The State of New York, NY

Community Development Block Grant Disaster Recovery-Funded New York Rising Buyout and Acquisition Program

Office of Audit, Region 2
New York, NY

Audit Report Number: 2019-NY-1002
May 29, 2019

To: Stanley A. Gimont, Deputy Assistant Secretary for Grant Programs, DG

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From: Kimberly S. Dahl, Regional Inspector General for Audit, 2AGA

Subject: The State of New York Did Not Ensure That Appraised Values Used by Its Program Were Supported and Appraisal Costs and Services Complied With Requirements

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of the State of New York's Community Development Block Grant Disaster Recovery-funded New York Rising Buyout and Acquisition program.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG website. Accordingly, this report will be posted at http://www.hudoig.gov.

If you have any questions or comments about this report, please do not hesitate to call me at 212-264-4174.

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The State of New York Did Not Ensure That Appraised Values Used by Its Program Were Supported and Appraisal Costs and Services Complied With Requirements

Highlights

What We Audited and Why

We audited the State of New York's Community Development Block Grant Disaster Recovery-funded New York Rising Buyout and Acquisition program. We initiated this audit based on observations related to the appraised fair market values made during a previous audit (2015-NY-1010) of the State's program. Our objectives were to determine whether the State ensured that (1) the appraised fair market values used to determine award amounts under its program were supported and (2) appraisal costs for its program complied with applicable requirements and were for services performed in accordance with Federal, State, and industry standards.

What We Found

The State did not ensure that (1) appraised fair market values used to determine award amounts under its program were supported and (2) appraisal costs complied with applicable requirements and were for services performed in accordance with applicable Federal, State, and industry standards. The State also did not ensure that it had a clear and enforceable agreement with the City of New York before relying on appraisal services provided by the City's contractor and did not ensure that the appraisal services were properly procured and performed. These issues occurred because the State did not have adequate controls over its program. As a result, the U.S. Department of Housing and Urban Development (HUD) and the State did not have assurance that (1) more than $367.3 million paid to purchase properties was supported; (2) more than $3.4 million disbursed for appraisal services was for costs that were reasonable, necessary, and adequately documented; and (3) appraisal services were properly procured and performed. If the State improves controls over its program, it can ensure that up to $93.4 million not yet disbursed is put to better use.

What We Recommend

We recommend that HUD require the State to (1) provide documentation to support the appraised values of the properties purchased; (2) provide support to show that appraisal costs were reasonable, necessary, supported, and for services that were performed in accordance with requirements; (3) execute an agreement with the City for the use of appraisal services and show that services were properly procured; and (4) strengthen controls to ensure that Disaster Recovery funds used for appraisal services are for costs that are reasonable, necessary, supported, and for services that comply with applicable requirements.

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Background and Objectives

On October 29, 2012, Hurricane Sandy made landfall on the east coast, causing unprecedented damage to New York and other eastern States. Through the Disaster Relief Appropriations Act of 2013,[1] Congress made available $16 billion in Community Development Block Grant Disaster Recovery funds for necessary expenses related to disaster relief, long-term recovery, restoration of infrastructure and housing, and economic revitalization. These funds were to be used in the most impacted and distressed areas affected by Hurricane Sandy and other declared disaster events that occurred during calendar years 2011, 2012, and 2013.

The U.S. Department of Housing and Urban Development (HUD) awarded the State of New York $4.4 billion of the $16 billion in Disaster Recovery funds. The governor of New York established the Governor's Office of Storm Recovery under its Housing Trust Fund Corporation to administer the funds.

The State allocated more than $680 million of the Disaster Recovery funds to its New York Rising Buyout and Acquisition program, which was established to purchase the properties of interested homeowners whose homes were damaged or destroyed by the disasters. The program included two components.

- The buyout component purchased properties located in certain high-risk areas within the 100-year floodplain that were most susceptible to future disasters. Once purchased, the properties were to be transformed into wetlands, open space, or stormwater management systems to create a natural coastal buffer to safeguard against future storms and improve the resiliency of the larger community. The award amounts the State paid for the buyout properties were generally based on the appraised fair market values of the properties before the storm. Until April 2016, the appraised values of these buyout properties were assessed by a contractor of the State's Department of Transportation (agency), with which the Governor's Office of Storm Recovery had a memorandum of understanding[2] for appraisal services. After the memorandum expired, the appraised values of buyout properties were assessed by a subcontractor of the State.

- The acquisition component purchased substantially damaged properties located within the 500-year floodplain, but outside designated buyout areas. Once purchased, these properties were eligible for redevelopment in a resilient manner to protect future occupants of the properties. The award amounts the State paid for the acquisition properties were generally based on the appraised fair market values of the properties after

[1] Public Law 113-2, dated January 29, 2013

[2] Under the memorandum, the agency was responsible for supervising the performance of appraisal services, and the State reimbursed the agency for the appraisal costs. The memorandum included provisions related to substandard performance, the disallowance and repayment of funds, and termination of the agreement.

the storm. The appraised values for the acquisition properties transferred[3] from the City were assessed by the City's contractor. The appraised values for the remaining acquisition properties were assessed by the State agency contractor discussed above.

As of January 2016,[4] the State had disbursed more than $456.2 million under the program, including $367.3 million paid to purchase 956 buyout and acquisition properties. We selected 14 of the 956 properties for review during our audit,[5] with award settlements totaling approximately $5.9 million. The following chart shows the number of properties purchased during our audit period under the different components of the program, the number of properties selected for review, the entity that determined the appraised values for the properties, and the types of reports that were produced to document these values.

Description of properties	Number of properties purchased as of January 2016	Number of properties selected for review	Entity that assessed the appraised fair market values of the properties	Reports produced to document the appraised fair market values
Buyout properties	542	8	State agency contractor	Prestorm appraisals
Acquisition properties transferred from the City	62	1	City contractor	Prestorm and poststorm appraisals
Other acquisition properties	352	5	State agency contractor	Prestorm appraisals and poststorm addenda
Totals	**956**	**14**		

In total, the State contractor had performed appraisal work for 894 of the 956 properties purchased as of January 2016, and the City contractor performed appraisal work for the remaining 62 properties. Of the 14 properties sampled, the State agency's contractor prepared prestorm appraisal reports for 13 properties, as well as poststorm addendum reports for the 5 properties that were part of the acquisition component of the program. The City contractor prepared prestorm and poststorm appraisal reports for the remaining property in our sample. The State used these reports to calculate more than $5.9 million in award settlements for the 14 sampled properties, and similar reports were used to calculate more than $361.4 million in award settlements for the other 942 properties that were not selected for review.

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[3] Under a 2013 agreement with the City, the owners of properties that had originally applied to the City's Build It Back Program could transfer their applications to the State's program. The State relied on the appraisals conducted by the City's contractor to calculate the award amount for each property. As discussed in findings 1 and 2, the State later decided not to move forward with the agreement and considered the agreement null and void. However, it purchased a total of 62 properties that were transferred from the City's program and appraised by the City's contractor.

[4] This information was current at the beginning of the audit when we selected a sample for review. As of July 6, 2018, the State had disbursed nearly $586.9 million. This means that the State used more than $130.6 million to purchase properties and for other costs under the program between January 2016 and July 2018 and that $93.4 million had not been disbursed from the $680 million allocated.

[5] See the Scope and Methodology section for additional information about our sample selection and review.

As of January 2016, the State had disbursed more than $3.3 million for appraisal services performed by the State agency and its contractor under the memorandum of agreement. Further, as of October 2016, the State had disbursed $118,800 for appraisal services performed by a State contractor after the memorandum with the State agency expired. We selected 100 percent of these funds for review.

Our objectives were to determine whether the State ensured that (1) the appraised fair market values used to determine award amounts under its program were supported and (2) appraisal costs for its program complied with applicable requirements and were for services performed in accordance with Federal, State, and industry standards.

Results of Audit

Finding 1: The State Did Not Ensure That Appraised Values of Properties Purchased Were Supported

The State did not ensure that appraised fair market values used to determine award amounts under its program were supported. The appraisals reviewed for the 14 properties sampled contained more than 400 deficiencies, including many that impacted the value determinations. For example, appraisals were based on inaccurate gross living areas,[6] unsupported time adjustments, and excessive and unsupported adjustments to comparable properties. These deficiencies occurred because the State did not have adequate controls over its program. As a result, HUD and the State did not have assurance that the $5.9 million paid to purchase the 14 properties reviewed was supported. Due to the significant and widespread nature of the issues identified below, HUD and the State also did not have assurance that the $361.5 million paid for the other 942 properties that were purchased was supported. If the State improves controls over its program, it can ensure that up to $93.4 million not yet disbursed is put to better use.

Appraised Values Determined by the State's Contractor Were Not Supported

The State did not ensure that the appraised prestorm and poststorm fair market values determined by its contracted appraiser for 13 properties were supported. We reviewed the prestorm appraisal reports prepared for each property, along with the poststorm addendum reports prepared for the five that were acquisition properties, the appraiser's work files, and quality control reviews. The pre-storm appraisal and poststorm addendum reports reviewed contained more than 360 deficiencies, including many that impacted the value determinations. For example, appraisals were based on inaccurate gross living areas, unsupported time adjustments, and excessive and unsupported adjustments to comparable properties. The sections below provide details on some of the most serious deficiencies identified and the causes of these issues.

Appraisals Were Based on Inaccurate Gross Living Areas

The prestorm appraisals for at least three properties were based on inaccurate gross living areas. The gross living areas used by the appraisers were approximately 39, 77, and 269 percent more than the actual gross living area in the three cases. In the most prominent case, the appraiser incorrectly listed the year the subject property was built (1948) as its square footage when the property had only 528 square feet. In the other two cases, the appraiser incorrectly included below-grade basement space in the gross living area. Further, the appraisal for a fourth property contained significant conflicting information regarding the gross living area of the property purchased.

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[6] According to the Federal National Mortgage Association's Selling Guide, paragraph B4-1.3-05, and HUD Handbook 4150.2, section 3-3A, the gross living area is the total area of finished, above-grade residential space. It is calculated by measuring the outside perimeter of the structure, which includes only finished, habitable, and above-grade living space.

Because the gross living areas for the subject properties were overstated, the appraiser selected comparable sales that were significantly larger and made adjustments related to the living area. For example, in the case in which the appraiser improperly cited the year the property was built as its gross living area, they selected a property with 1,450 square feet as comparable and then added $24,900 to account for the property being smaller than 1,948 square feet. As shown in figures 1 and 2, this comparable property was significantly larger than the property purchased.

Figures 1 and 2: Subject property with 528 square feet and comparable property with 1,450 square feet

Appraisals Contained Unsupported Time Adjustments

The appraiser used a regression[7] model to increase the prestorm values of six Staten Island enhanced buyout properties reviewed, but the State and the appraiser were unable to provide adequate support for the model used or its results. According to the State, property values were increasing before Superstorm Sandy hit the area, and the adjustments made to the comparable properties sold before the storm were meant to account for that inflation. For example, one comparable property that was sold 5 days before the storm made landfall received a $9,000 time adjustment to its sales price, and another comparable property that was sold approximately 4 months before the storm received a $40,400 time adjustment. However, neither the State nor the appraiser provided adequate support for the model used or the results.

Our review[8] of the data and variables provided by the State could not support its claim regarding prestorm inflation. Similarly, documentation from the appraiser did not show the passage of time to be a relevant predictor of price. The appraisal for a Staten Island vacant property, which was also part of the sample, stated that the market was flat during the period in question, and a

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[7] Regression analysis is a statistical technique used to analyze data and predict the value of one variable based on one or more other variables. In this case, the regression model was used to assign values for prestorm inflation.

[8] An Office of Inspector General (OIG) statistician ran several models using the data and variables provided for that purpose by the State. The models were consistently resistant to using inflation as a predictor of price and did not score the passage of time as being significant when forced to include it as a factor. In contrast, the strongest indicator of a time effect was a weak tendency toward deflation in one of the three periods used by the State's appraiser. Similarly, computer output from the appraiser's statistical consultant did not show the passage of time to be a relevant predictor of price. Therefore, we concluded that adding an inflation factor based on the modeling data that the State provided was not statistically credible.

third-party review performed on a different appraisal completed after the owner appealed the value stated that the time adjustment analysis was inappropriate.

In total, the six appraisals contained time adjustments to 34 comparable properties, which averaged more than $20,400 each. This is significant because the appraiser used this methodology on appraisals for 422 of the 956 properties[9] that were purchased during our audit period.

Appraisals Contained Excessive Adjustments Without Justification

The appraisals contained a number of excessive adjustments to the comparable properties without providing justifications or support. According to paragraph B4-1.4-17 of the Federal National Mortgage Association's Selling Guide and HUD Handbook 4150.2, paragraph 4-6(B),[10] adjustments to comparable properties should not exceed 10 percent of their sales price for individual line items, 25 percent for gross adjustments, and 15 percent for net adjustments without additional supporting documentation in the appraisal report or appraiser's work file. The gross adjustment is the total adjustment to each comparable sales price calculated in absolute terms. Similarly, the net adjustment is the difference between the total positive and negative adjustments made to a comparable sales price. The appraisals reviewed for the 12 single-family[11] properties had comparable properties with adjustments that exceeded one or more of these benchmarks without providing justification. Specifically,

- 12 of the 12 appraisals contained gross adjustments that exceeded 25 percent of the comparable property's sales price. The 12 appraisals contained 67 comparable properties. In total, 47 of the 67 properties had gross adjustments exceeding 25 percent of the sales price. Of the 47 properties, 15 had gross adjustments that were more than double the benchmark, and 7 had gross adjustments that exceeded 100 percent of the comparable property's sales price.
- 11 of the 12 appraisals contained net adjustments that exceeded 15 percent of the comparable property's sales price. In total, the 11 appraisals contained 36 comparable properties that had net adjustments exceeding 15 percent of the sales price. Of the 36 properties, 18 had net adjustments that were more than double the benchmark, and 4 had net adjustments that exceeded 100 percent of the comparable property's sales price.
- 10 of the 12 appraisals contained individual line item adjustments that exceeded 10 percent of a comparable property's sales price. Specifically, the 10 appraisals contained 65 adjustments[12] made to 38 comparable properties that exceeded 10 percent of the comparable property's sales price.

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[9] The State contractor prepared appraisals for 542 buyout properties, including 422 located in Staten Island.

[10] While the memorandum and contract did not specifically require the appraiser to follow these benchmarks related to individual, gross, and net adjustments, the contract required the appraiser to use industry standards. The criteria cited were standard guidance used for single-family appraisals completed at that time.

[11] The 12 single-family properties included those noted as having the gross living area issues noted above. The remaining property was vacant land, so we did not measure it against these criteria.

[12] One of the excessive adjustments was also included in the time adjustments section above. The remaining 64 adjustments that exceeded 10 percent were not related to the time adjustments.

Appendix C contains more details on the comparable properties and adjustments made on each appraisal reviewed.

This frequency and the amount of these adjustments could indicate that the comparable sales were not truly representative of the subject properties. In total, the 12 appraisals in question contained more than $9.5 million in adjustments to the 67 comparable properties. Because there was no evidence or justification in the appraisal reports or the appraiser's work files to support these adjustments, the appraised fair market values determined were not considered supported.

Appraisals Contained Other Unsupported Adjustments

In addition to the adjustments discussed above, many of the appraisals contained other adjustments to comparable properties that were not supported.

For example, in one case, the appraiser made a $30,000 adjustment[13] to the final appraised fair market value of a property after the homeowner made an appeal to the State, claiming that the home was worth more than the initial appraisal. Specifically, the homeowner stated that the dwelling was custom built with brass door knobs and outlet plates, wood and paneled interior doors, and Casablanca fans. However, there was no documentation in the appeal or the appraiser's work file to support the owner's claims or explain how these items increased the value of the property.

In another case, the appraiser improperly made $12,500 and $15,000 adjustments to each comparable property because of a perceived difference in the type of basement each property had. The appraiser stated that the subject property had a full unfinished basement and the comparable properties each had slab foundations or crawl spaces, which were not as valuable. However, pictures of the property contained in the appraisal and available online showed that the perimeter walls of the basement had flood vents to allow pressure from high water or storm surges to equalize and pass through the foundation (figures 3 and 4). These pictures showed a washout floor and not a full unfinished basement with the potential to be finished.

Figures 3 and 4: Subject property exterior and interior pictures showing wash-out floor flood vents (see red arrows)

[13] The appraiser accomplished this by changing the listed condition of the subject property from "good" to "good+" and then making positive dollar value adjustments to the comparable properties.

Poststorm Addenda Were Not Supported and Did Not Comply With Requirements

The poststorm addenda for five acquisition properties performed by the State's contractor were not supported and did not comply with applicable requirements. The memorandum and contract required separate appraisal reports to estimate the prestorm value and the current "as is" value. Further, Uniform Standards of Professional Appraisal Practice (USPAP) Advisory Opinion 3 states that when a client seeks a more current value or analysis of a property that was the subject of a prior assignment, this value is not an extension of that prior assignment that was already completed. It is part of a new assignment. However, the appraiser provided only prestorm appraisals with poststorm addenda at the end. The format used for the addenda started at the appraised prestorm fair market value and then made negative adjustments for market conditions and the estimated cost to cure, and positive adjustments for poststorm improvements previously made by the homeowner. The five addendum reports reviewed contained market adjustments ranging from $42,000 to $106,500 and cost to cure adjustments ranging from $30,000 to $100,000. However, the addenda and appraiser work files did not contain support to show how the market and cost to cure adjustments were determined. Further, as discussed above, the prestorm appraisals for these properties contained significant deficiencies and should not have been relied upon as a starting point to determine the poststorm "as is" value. Because the addendum reports did not comply with professional appraisal standards and follow recognized methods and techniques, were based on unsupported prestorm values, and lacked support for adjustments made, the appraised poststorm fair market values determined were not supported. This fact is significant because the appraiser used this methodology to determine appraised poststorm values for 352 of the 956 properties purchased during our audit period.

The State Did Not Have Adequate Controls

These issues occurred because the State did not have adequate controls to ensure that the appraisal work performed complied with the memorandum, contract, USPAP, and other applicable requirements.

The memorandum stated that the State agency was responsible for supervising the performance of the contracted appraiser's activities. For example, it required the agency to perform quality control reviews of each appraisal, summarize its monitoring in written reports, and support its monitoring reports with documented evidence of followup actions taken. However, the State did not have a review process to ensure that the work performed by its agency and contractor was of sufficient quality and complied with the memorandum. Our review identified several issues with the quality control reviews and monitoring. For example, quality control reports for 13 properties reviewed (1) provided only summary-level information, (2) did not identify any deficiencies despite the many deficiencies identified by our appraiser, and (3) did not include a review of the poststorm addendum reports discussed above. Although State officials provided timesheets and appraisal review reports to support the quality control costs, they could not provide detailed work review files to ensure that the quality control appraisal reviews were adequate and documented in accordance with industry standards. Further, the State was unable to provide details of the reviewer's qualifications, and at least six of the quality control reviews were performed by someone who was not a certified or licensed appraiser. These issues showed that the State did not have adequate controls over the quality control review process to ensure compliance with appraisal requirements.

Further, the State did not ensure that problems identified were addressed. In the case in which the subject property's gross living area was improperly listed as the year it was built (528 versus 1948), the appraisal company identified the error after the State had purchased the property and was preparing to auction it. However, the State did not take action to ensure that the appraised value was supported or to repay any amount that was not supported. In another case, a third-party review performed on one appraisal after the owner appealed the appraised value stated that the time adjustment analysis was inappropriate. However, the State did not take action to show that (1) the regression model used to make the time adjustments was supported and (2) multiple valuation models had been developed, carefully refined, and rigorously tested by certified appraisers as required by the memorandum and contract. While the memorandum and contract included provisions related to substandard performance, the disallowance and repayment of funds, and termination of the agreement, the State did not show that it took action to enforce these provisions when problems were identified or were not addressed by the agency or contractor.

As a result of the issues identified, HUD and the State did not have assurance that more than $5.4 million in Disaster Recovery funds used to purchase these 13 properties was supported.

Appraised Values Determined by the City's Contractor Were Not Supported

The State did not ensure that the appraised prestorm and poststorm fair market values determined by the City of New York's contracted appraiser were supported. We reviewed the prestorm and poststorm appraisal reports prepared for the sampled property, along with the City's quality control review. These reports contained more than 34 deficiencies, including many that impacted the value determinations. For example, the appraiser did not adequately verify the comparable sales and that market values were stable and unchanged. The appraiser also did not provide support for $20,000 adjustments made to three comparable properties for the condition of the homes, and the number of bathrooms it cited for two comparable properties did not match the multiple listing service data.

These issues occurred because the State did not have adequate controls to ensure that the appraisal work performed by the City and its contractor was of sufficient quality and complied with applicable requirements. While the State had a 2013 signed agreement with the City that provided the framework for how the transferred applications would be handled and stated that the City was responsible for obtaining prestorm and poststorm appraisals for properties transferred, the agreement did not (1) provide details on how the appraisals or related quality control reviews would be performed or (2) contain provisions outlining the rights of either party to enforce the terms of the agreement. Further, according to State officials, the State and City verbally agreed in mid-2015 that the State would not proceed with the agreement, although the State would continue to accept transfer properties through October 2015. The State indicated that regardless of whether the agreement was null and void, it did not have the right to monitor the work performed or request procurement documentation because the agreement was only a "written handshake" and the City was not a vendor or subrecipient. However, the amount the State paid to purchase each property transferred from the City's program was based on the appraised fair market values, and the State needed to ensure that the amount paid was reasonable.

As a result, HUD and the State did not have assurance that the $495,000 in Disaster Recovery funds used to purchase the sampled property was supported.

Conclusion

The State did not ensure that the appraised values determined were supported. The appraisal and addendum reports reviewed for the 14 properties sampled contained more than 400 deficiencies. While some of the deficiencies were regulatory in nature, many would have impacted the value determinations of the appraisers and would have lowered the amount the State paid to purchase the properties. As a result, HUD and the State did not have assurance that the $5.9 million paid to purchase the 14 properties was supported. These issues occurred because the State did not have adequate controls to ensure that (1) the appraisal and quality control work performed complied with the applicable requirements and (2) problems identified were addressed and requirements were enforced when necessary.

Due to the significant and widespread nature of the issues identified, the $361.4 million paid for the other 942 properties that were purchased was also considered unsupported, as were the amounts paid for any other properties purchased after our audit period that relied on the work performed by the agency, City, and contractors discussed in this finding. For example, two of the issues identified affected a total of 774 of the 956 properties purchased during our audit period. Specifically, the unsupported time adjustments affected 422 of the 956 properties purchased during our audit period, and the issues with the poststorm addendums affected 352 of the 956 properties. Further, the internal control issues discussed in this finding affected all 956 properties because the State did not have adequate processes to review work performed by others. If the State strengthens its controls over the property valuation process, it could ensure that the remaining $93.4 million in Disaster Recovery funds not yet disbursed is put to better use.

Recommendations

We recommend that HUD's Deputy Assistant Secretary for Grant Programs require the State to

1A. Provide documentation to support the appraised fair market values of the 14 properties sampled to ensure that $5,920,097 in settlement costs was supported. This recommendation includes but is not limited to providing support to show that appraisals contained accurate and verified information for the subject and comparable properties, time adjustments were supported, and other adjustments were supported. If support cannot be provided, the State should reimburse the unsupported costs from non-Federal funds.

1B. Provide documentation to support the appraised fair market values of the 942 other properties included in our sampling universe to ensure that $361,465,173 in settlement costs was supported. This recommendation includes but is not limited to providing support to show that appraisals contained accurate and verified information for the subject and comparable properties, time adjustments were supported, and other adjustments were supported. If support cannot be provided, the State should reimburse the unsupported costs from non-Federal funds.

1C. Provide documentation to support the appraised fair market values of any other properties purchased under the program since January 2016 that relied upon appraisals conducted by the contractors discussed in this report to ensure that settlement costs[14] for those properties were supported. If support cannot be provided, the State should reimburse the unsupported costs from non-Federal funds.

1D. Strengthen controls over the property valuation process for its program to ensure that up to $93,350,616 not yet disbursed[15] is put to better use. This recommendation includes but is not limited to implementing a process to review the appraisal and quality control work to ensure that appraised fair market values are supported and that quality control reviews are performed as required by Federal, State, and industry standards and to take appropriate action for cases in which the work does not comply with requirements.

[14] See the Scope and Methodology section for details on the amount disbursed since January 2016.
[15] The $93.4 million had not yet been disbursed under the program as of July 6, 2018.

Finding 2: The State Did Not Ensure That Appraisal Costs and Services Complied With Requirements

The State did not ensure that appraisal costs complied with applicable requirements and were for services performed in accordance with applicable Federal, State, and industry standards. The State also did not ensure that it had a clear and enforceable agreement with the City before relying on appraisal services provided by its contractor and that appraisal services were properly procured and performed. These issues occurred because the State did not have adequate controls over its program. As a result, HUD and the State did not have assurance that more than $3.4 million disbursed for appraisal services was for costs that were reasonable, necessary, and adequately documented. Further, they did not have assurance that the appraisal services were properly procured and performed or that appraised values used to calculate program awards were supported.

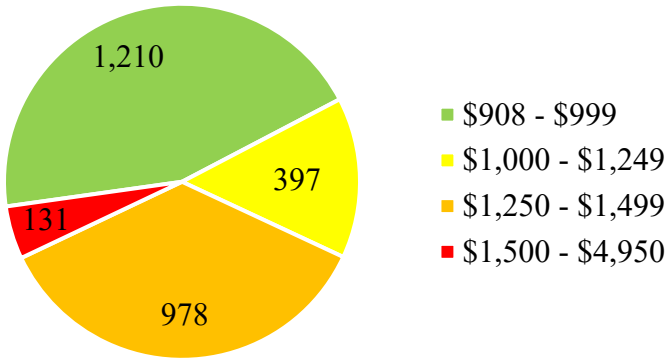
State Contractor Costs Did Not Comply With Federal Cost Principle Requirements

The State did not ensure that nearly $3.3 million paid for appraisal services performed by its contractor complied with Federal cost principle requirements at 2 CFR (Code of Federal Regulations) Part 225, appendix A, paragraph C(2), and with the contract. As described in the sections below, costs were not reasonable and necessary, and invoices were not always supported and properly approved.

