ensures that interviews are conducted to verify the accuracy and truthfulness of certified payrolls before recommending closing this recommendation.

**Comment 10** The Authority accepted the finding and agreed to make procedural changes.

**Comment 11** The Authority rejected implementing 8 of the report's 10 recommendations. The Authority's response and comments to the findings and recommendations clearly indicates that the Authority misunderstood its responsibilities in the administration of the Recovery Act funds. Based on our audit results and evaluation of the Authority's comments above we strongly encourage HUD to ensure that the Authority fully implements each recommendation, and ensures the Authority improves its internal controls, and becomes a better manager of federal funds

**Comment 12** The conditions identified in this report were not merely procedural in nature. As stated above, the Authority's response and comments to the findings and recommendations clearly indicates that the Authority misunderstood its responsibilities in the administration of the Recovery Act funds. Also, the Authority's use of \$415,692 in Recovery Act grant funds for ineligible, unnecessary, and unreasonable costs had a real negative effect on housing improvements when only 38 of 102 boilers were replaced, and porches and a driveway were not completed that were included in the contract. Therefore, the Authority needs to return the mismanaged and misused funds to HUD and improve its management controls as indicated in the recommendations.

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<sup>21</sup> Indeed, the contractor did not complete the required 9 month and only completed 1 of the 2 additional inspections, at the end of the warranty period, after we identified no inspections were completed.

<sup>22</sup> as required by Section 5 of the Authority's Annual Contributions Contract

## Appendix C

### AUDITED CONTRACT COSTS

<b>Audited Contract Costs</b>			
Per Construction Manager's Cost Certification			
Construction Manager Cost Certification Costs -			
Div. / Trade Items	\$1,970,700		
Reimbursable Costs	77,923		
Building Permit	32,670		
Insurance	<u>31,066</u>		
Costs per Cost Certification (not incl. 9% CM Fee, Profit & Overhead) -		\$2,112,359	
<b>Plus</b> eligible OH&P and charges for Construction Manager employee services earned on change orders		36,228	
<b>Plus</b> The HUD Approved Construction Manager fee		50,000	
<b>Less</b> ineligible general clean-up on Cost Cert		(27,040)	
<b>Less</b> ineligible profit for Mock-up on Cost Cert		(12,912)	
<b>Less</b> Unnecessary Safety Observer costs on Cost Cert (included in Cost Cert Reimbursable Cost total)		(60,180)	
<b>Audited Contract Costs</b>			\$2,098,455
<b>Amount Paid to Construction Manager</b>			<u>2,514,147</u>
<b>Questioned Costs</b>			<b>\$415,692</b>
<b>Itemized Questioned Costs</b>			
<b>Ineligible Costs</b>			
Profit for mock-up	\$12,912		
Additional Ineligible Profits paid to Construction Manager	\$32,334		
Construction Mgr. fees in excess of the \$50 K HUD approved (\$226,273 - \$50,000)	\$176,273		
General clean-up	\$27,040		
		\$248,559	
<b>Unnecessary Costs :</b>			
Safety observer	\$60,180		
Program Manager and office admin. Services for Harrison Ave. mock-up (CO # 41)	\$50,510		
Full time superintendent for the Harrison Ave mock-up (CO # 42)	\$22,400		
		\$133,090	
<b>Unreasonable Costs:</b>			
CM fees for work at New Britain Ave (CO # 46)	\$34,043		
		\$34,043	
<b>Total Questioned Costs</b>			<b>\$415,692</b>

## Appendix D

### WARRANTY DEFICIENCIES

Warranty conditions report	Sidewalks		Porch overhangs	Porches		Plantings	Totals
	Caulking	Handrail issues	Rain spouts	Split/Cracks	Storm drain issues	Alive and thriving?	
HUD	15	21	21	0	1	6	64
Architect	0	4	0	1	1	0	6
<b>Number of deficiencies the architect failed to identify</b>							<b>58</b>

A majority of porches had deficient caulking/sealant at the connections of the slabs to the walls of the houses. As a result, the life span of these improvements will be shortened due to cracking from freeze thaw forces and possible settlement could occur.

Some handrails were already rusting and all were susceptible to rusting at the base because of improper installation. Some rails were unsecured to their base, one loose rail was leaning, and one loose railing protruded into the driveway.

Rain spouts were not connected to drainage systems. Instead of entering the drain and flowing away from the building, water from the rain spouts emptied to the foundations exposing them to water penetration and increasing the chance of settlement.

Several landscaping locations contained dead plants that should be dug up and replaced. Not only do plants play an aesthetic role; they also help prevent erosion and reduce run-off.

Drains at one location were improperly designed and clogged with debris due in part to screens installed during construction that were not removed. One resident told us that when it rained, water came over the porch and under the door. Gravel was also washing out from under the porch eroding its base due to water coming down the sloped front of the building that should have been directed away from the porches.