Appraisal and Appraisal Addendum Prices Were Not Reasonable

The State paid more than $3.1 million for more than 2,716[16] prestorm appraisals and poststorm appraisal addenda performed by its appraiser without ensuring that the prices paid were reasonable. According to contractor invoices, the contractor charged from $990 to $4,950 for each appraisal and $908 for each appraisal addendum. The chart below shows how many of the 2,716 appraisals and addenda were charged at each price.[17]

Appraisals and addenda sorted by price



[16] One invoice did not list the number of appraisals, so it is not included in the 2,716 number cited.

[17] For invoices that showed only the total price and number of appraisals or addenda, we calculated the average.

While the State explained that these appraisals were more complex than standard appraisals and may have warranted higher prices, it could not provide support showing how the appraisals were more complex, how it justified the wide variations, or how the prices charged were determined.[18] In some cases, the contract appraisals did not list a per appraisal price, while in others, it listed a flat rate for certain appraisals or stated an hourly rate and number of hours per appraisal. In contrast to the $908 to $4,950 rate the State paid for each appraisal or addenda, an additional contract the State had with a firm for Disaster Recovery work listed a price of $500 per appraisal, and the City-contracted appraisals[19] that the State used for this program cost no more than $450 per appraisal. Further, local appraisers contacted in Staten Island and Long Island stated that the prices for single-family residential properties ranged from $350 to $450.

Other Appraiser Costs Were Not Reasonable and Necessary

The State paid $156,940 for additional contractor services and consultant fees without showing that the costs were reasonable and necessary. The following paragraphs provide more details on why the sales brochures, economic land analysis studies, and consultant fees may not have been reasonable and necessary.

- Sales brochures - The $98,650 the State paid for sales brochures may not have been reasonable and necessary because (1) sales brochures are typically used for eminent domain projects, such as highway projects, and are not generally used for single-family residential property appraisals; (2) the appraisals reviewed included excessive adjustments to comparable properties taken from the sales brochures, which showed that the sales brochure properties may not have been comparable to the subject properties; and (3) the appraisals reviewed sometimes relied on comparable properties not included on the sales brochures, which showed that the sales brochures did not contain the most relevant properties. Further, the State could not show that using the sales brochures resulted in a benefit, such as reducing the time or cost of the individual appraisals performed.
- Economic land analysis studies - The $50,700 the State paid for economic land analysis studies may not have been reasonable and necessary because (1) they were typically used for multifamily and commercial projects and were not generally used for single-family residential appraisals, (2) the appraisals reviewed did not show how the land studies were used, and (3) the State could not show how the studies were necessary to complete the agreed-upon appraisals.
- Consultant fees - The $7,590 the State paid for consultant fees may not have been reasonable and necessary because the State could not show what services were

[18] The contract amendments executed by the State agency and its contractor to cover the appraisals for this program did not include support for how the prices were determined and did not always detail a per-appraisal price. When they did detail per-appraisal prices, the average budgeted prices varied from $990 to $1,272 per appraisal.

[19] As discussed later in this finding, the State used appraisals provided by the City for certain properties located in Staten Island.

provided for the fees and how those services were necessary to complete the agreed-upon appraisals.

Invoices Did Not Always Contain Adequate Support

The State did not maintain property listings and support for contractor consultant fees for 14 of the 136 contractor invoices that it reimbursed. The property listings are an important control measure because they can be used to ensure that Disaster Recovery funds were used only for appraisals performed, the contractor billed for each appraisal only once, and the appraisals were conducted on properties within the scope of the contract. For example, according to the property listing provided for one invoice, the contractor billed for appraisals on at least two properties that were located in upstate New York, which appeared to be outside the scope of the contract.

Further, if the charges for appraisals and addenda were intended to be based on an hourly rate and actual hours, the supporting documentation should have detailed the hours spent on each appraisal and the State would have needed to obtain timekeeping or similar records in order to comply with Federal cost principle requirements.

Invoices Were Not Properly Approved

The State did not ensure that contractor invoices were properly approved. The contract authorized a specific employee to approve the invoices. However, the designated employee did not approve the 136 invoices. While the State had vouchers related to 89 of the 136 invoices, the approval section of the vouchers was not completed, and the only signatures were from a different employee, who inserted a handwritten note saying that the invoices were "ok to pay." The State could not show that this employee was authorized to approve the invoices for payment. Further, the approvals violated State requirements for segregation of duties because the employee was also responsible for performing quality control of the contractor's work.

These issues occurred because the State did not have adequate controls to ensure that the memorandum, contract, and invoices were adequately reviewed to ensure that the services were necessary and that the prices paid were consistent with sound business practices and market prices before using Disaster Recovery funds for these costs.

As a result, HUD and the State did not have assurance that nearly $3.3 million paid for appraisal services performed by its contractor was for costs that were reasonable, necessary, and adequately documented.

Work Performed by the State and Its Contractor Was Not Performed Properly

The State did not ensure that the work performed by its contractor and the quality control reviews performed by its agency complied with Federal, State, and industry standards. As described in the sections below, there were significant issues with the prestorm appraisals, poststorm addenda, sales brochures, and quality control reviews.

Prestorm Appraisals Did Not Comply With Requirements

As discussed in finding 1, the contractor did not perform prestorm appraisal work in accordance with the contract, professional appraisal standards, and other requirements. Our review of 13 prestorm appraisal reports from the contractor identified several issues, such as unsupported time value adjustments made with a regression model, other excessive adjustments, and unsupported information that affected the appraised value. For example, for the time value adjustments, the State could not show that (1) the regression model used to make the adjustments was supported; (2) the contractor had properly procured the subcontractor that performed the regression analysis as required by the contract; and (3) multiple valuation models had been developed, carefully refined, and rigorously tested by certified appraisers as required by the memorandum and contract.

Poststorm Addenda Did Not Comply With Requirements

As discussed in finding 1, the contractor did not perform full poststorm appraisals for 352 acquisition properties located in Long Island, NY. The memorandum and contract required separate appraisal reports to estimate the prestorm value and the current "as is" value. However, the appraiser provided only prestorm appraisals with poststorm addenda at the end. The addenda provided adjustments to the appraised prestorm fair market value, such as a market condition adjustment and an adjustment for the estimated cost to cure damage caused by the storm, but did not include support for the adjustments and did not comply with professional appraisal standards.

Sales Brochures Were Not Prepared in Accordance With Requirements

Although we questioned the necessity of the sales brochures, our review of them also showed that they did not comply with contract requirements because the contractor did not (1) verify sales and related sales prices with knowledgeable parties; (2) allocate site and improvement values; (3) provide a map of the comparable properties; and (4) always document the highest and best use of comparable properties, accurate flood zone information, sales conditions, and dates and terms of financing. As a result, the brochures were not fully credible and should not have been relied upon by the State or its appraisers.

Quality Control Reviews Were Not Adequately Performed

As discussed in finding 1, the State did not ensure that quality control work was adequately performed. The memorandum stated that the State agency was responsible for supervising the performance of the contracted appraiser's activities. Although State officials provided timesheets and appraisal review reports to support the $75,006 paid for quality control work performed, it could not provide detailed work review files to ensure that the quality control appraisal reviews were adequate and documented in accordance with industry standards. This is important because the State relied on these reviews to ensure that the appraised values used to calculate program awards were supported.

These issues occurred because the State did not have adequate controls to ensure that the work performed complied with the memorandum, contract, USPAP, and other applicable requirements.

As a result, HUD and the State did not have assurance that the State used Disaster Recovery funds only for work that was performed in accordance with requirements. Further, as discussed in finding 1, HUD and the State did not have assurance that the $5.9 million paid to purchase the 14 properties was supported.

Subcontractors May Not Have Been Procured Properly and Subcontractor Costs Did Not Comply With Requirements

The State did not ensure that a contractor followed applicable procurement requirements when subcontracting with two appraisal firms previously used by the State agency. It then paid more than $118,000 for appraisal services without ensuring that the costs complied with the contract and Federal cost principle requirements at 2 CFR Part 225, appendix A, paragraph C(2). As described in the sections below, (1) services may not have been procured properly, (2) appraisal prices were not reasonable, and (3) invoices did not always contain adequate support and were not properly approved.

Services May Not Have Been Procured Properly

Before the memorandum of understanding expired with its agency in April 2016, the State recommended that one of its other contractors subcontract with two of the appraisal firms used under the memorandum. Two weeks before the memorandum of understanding expired, the contractor executed subcontracts with the two firms. The State noted that the contractor selected the two appraisal firms based on a prior competitive procurement performed by the State agency[20] and that the contractor performed independent cost comparisons before executing the subcontracts. However, it could not provide copies of the analyses performed or documentation showing that its contractor had otherwise procured the subcontracts in accordance with applicable Federal, State, and contract requirements.

Appraisal Prices Were Not Reasonable

The State later reimbursed its contractor $118,800 for 75 appraisals and poststorm addenda prepared by the subcontractors without ensuring that the prices paid were reasonable. While the underlying contract stated that appraisals would cost $500, the subcontractors continued to charge excessive prices similar to those charged when they worked under the agency, with per-appraisal prices ranging from $750 to $3,960. The State could not provide support showing how the subcontractor prices were determined or justifying the wide variations.

Invoices Did Not Always Contain Adequate Support and Were Not Properly Approved

The State did not maintain a property listing for one of the four subcontractor invoices for which it reimbursed its contractor, and it did not maintain documentation showing that the contractor had approved and paid the four subcontractor invoices as required by the subcontracts.

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[20] As discussed in the Followup on Prior Audits section, we previously recommended that HUD require the State to provide documentation showing that the selection of the appraiser in Staten Island (the agency's appraiser) was consistent with State requirements.

These issues occurred because the State did not have adequate controls to ensure that invoices were adequately reviewed, appraisal costs were reasonable, and appraisal services were properly procured before reimbursing its contractor.

As a result, HUD and the State did not have assurance that the State reimbursed its contractor only for work that was performed in accordance with requirements and that the appraised values used to calculate program awards were supported. Further HUD and the State did not have assurance that the services were properly procured and that the $118,800 reimbursed to its contractor was for costs that were reasonable and adequately documented.

The City Contractor May Not Have Been Procured Properly and Work Was Not Performed Properly

The State used appraisal services provided through the City of New York without ensuring that there was a clear and enforceable agreement with the City and that the appraisal services were properly procured and performed in accordance with applicable requirements.

Under a signed 2013 agreement with the City, the owners of Staten Island properties that had originally applied to the City's Build It Back Program could transfer[21] their applications to the State's New York Rising Buyout and Acquisition program. The State then relied on the appraisals conducted by the City's contractor to calculate the award amount for each of the 62 properties transferred. However, as discussed in finding 1, the agreement did not (1) provide details on how the appraisals or related quality control reviews would be performed or (2) contain provisions outlining the rights of either party to enforce the terms of the agreement. Further, while the State indicated that the City verbally agreed in mid-2015 that the State would not proceed with the agreement, the State continued to accept transfer properties through October 2015. These transfers occurred despite the State asserting that the agreement was null and void for all intents and purposes and that it did not have the right to monitor the work performed or request procurement documentation because the agreement was only a "written handshake" and the City was not a vendor or subrecipient.

Based on the documentation reviewed, the appraisal services provided by the City's contractor may not have been properly procured and performed in accordance with requirements. For example, the contract reviewed did not contain Federal provisions discussing record retention requirements, the remedies for violating the contract terms, and how terminations for cause and convenience would be handled. Further, as discussed in finding 1, the prestorm and poststorm appraisal reports reviewed that were prepared by the City's contractor contained more than 34 deficiencies, including many that impacted the value determinations.

These issues occurred because the State did not have adequate controls to ensure that (1) it had a clear and enforceable agreement with the City, (2) appraisal services were properly procured, and (3) the appraisal work performed complied with applicable requirements. Even if the State

[21] By transferring to the State's program, the owners were requesting that their properties be purchased by the State rather than rehabilitated through the City's program.

believed that it did not have authority to monitor the work performed by the City and its contractor, the amount it paid to purchase each property transferred from the City was based on the appraised fair market values, and the State needed to ensure that the amount paid was reasonable. As a result, HUD and the State did not have assurance that the services were properly procured, work was performed in accordance with requirements, and appraised values used to calculate program awards were supported.

Conclusion

The State did not have adequate controls to ensure that (1) Disaster Recovery funds used for appraisal services complied with Federal cost principle requirements and were for services procured and performed in accordance with applicable Federal, State, and industry standards and (2) it had a clear and enforceable agreement with the City and appraisal services provided by the City's contractor were properly procured and performed in accordance with applicable requirements. As a result, HUD and the State did not have assurance that more than $3.4 million paid was for costs that were reasonable, necessary, and adequately documented. Further, they did not have assurance that appraisal services were properly procured and performed and that the appraised values used to calculate program awards were supported. If the State improves controls, it can ensure that the remaining Disaster Recovery funds are used only for costs that are reasonable, necessary, supported, and for services that were properly performed.

Recommendations

We recommend that HUD's Deputy Assistant Secretary for Grant Programs require the State to

2A. Provide documentation to show that $3,119,209 paid for appraisals and poststorm addenda performed by its contractor was reasonable, supported, and for services that were performed in accordance with applicable requirements or reimburse any unsupported costs from non-Federal funds.

2B. Provide documentation to show that $156,940 paid for sales brochures, economic land analysis studies, and consultant fees was reasonable, necessary, supported, and for services that were performed in accordance with applicable requirements or reimburse any unsupported costs from non-Federal funds.

2C. Provide documentation to show that $75,006 used for appraisal quality control reviews was for services that complied with applicable requirements or reimburse any unsupported costs from non-Federal funds.

2D. Provide documentation to show that $118,800 paid to the State's contractor for appraisals performed by its subcontractors was reasonable, supported, and for services that were performed in accordance with applicable requirements or reimburse any unsupported costs from non-Federal funds.

2E. Execute an agreement with the City for the use of appraisal services and obtain documentation to show that services were procured in accordance with applicable requirements and that contracts contained all required provisions. If the State

cannot provide the executed agreement and documentation, HUD should use one or more of the remedies[22] for noncompliance in 24 CFR 570.495.

2F. Strengthen controls to ensure that future Disaster Recovery funds used for appraisal services and quality control reviews under the program are for costs that are reasonable, necessary, supported, and for services that comply with applicable requirements.

[22] Because the State had not reimbursed the City for the appraisal services, we did not recommend repayment at this time. However, it used Disaster Recovery funds to purchase the properties based on appraisals performed by the City's contractor. If the State cannot provide the documentation requested, HUD should consider the remedies available to prevent a continuation of and mitigate the effects of the deficiency.

Scope and Methodology

We conducted our audit from February 2016 through July 2018 at the State's office located at 25 Beaver Street, New York, NY, and our offices located in New York, NY, and Newark, NJ. The audit covered the period October 1, 2013, through January 31, 2016, and was extended as necessary. Specifically, it was expanded to October 2016 to (1) obtain background information on the agreements, contracts, and services used to assess the appraised values of properties purchased under the program; (2) obtain information on local property sales; and (3) account for the appraisal services used to determine the appraised values of these properties.

To accomplish our objectives, we reviewed

- relevant background information;
- applicable laws; regulations; HUD notices and guidance; and the State's policies and procedures related to accounting, procurement, and the program;
- the State's HUD-approved action plan and amendments;
- funding agreements between HUD and the State;
- HUD monitoring reports and the State's quarterly Disaster Recovery performance reports;
- data and reports from HUD's Disaster Recovery Grant Reporting system;[23]
- data, reports, and documents from the State's accounting system and NY Rising IntelliGrants system;[24]
- data subpoenaed from the Staten Island and Long Island Multiple Listing Service for local property sales completed between October 1, 2010, and January 31, 2016;
- program, appraisal, and quality control files provided by the State and subpoenaed from the appraisers for the properties selected for review;
- appraiser work files subpoenaed from the State's appraisers for the properties selected for review; and
- accounting and procurement records provided by the State for the appraisal costs and services selected for review.

We interviewed key State and HUD employees located in New York, NY, and Washington, DC. We also interviewed appraisers located in Staten Island, NY, and Long Island, NY, to obtain an understanding of the market before and after Superstorm Sandy.

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[23] The Disaster Recovery Grant Reporting system was developed by HUD's Office of Community Planning and Development for the Disaster Recovery program and other special appropriations to allow grantees to access grant funds and report performance accomplishments.

[24] The NY Rising IntelliGrants system was used by the State to manage its program and contains key program documentation, such as applications, source documentation establishing eligibility, and appraisals.

Between October 2013 and January 2016, the State disbursed more than $456.2 million under the program, including $367.3 million to purchase 956 buyout and acquisition properties. To prepare for the possibility of a statistical sample, we removed[25] the nine properties with the highest estimated prestorm values and the two properties that had no prestorm value listed. After removing the 11 outliers, we examined data for the remaining 945 properties and established a series of sample sizes based on conditions. For events occurring more often than 20 percent of the time, we determined that a sample size of 60 properties was sufficient. We then selected a random, representative sample of 14 of the 60 properties to begin our review. The 14 properties had award settlements totaling approximately $5.9 million and each was systematically selected to ensure a distribution across the range of settlement amounts and program components. The sample designs, strata, and sample counts were validated with replicated sampling using traditional means, standard errors, and confidence intervals.

To determine whether the appraised fair market values used to determine award amounts for the 14 properties selected were reasonable and supported, we reviewed the appraisal and addendum reports for each property, along with the appraiser's work files and quality control reviews. We also performed site visits to the 14 properties and to 76 comparable properties cited in the appraisals reviewed.

The issues identified during our review of the 14 properties were pervasive and systemic rather than intermittent events. In such situations, statistical projections are neither helpful nor needed. Therefore, we did not review the remaining 46 properties. Although this approach did not allow us to make a projection to the universe from which our sample was selected, it was sufficient to meet our objectives. As discussed in the finding, due to the significant and widespread nature of the issues identified, the $361.4 million paid for the remaining 942 properties that were not selected for review out of the 956 properties purchased was also considered unsupported.

As of January 2016, the State had disbursed more than $3.3 million for appraisal services, including appraisals, quality control reviews, sales brochures, economic land analysis studies, and consultants. Further, as of October 2016, the State had disbursed $118,800 for appraisal services performed by a State contractor after the memorandum with the State agency expired. We reviewed supporting documentation for 100 percent of these funds to assess compliance with applicable requirements.

As of July 2018, the State had disbursed nearly $586.9 million. This means that the State used more than $130.6 million between January 2016 and July 2018 to purchase properties and for other costs under the program, such as the costs for demolition and remediation, auctions,

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[25] In accordance with professional practice, we analyzed the data for the 956 properties purchased during our audit period and removed outliers from the sampling universe to avoid random, high-dollar finding amounts that might reduce the precision of our findings. In this case, we removed any records that had a listed home value which either exceeded $875,000 or had no market value listed at all. We established the $875,000 threshold using replicated sampling with various sample designs to determine the cutoff point needed to protect a reliable sampling distribution.

construction management, and program management. Further, it means that $93.4 million had not yet been disbursed from the $680 million allocated.

To achieve our objectives, we relied in part on computer-processed data from HUD and the State. We used the data to obtain background information and to select a sample of properties for review. Although we did not perform a detailed assessment of the reliability of the data, we performed minimal testing and found the data to be sufficiently accurate for our purposes. Specifically, we compared data on the properties against source documentation contained in the State's files.

We also relied in part on computer-processed data received from the State and its contractor to support appraisals. Although we did not perform a detailed assessment of the reliability of the data, we found it to be sufficient for our purposes of reviewing the time adjustments made to comparable properties on the prestorm appraisals of six enhanced buyout properties reviewed. As discussed in finding 1, an OIG statistician ran several models using the data and variables provided for that purpose by the State. We concluded that the time adjustments made by its contractor using the data were not supported.

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:

- Program operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Safeguarding resources – Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.
- Validity and reliability of data – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- The State did not have adequate controls over the property valuation process used to determine award amounts under its program and to ensure that it used Disaster Recovery funds only for costs that were reasonable, necessary, supported, and for services performed in accordance with applicable requirements (findings 1 and 2).

Followup on Prior Audits

New York State Did Not Always Administer Its Rising Home Enhanced Buyout Program in Accordance With Federal and State Regulations, Audit Report 2015-NY-1010, Issued September 17, 2015

The following recommendation relevant to our objectives was still open at the time of this report:

3E. Provide documentation that the selection of the appraiser in Staten Island was consistent with the other State agency's contract provisions. If such documentation cannot be provided, the $1,093,290 budgeted should be deobligated, thus ensuring that the funds will be put to better use.

The appraiser discussed in this recommendation is the State contractor that determined the appraised values of 13 of the 14 properties reviewed during this audit. While the prior report identified concerns related to the procurement of this contractor, this report focuses on the appraised fair market value determinations made by this and other contractors as well as the appraisal costs paid by the State. On March 1, 2016, we agreed with HUD's proposed management decision for this recommendation. HUD agreed to review documentation related to the selection of the appraiser and take action if the selection was not consistent with the State's procurement policies and procedures. The final action target date for completing the corrective actions was February 16, 2017. As of the date of this report, HUD had not completed the actions described in the agreed-upon management decision.

The State of New York Did Not Ensure That Properties Purchased Under the Acquisition Component of Its Program Were Eligible, Audit Report 2019-NY-1001, Issued March 29, 2019

The following recommendations relevant to our objectives were still open at the time of this report:

1A. Reimburse from non-Federal funds the $2,595,127 paid to purchase six properties that were not substantially damaged. Further, the State should identify and reimburse from non-Federal funds any additional Disaster Recovery funds used to acquire and dispose of the properties.

1B. Reimburse from non-Federal funds the $783,571 paid to purchase two properties that did not comply with flood hazard requirements and for which the State did not have sufficient documentation to show that the properties were substantially damaged. Further, the State should identify and reimburse from non-Federal funds any additional Disaster Recovery funds used to acquire and dispose of the properties.

1C. Provide documentation to support the hardship letter provided for a property located outside the 500-year floodplain and documentation to show that the property was substantially damaged or reimburse from non-Federal funds the $435,069 in settlement costs paid to purchase the property. Further, the State should identify and reimburse from non-Federal funds any additional Disaster Recovery funds used to acquire and dispose of the property.

1E. Provide documentation to show that the five properties for which the homeowners failed to maintain flood insurance were eligible for assistance and documentation to show that the properties were substantially damaged or reimburse from non-Federal funds the $1,336,883 paid to purchase the properties, including incentives for one property. Further, the State should identify and reimburse from non-Federal funds any additional Disaster Recovery funds used to acquire and dispose of the properties.

1F. Provide documentation to show that the remaining nine properties were substantially damaged or reimburse from non-Federal funds the $4,158,836 paid to purchase the properties. Further, the State should identify and reimburse from non-Federal funds any additional Disaster Recovery funds used to acquire and dispose of the nine properties.

Of the 23 properties discussed in the five recommendations listed above, 18 properties were also questioned as part of the recommendations of this report. The State paid $8,113,962 for these 18 properties. As of the date of this report, HUD had not proposed management decisions for the recommendations listed above. If HUD requires the State to reimburse the amount paid for all or a portion of these properties as part of the audit resolution for the five recommendations, we will reduce the questioned costs claimed in HUD's Audit Resolution and Corrective Action Tracking System for the relevant recommendations of this report.

Appendixes

Appendix A

Schedule of Questioned Costs and Funds To Be Put to Better Use

Recommendation number	Unsupported 1/	Funds to be put to better use 2/
1A	$5,920,097	
1B	361,465,173	
1D		$93,350,616
2A	3,119,209	
2B	156,940	
2C	75,006	
2D	118,800	
Totals	**370,855,225**	**93,350,616**

1/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.

2/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an OIG recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. In this instance, if the State implements our recommendations to improve its controls to ensure that appraised values are supported and quality control reviews are performed as required, it will help to ensure that the remaining $93.4 million in Disaster Recovery funds allocated for the program will be put to its intended use.

Appendix B

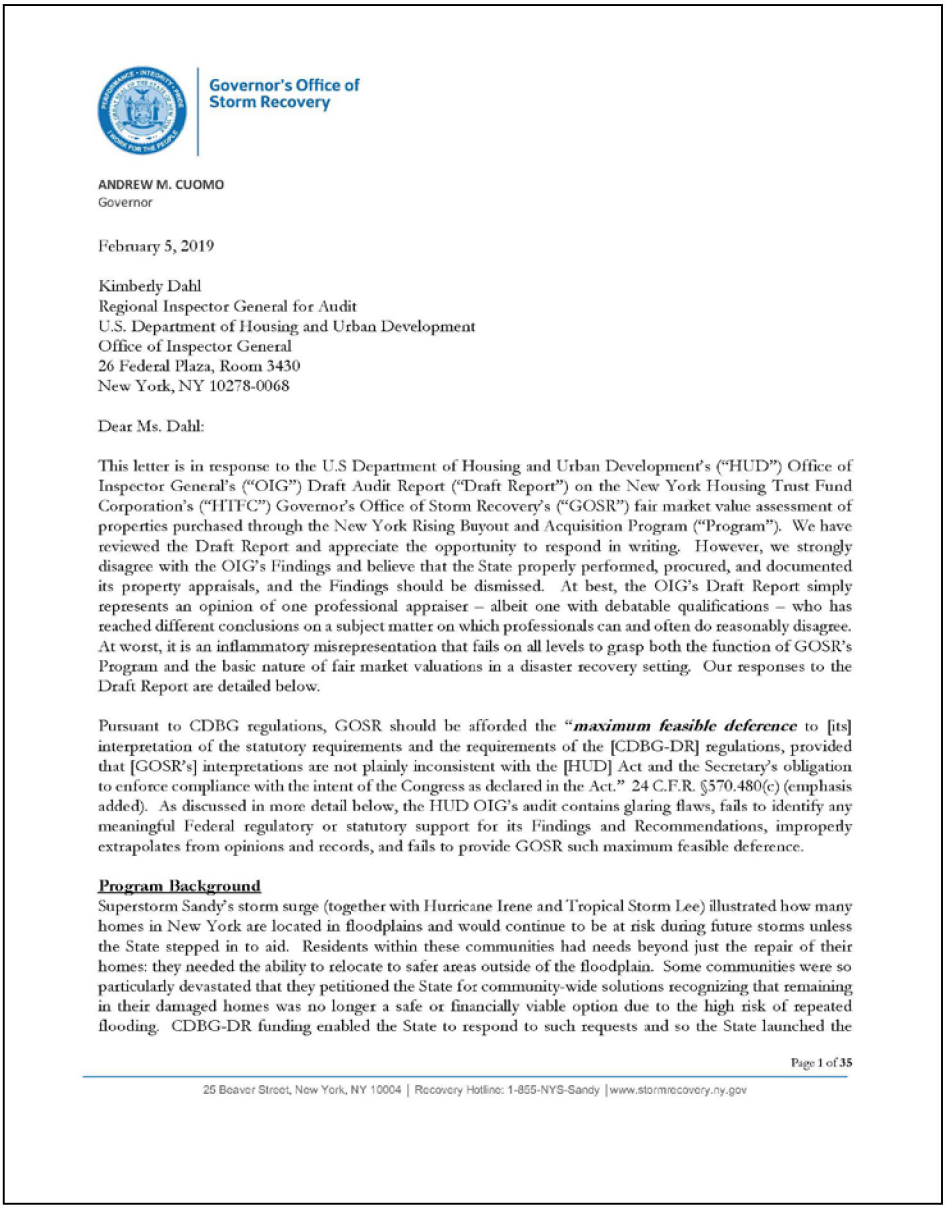
Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

Comment 1

Comment 2



Governor's Office of Storm Recovery

ANDREW M. CUOMO
Governor

February 5, 2019

Kimberly Dahl
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Office of Inspector General
26 Federal Plaza, Room 3430
New York, NY 10278-0068

Dear Ms. Dahl:

This letter is in response to the U.S Department of Housing and Urban Development's ("HUD") Office of Inspector General's ("OIG") Draft Audit Report ("Draft Report") on the New York Housing Trust Fund Corporation's ("HTFC") Governor's Office of Storm Recovery's ("GOSR") fair market value assessment of properties purchased through the New York Rising Buyout and Acquisition Program ("Program"). We have reviewed the Draft Report and appreciate the opportunity to respond in writing. However, we strongly disagree with the OIG's Findings and believe that the State properly performed, procured, and documented its property appraisals, and the Findings should be dismissed. At best, the OIG's Draft Report simply represents an opinion of one professional appraiser – albeit one with debatable qualifications – who has reached different conclusions on a subject matter on which professionals can and often do reasonably disagree. At worst, it is an inflammatory misrepresentation that fails on all levels to grasp both the function of GOSR's Program and the basic nature of fair market valuations in a disaster recovery setting. Our responses to the Draft Report are detailed below.

Pursuant to CDBG regulations, GOSR should be afforded the "***maximum feasible deference*** to [its] interpretation of the statutory requirements and the requirements of the [CDBG-DR] regulations, provided that [GOSR's] interpretations are not plainly inconsistent with the [HUD] Act and the Secretary's obligation to enforce compliance with the intent of the Congress as declared in the Act." 24 C.F.R. §570.480(c) (emphasis added). As discussed in more detail below, the HUD OIG's audit contains glaring flaws, fails to identify any meaningful Federal regulatory or statutory support for its Findings and Recommendations, improperly extrapolates from opinions and records, and fails to provide GOSR such maximum feasible deference.

Program Background

Superstorm Sandy's storm surge (together with Hurricane Irene and Tropical Storm Lee) illustrated how many homes in New York are located in floodplains and would continue to be at risk during future storms unless the State stepped in to aid. Residents within these communities had needs beyond just the repair of their homes: they needed the ability to relocate to safer areas outside of the floodplain. Some communities were so particularly devastated that they petitioned the State for community-wide solutions recognizing that remaining in their damaged homes was no longer a safe or financially viable option due to the high risk of repeated flooding. CDBG-DR funding enabled the State to respond to such requests and so the State launched the

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Comment 3

Comment 4

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Governor

Program through its HUD-approved Action Plan (and subsequent amendments), to purchase storm-damaged properties from homeowners to improve the resiliency of the larger community. In addition to purchasing properties with the goal of restricting them as open space (the "Buyout component"), the Program also purchased storm-damaged properties with the goal of ensuring the homes were rebuilt in a resilient manner (the "Acquisition component").

After consultation with HUD Community and Planning Development ("CPD") staff – the State's CDBG-DR grant managers – the Program decided that conducting appraisals, though not required, was the most fair, impartial, and cost-effective methodology for determining a property's fair market value.[1] Given the emergent nature of valuing and purchasing properties following the largest and most destructive hurricane to ever make landfall in New York State, the Program decided to leverage the expertise of another New York State agency – the Department of Transportation[2] ("DOT") – an agency uniquely qualified for the complicated task at hand with extensive experience valuing land and conducting complex appraisals in New York State. To that end, GOSR entered into a Memorandum of Understanding ("MOU") with DOT allowing GOSR to access DOT's existing pool of competitively-procured appraisal firm contracts. GOSR and DOT partnered with an expert appraisal consultant (the "APPRAISER") to begin the daunting task of determining the fair market value of properties, some of which had literally been washed out to sea.

At the outset of the Program, the APPRAISER was required to appraise thousands of homes on a mass scale, in a short timeframe. Entire communities had been underwater; vacant lots and severely damaged homes were all that remained in many instances. Determining home values pre- and post-disaster proved to be a monumental challenge, particularly due to the diversity of home types in New York State and particularly in the Program areas. The geographic areas involved in the Program do not contain a homogenous housing stock; many properties have widely divergent features. As explained in greater detail below, this justifies larger adjustments for comparison properties, which can only be determined by an appraiser with geographic competency. The widespread devastation literally washed away many comparable neighborhoods and properties. Incomplete, incorrect, or missing local public property records further complicated the project.

Fortunately, the State's expert appraisal team was up to such a challenge. The State's appraisal team consisted of nineteen (19) New York State licensed appraisal consultants from the APPRAISER, a firm with over 200 years of collective experience in performing appraisals in Long Island, Staten Island, and New York City, as well as six (6) real property officers and appraisers – who reviewed each appraisal conducted by the APPRAISER – with over 150 years combined experience with property appraisals, including the specialized area of property acquisitions by State government within New York State. Property valuation data had to be forensically reassembled and the State's expert appraisal team worked diligently to ensure property information and values were accurate and reasonable. The appraisal team met with homeowners and community members, measured every house that was still standing, and reviewed surveys, floorplans, and all relevant public data.

[1] 49 CFR Part 24, Appendix A.
[2] Referred to in the Draft Report as the "State Agency."

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Comment 5

Comments 2 and 6

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By its very size, nature, intent, and post-disaster timing, this was a complicated task within a complex Program – the success of which was of great importance to the future resiliency of New Yorkers – and the Program has been a resounding success. The Program has purchased 711 properties to preserve in perpetuity as open space, and 568 properties to ensure resilient redevelopment. The Program has been looked to as a model by other State and local governments for how to implement a voluntary, strategic retreat and resilient redevelopment program. Despite its ongoing success, or perhaps because of it, the OIG has made this Program a repeated target of its audit plan. Since the launch of the Program in June of 2013, the Program has been audited a total of three (3) times. The first audit commenced in February of 2014 and the final report was issued on September 17, 2015. The second audit – the "fair market value" audit, the subject of this very report – commenced on February 5, 2016. Even before the conclusion of the fair market value audit, the OIG commenced yet a third audit on April 17, 2017 and has not, as of the date of this writing, issued its final report. The fair market value audit spanned a total of thirty-five (35) months, including fifteen (15) months with little to no communication from the OIG.[3] The Program has dedicated countless resources and hours responding to the OIG's requests for interviews and producing hundreds and thousands of documents. The fair market value audit has been lengthy and complicated and has resulted in two (2) Findings, each with multiple subparts, with which the State takes exception and strongly disagrees, as further discussed below.

The Role of Fair Market Value Determinations in Disaster Recovery Programs and Applicable Federal Regulations

The OIG does not appear to fundamentally understand the difference between what Federal regulations required the State to do versus what the State chose to do by developing its own policies with respect to determining a property's fair market value.

Firstly, it is essential to recognize that Federal statutes and regulations did not require the State to obtain formal appraisals for these properties.[4] The acquisition of property that is "blighted, deteriorated, [or] deteriorating . . . appropriate for rehabilitation or conservation activities . . . the conservation of open spaces, natural resources, and scenic areas, . . . [or] the provision of recreational opportunities" is a statutorily eligible HUD activity.[5] Pursuant to the March 5, 2013 Federal Register Notice, HUD did not specify a method for determining pre- and post-storm fair market values.[6] Rather, New York State had "the discretion to determine an appropriate valuation method (including the use of pre-flood value or post-flood value as a basis for property value)" and the directive to "uniformly apply whichever valuation method it chooses."[7] In other words, GOSR did not need to perform appraisals; it only needed to "have some reasonable basis for [its]

[3] In fact, the OIG's audit of fourteen (14) properties has longer than the period in which the APPRAISER performed all of the appraisals for the Program that is the subject of this report.
[4] *See* 49 CFR 24.101(b); 49 CFR Part 24, Appendix A ("[w]hile this part does not require an appraisal for these transactions . . . [a]gencies must have some reasonable basis for their determination of fair market value.").
[5] 42 U.S.C. 5305(a)(1).
[6] 78 Fed. Reg. 14345.
[7] 78 Fed. Reg. 14345.

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determination of fair market value."[8] The State chose, but was not required, to use independent appraisals to determine fair market values. The OIG either does not know or completely ignores that appraisals were not a required valuation method for the State's purchases under the Program.

Secondly, and equally importantly, all homeowners who participated in the Program did so voluntarily – a crucial fact that established the applicable standards by which the Program was administered and should also be reviewed. The Program was established to accommodate citizen requests for a government buyout. At no point did the State leverage its superior bargaining position or threaten condemnation.[9] In fact, that participation was voluntary was the primary consideration for HUD CPD when it advised the State that appraisals were not required and that the more onerous requirement of involuntary acquisitions were not triggered. (See attached Appendix A, email between the State and HUD CPD.) Though this fact is certainly known by the OIG – even if only because the State has shared this email on multiple occasions – it is a fact that the OIG has chosen to ignore in an apparent attempt to bolster its baseless argument against the State.

The State's APPRAISER followed accepted, applicable appraisal standards and at all times adhered to guidance provided by HUD CPD. Nevertheless, the OIG's fundamental lack of understanding of this Program and the related requirements has led them to repeatedly reference and rely upon inapplicable standards.

For example, the OIG argues GOSR's appraisals are unsupported by relying heavily on the Uniform Relocation Assistance and Real Property Acquisition Policies Act ("URA") and its implementing regulation at 49 CFR 24.103, which contains the requirements for property appraisals for Federally-assisted programs. The URA's primary purpose is to protect citizens from government actors who improperly leverage their superior bargaining position or threaten condemnation.[10] Here, the State expressly and repeatedly declared that it would never exercise its power of eminent domain in its administration of the Program.[11] All acquisitions were

[8] 49 CFR Part 24, Appendix A.
[9] *See Regional Transp. Dist. v Outdoor Sys. Inc.*, 34 P.3d 408, 417 (Colo. 2001).
[10] Examining the legislative history of the URA, "the emphasis of the legislative hearings and reports was on involuntary or coerced acquisitions." *Regional Transp. Dist. v Outdoor Sys. Inc.*, 34 P3d 408, 415 (Colo. 2001). The Program's acquisitions were voluntary, marketplace transactions and Courts have found that "the term 'acquisition' should be read to exclude marketplace transactions." *Regional Transp. Dist. v Outdoor Sys. Inc.*, 34 P3d 408, 416 (Colo. 2001)). "By implication, the legislative history suggests that a construction of 'acquisition' that reaches voluntary, arm's-length transactions would be incompatible with the statute's [URA's] purpose." *Regional Transp. Dist. v Outdoor Sys. Inc.*, 34 P3d 408, 415-416 (Colo. 2001). "The legislative history thus evidences an unambiguous and overarching concern with ensuring that those whose property is coercively obtained or taken by the government for federal or federally assisted programs are treated fairly and equipped with sufficient rights to prevent government overreaching." *Regional Transp. Dist. v Outdoor Sys. Inc.*, 34 P3d 408, 416 (Colo. 2001).
[11] *See e.g.*, Peter Szekely, *New York Lets Neighborhood Return to Nature to Guard Against Storms*, Reuters, October 27, 2017, *available at* https://www.reuters.com/article/us-usa-storm-sandy/new-york-lets-neighborhood-return-to-nature-to-guard-against-storms-idUSKBN1CW19G ("'The program is voluntary,' said Bova-Hiatt. 'However, at some point it would be fantastic to have the entire area as a buffer zone.' Bova-Hiatt, herself a Staten Island resident, said the state will never use its power of eminent domain to force out the Staten Islanders who declined buyout offers for 142 properties and can no longer accept them because the program has ended."); Denise Bonilla, *Long Island Homeowners Feel Effects of New York State Buyout Program*, Newsday, October 29, 2016, *available at* https://www.newsday.com/long-island/suffolk/long-island-homeowners-feel-effects-of-ny-s-buyout-program-1.12516964

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entirely voluntary[12], arms-length transactions that met the conditions of 49 CFR 24.101(b)(1)(i) through (iv).[13] In fact, as previously noted herein, it was the affected homeowners who first petitioned the State to implement a community-wide solution and purchase their homes.[14] The appraisal requirements detailed in 49 CFR 24.103 do not apply to voluntary acquisitions such as those conducted by the Program.[15] Significantly, throughout the design and implementation of this Program, GOSR consulted not only with HUD CPD, but also with HUD's URA experts, who expressly supported the fact that, due to the voluntary nature of the Program, the provisions of the URA do not apply. Nonetheless, the OIG repeatedly ignores the voluntary nature of the Program – a fact that is wholly known by the OIG if only because it has audited the Program three (3) times – and utilizes inapplicable regulations in reviewing the Program's appraisals in an apparent attempt to disparage the Program and increase the pecuniary value of its purported Findings.

Additionally, the OIG's Draft Report applies Federal National Mortgage Association's ("Fannie Mae") Selling Guide and HUD Handbook 4150.2 as (herein, "Selling Guide" and "4150.2", respectively).[16] However, both standards apply to the mortgage-lending industry, **not voluntary property acquisition**, and are not applicable to the State's administration of this Program.[17]

("Lindenhurst and NY Rising officials stated that there are no plans to use eminent domain.")

[12] The Federal Highway Administration (FHWA) emphasized the voluntary transactions exception for programs receiving Federal financial assistance while implementing its most recent amendments to 49 CFR Part 24, Subpart B. The Final Rule states "the two major exceptions to real property acquisition requirements in Subpart B were voluntary transactions and acquisitions in which the Agency does not have the power of eminent domain . . . [and] the exceptions for federally-assisted projects and programs remains in § 24.101(b)." 70 Fed. Reg. 595.

[13] *See* 49 CFR 24.101(b); *Regional Transp. Dist. v Outdoor Sys. Inc.*, 34 P3d 408, 416-417 (Colo. 2001) ("[T]he regulations exempt from the statute's [the URA] scope voluntary transactions that meet certain requirements."). Courts have held that "[i]f the [URA's] scope does not extend to voluntary transactions where the agency approaches the buyer wishing to obtain her property and complies with the necessary conditions, certainly it does not encompass arm's-length transactions where a property owner wishes to sell her property to the government." *Regional Transp. Dist. v Outdoor Sys. Inc.*, 34 P3d 408, 417 (Colo. 2001).

[14] "If the [URA's] scope does not extend to voluntary transactions where the agency approaches the buyer wishing to obtain her property and complies with the necessary conditions, certainly it does not encompass arm's-length transactions where a property owner wishes to sell her property to the government. To conclude otherwise would be to undermine the purpose of the regulations." *Regional Transp. Dist. v Outdoor Sys. Inc.*, 34 P.3d 408, 417 (Colo. 2001). "The regulations thus except those voluntary transactions in which an agency sets out to gain possession of a particular parcel but does not improperly leverage its superior bargaining position or threaten condemnation." *Regional Transp. Dist. v Outdoor Sys. Inc.*, 34 P.3d 408, 417 (Colo. 2001).

[15] "Where an owner offers to sell her property and accepts a market price for it, she cannot be understood to have suffered a deprivation of the property's value. Nor is it plausible to infer that the government 'intrudes' on property rights when it functions like any other buyer in the marketplace and complies with the seller's terms. Instead, understanding the [URA's] ambit to exclude voluntary open-market purchases is consonant with the [URA's] aim of 'protecting individual property owners from the superior negotiating position that the Federal Government or State and local Governments (for federally assisted projects) enjoy.'" *Regional Transp. Dist. v Outdoor Sys. Inc.*, 34 P.3d 408, 416 (Colo. 2001) (internal citations omitted).

[16] The OIG's references to Fannie Mae's Selling Guide, paragraph B4-1.3-05, regarding gross living area, cites to an April 15, 2014 or more current version. Paragraph B4-1.3-05 of Fannie Mae's 2013 Selling Guide, in effect for all post-storm appraisals conducted prior to April 15, 2014, address "Special Appraisal Considerations for Properties in Special Assessment Districts," and does not address gross living area.

[17] The OIG cites to Selling Guide paragraph B4-1.3-05, and 4150.2 Section 3-3A. These are not applicable standards because they apply

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The State's Fair Market Value Determination Methodology was Approved by HUD and Reasonable

The State's fair market value determination methodology was both reasonable and approved in advance by the HUD CPD grant managers.

As explained above, the State had "the discretion to determine an appropriate valuation method" and the directive to "uniformly apply whichever valuation method it chooses."[18] The State needed to "have some reasonable basis for [its] determination of fair market value."[19] With this standard in mind, the State sought out technical assistance from HUD CPD to discuss what methodology might satisfy this requirement. CPD confirmed the State's understanding that though appraisals were not required for the Program's voluntary acquisitions, appraisals following criteria outlined in the Uniform Standards of Professional Appraisal Practice ("USPAP") were encouraged. The State heeded this advice and chose to use independent appraisals to achieve this objective.

The State continued conversations with CPD to seek their continued guidance during every step of the appraisal process. The State proposed to follow a fair market valuation process fundamentally similar to the property valuation methodology used by DOT for Right-of-Way acquisitions for hundreds of Federally-funded highway and bridge projects each year – a process that aligns with the universally-accepted criteria outlined in the USPAP. The State provided CPD with sample appraisal documents and template forms for review so that CPD could assess the proposed valuation method for pre-storm fair market value. HUD CPD approved of the State's approach. As previously noted, DOT and its appraisal team consisted of nineteen (19) New York State licensed appraisal consultants as well as six (6) real property officers and appraisers. Upon consideration, HUD CPD representatives agreed that the State's plan – to capitalize on the State's own experts with knowledge and experience conducting New York State USPAP-compliant appraisals on a mass scale – was in fact a reasonable basis by which to determine fair market value.

In addition to utilizing State experts performing USPAP-compliant appraisals, the State also followed the requirements for voluntary acquisitions set forth in 49 CFR 24.101(b)(1). Per this regulation, GOSR was required to "[i]nform the owner(s) in writing of the [a]gency's **estimate** of the fair market value for the property to be acquired."[20] In a voluntary acquisition, the estimated fair market value is used to educate homeowners

strictly to the mortgage industry. "This Transmits: A new Handbook, 4150.2, Valuation Analysis **for Home Mortgage Insurance** for Single Family One- to Four- Unit Dwellings. . . . This handbook reflects policy clarifications and improvements since March 15, 1990 on valuation requirements for existing, proposed and new construction of one- to four-family units for mortgage insurance purposes." HUD Handbook 4150.2, directive transmittal precursor (emphasis added). "Analysis of the physical improvements results in conclusions as to the desirability, utility and appropriateness of the physical improvements as factors in determining mortgage risk and the ultimate estimate of value." HUD Handbook 4150.2, Section 3-3 Analysis of Physical Improvements. Fannie Mae's Selling Guide, Part B, Origination Through Closing, "[P]rovides the **requirements for** originating conventional and government **loans** for sale to Fannie Mae" and subpart B4, Underwriting Property, "[C]ontains property underwriting and appraisal **requirements for conventional loans.**" Fannie Mae's Selling Guide at 162, 527 (2018) (emphasis added).

[18] 78 Fed. Reg. 14345.

[19] 49 CFR Part 24, Appendix A.

[20] 49 CFR 24, Appendix A, Subpart B (emphasis added).

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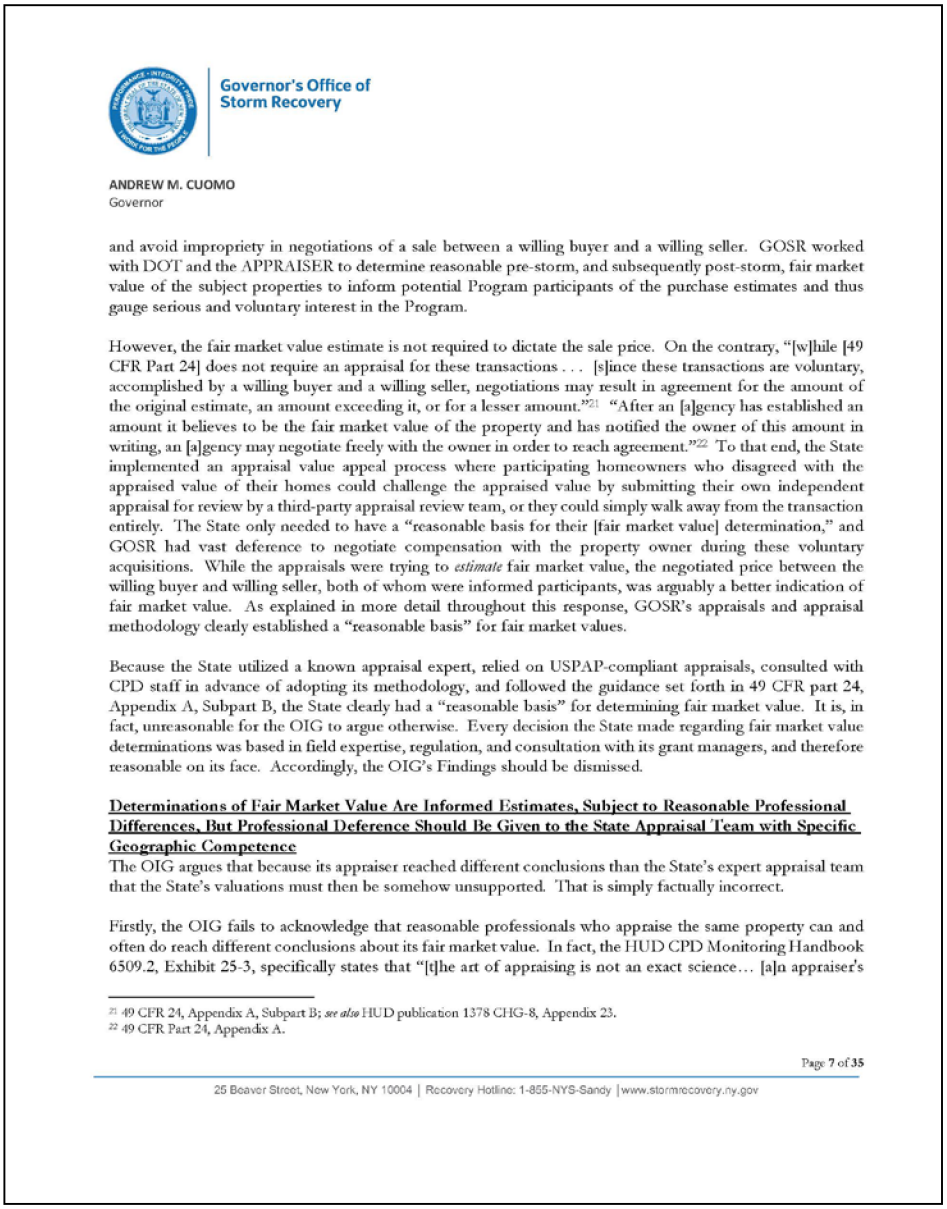

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and avoid impropriety in negotiations of a sale between a willing buyer and a willing seller. GOSR worked with DOT and the APPRAISER to determine reasonable pre-storm, and subsequently post-storm, fair market value of the subject properties to inform potential Program participants of the purchase estimates and thus gauge serious and voluntary interest in the Program.

However, the fair market value estimate is not required to dictate the sale price. On the contrary, "[w]hile [49 CFR Part 24] does not require an appraisal for these transactions . . . [s]ince these transactions are voluntary, accomplished by a willing buyer and a willing seller, negotiations may result in agreement for the amount of the original estimate, an amount exceeding it, or for a lesser amount."[21] "After an [a]gency has established an amount it believes to be the fair market value of the property and has notified the owner of this amount in writing, an [a]gency may negotiate freely with the owner in order to reach agreement."[22] To that end, the State implemented an appraisal value appeal process where participating homeowners who disagreed with the appraised value of their homes could challenge the appraised value by submitting their own independent appraisal for review by a third-party appraisal review team, or they could simply walk away from the transaction entirely. The State only needed to have a "reasonable basis for their [fair market value] determination," and GOSR had vast deference to negotiate compensation with the property owner during these voluntary acquisitions. While the appraisals were trying to *estimate* fair market value, the negotiated price between the willing buyer and willing seller, both of whom were informed participants, was arguably a better indication of fair market value. As explained in more detail throughout this response, GOSR's appraisals and appraisal methodology clearly established a "reasonable basis" for fair market values.

Because the State utilized a known appraisal expert, relied on USPAP-compliant appraisals, consulted with CPD staff in advance of adopting its methodology, and followed the guidance set forth in 49 CFR part 24, Appendix A, Subpart B, the State clearly had a "reasonable basis" for determining fair market value. It is, in fact, unreasonable for the OIG to argue otherwise. Every decision the State made regarding fair market value determinations was based in field expertise, regulation, and consultation with its grant managers, and therefore reasonable on its face. Accordingly, the OIG's Findings should be dismissed.

Determinations of Fair Market Value Are Informed Estimates, Subject to Reasonable Professional Differences, But Professional Deference Should Be Given to the State Appraisal Team with Specific Geographic Competence

The OIG argues that because its appraiser reached different conclusions than the State's expert appraisal team that the State's valuations must then be somehow unsupported. That is simply factually incorrect.

Firstly, the OIG fails to acknowledge that reasonable professionals who appraise the same property can and often do reach different conclusions about its fair market value. In fact, the HUD CPD Monitoring Handbook 6509.2, Exhibit 25-3, specifically states that "[t]he art of appraising is not an exact science… [a]n appraiser's

[21] 49 CFR 24, Appendix A, Subpart B; *see also* HUD publication 1378 CHG-8, Appendix 23.
[22] 49 CFR Part 24, Appendix A.

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opinion of fair market value is an informed estimate, and two or more reasonable persons appraising the same property can, within reasonable limits, disagree with respect to their opinions of value." The HUD OIG's Draft Report blatantly rejects the fact that differences in opinion are expected and permissible in appraisal valuations. The fact that the OIG appraiser reached different conclusions than the State's appraisal team does not mean that the State's valuations were incorrect or unsupported.

Secondly, if any opinion of fair market value should be afforded more weight, it should be the opinion of the appraisal team with over 200 years of collective experience in performing appraisals in Long Island, Staten Island, and New York City. As discussed above, the State's appraisal team consisted of nineteen (19) New York State licensed appraisal consultants from the APPRAISER, as well as six (6) real property officers and appraisers with over 150 years combined experience with property appraisals, including the specialized area of property acquisitions by State government within New York State. The State's appraisal team conducted its fair market valuations in accordance with USPAP guidelines. By contrast, the OIG employed a single appraiser who is licensed only in the State of Mississippi and thus cannot understand the unique nature of the Long Island and Staten Island shoreline homes, which only a local New York State licensed appraiser would have the specialized knowledge and experience to appreciate. The 2012-2013 edition of USPAP Advisory Opinion 294 states that "review assignments that include evaluating the selection and adjustment of comparable sales typically **require geographic competence**" (emphasis added).[23] This is significant because the OIG appraiser does not have the geographic competence to perform appraisals in New York State under normal circumstances, much less to perform appraisals under the extreme circumstances following the aftermath of a massive natural disaster.

Thirdly, based on the Draft Report, it is difficult to even ascertain what the OIG's appraiser's involvement in the audit was, or what role the OIG's appraiser was performing. If the OIG's appraiser was performing the function of an appraisal review, then the language of the Draft Report and information provided by the OIG suggests that the review was not in compliance with the applicable USPAP standards. Further, the review does not appear to have been objective; rather, it focuses on targeted, discreet criteria without justifying why, and the conclusions drawn from the review are never fully explained by the OIG. Similarly, if the appraiser was simply performing an independent appraisal function, then it is difficult for the State to respond to the appraiser's ultimate conclusions regarding the values of the properties, as these were never provided to the State. It should be noted that throughout the duration of the audit, the State made multiple offers to have the State's appraisal team sit down with the OIG's appraiser to answer any questions about the valuation methodologies. Each and every offer was soundly rejected by the OIG. In light of these rejections, and in consideration of the nature of OIG's Findings – many of which lack sufficient reasoning for the appraiser's disagreements – it is difficult to even opine on the validity of the OIG's appraiser's review.

[23] *See also* USPAP 3-1(a) ("The reviewer must have the knowledge and experience needed to identify and perform the scope of work necessary to produce credible assignment results. Aspects of competency for an appraisal review . . . include, without limitation, familiarity with the specific type of property or asset, market, [and] geographic area . . .").

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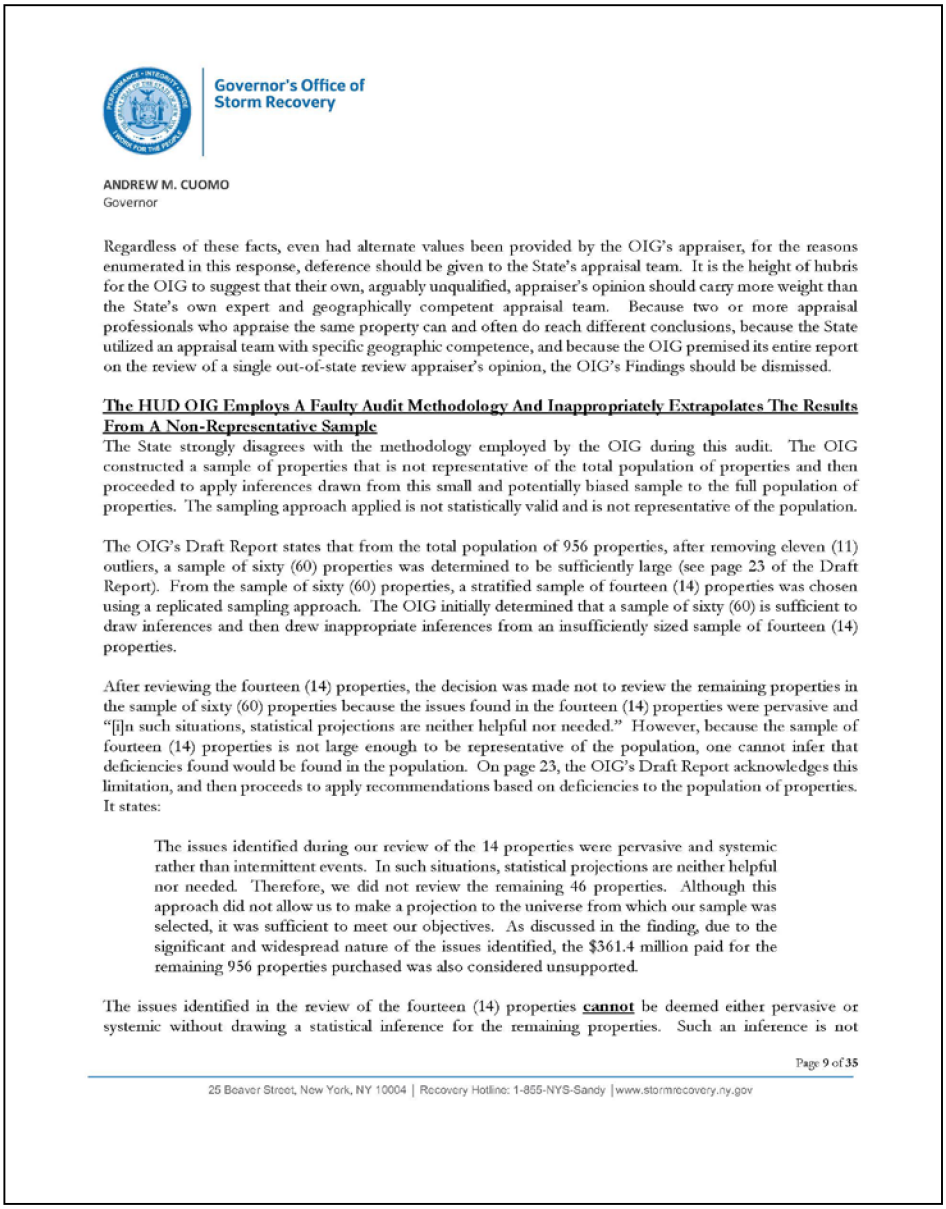

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Regardless of these facts, even had alternate values been provided by the OIG's appraiser, for the reasons enumerated in this response, deference should be given to the State's appraisal team. It is the height of hubris for the OIG to suggest that their own, arguably unqualified, appraiser's opinion should carry more weight than the State's own expert and geographically competent appraisal team. Because two or more appraisal professionals who appraise the same property can and often do reach different conclusions, because the State utilized an appraisal team with specific geographic competence, and because the OIG premised its entire report on the review of a single out-of-state review appraiser's opinion, the OIG's Findings should be dismissed.

The HUD OIG Employs A Faulty Audit Methodology And Inappropriately Extrapolates The Results From A Non-Representative Sample

The State strongly disagrees with the methodology employed by the OIG during this audit. The OIG constructed a sample of properties that is not representative of the total population of properties and then proceeded to apply inferences drawn from this small and potentially biased sample to the full population of properties. The sampling approach applied is not statistically valid and is not representative of the population.

The OIG's Draft Report states that from the total population of 956 properties, after removing eleven (11) outliers, a sample of sixty (60) properties was determined to be sufficiently large (see page 23 of the Draft Report). From the sample of sixty (60) properties, a stratified sample of fourteen (14) properties was chosen using a replicated sampling approach. The OIG initially determined that a sample of sixty (60) is sufficient to draw inferences and then drew inappropriate inferences from an insufficiently sized sample of fourteen (14) properties.

After reviewing the fourteen (14) properties, the decision was made not to review the remaining properties in the sample of sixty (60) properties because the issues found in the fourteen (14) properties were pervasive and "[i]n such situations, statistical projections are neither helpful nor needed." However, because the sample of fourteen (14) properties is not large enough to be representative of the population, one cannot infer that deficiencies found would be found in the population. On page 23, the OIG's Draft Report acknowledges this limitation, and then proceeds to apply recommendations based on deficiencies to the population of properties. It states:

> The issues identified during our review of the 14 properties were pervasive and systemic rather than intermittent events. In such situations, statistical projections are neither helpful nor needed. Therefore, we did not review the remaining 46 properties. Although this approach did not allow us to make a projection to the universe from which our sample was selected, it was sufficient to meet our objectives. As discussed in the finding, due to the significant and widespread nature of the issues identified, the $361.4 million paid for the remaining 956 properties purchased was also considered unsupported.

The issues identified in the review of the fourteen (14) properties **cannot** be deemed either pervasive or systemic without drawing a statistical inference for the remaining properties. Such an inference is not

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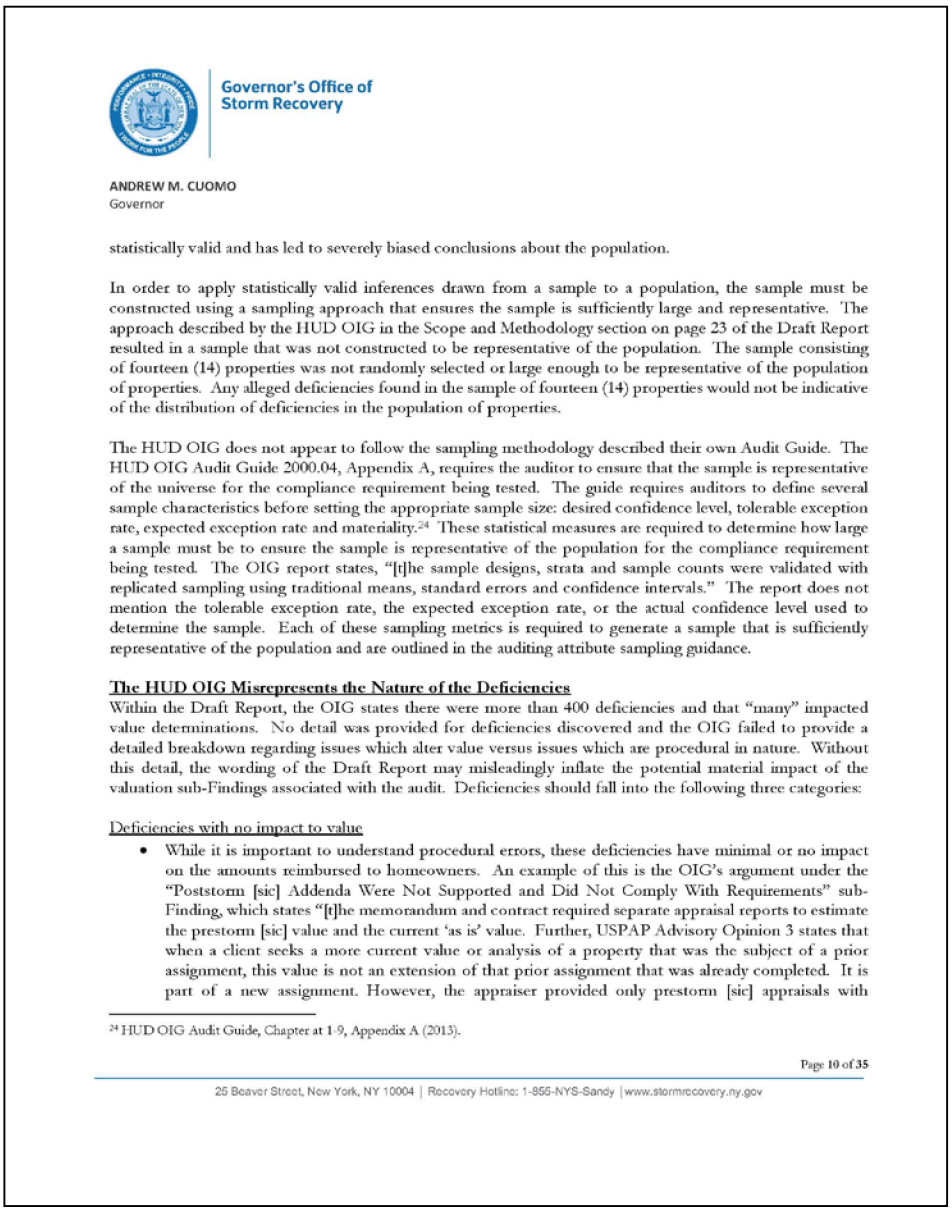

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statistically valid and has led to severely biased conclusions about the population.

In order to apply statistically valid inferences drawn from a sample to a population, the sample must be constructed using a sampling approach that ensures the sample is sufficiently large and representative. The approach described by the HUD OIG in the Scope and Methodology section on page 23 of the Draft Report resulted in a sample that was not constructed to be representative of the population. The sample consisting of fourteen (14) properties was not randomly selected or large enough to be representative of the population of properties. Any alleged deficiencies found in the sample of fourteen (14) properties would not be indicative of the distribution of deficiencies in the population of properties.

The HUD OIG does not appear to follow the sampling methodology described their own Audit Guide. The HUD OIG Audit Guide 2000.04, Appendix A, requires the auditor to ensure that the sample is representative of the universe for the compliance requirement being tested. The guide requires auditors to define several sample characteristics before setting the appropriate sample size: desired confidence level, tolerable exception rate, expected exception rate and materiality.[24] These statistical measures are required to determine how large a sample must be to ensure the sample is representative of the population for the compliance requirement being tested. The OIG report states, "[t]he sample designs, strata and sample counts were validated with replicated sampling using traditional means, standard errors and confidence intervals." The report does not mention the tolerable exception rate, the expected exception rate, or the actual confidence level used to determine the sample. Each of these sampling metrics is required to generate a sample that is sufficiently representative of the population and are outlined in the auditing attribute sampling guidance.

The HUD OIG Misrepresents the Nature of the Deficiencies

Within the Draft Report, the OIG states there were more than 400 deficiencies and that "many" impacted value determinations. No detail was provided for deficiencies discovered and the OIG failed to provide a detailed breakdown regarding issues which alter value versus issues which are procedural in nature. Without this detail, the wording of the Draft Report may misleadingly inflate the potential material impact of the valuation sub-Findings associated with the audit. Deficiencies should fall into the following three categories:

Deficiencies with no impact to value

- While it is important to understand procedural errors, these deficiencies have minimal or no impact on the amounts reimbursed to homeowners. An example of this is the OIG's argument under the "Poststorm [sic] Addenda Were Not Supported and Did Not Comply With Requirements" sub-Finding, which states "[t]he memorandum and contract required separate appraisal reports to estimate the prestorm [sic] value and the current 'as is' value. Further, USPAP Advisory Opinion 3 states that when a client seeks a more current value or analysis of a property that was the subject of a prior assignment, this value is not an extension of that prior assignment that was already completed. It is part of a new assignment. However, the appraiser provided only prestorm [sic] appraisals with

[24] HUD OIG Audit Guide, Chapter at 1-9, Appendix A (2013).

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poststorm [sic] addenda at the end." This is a procedural or formatting deficiency and does not impact either value estimated by the APPRAISER. As stated above, comments such as these misleadingly inflate the valuation sub-Findings from the audit and should have no bearing on whether appraisals or their costs are adequately supported, and are erroneously identified as ineligible costs by the OIG.

Difference of opinion

- Alleged deficiencies under this category relate to adjustments made by the APPRAISER with which the OIG's appraiser disagrees. An example of this is the argument under the "Appraisals Contained Excessive Adjustments Without Justification" sub-Finding which states "12 of the 12 appraisals contained gross adjustments that exceeded 25 percent of the comparable property's sales price. The 12 appraisals contained 67 comparable properties." The OIG only states that these appraisals included adjustments over 25 percent, yet fails to demonstrate that such adjustments were not appropriate, nor does the OIG provide a sensitivity analysis suggesting what adjustments should have been made or if alternate comparable properties should have been used within the sample selections. In addition, USPAP Advisory Opinion 193 states that "USPAP places no limitations on the size of adjustments made in the sales comparison approach," so it is unreasonable to state that because adjustments exceeded 25 percent the whole analysis is incorrect. Further, the OIG provides no basis for claiming that the particular threshold of 25 percent is appropriate. When there is a lack of comparable properties within the market, larger adjustments are often necessary.

Factual deficiencies

- Alleged deficiencies under this category are factual issues related to the APPRAISER's analysis. An example of this is the argument under the section title "Appraisals Were Based on Inaccurate Gross Living Areas" which states that "the gross living areas used by the appraisers were approximately 39, 77, and 269 percent more than the actual gross living area in three cases." However, except for one (1) typographical error (discussed further herein), the alleged deficiencies are debatable at best given the lack of information and detail provided by the OIG. Moreover, even with respect to the typographical error, the OIG only states that a difference exists without performing a sensitivity analysis related to the impact on value, if any, that may arise if the square footage were to be corrected. Reviewing percentage differences in gross square footage in isolation is not a valid way to analyze these properties given the fact that these are smaller homes. Further, a typographical error such as this one appears to be an anomaly within the sample selected and therefore **should not** be extrapolated over the entire population.

The OIG Has Failed to Provide Alternate Property Values and Misrepresents the State's Potential Exposure

The OIG improperly and unreasonably asserts that **all** amounts paid for the storm-damaged properties are unsupported and should be reimbursed. Recommendation 1B demands that HUD requires the State to "[p]rovide documentation to support the appraised fair market values of the 942 other properties included in

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our sampling universe to ensure that $361,465,173 in settlement costs was supported." Firstly, not all 942 properties were in the OIG's sampling universe. As noted above, the OIG only sampled fourteen (14) properties. By generally accepted auditing standards and by the OIG's own sampling guidelines, this sample is not statistically significant and does not allow for a statistical projection. Secondly, it is clearly unreasonable to conclude that all costs paid for the properties are unsupported; logically, all the properties purchased have meaningful value, even if only the value of the underlying land. The OIG's audit fails entirely to provide alternative property values or preferred valuation methods.

The OIG rejects the State's property valuation methodologies; yet does not provide a preferred or alternative approach which it believes the State should have followed. If the OIG truly takes issue with the State's Program, a comprehensive audit would have informed the State what the property values should have been, and then questioned the difference. Implying that all the State's property acquisitions are unsupported, and the State should repay **all** costs is nonsensical, unhelpful, and defeats both the Program's purpose and the usefulness of an audit by the OIG.

On this point, the OIG's assertion that all property acquisition costs – for all 956 properties that are part of the universe referenced by the OIG – are unsupported and should be repaid is akin to stating that the properties' value is $0. In addition to this being an unreasonable conclusion as discussed above, it is also a conclusion that does not meet USPAP standards. The USPAP review standards require a review appraiser (if this was, in fact, the function that was performed by the OIG's appraiser – a point that remains unclear) to follow USPAP standards for appraisal development when the review assignment results in the reviewer developing his own opinion of value.[25] In this case, the reviewer's value opinion of $0 was not developed following USPAP standards, neither in terms of applying generally accepted appraisal methodology nor in terms of utilizing market data. The implied conclusion of $0 is offered by the OIG without support of any kind.

HUD OIG FINDING 1: The State Did Not Ensure That Appraised Values of Properties Purchased Were Supported

GOSR RESPONSE:
Overall in Finding 1, the OIG claims that, due to a lack of adequate Program controls, the State's appraisal reports contained more than 400 deficiencies which resulted in unsupported appraised values. Alleged deficiencies include inaccurate gross living areas, unsupported time adjustments, and excessive and unsupported adjustments to comparable properties. As explained in detail below, GOSR strongly objects to this characterization, to the OIG's results, and to the audit standards employed by the OIG.

[25] USPAP 3-3(c) and Advisory Opinion 20 (2012-2013).

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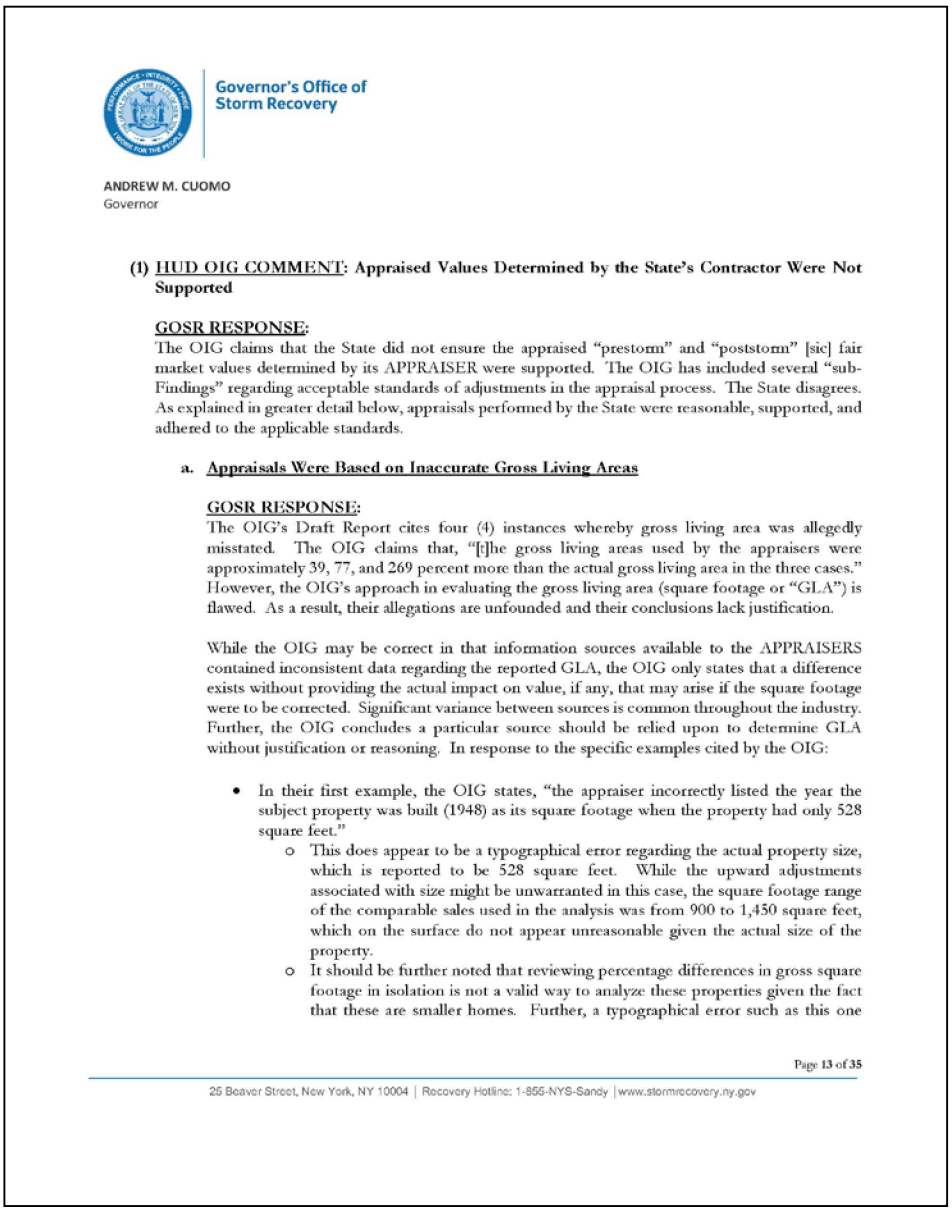

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(1) HUD OIG COMMENT: Appraised Values Determined by the State's Contractor Were Not Supported

GOSR RESPONSE:
The OIG claims that the State did not ensure the appraised "prestorm" and "poststorm" [sic] fair market values determined by its APPRAISER were supported. The OIG has included several "sub-Findings" regarding acceptable standards of adjustments in the appraisal process. The State disagrees. As explained in greater detail below, appraisals performed by the State were reasonable, supported, and adhered to the applicable standards.

a. Appraisals Were Based on Inaccurate Gross Living Areas

GOSR RESPONSE:
The OIG's Draft Report cites four (4) instances whereby gross living area was allegedly misstated. The OIG claims that, "[t]he gross living areas used by the appraisers were approximately 39, 77, and 269 percent more than the actual gross living area in the three cases." However, the OIG's approach in evaluating the gross living area (square footage or "GLA") is flawed. As a result, their allegations are unfounded and their conclusions lack justification.

While the OIG may be correct in that information sources available to the APPRAISERS contained inconsistent data regarding the reported GLA, the OIG only states that a difference exists without providing the actual impact on value, if any, that may arise if the square footage were to be corrected. Significant variance between sources is common throughout the industry. Further, the OIG concludes a particular source should be relied upon to determine GLA without justification or reasoning. In response to the specific examples cited by the OIG:

- In their first example, the OIG states, "the appraiser incorrectly listed the year the subject property was built (1948) as its square footage when the property had only 528 square feet."
  - This does appear to be a typographical error regarding the actual property size, which is reported to be 528 square feet. While the upward adjustments associated with size might be unwarranted in this case, the square footage range of the comparable sales used in the analysis was from 900 to 1,450 square feet, which on the surface do not appear unreasonable given the actual size of the property.
  - It should be further noted that reviewing percentage differences in gross square footage in isolation is not a valid way to analyze these properties given the fact that these are smaller homes. Further, a typographical error such as this one

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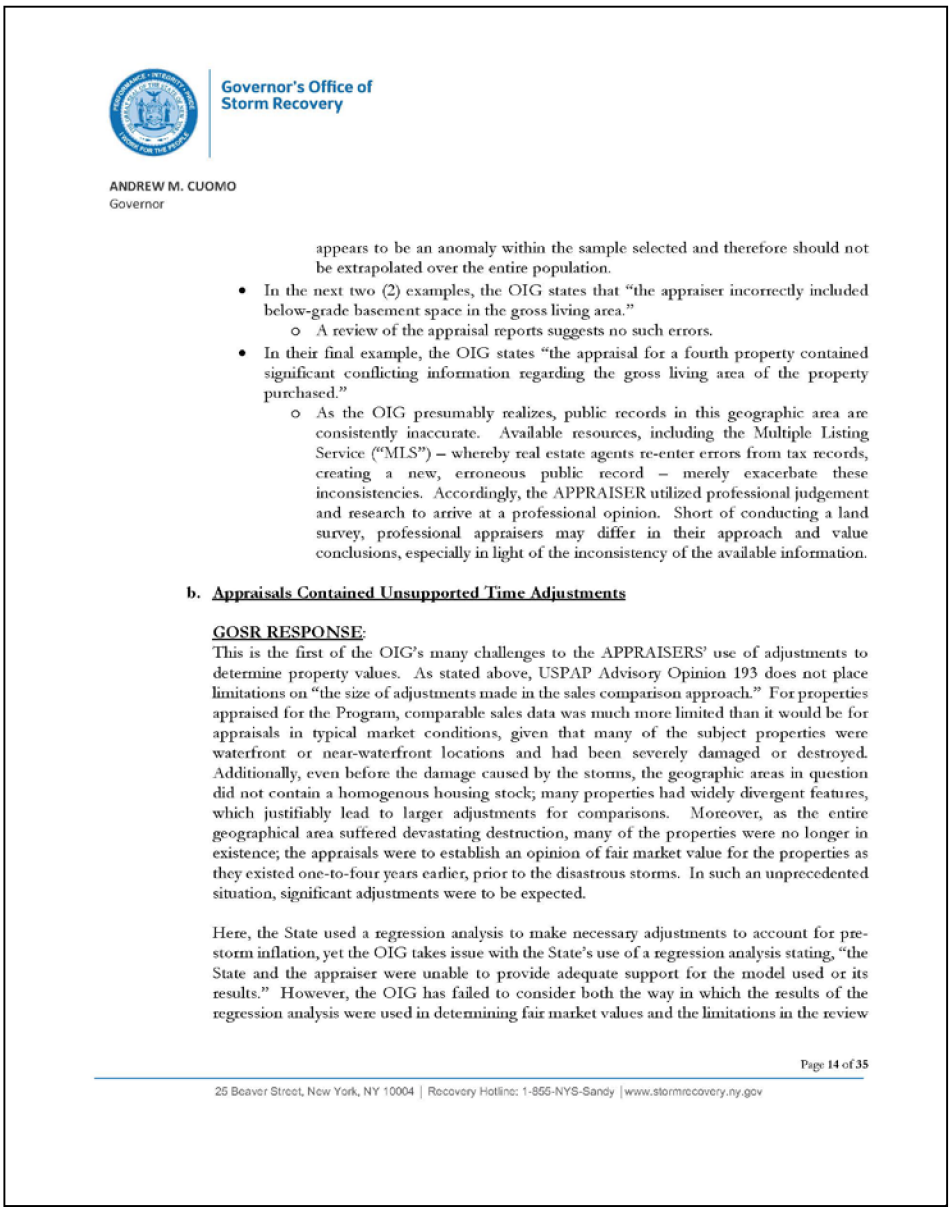

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appears to be an anomaly within the sample selected and therefore should not be extrapolated over the entire population.

- In the next two (2) examples, the OIG states that "the appraiser incorrectly included below-grade basement space in the gross living area."
  - A review of the appraisal reports suggests no such errors.
- In their final example, the OIG states "the appraisal for a fourth property contained significant conflicting information regarding the gross living area of the property purchased."
  - As the OIG presumably realizes, public records in this geographic area are consistently inaccurate. Available resources, including the Multiple Listing Service ("MLS") – whereby real estate agents re-enter errors from tax records, creating a new, erroneous public record – merely exacerbate these inconsistencies. Accordingly, the APPRAISER utilized professional judgement and research to arrive at a professional opinion. Short of conducting a land survey, professional appraisers may differ in their approach and value conclusions, especially in light of the inconsistency of the available information.

b. Appraisals Contained Unsupported Time Adjustments

GOSR RESPONSE:
This is the first of the OIG's many challenges to the APPRAISERS' use of adjustments to determine property values. As stated above, USPAP Advisory Opinion 193 does not place limitations on "the size of adjustments made in the sales comparison approach." For properties appraised for the Program, comparable sales data was much more limited than it would be for appraisals in typical market conditions, given that many of the subject properties were waterfront or near-waterfront locations and had been severely damaged or destroyed. Additionally, even before the damage caused by the storms, the geographic areas in question did not contain a homogenous housing stock; many properties had widely divergent features, which justifiably lead to larger adjustments for comparisons. Moreover, as the entire geographical area suffered devastating destruction, many of the properties were no longer in existence; the appraisals were to establish an opinion of fair market value for the properties as they existed one-to-four years earlier, prior to the disastrous storms. In such an unprecedented situation, significant adjustments were to be expected.

Here, the State used a regression analysis to make necessary adjustments to account for pre-storm inflation, yet the OIG takes issue with the State's use of a regression analysis stating, "the State and the appraiser were unable to provide adequate support for the model used or its results." However, the OIG has failed to consider both the way in which the results of the regression analysis were used in determining fair market values and the limitations in the review

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of the regression model performed by their own statistician.

The use of a regression analysis was entirely appropriate for the situation the State's appraisal team was facing following the mass devastation of Superstorm Sandy. Because the passage of time has an effect on property value, it was necessary to utilize an appraisal methodology that accounted for this variable when calculating values for homes that had been severely damaged or destroyed. Here, a regression analysis was used to construct and support a "but for" market trend that could take into account projected changes that would have occurred in the one-to-three years following Superstorm Sandy had the disaster never occurred.

A regression analysis is a statistical method that allows examinations of relationships between two (2) or more variables of interest. The regression analysis in this instance was utilized to determine if market pricing correlated with an unobserved difference between variables, and if so, to what extent. The APPRAISER's statistician utilized a regression analysis to identify major value influencing factors, and to evaluate their relative impact on pricing. The results of the regression analysis indicated that specific adjustments should be applied, with consideration to the APPRAISERS' knowledge of the appropriate factor.[26]

Once the APPRAISERS assessed the regression analysis output, they established what elements of comparison were to be included and exercised professional judgement of what adjustments should be applied, based upon local market findings and their collective experience. Importantly, the regression analysis was simply one (1) tool utilized as part of the determination of one (1) adjustment factor. The results of the regression model were an additional tool that provided a basis to develop a standard adjustment factor to be applied consistently for all of the sales as compared to each subject property. Ultimately, regression was determined to best serve as a tool to establishing and explaining time (market condition) trends and influence (if any) of other factors conventionally adjusted for in the appraisal process.

In general, the adjustments applied reflect the APPRAISERS' independent analysis of the sales data and subject properties. As with all of the appraisals performed, for properties where the regression analysis was used, the APPRAISER also researched and selected a portfolio of the closest comparable property sales available as a core starting point, and then utilized professional judgment to make a number of adjustments to estimate property value, the adjustments relating to the regression analysis being just one (1) of these factors.

A standard rate for each variable was applied uniformly and consistently to each sale as

[26] These factors (elements of comparison) included time, market conditions, location (neighborhood), site area, year built, grade, condition, living area, bedrooms/baths, basement, basement finish, garage, style, fireplace, central air, site view, water frontage. Additional variables considered were deck/patio, pool, landscaping, kitchen grade, and additional improvements.

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compared to the subject property. These adjustments were fine-tuned by the APPRAISERS' experience in the market on a case-by-case basis. This reflected a conventional adjustment process for residential properties, applying dollar adjustments for factors such as gross living area, baths, and site area. Subject property sales histories were also weighted in the final value conclusion.

Further, the OIG takes a possible non-mandatory minor record-keeping Finding in one (1) adjustment factor and turns it into a fundamental underlying flaw applied to the entire appraisal process. Namely, the OIG's objection to the inclusion of the time factor is based on the OIG statistician's inability to generate a model that includes a statistically significant time factor. The OIG states that their retained statistician experienced difficulty in reconstructing the regression model used by the APPRAISER, based upon paper records provided to the OIG and reviewed during the audit. However, what the OIG fails to recognize or acknowledge is that it is industry standard that modelers do not document each model run attempted. It is not unusual for modeling runs and the factors that comprise them to be revised and adjusted using professional expertise during the modeling development. Additionally, despite requests by the State, the OIG declined to allow the State's modeler to meet with the OIG's statistician to better understand the approach used in their review of the State's regression model.

To validate a linear regression model there are multiple statistical tests that should be conducted and interpreted. That does not appear to have been done here, as no empirical information is provided in the OIG's Draft Report which documents the extent of the model misspecification the OIG believes occurs. The OIG's Draft Report does not discuss the results of any model specification tests or assessment of the model performance. The Draft Report states that their assessment of the inclusion of the time factor is based only on the statistical significance of the time factor coefficient. Since their statistician was not able to show that time is a "relevant predictor of price," they conclude that the model is not "statistically credible." No assessments of residuals or model fit statistics were discussed, so it is not clear what is meant by their Finding that the model is not "statistically credible." Additionally, the OIG does not report findings from any model specification tests that might be indicative of violations to the model specification. In other words, the OIGs inability to replicate the model is not evidence of poor model performance.

Furthermore, the OIG fails to recognize the differences between including extraneous variables and omitting relevant independent variables, the consequences of which are not the same. In general, the omission of relevant variables leads to bias in the remaining variables, a smaller variance-covariance matrix of the coefficients, and consequently inaccurate inferences based on the coefficients. That is to say, omission of independent variables likely leads to improper

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inferences and introduces statistical bias to the estimates.[27] The inclusion of an irrelevant variable does not generate bias in the coefficients or estimator in the variance-covariance matrix of the estimators. The impact of inclusion of a variable that is not statistically significant is that the ordinary least squares (OLS) estimator is less efficient, implying the mean squared error (MSE) of the estimator is larger. In other words, the estimator may have more uncertainty, but it still converges to the true population value.[28] Therefore, any potential impact suggested by the OIG is grossly overstated, particularly given the lack of support to explain their conclusions.

Additionally, it is essential to recognize that the consequences of including or omitting variables are not the same, which the OIG fails to do here. Simply referring to the statistical significance of a single variable without conducting any additional analysis of the model specification or the residuals is not sufficient to judge the model performance or to establish the model's credibility.

Finally, the Draft Report also fails to recognize the appraisal team's statistical expertise and experience in real estate appraisal modeling, the market in question, and real estate appraisal regression models in particular.[29] Advisory Opinion 18 states that "[a] client may suggest the use of and 'Automated Valuation Model' (AVM) in an appraisal, appraisal review, or appraisal consulting assignment, [but **ultimately] the appraiser is responsible for the decision to use or not to use the AVM and its output."**

c. **Appraisals Contained Excessive Adjustments Without Justification**

GOSR RESPONSE:
The OIG cites Fannie Mae's Selling Guide paragraph B4 and HUD Handbook 4150.2 to support its assertion that the State's appraisals contained a number of excessive adjustments to comparable properties without support. However, adjustments made to the subject properties were appropriate and permissible under USPAP, because USPAP places no limitations on "the size of adjustments made in the sales comparison approach." Once again, the OIG's citations to the Fannie Mae's Selling Guide paragraph B4 and HUD Handbook 4150.2 are inapplicable. Further, in response to the examples provided in the Draft Report, the OIG is merely repeating the same Finding three (3) times, at different percentage thresholds. This does not change the fact that the OIG has not provided applicable regulatory references to support their assertions regarding acceptable adjustments amounts.

[27] Note that statistically unbiased estimates converge to their population statistics. Alternatively, when an estimator is biased, it does not converge to the population statistic, implying the inferences drawn are not appropriate and cannot be applied to the population.
[28] For an extended discussion see, "A Guide to Econometrics", Peter Kennedy, 6th Edition, 2008, Blackwell Publishers, Page 94, or any introductory econometrics text book.
[29] The OIG presents no evidence that their statistician has comparable experience in real estate appraisals or experience with the New York real estate market.

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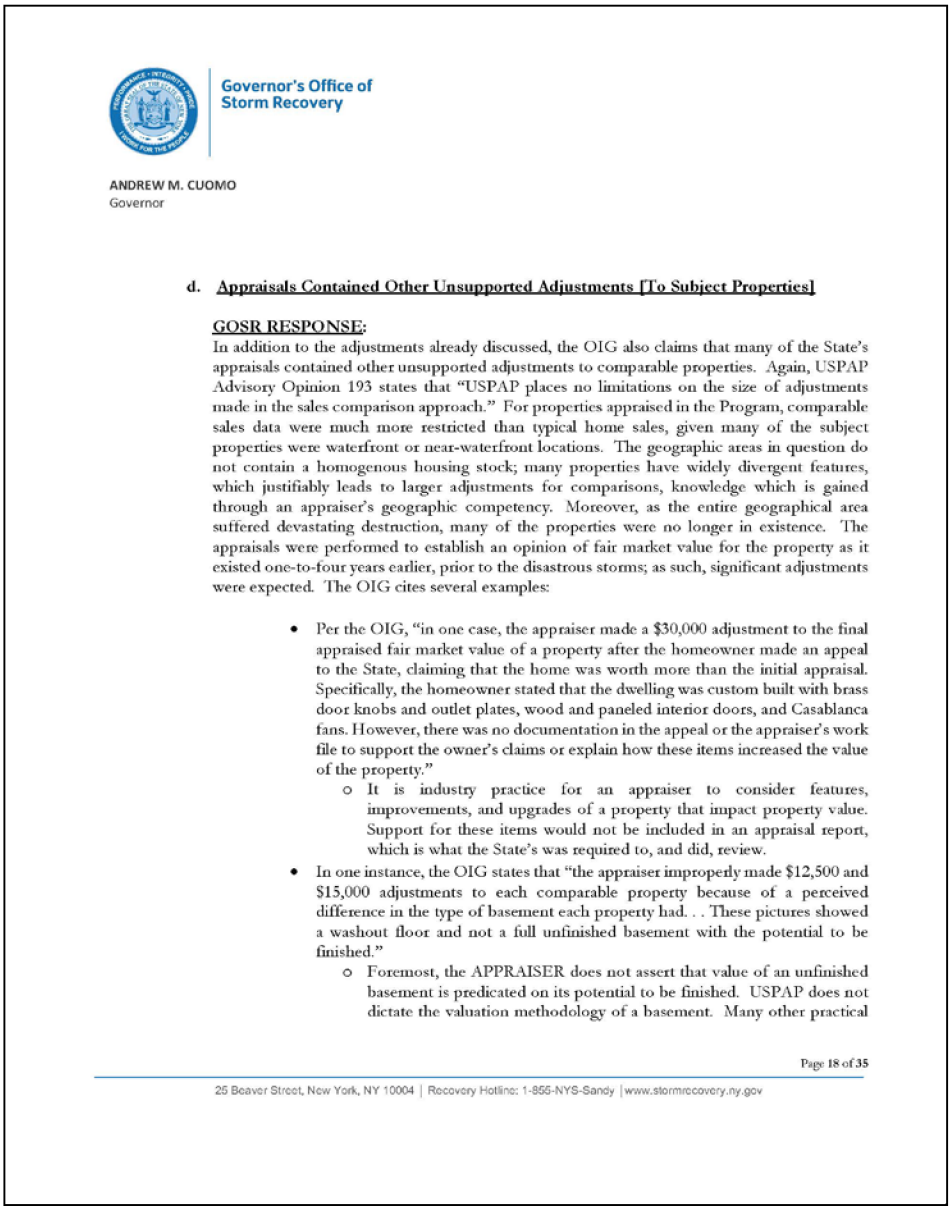

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d. Appraisals Contained Other Unsupported Adjustments [To Subject Properties]

GOSR RESPONSE:

In addition to the adjustments already discussed, the OIG also claims that many of the State's appraisals contained other unsupported adjustments to comparable properties. Again, USPAP Advisory Opinion 193 states that "USPAP places no limitations on the size of adjustments made in the sales comparison approach." For properties appraised in the Program, comparable sales data were much more restricted than typical home sales, given many of the subject properties were waterfront or near-waterfront locations. The geographic areas in question do not contain a homogenous housing stock; many properties have widely divergent features, which justifiably leads to larger adjustments for comparisons, knowledge which is gained through an appraiser's geographic competency. Moreover, as the entire geographical area suffered devastating destruction, many of the properties were no longer in existence. The appraisals were performed to establish an opinion of fair market value for the property as it existed one-to-four years earlier, prior to the disastrous storms; as such, significant adjustments were expected. The OIG cites several examples:

- Per the OIG, "in one case, the appraiser made a $30,000 adjustment to the final appraised fair market value of a property after the homeowner made an appeal to the State, claiming that the home was worth more than the initial appraisal. Specifically, the homeowner stated that the dwelling was custom built with brass door knobs and outlet plates, wood and paneled interior doors, and Casablanca fans. However, there was no documentation in the appeal or the appraiser's work file to support the owner's claims or explain how these items increased the value of the property."
  - It is industry practice for an appraiser to consider features, improvements, and upgrades of a property that impact property value. Support for these items would not be included in an appraisal report, which is what the State's was required to, and did, review.
- In one instance, the OIG states that "the appraiser improperly made $12,500 and $15,000 adjustments to each comparable property because of a perceived difference in the type of basement each property had. . . These pictures showed a washout floor and not a full unfinished basement with the potential to be finished."
  - Foremost, the APPRAISER does not assert that value of an unfinished basement is predicated on its potential to be finished. USPAP does not dictate the valuation methodology of a basement. Many other practical

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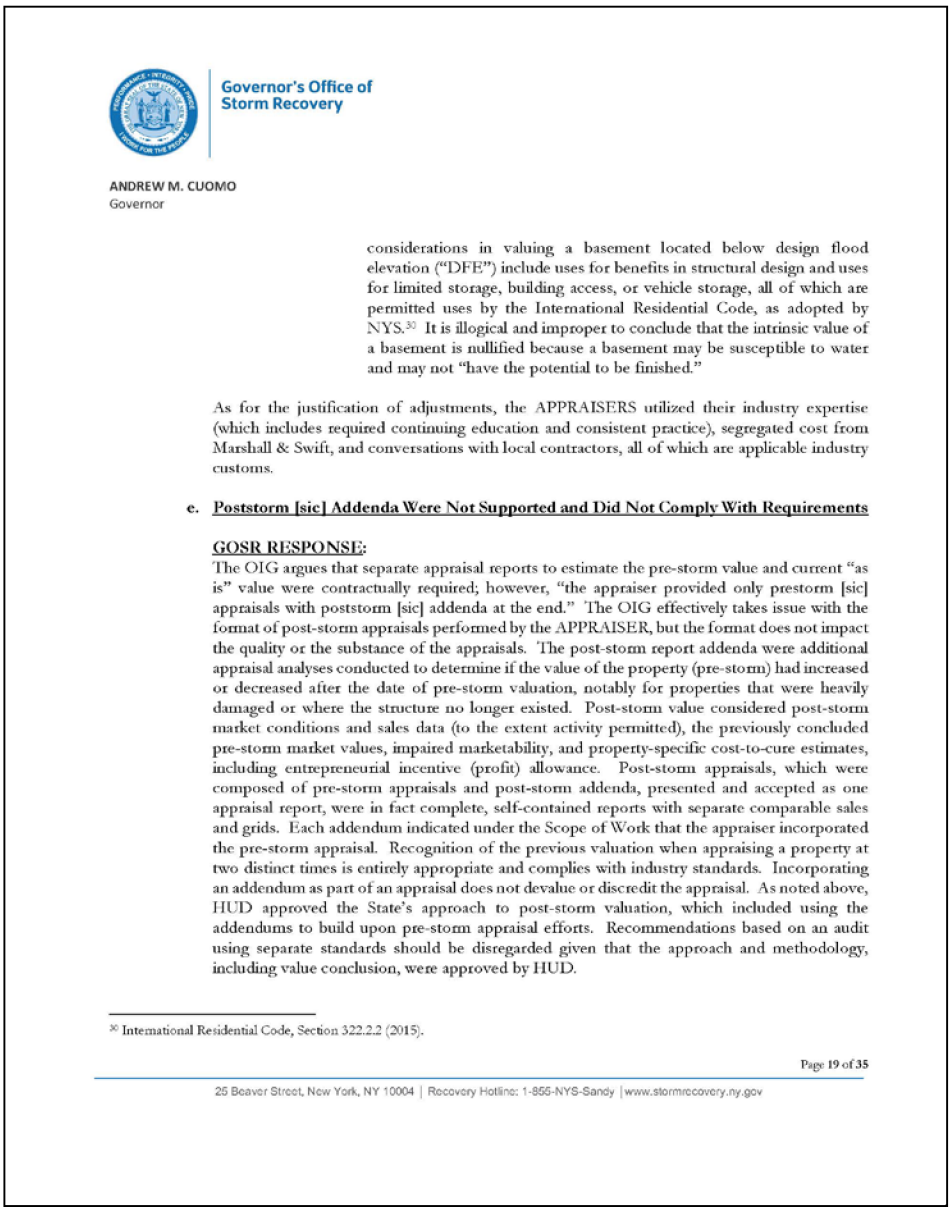

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considerations in valuing a basement located below design flood elevation ("DFE") include uses for benefits in structural design and uses for limited storage, building access, or vehicle storage, all of which are permitted uses by the International Residential Code, as adopted by NYS.[30] It is illogical and improper to conclude that the intrinsic value of a basement is nullified because a basement may be susceptible to water and may not "have the potential to be finished."

As for the justification of adjustments, the APPRAISERS utilized their industry expertise (which includes required continuing education and consistent practice), segregated cost from Marshall & Swift, and conversations with local contractors, all of which are applicable industry customs.

e. **Poststorm [sic] Addenda Were Not Supported and Did Not Comply With Requirements**

GOSR RESPONSE:
The OIG argues that separate appraisal reports to estimate the pre-storm value and current "as is" value were contractually required; however, "the appraiser provided only prestorm [sic] appraisals with poststorm [sic] addenda at the end." The OIG effectively takes issue with the format of post-storm appraisals performed by the APPRAISER, but the format does not impact the quality or the substance of the appraisals. The post-storm report addenda were additional appraisal analyses conducted to determine if the value of the property (pre-storm) had increased or decreased after the date of pre-storm valuation, notably for properties that were heavily damaged or where the structure no longer existed. Post-storm value considered post-storm market conditions and sales data (to the extent activity permitted), the previously concluded pre-storm market values, impaired marketability, and property-specific cost-to-cure estimates, including entrepreneurial incentive (profit) allowance. Post-storm appraisals, which were composed of pre-storm appraisals and post-storm addenda, presented and accepted as one appraisal report, were in fact complete, self-contained reports with separate comparable sales and grids. Each addendum indicated under the Scope of Work that the appraiser incorporated the pre-storm appraisal. Recognition of the previous valuation when appraising a property at two distinct times is entirely appropriate and complies with industry standards. Incorporating an addendum as part of an appraisal does not devalue or discredit the appraisal. As noted above, HUD approved the State's approach to post-storm valuation, which included using the addendums to build upon pre-storm appraisal efforts. Recommendations based on an audit using separate standards should be disregarded given that the approach and methodology, including value conclusion, were approved by HUD.

[30] International Residential Code, Section 322.2.2 (2015).

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The OIG also relies on the logical leap that because the pre-storm appraisals contained deficiencies, the post-storm values are also invalid because they were derived from the pre-storm values. However, as previously discussed, this assertion is erroneous.

f. The State Did Not Have Adequate Controls

GOSR RESPONSE:

The OIG goes further to assert that the alleged deficiencies with the State's appraisals occurred because the State did not have adequate controls to ensure that the appraisal work performed complied with applicable requirements. To the contrary, a robust system of internal controls and appraisal review was in place to ensure that appraisals were performed in accordance with applicable standards. Though the State was not required by contract to conduct a formal appraisal review,[31] DOT's appraisal review team performed a function similar to that of a review appraiser. Under USPAP Standards 3, criteria which govern review appraisers, a review appraiser is not required to ensure the appraisal report conforms to the applicable USPAP standards, nor does Standard 3 require the review appraiser to review the appraiser's file or the appraiser's data analysis. The actual scope of appraisal review, as required by contract and indicated within the review reports, did not require an in-depth analysis of the APPRAISERS' statistical and analytical models and techniques, nor did it require a separate duplicative recreation of the APPRAISERS' work product. Instead, a reviewer is required to ensure that the work product is reasonable based upon proper information gathering, analysis, industry practices, application of appropriate methodology(ies) and sound professional judgment.

For the appraisals in question, desk reviews and on-site visits were conducted thoroughly and in accordance with New York State Agency procedures. Agency procedures required the reviewer to evaluate appraisal materials for completeness and apparent adequacy of data used, appropriateness of the appraisal methodology employed, and conclusions of the appraisal report. Reports were also evaluated for compliance with applicable Federal and State laws, regulations, and policies.

The State's appraisal review team held regular meetings, including numerous detailed calls, with the APPRAISER. During these meetings, the appraisal review team verbally addressed any questions, concerns, or ambiguities observed in the appraisals. These interchanges occurred during preliminary appraisal report discussions, and resulting changes were reflected in the final appraisal report. In general, final appraisal reports did not contain substantive errors or deficiencies, given they were previously addressed, and therefore no commentary regarding such was necessary in the review reports.

[31] *See* GOSR/DOT MOU, Section VII. General Conditions, (A)(2), "[t]he Agency does not assume Grantee's responsibility for initiating the review process under the provisions of 24 CFR Part 52."

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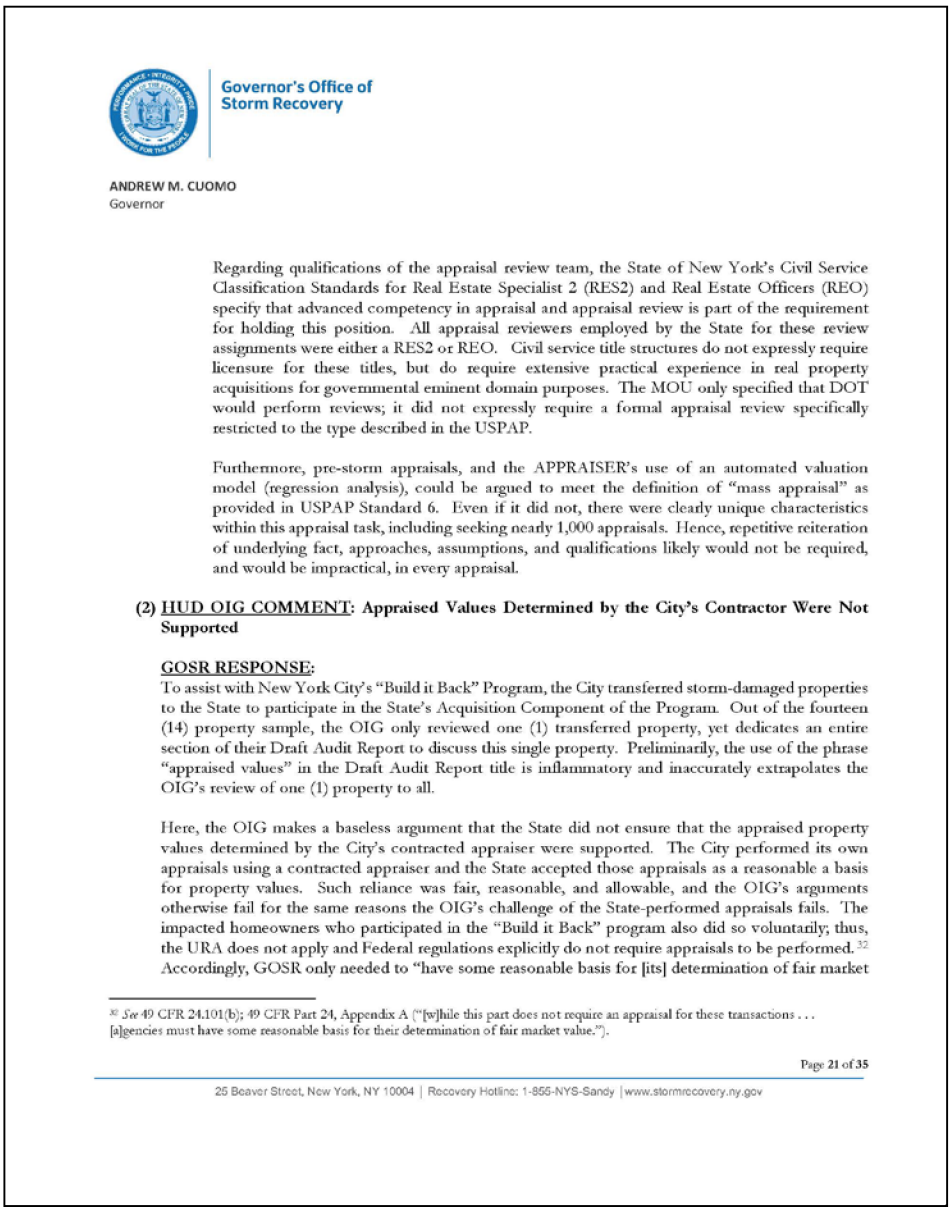

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Regarding qualifications of the appraisal review team, the State of New York's Civil Service Classification Standards for Real Estate Specialist 2 (RES2) and Real Estate Officers (REO) specify that advanced competency in appraisal and appraisal review is part of the requirement for holding this position. All appraisal reviewers employed by the State for these review assignments were either a RES2 or REO. Civil service title structures do not expressly require licensure for these titles, but do require extensive practical experience in real property acquisitions for governmental eminent domain purposes. The MOU only specified that DOT would perform reviews; it did not expressly require a formal appraisal review specifically restricted to the type described in the USPAP.

Furthermore, pre-storm appraisals, and the APPRAISER's use of an automated valuation model (regression analysis), could be argued to meet the definition of "mass appraisal" as provided in USPAP Standard 6. Even if it did not, there were clearly unique characteristics within this appraisal task, including seeking nearly 1,000 appraisals. Hence, repetitive reiteration of underlying fact, approaches, assumptions, and qualifications likely would not be required, and would be impractical, in every appraisal.

(2) HUD OIG COMMENT: Appraised Values Determined by the City's Contractor Were Not Supported

GOSR RESPONSE:
To assist with New York City's "Build it Back" Program, the City transferred storm-damaged properties to the State to participate in the State's Acquisition Component of the Program. Out of the fourteen (14) property sample, the OIG only reviewed one (1) transferred property, yet dedicates an entire section of their Draft Audit Report to discuss this single property. Preliminarily, the use of the phrase "appraised values" in the Draft Audit Report title is inflammatory and inaccurately extrapolates the OIG's review of one (1) property to all.

Here, the OIG makes a baseless argument that the State did not ensure that the appraised property values determined by the City's contracted appraiser were supported. The City performed its own appraisals using a contracted appraiser and the State accepted those appraisals as a reasonable a basis for property values. Such reliance was fair, reasonable, and allowable, and the OIG's arguments otherwise fail for the same reasons the OIG's challenge of the State-performed appraisals fails. The impacted homeowners who participated in the "Build it Back" program also did so voluntarily; thus, the URA does not apply and Federal regulations explicitly do not require appraisals to be performed.[32] Accordingly, GOSR only needed to "have some reasonable basis for [its] determination of fair market

[32] *See* 49 CFR 24.101(b); 49 CFR Part 24, Appendix A ("[w]hile this part does not require an appraisal for these transactions . . . [a]gencies must have some reasonable basis for their determination of fair market value.").

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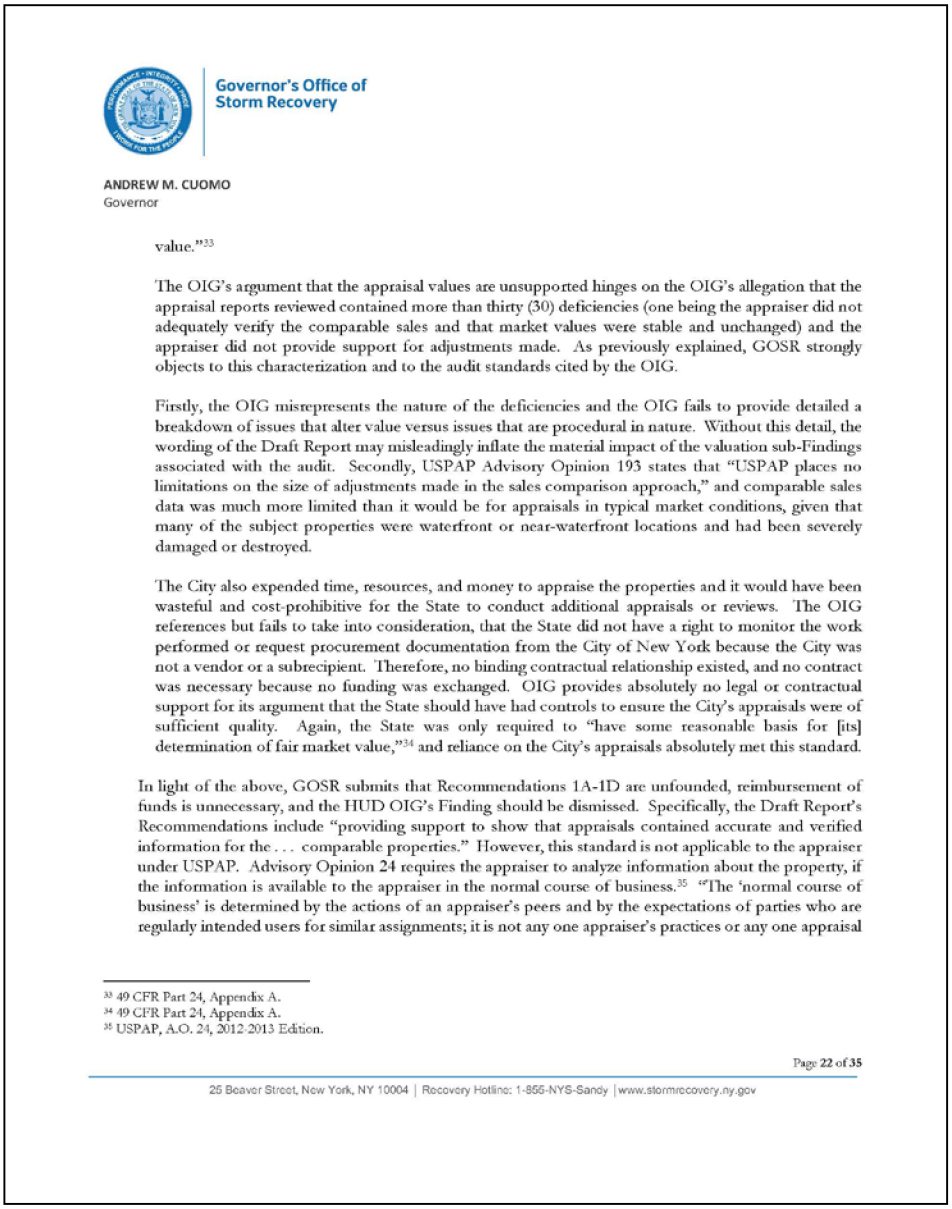

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value."[33]

The OIG's argument that the appraisal values are unsupported hinges on the OIG's allegation that the appraisal reports reviewed contained more than thirty (30) deficiencies (one being the appraiser did not adequately verify the comparable sales and that market values were stable and unchanged) and the appraiser did not provide support for adjustments made. As previously explained, GOSR strongly objects to this characterization and to the audit standards cited by the OIG.

Firstly, the OIG misrepresents the nature of the deficiencies and the OIG fails to provide detailed a breakdown of issues that alter value versus issues that are procedural in nature. Without this detail, the wording of the Draft Report may misleadingly inflate the material impact of the valuation sub-Findings associated with the audit. Secondly, USPAP Advisory Opinion 193 states that "USPAP places no limitations on the size of adjustments made in the sales comparison approach," and comparable sales data was much more limited than it would be for appraisals in typical market conditions, given that many of the subject properties were waterfront or near-waterfront locations and had been severely damaged or destroyed.

The City also expended time, resources, and money to appraise the properties and it would have been wasteful and cost-prohibitive for the State to conduct additional appraisals or reviews. The OIG references but fails to take into consideration, that the State did not have a right to monitor the work performed or request procurement documentation from the City of New York because the City was not a vendor or a subrecipient. Therefore, no binding contractual relationship existed, and no contract was necessary because no funding was exchanged. OIG provides absolutely no legal or contractual support for its argument that the State should have had controls to ensure the City's appraisals were of sufficient quality. Again, the State was only required to "have some reasonable basis for [its] determination of fair market value,"[34] and reliance on the City's appraisals absolutely met this standard.

In light of the above, GOSR submits that Recommendations 1A-1D are unfounded, reimbursement of funds is unnecessary, and the HUD OIG's Finding should be dismissed. Specifically, the Draft Report's Recommendations include "providing support to show that appraisals contained accurate and verified information for the . . . comparable properties." However, this standard is not applicable to the appraiser under USPAP. Advisory Opinion 24 requires the appraiser to analyze information about the property, if the information is available to the appraiser in the normal course of business.[35] "The 'normal course of business' is determined by the actions of an appraiser's peers and by the expectations of parties who are regularly intended users for similar assignments; it is not any one appraiser's practices or any one appraisal

[33] 49 CFR Part 24, Appendix A.
[34] 49 CFR Part 24, Appendix A.
[35] USPAP, A.O. 24, 2012-2013 Edition.

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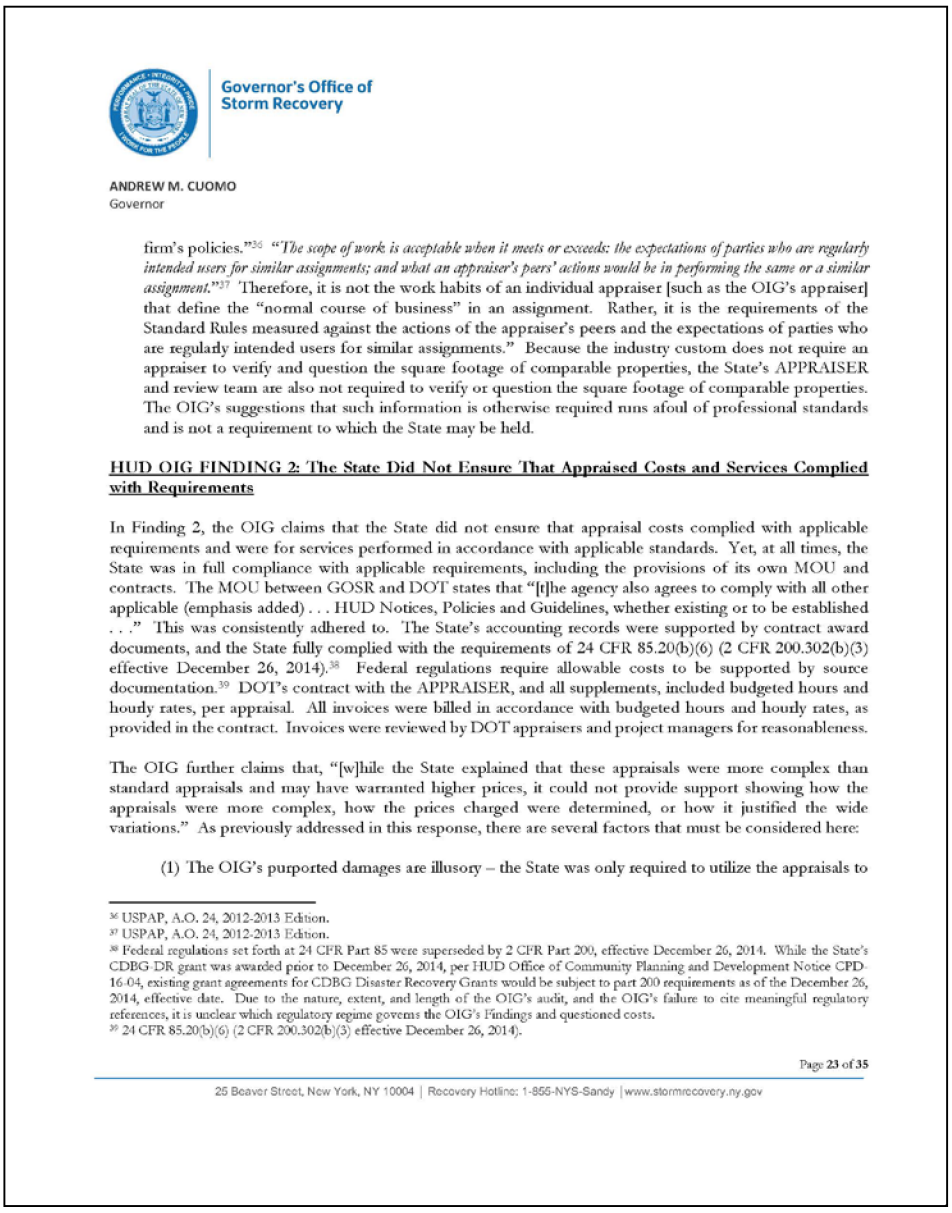

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firm's policies."[36] *"The scope of work is acceptable when it meets or exceeds: the expectations of parties who are regularly intended users for similar assignments; and what an appraiser's peers' actions would be in performing the same or a similar assignment."*[37] Therefore, it is not the work habits of an individual appraiser [such as the OIG's appraiser] that define the "normal course of business" in an assignment. Rather, it is the requirements of the Standard Rules measured against the actions of the appraiser's peers and the expectations of parties who are regularly intended users for similar assignments." Because the industry custom does not require an appraiser to verify and question the square footage of comparable properties, the State's APPRAISER and review team are also not required to verify or question the square footage of comparable properties. The OIG's suggestions that such information is otherwise required runs afoul of professional standards and is not a requirement to which the State may be held.

HUD OIG FINDING 2: The State Did Not Ensure That Appraised Costs and Services Complied with Requirements

In Finding 2, the OIG claims that the State did not ensure that appraisal costs complied with applicable requirements and were for services performed in accordance with applicable standards. Yet, at all times, the State was in full compliance with applicable requirements, including the provisions of its own MOU and contracts. The MOU between GOSR and DOT states that "[t]he agency also agrees to comply with all other applicable (emphasis added) . . . HUD Notices, Policies and Guidelines, whether existing or to be established . . ." This was consistently adhered to. The State's accounting records were supported by contract award documents, and the State fully complied with the requirements of 24 CFR 85.20(b)(6) (2 CFR 200.302(b)(3) effective December 26, 2014).[38] Federal regulations require allowable costs to be supported by source documentation.[39] DOT's contract with the APPRAISER, and all supplements, included budgeted hours and hourly rates, per appraisal. All invoices were billed in accordance with budgeted hours and hourly rates, as provided in the contract. Invoices were reviewed by DOT appraisers and project managers for reasonableness.

The OIG further claims that, "[w]hile the State explained that these appraisals were more complex than standard appraisals and may have warranted higher prices, it could not provide support showing how the appraisals were more complex, how the prices charged were determined, or how it justified the wide variations." As previously addressed in this response, there are several factors that must be considered here:

(1) The OIG's purported damages are illusory – the State was only required to utilize the appraisals to

[36] USPAP, A.O. 24, 2012-2013 Edition.
[37] USPAP, A.O. 24, 2012-2013 Edition.
[38] Federal regulations set forth at 24 CFR Part 85 were superseded by 2 CFR Part 200, effective December 26, 2014. While the State's CDBG-DR grant was awarded prior to December 26, 2014, per HUD Office of Community Planning and Development Notice CPD-16-04, existing grant agreements for CDBG Disaster Recovery Grants would be subject to part 200 requirements as of the December 26, 2014, effective date. Due to the nature, extent, and length of the OIG's audit, and the OIG's failure to cite meaningful regulatory references, it is unclear which regulatory regime governs the OIG's Findings and questioned costs.
[39] 24 CFR 85.20(b)(6) (2 CFR 200.302(b)(3) effective December 26, 2014).

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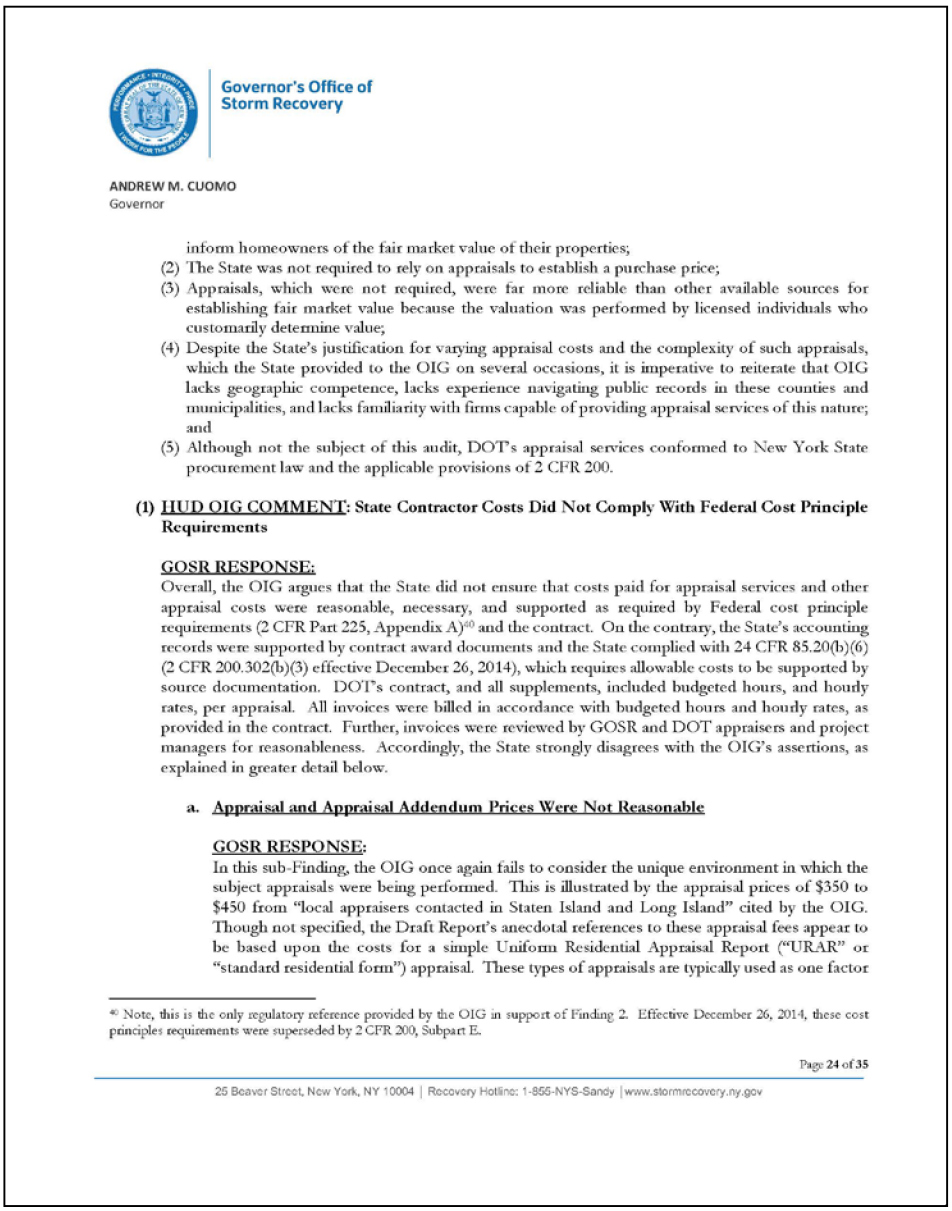

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inform homeowners of the fair market value of their properties;
(2) The State was not required to rely on appraisals to establish a purchase price;
(3) Appraisals, which were not required, were far more reliable than other available sources for establishing fair market value because the valuation was performed by licensed individuals who customarily determine value;
(4) Despite the State's justification for varying appraisal costs and the complexity of such appraisals, which the State provided to the OIG on several occasions, it is imperative to reiterate that OIG lacks geographic competence, lacks experience navigating public records in these counties and municipalities, and lacks familiarity with firms capable of providing appraisal services of this nature; and
(5) Although not the subject of this audit, DOT's appraisal services conformed to New York State procurement law and the applicable provisions of 2 CFR 200.

(1) HUD OIG COMMENT: State Contractor Costs Did Not Comply With Federal Cost Principle Requirements

GOSR RESPONSE:
Overall, the OIG argues that the State did not ensure that costs paid for appraisal services and other appraisal costs were reasonable, necessary, and supported as required by Federal cost principle requirements (2 CFR Part 225, Appendix A)[40] and the contract. On the contrary, the State's accounting records were supported by contract award documents and the State complied with 24 CFR 85.20(b)(6) (2 CFR 200.302(b)(3) effective December 26, 2014), which requires allowable costs to be supported by source documentation. DOT's contract, and all supplements, included budgeted hours, and hourly rates, per appraisal. All invoices were billed in accordance with budgeted hours and hourly rates, as provided in the contract. Further, invoices were reviewed by GOSR and DOT appraisers and project managers for reasonableness. Accordingly, the State strongly disagrees with the OIG's assertions, as explained in greater detail below.

a. Appraisal and Appraisal Addendum Prices Were Not Reasonable

GOSR RESPONSE:
In this sub-Finding, the OIG once again fails to consider the unique environment in which the subject appraisals were being performed. This is illustrated by the appraisal prices of $350 to $450 from "local appraisers contacted in Staten Island and Long Island" cited by the OIG. Though not specified, the Draft Report's anecdotal references to these appraisal fees appear to be based upon the costs for a simple Uniform Residential Appraisal Report ("URAR" or "standard residential form") appraisal. These types of appraisals are typically used as one factor

[40] Note, this is the only regulatory reference provided by the OIG in support of Finding 2. Effective December 26, 2014, these cost principles requirements were superseded by 2 CFR 200, Subpart E.

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to ensure that mortgage loans have sufficient value to reduce loan risk, along with other risk-mitigating factors such as down-payments, mortgage insurance, and collection remedies which would also be present in the mortgage-lending world. Such a simple URAR residential form appraisal would not at all be applicable to the circumstances under the Project, whereby (1) the properties were subject to extensive storm damage or obliteration, (2) to complete an appraisal, additional effort was required to establish prior retrospective property conditions had the disasters not occurred, and (3) appraisal prices factored in a lack of public records and neighborhood-wide, municipality-wide and regional devastation to the housing market. Further, DOT is responsible for numerous property acquisition projects across the State each year, performed in accordance with Federal cost principles, and often pays $1,000 to $1,200 for simple land acquisition appraisals.

For the appraisal services performed, the contracted hourly labor rate[41] was reasonable, established through a public competitive procurement, and awarded based on a best-value determination of all qualified proposers. Supporting documentation pertaining to this procurement was previously provided to the OIG. Award criteria included: (a) technical and management evaluation (70%) of experience, location of the firm related to the geographic area for which the proposal was based, ability to provide specified deliverables in electronic format, etc., and (b) cost evaluation (30%). DOT awarded this contract to multiple consultants per region, resulting in a pool of eligible consultant firms. As is common in State contracts for similar services, the contract reserved the express authority to expand and supplement the scope of work.

DOT received forty-three (43) proposals for appraisal services in the regions that are the subject of this audit in response to DOT's 2009 competitive procurement. The average four (4)-year hourly price of all forty-three (43) proposals totaled $151.79 per hour, which included pricing from firms that were not awarded contracts by DOT; this sample represents the industry landscape. The appraiser consultant's hourly price, averaged throughout their four (4)-year proposal, totaled $157.50. Though cost was only one factor in DOT's best value source selection, because the consultant's average price was within 3.6% of the average competitive market, the consultant's prices are reasonable and justifiable under State procurement law and Federal cost principles, and the OIG's references related to "[appraisal] prices for single-family residential properties" are unfounded.

Prior to issuing the second contract supplement on April 12, 2013, DOT conducted market research into the pool of eligible consultant firms and concluded that the selected consultant APPRAISER (1) was the only appraisal firm with resources to complete the voluminous scope

[41] The hourly rate was initially $150, per the original contract. The rate increased incrementally each year for four (4) years, with the final hourly rate of $165.

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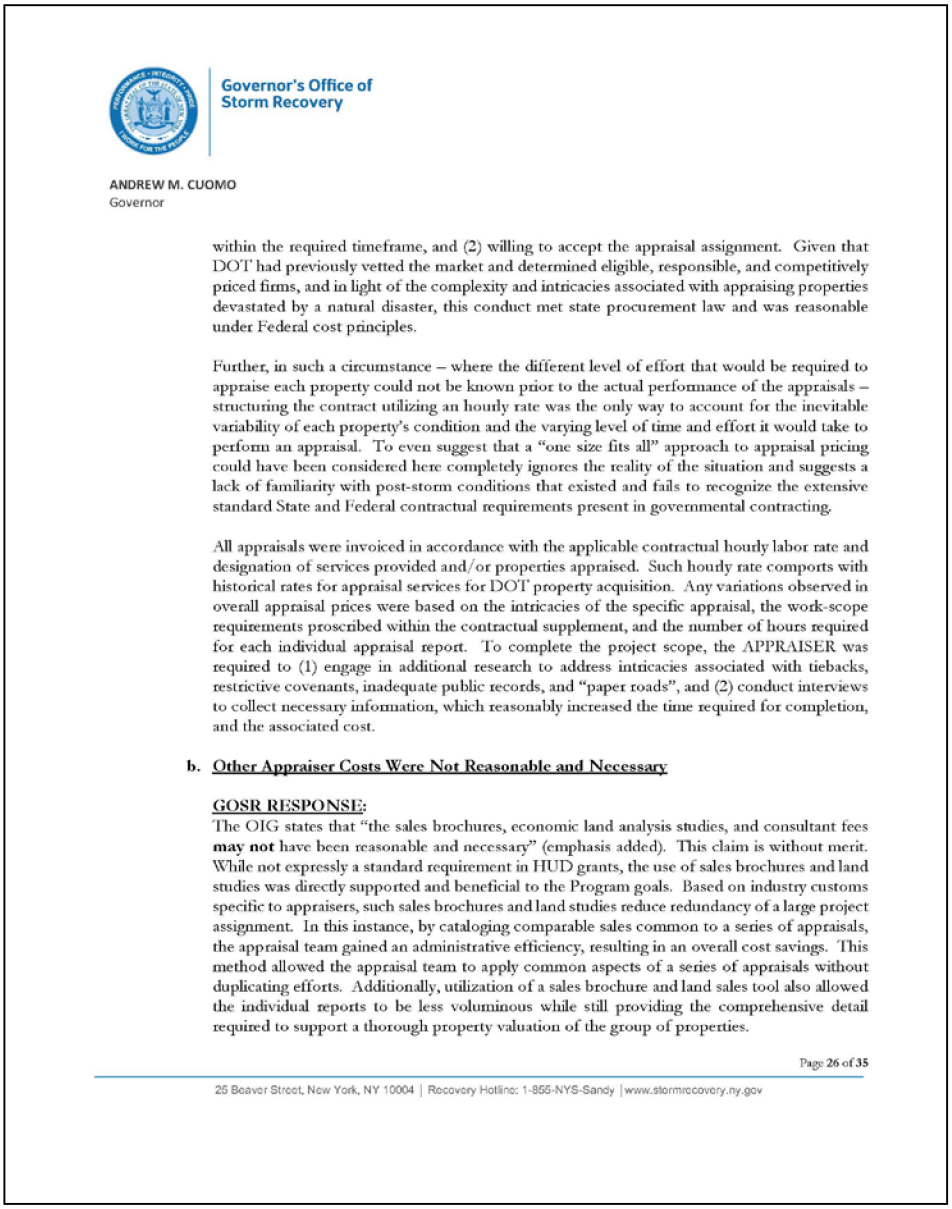

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within the required timeframe, and (2) willing to accept the appraisal assignment. Given that DOT had previously vetted the market and determined eligible, responsible, and competitively priced firms, and in light of the complexity and intricacies associated with appraising properties devastated by a natural disaster, this conduct met state procurement law and was reasonable under Federal cost principles.

Further, in such a circumstance – where the different level of effort that would be required to appraise each property could not be known prior to the actual performance of the appraisals – structuring the contract utilizing an hourly rate was the only way to account for the inevitable variability of each property's condition and the varying level of time and effort it would take to perform an appraisal. To even suggest that a "one size fits all" approach to appraisal pricing could have been considered here completely ignores the reality of the situation and suggests a lack of familiarity with post-storm conditions that existed and fails to recognize the extensive standard State and Federal contractual requirements present in governmental contracting.

All appraisals were invoiced in accordance with the applicable contractual hourly labor rate and designation of services provided and/or properties appraised. Such hourly rate comports with historical rates for appraisal services for DOT property acquisition. Any variations observed in overall appraisal prices were based on the intricacies of the specific appraisal, the work-scope requirements proscribed within the contractual supplement, and the number of hours required for each individual appraisal report. To complete the project scope, the APPRAISER was required to (1) engage in additional research to address intricacies associated with tiebacks, restrictive covenants, inadequate public records, and "paper roads", and (2) conduct interviews to collect necessary information, which reasonably increased the time required for completion, and the associated cost.

b. Other Appraiser Costs Were Not Reasonable and Necessary

GOSR RESPONSE:
The OIG states that "the sales brochures, economic land analysis studies, and consultant fees **may not** have been reasonable and necessary" (emphasis added). This claim is without merit. While not expressly a standard requirement in HUD grants, the use of sales brochures and land studies was directly supported and beneficial to the Program goals. Based on industry customs specific to appraisers, such sales brochures and land studies reduce redundancy of a large project assignment. In this instance, by cataloging comparable sales common to a series of appraisals, the appraisal team gained an administrative efficiency, resulting in an overall cost savings. This method allowed the appraisal team to apply common aspects of a series of appraisals without duplicating efforts. Additionally, utilization of a sales brochure and land sales tool also allowed the individual reports to be less voluminous while still providing the comprehensive detail required to support a thorough property valuation of the group of properties.

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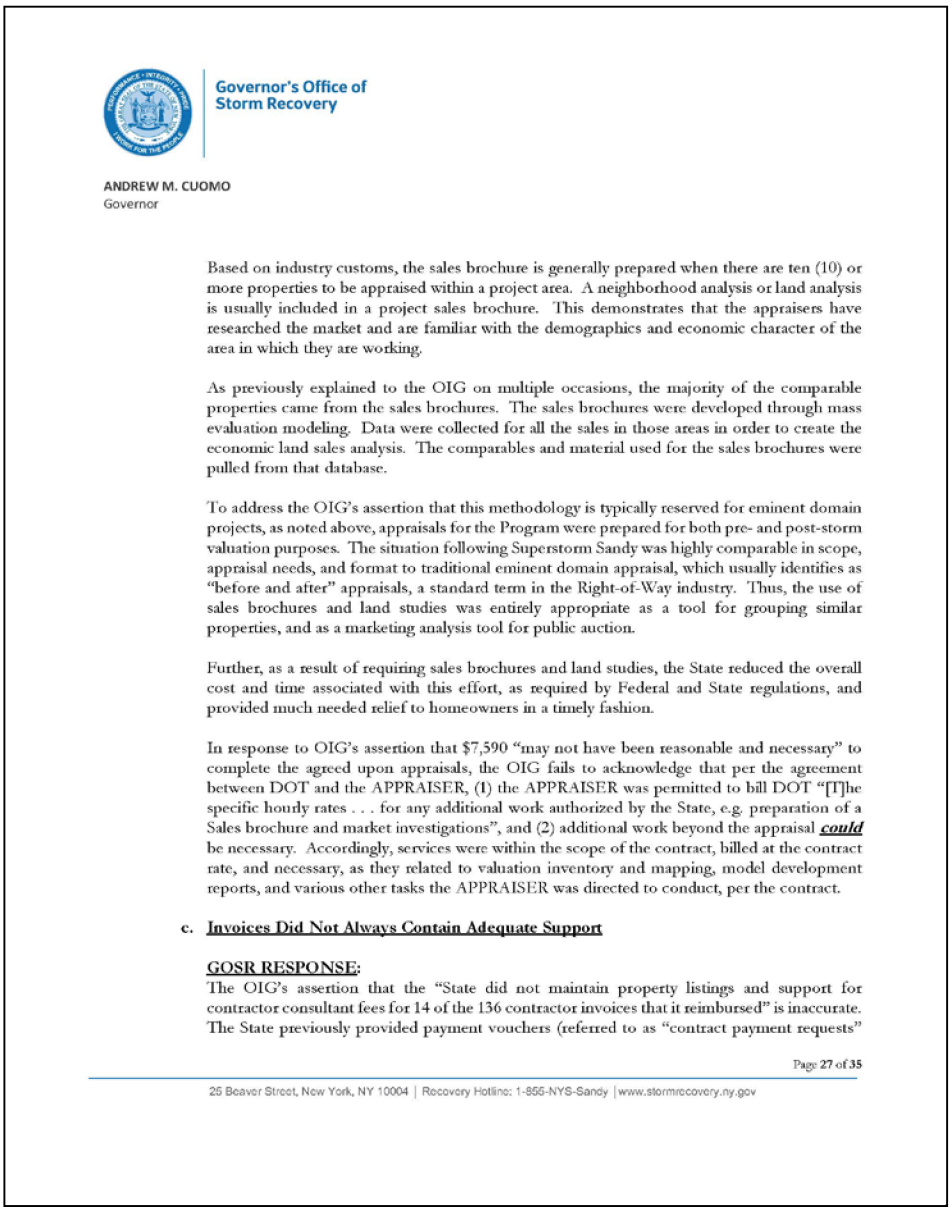

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Based on industry customs, the sales brochure is generally prepared when there are ten (10) or more properties to be appraised within a project area. A neighborhood analysis or land analysis is usually included in a project sales brochure. This demonstrates that the appraisers have researched the market and are familiar with the demographics and economic character of the area in which they are working.

As previously explained to the OIG on multiple occasions, the majority of the comparable properties came from the sales brochures. The sales brochures were developed through mass evaluation modeling. Data were collected for all the sales in those areas in order to create the economic land sales analysis. The comparables and material used for the sales brochures were pulled from that database.

To address the OIG's assertion that this methodology is typically reserved for eminent domain projects, as noted above, appraisals for the Program were prepared for both pre- and post-storm valuation purposes. The situation following Superstorm Sandy was highly comparable in scope, appraisal needs, and format to traditional eminent domain appraisal, which usually identifies as "before and after" appraisals, a standard term in the Right-of-Way industry. Thus, the use of sales brochures and land studies was entirely appropriate as a tool for grouping similar properties, and as a marketing analysis tool for public auction.

Further, as a result of requiring sales brochures and land studies, the State reduced the overall cost and time associated with this effort, as required by Federal and State regulations, and provided much needed relief to homeowners in a timely fashion.

In response to OIG's assertion that $7,590 "may not have been reasonable and necessary" to complete the agreed upon appraisals, the OIG fails to acknowledge that per the agreement between DOT and the APPRAISER, (1) the APPRAISER was permitted to bill DOT "[T]he specific hourly rates . . . for any additional work authorized by the State, e.g. preparation of a Sales brochure and market investigations", and (2) additional work beyond the appraisal ***could*** be necessary. Accordingly, services were within the scope of the contract, billed at the contract rate, and necessary, as they related to valuation inventory and mapping, model development reports, and various other tasks the APPRAISER was directed to conduct, per the contract.

c. **Invoices Did Not Always Contain Adequate Support**

GOSR RESPONSE:
The OIG's assertion that the "State did not maintain property listings and support for contractor consultant fees for 14 of the 136 contractor invoices that it reimbursed" is inaccurate. The State previously provided payment vouchers (referred to as "contract payment requests"

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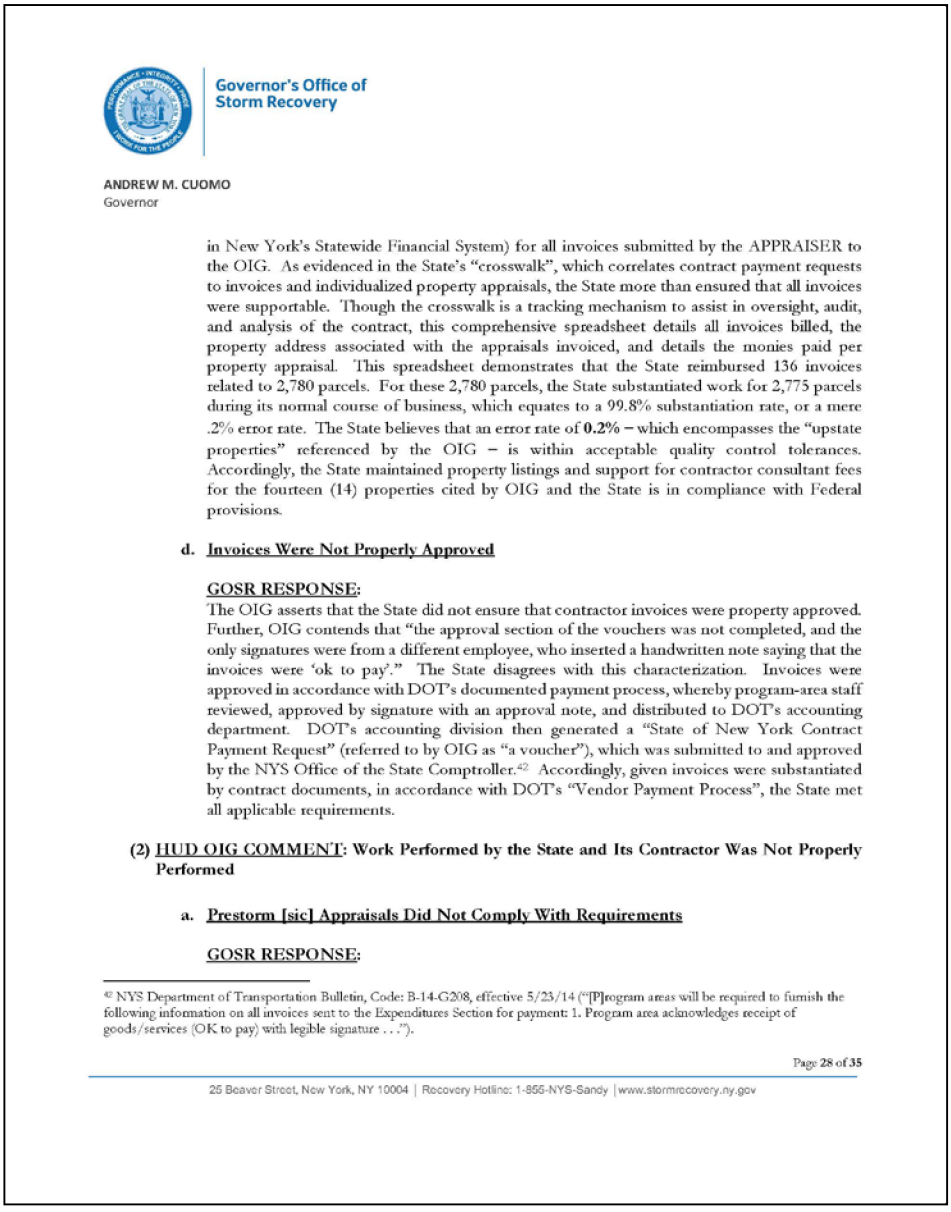

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in New York's Statewide Financial System) for all invoices submitted by the APPRAISER to the OIG. As evidenced in the State's "crosswalk", which correlates contract payment requests to invoices and individualized property appraisals, the State more than ensured that all invoices were supportable. Though the crosswalk is a tracking mechanism to assist in oversight, audit, and analysis of the contract, this comprehensive spreadsheet details all invoices billed, the property address associated with the appraisals invoiced, and details the monies paid per property appraisal. This spreadsheet demonstrates that the State reimbursed 136 invoices related to 2,780 parcels. For these 2,780 parcels, the State substantiated work for 2,775 parcels during its normal course of business, which equates to a 99.8% substantiation rate, or a mere .2% error rate. The State believes that an error rate of **0.2%** – which encompasses the "upstate properties" referenced by the OIG – is within acceptable quality control tolerances. Accordingly, the State maintained property listings and support for contractor consultant fees for the fourteen (14) properties cited by OIG and the State is in compliance with Federal provisions.

d. Invoices Were Not Properly Approved

GOSR RESPONSE:
The OIG asserts that the State did not ensure that contractor invoices were property approved. Further, OIG contends that "the approval section of the vouchers was not completed, and the only signatures were from a different employee, who inserted a handwritten note saying that the invoices were 'ok to pay'." The State disagrees with this characterization. Invoices were approved in accordance with DOT's documented payment process, whereby program-area staff reviewed, approved by signature with an approval note, and distributed to DOT's accounting department. DOT's accounting division then generated a "State of New York Contract Payment Request" (referred to by OIG as "a voucher"), which was submitted to and approved by the NYS Office of the State Comptroller.[42] Accordingly, given invoices were substantiated by contract documents, in accordance with DOT's "Vendor Payment Process", the State met all applicable requirements.

(2) HUD OIG COMMENT: Work Performed by the State and Its Contractor Was Not Properly Performed

a. Prestorm [sic] Appraisals Did Not Comply With Requirements

GOSR RESPONSE:

[42] NYS Department of Transportation Bulletin, Code: B-14-G208, effective 5/23/14 ("[P]rogram areas will be required to furnish the following information on all invoices sent to the Expenditures Section for payment: 1. Program area acknowledges receipt of goods/services (OK to pay) with legible signature . . .").

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Here, the OIG attempts to reallege and reframe same alleged deficiencies with the State's appraisals as was alleged in Finding 1. For all the reasons already explained, the OIG's Finding should be dismissed. As described above, the State and its contractor performed all work in accordance with the contract and professional appraisal standards.[43]

Firstly, the OIG inaccurately claims that for the time value adjustments, the State could not show that the regression model used was supported. However, the regression analysis was performed properly and utilized according to industry standards. The regression analysis used to support this inflation adjustment was also thoroughly developed and tested by the APPRAISER. It was then modified based on the review and feedback from DOT's highly experienced appraisal reviewer team, who utilized their professional judgment, market knowledge, and expertise in property acquisition to provide any necessary feedback.

Secondly, the OIG also claims that the State could not show that the APPRAISER had properly procured the subcontractor who performed the regression analysis; however, this assertion has no statutory or regulatory support, and has to do with quality of work. For-profit prime contractors are **not** required to follow applicable Federal procurement requirements when subcontracting. The Federal procurement requirements set forth at 2 CFR 200.317 through 2 CFR 200.326[44] only apply to "non-federal entities." 2 CFR 200.317 states "[w]hen procuring property and services under a Federal award, a state must follow the same policies and procedures it uses for procurements from its non-Federal funds . . . [a]ll other non-Federal entities, including subrecipients of a state, will follow §§ 200.318 General procurement standards through 200.326 Contract provisions." Federal regulations define "non-Federal entity" as a "local government, Indian tribe, institution of higher education (IHE), or nonprofit organization that carries out a Federal award as a recipient or subrecipient."[45] For-profit contractors are **not** classified as non-Federal entities or subrecipients, and therefore not required to follow Federal procurement standards.

Thirdly, the OIG claims that the State could not show that multiple valuation models had been developed, refined and tested as required by the MOU and contract. The MOU only requires, "[d]evelopment of multiple valuation models for distinct property types within the study area, using carefully refined (rigorously tested by NYS certified appraisers, through conventional

[43] The OIG's use of the phrase "other requirements" is vague and misleading.
[44] As discussed above, Federal regulations set forth at 24 CFR Part 85 were superseded by 2 CFR Part 200, effective December 26, 2014. Due to the nature, extent, and length of the OIG's audit, and the OIG's failure to cite meaningful regulatory references, it is unclear which regulatory regime governs the OIG's Findings and questioned costs. However, for-profit contractors were also not required to follow Federal procurement requirements when subcontracting under the superseded regulations. 24 CFR 85.36(a) states "[w]hen procuring property and services under a grant, a State will follow the same policies and procedures it uses for procurements from its non-Federal funds . . . [o]ther grantees and subgrantees will follow paragraphs (b) through (i) in this section." A for-profit contractor is neither a grantee or a subgrantee.
[45] 2 CFR 200.69.

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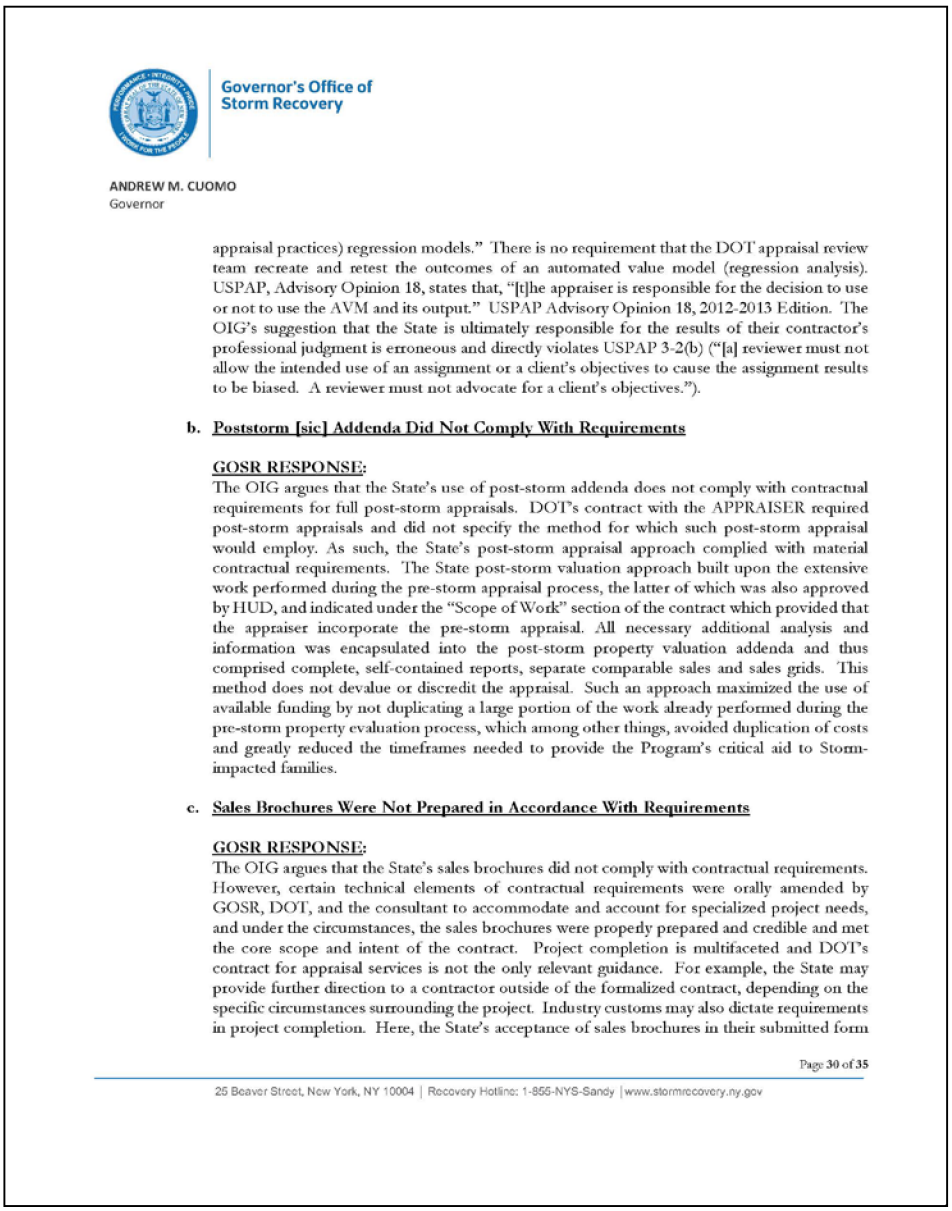

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appraisal practices) regression models." There is no requirement that the DOT appraisal review team recreate and retest the outcomes of an automated value model (regression analysis). USPAP, Advisory Opinion 18, states that, "[t]he appraiser is responsible for the decision to use or not to use the AVM and its output." USPAP Advisory Opinion 18, 2012-2013 Edition. The OIG's suggestion that the State is ultimately responsible for the results of their contractor's professional judgment is erroneous and directly violates USPAP 3-2(b) ("[a] reviewer must not allow the intended use of an assignment or a client's objectives to cause the assignment results to be biased. A reviewer must not advocate for a client's objectives.").

b. Poststorm [sic] Addenda Did Not Comply With Requirements

GOSR RESPONSE:
The OIG argues that the State's use of post-storm addenda does not comply with contractual requirements for full post-storm appraisals. DOT's contract with the APPRAISER required post-storm appraisals and did not specify the method for which such post-storm appraisal would employ. As such, the State's post-storm appraisal approach complied with material contractual requirements. The State post-storm valuation approach built upon the extensive work performed during the pre-storm appraisal process, the latter of which was also approved by HUD, and indicated under the "Scope of Work" section of the contract which provided that the appraiser incorporate the pre-storm appraisal. All necessary additional analysis and information was encapsulated into the post-storm property valuation addenda and thus comprised complete, self-contained reports, separate comparable sales and sales grids. This method does not devalue or discredit the appraisal. Such an approach maximized the use of available funding by not duplicating a large portion of the work already performed during the pre-storm property evaluation process, which among other things, avoided duplication of costs and greatly reduced the timeframes needed to provide the Program's critical aid to Storm-impacted families.

c. Sales Brochures Were Not Prepared in Accordance With Requirements

GOSR RESPONSE:
The OIG argues that the State's sales brochures did not comply with contractual requirements. However, certain technical elements of contractual requirements were orally amended by GOSR, DOT, and the consultant to accommodate and account for specialized project needs, and under the circumstances, the sales brochures were properly prepared and credible and met the core scope and intent of the contract. Project completion is multifaceted and DOT's contract for appraisal services is not the only relevant guidance. For example, the State may provide further direction to a contractor outside of the formalized contract, depending on the specific circumstances surrounding the project. Industry customs may also dictate requirements in project completion. Here, the State's acceptance of sales brochures in their submitted form

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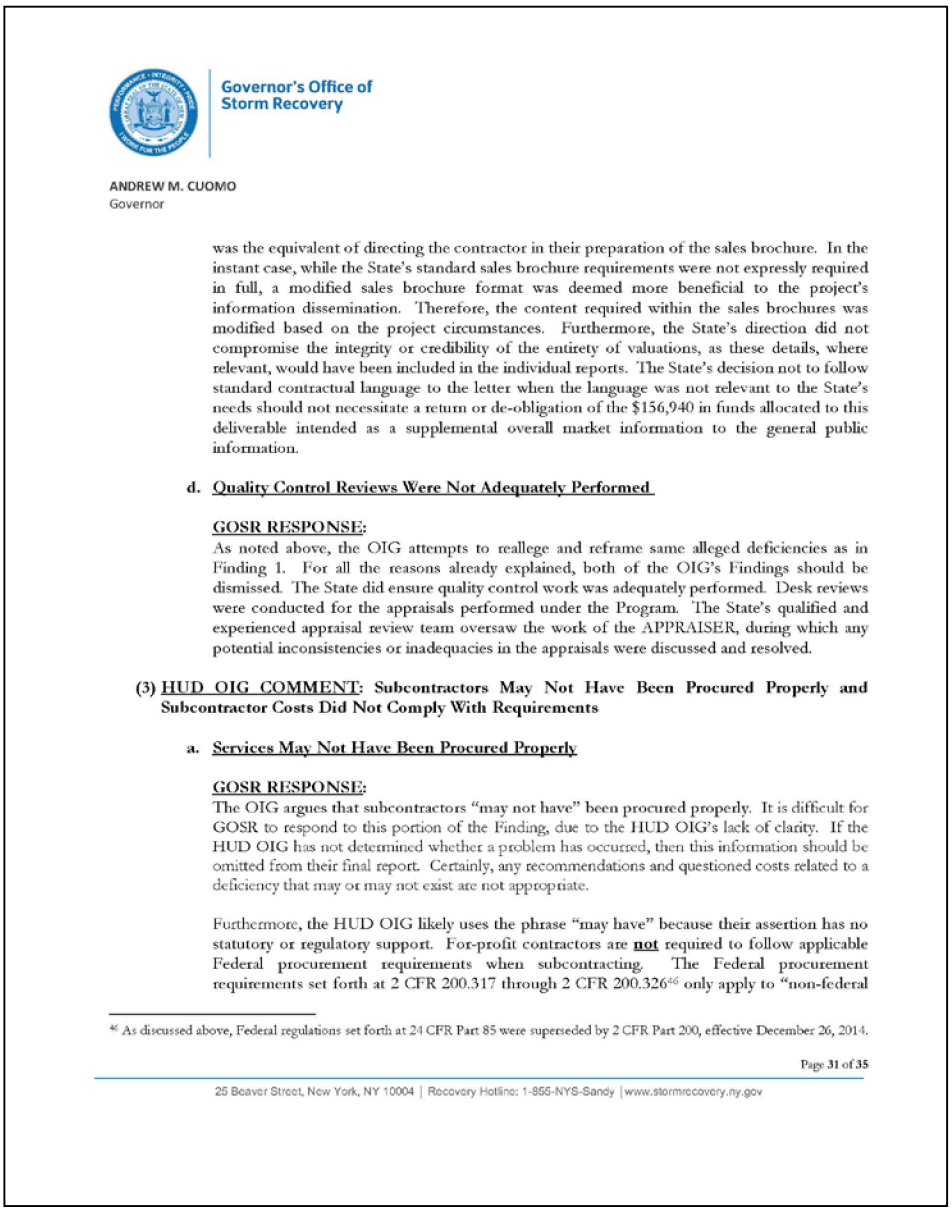

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was the equivalent of directing the contractor in their preparation of the sales brochure. In the instant case, while the State's standard sales brochure requirements were not expressly required in full, a modified sales brochure format was deemed more beneficial to the project's information dissemination. Therefore, the content required within the sales brochures was modified based on the project circumstances. Furthermore, the State's direction did not compromise the integrity or credibility of the entirety of valuations, as these details, where relevant, would have been included in the individual reports. The State's decision not to follow standard contractual language to the letter when the language was not relevant to the State's needs should not necessitate a return or de-obligation of the $156,940 in funds allocated to this deliverable intended as a supplemental overall market information to the general public information.

d. Quality Control Reviews Were Not Adequately Performed

GOSR RESPONSE:
As noted above, the OIG attempts to reallege and reframe same alleged deficiencies as in Finding 1. For all the reasons already explained, both of the OIG's Findings should be dismissed. The State did ensure quality control work was adequately performed. Desk reviews were conducted for the appraisals performed under the Program. The State's qualified and experienced appraisal review team oversaw the work of the APPRAISER, during which any potential inconsistencies or inadequacies in the appraisals were discussed and resolved.

(3) HUD OIG COMMENT: Subcontractors May Not Have Been Procured Properly and Subcontractor Costs Did Not Comply With Requirements

a. Services May Not Have Been Procured Properly

GOSR RESPONSE:
The OIG argues that subcontractors "may not have" been procured properly. It is difficult for GOSR to respond to this portion of the Finding, due to the HUD OIG's lack of clarity. If the HUD OIG has not determined whether a problem has occurred, then this information should be omitted from their final report. Certainly, any recommendations and questioned costs related to a deficiency that may or may not exist are not appropriate.

Furthermore, the HUD OIG likely uses the phrase "may have" because their assertion has no statutory or regulatory support. For-profit contractors are **not** required to follow applicable Federal procurement requirements when subcontracting. The Federal procurement requirements set forth at 2 CFR 200.317 through 2 CFR 200.326[46] only apply to "non-federal

[46] As discussed above, Federal regulations set forth at 24 CFR Part 85 were superseded by 2 CFR Part 200, effective December 26, 2014.

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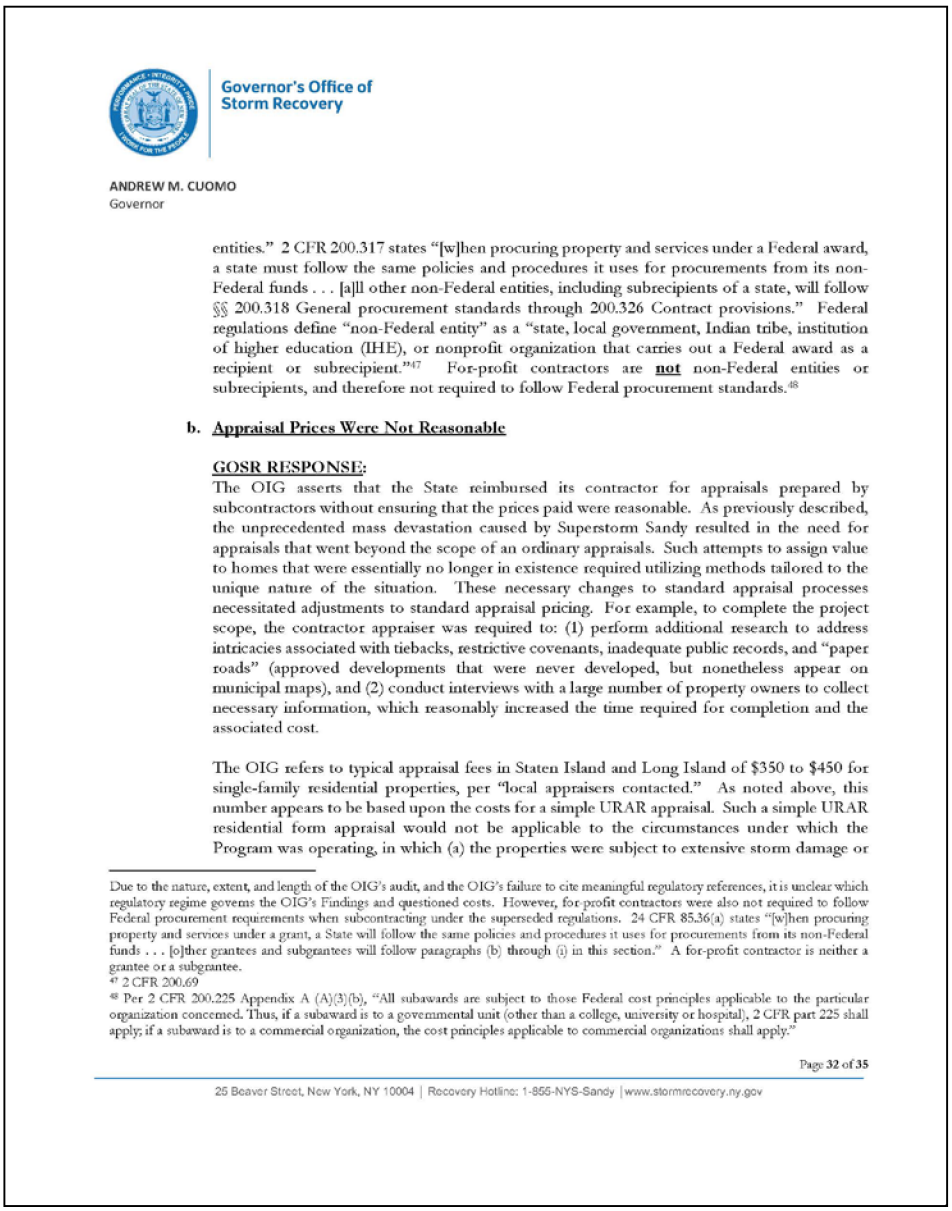

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entities." 2 CFR 200.317 states "[w]hen procuring property and services under a Federal award, a state must follow the same policies and procedures it uses for procurements from its non-Federal funds . . . [a]ll other non-Federal entities, including subrecipients of a state, will follow §§ 200.318 General procurement standards through 200.326 Contract provisions." Federal regulations define "non-Federal entity" as a "state, local government, Indian tribe, institution of higher education (IHE), or nonprofit organization that carries out a Federal award as a recipient or subrecipient."[47] For-profit contractors are **not** non-Federal entities or subrecipients, and therefore not required to follow Federal procurement standards.[48]

b. Appraisal Prices Were Not Reasonable

GOSR RESPONSE:

The OIG asserts that the State reimbursed its contractor for appraisals prepared by subcontractors without ensuring that the prices paid were reasonable. As previously described, the unprecedented mass devastation caused by Superstorm Sandy resulted in the need for appraisals that went beyond the scope of an ordinary appraisals. Such attempts to assign value to homes that were essentially no longer in existence required utilizing methods tailored to the unique nature of the situation. These necessary changes to standard appraisal processes necessitated adjustments to standard appraisal pricing. For example, to complete the project scope, the contractor appraiser was required to: (1) perform additional research to address intricacies associated with tiebacks, restrictive covenants, inadequate public records, and "paper roads" (approved developments that were never developed, but nonetheless appear on municipal maps), and (2) conduct interviews with a large number of property owners to collect necessary information, which reasonably increased the time required for completion and the associated cost.

The OIG refers to typical appraisal fees in Staten Island and Long Island of $350 to $450 for single-family residential properties, per "local appraisers contacted." As noted above, this number appears to be based upon the costs for a simple URAR appraisal. Such a simple URAR residential form appraisal would not be applicable to the circumstances under which the Program was operating, in which (a) the properties were subject to extensive storm damage or

Due to the nature, extent, and length of the OIG's audit, and the OIG's failure to cite meaningful regulatory references, it is unclear which regulatory regime governs the OIG's Findings and questioned costs. However, for-profit contractors were also not required to follow Federal procurement requirements when subcontracting under the superseded regulations. 24 CFR 85.36(a) states "[w]hen procuring property and services under a grant, a State will follow the same policies and procedures it uses for procurements from its non-Federal funds . . . [o]ther grantees and subgrantees will follow paragraphs (b) through (i) in this section." A for-profit contractor is neither a grantee or a subgrantee.

[47] 2 CFR 200.69

[48] Per 2 CFR 200.225 Appendix A (A)(3)(b), "All subawards are subject to those Federal cost principles applicable to the particular organization concerned. Thus, if a subaward is to a governmental unit (other than a college, university or hospital), 2 CFR part 225 shall apply; if a subaward is to a commercial organization, the cost principles applicable to commercial organizations shall apply."

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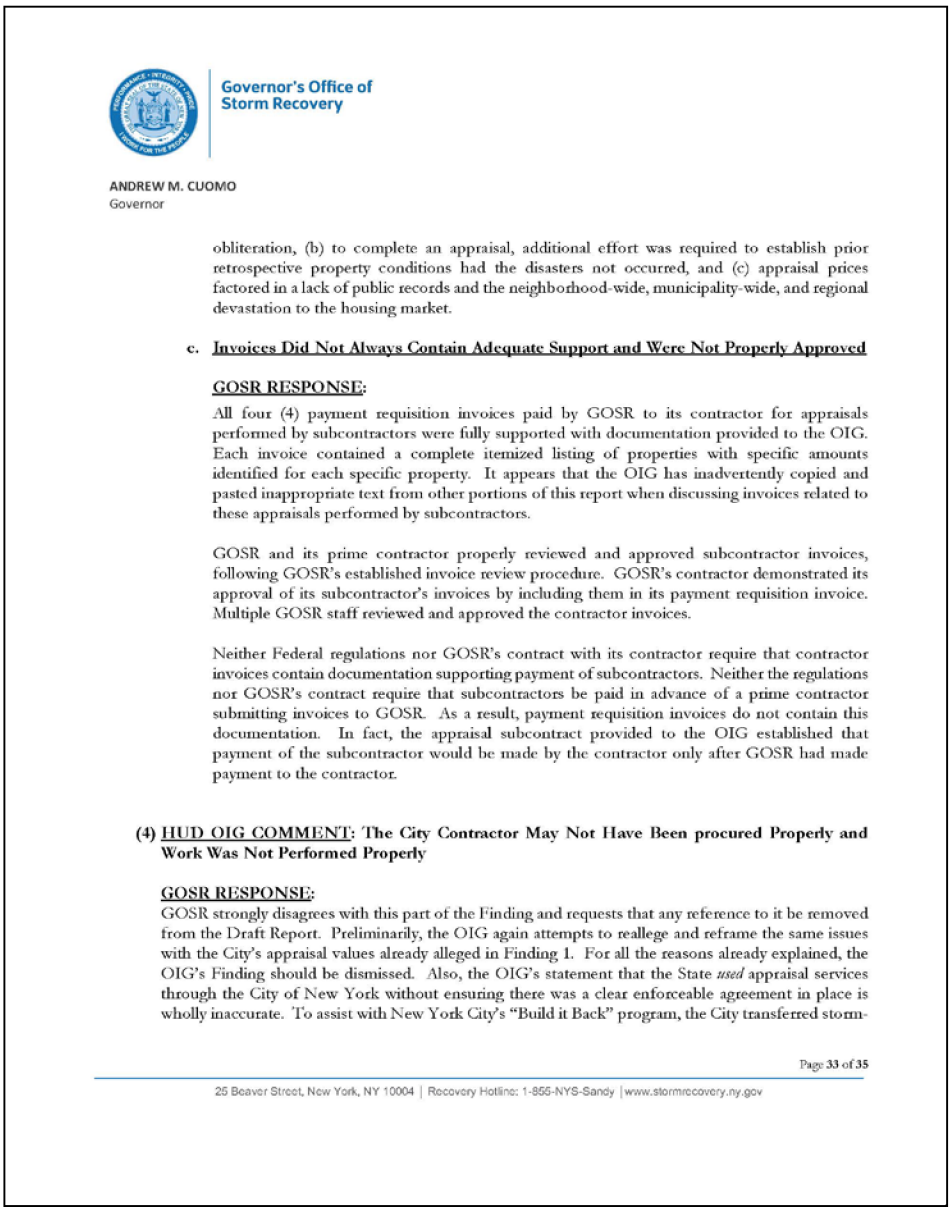
Comments 31 and 37

Comments 11 and 38



Governor's Office of Storm Recovery

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Governor

obliteration, (b) to complete an appraisal, additional effort was required to establish prior retrospective property conditions had the disasters not occurred, and (c) appraisal prices factored in a lack of public records and the neighborhood-wide, municipality-wide, and regional devastation to the housing market.

c. **Invoices Did Not Always Contain Adequate Support and Were Not Properly Approved**

GOSR RESPONSE:

All four (4) payment requisition invoices paid by GOSR to its contractor for appraisals performed by subcontractors were fully supported with documentation provided to the OIG. Each invoice contained a complete itemized listing of properties with specific amounts identified for each specific property. It appears that the OIG has inadvertently copied and pasted inappropriate text from other portions of this report when discussing invoices related to these appraisals performed by subcontractors.

GOSR and its prime contractor properly reviewed and approved subcontractor invoices, following GOSR's established invoice review procedure. GOSR's contractor demonstrated its approval of its subcontractor's invoices by including them in its payment requisition invoice. Multiple GOSR staff reviewed and approved the contractor invoices.

Neither Federal regulations nor GOSR's contract with its contractor require that contractor invoices contain documentation supporting payment of subcontractors. Neither the regulations nor GOSR's contract require that subcontractors be paid in advance of a prime contractor submitting invoices to GOSR. As a result, payment requisition invoices do not contain this documentation. In fact, the appraisal subcontract provided to the OIG established that payment of the subcontractor would be made by the contractor only after GOSR had made payment to the contractor.

(4) HUD OIG COMMENT: The City Contractor May Not Have Been procured Properly and Work Was Not Performed Properly

GOSR RESPONSE:

GOSR strongly disagrees with this part of the Finding and requests that any reference to it be removed from the Draft Report. Preliminarily, the OIG again attempts to reallege and reframe the same issues with the City's appraisal values already alleged in Finding 1. For all the reasons already explained, the OIG's Finding should be dismissed. Also, the OIG's statement that the State *used* appraisal services through the City of New York without ensuring there was a clear enforceable agreement in place is wholly inaccurate. To assist with New York City's "Build it Back" program, the City transferred storm-

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damaged properties to the State to participate in the State's Acquisition component of the Program. The City *performed their own appraisals* and the State *accepted those appraisals* as a reasonable a basis for property values. For reasons previously explained, this reliance was fair, reasonable, and allowable. At no time did the State use the City's appraisal services. There was never a binding contractual relationship between the City and the State, and no contract was necessary because no funding was ever exchanged.

While this section of the Draft Report takes up an entire page, the only new information raised by the OIG is that "the appraisal services provided by the City's contractor may not have been properly procured and performed in accordance with requirements." At no time did the State have anything to do with the City's appraisal services contractor. The State never procured, never paid for, never oversaw, and never managed the City's appraisal services contractor. Accordingly, and review of the City's procurement practices are outside the scope of the OIG's audit. Any allegations or issues related to the City's contractor should be addressed with the City and not included in a Draft Audit report directed to the State. And, once again, the use of the phrase "may have" alone should negate any recommendations and questioned costs related to this section of the Report.

In light of the above, GOSR submits that Recommendations 2A-2F are unfounded, reimbursement of funds is unnecessary, and the HUD OIG's Finding should be dismissed. The State properly performed, procured, and documented its property appraisals, and at all times was in compliance with Federal cost principles.

Should you require further information, please feel free to contact me via email at cassiah.ward@stormrecovery.ny.gov or by phone at (212)480-6457.

Sincerely,

Cassiah M. Ward
Director of Monitoring and Compliance/Senior Counsel
New York Governor's Office of Storm Recovery

Cc: Emily Thompson, Acting General Counsel, GOSR
Thehbia Hiwot, Executive Director of Housing, Buyout, and Acquisition Programs, GOSR
Alana Agosto, Managing Director, Housing and Resiliency Programs, GOSR
Jane Brogan, Chief Policy & Research Officer, GOSR

Appendix A

Comment 8

Comment 9

[redacted]

From: [redacted]
Sent: Tuesday, May 21, 2013 5:56 PM
To: [redacted]
Cc: [redacted]
Subject: FW: Appraisal Reports

[redacted]

As we discussed, I reviewed the Appraisal sample submitted by the State of New York for their Voluntary Buyout Program, and it looks like a reasonable methodology for establishing pre-disaster value. As I mentioned, I thought I would make some additional comments/suggestions about "buyout" programs and URA compliance which might be of value to NYS. Please let me know if you would like to discuss further or if the State would like some additional guidance as noted below. [redacted]

1. The first point has to do with issuing Voluntary Acquisition Letters to the owner. I have attached a sample letter for an entity with Eminent Domain Authority at its disposal. (There is a different letter for entities without eminent domain authority). In order for an Acquisition to qualify as "voluntary" pursuant to the URA, the seller must be informed in writing, prior to entering into a Contract of Sale, that the buyer has eminent domain authority but will not use it. The seller must also be advised of the buyer's estimate of Fair Market Value at that time. Failure to issue this notification timely would trigger the more onerous Involuntary acquisition requirements of the URA.

2. Negotiation: While the URA voluntary acquisition requirements do allow for negotiation once the above notifications have been met, OMB circulars on reasonableness make offers exceeding the market value

1

Comment 9

established by the appraisal difficult to justify. I have attached a Relocation Newsletter from HUD concerning this negotiation problem.

To avoid such problems, the State could have a no negotiation policy and use Incentives only as a means of enticing sellers to participate. From reading the Action Plan, this appears to be the State's intent. Once the Voluntary Acquisition requirements noted in item 1 above are met, the Grantee may negotiate but does not have to because the Seller has the right to refuse any offer without fear of eminent domain being used. For some Grantees, however, a negotiation process has evolved, sometimes haphazardly, as a result of the Grantees desire to acquire all or most of the properties in an area and the seller's desire to get a higher price. If the State anticipates that negotiation may be used (e.g., allowing the seller to provide their own appraisal as a rebuttal), it would be wise to develop a Review and Appeal process on the front end to ensure compliance with OMB circulars and consistency in practice among subrecipients, UGLG'S etc, if any.

In that regard, some Grantees have instituted a formal Appraisal Review process. Under the Involuntary Acquisition requirements, a formal Review of each appraisal by an independent appraiser is required to ensure consistency in the appraisal process. Some Grantees will use this methodology voluntarily to give their initial offerings more weight and to ensure that consistency is maintained even in a Voluntary Acquisition program. The Review appraiser could also be used to review the seller's appraisal to determine if there is "market data" that would substantiate increasing the original offer e.g., a better/more recent comparable sale. The Review appraiser could then cite such market data in a written report and still comply with reasonableness requirements because the revised value established would be based on market data. In cases, where there is no easy market data to use, the review appraiser might be of assistance in developing an Administrative Settlement which is noted in the attached newsletter. If the State wishes to explore these possibilities further, I would be happy to do so.

Comment 8

3. In [redacted] initial email on the appraisal, he notes that an appraisal is encouraged but not required by HUD for the buyouts. To clarify this a bit further, the URA valuation requirements for "Voluntary Acquisitions" do not require appraisals though they are recommended as [redacted] notes. If appraisals are not used, the URA voluntary acquisition requirements do require that the project file document that a reasonable determination of value with supporting evidence was made by someone familiar with real estate values. In addition, the use of CDBG funds requires compliance with OMB circulars as noted above and which emphasize reasonableness of cost as summarized in the following excerpt from Handbook 1378.

> 1) If HUD grant funds are used to acquire properties, acquiring agencies must also be guided by the applicable OMB Circulars when considering the original estimate of market value and any agreement which exceeds that amount. A fundamental requirement in the OMB Circulars is that costs charged to a federal grant must be reasonable. OMB Circular A-87 "Cost Principles for State, Local and Indian Tribal Governments, " in particular, provides that costs must "[b]e necessary and reasonable for proper and efficient performance and administration of Federal awards." Each OMB Circular provides additional guidance on determining whether a cost is reasonable.

2

a) For states, local, and Indian tribal governments, OMB Circular A-87 provides as follows:

(1) A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. The question of reasonableness is particularly important when governmental units or components are predominately federally-funded. In determining reasonableness of a given cost, consideration shall be given to:

(a) Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the governmental unit or the performance of the Federal award,

(b) The restraints or requirements imposed by such factors as: sound business practices; arms length bargaining; Federal, State and other laws and regulations; and, terms and conditions of the Federal award,

(c) Market prices for comparable goods or services,

(d) Whether the individuals concerned acted with prudence in the circumstances considering their responsibilities to the governmental unit, its employees, the public at large, and the Federal Government,

(e) Significant deviations from the established practices of the governmental unit which may unjustifiably increase the Federal award's cost.

OIG Evaluation of Auditee Comments

Comment 1 The State maintained that our report represented the opinion of one professional appraiser with debatable qualifications who reached different conclusions on a subject on which professionals can and often do reasonably disagree. Further, the State maintained that our report could also be seen as an inflammatory misrepresentation of its program and the basic nature of fair market valuations in a disaster recovery setting. As discussed in the Scope and Methodology section, we conducted our audit in accordance with generally accepted government auditing standards and believe that the evidence obtained provides a reasonable basis for our findings and conclusions. In addition to documentation provided by the State, our evidence included documents subpoenaed from the regional real estate multiple listing service and appraisal work files subpoenaed from the State's appraisers. Further, our appraiser had more than 40 years of experience and training in appraising and reviewing appraisals for residential, commercial, and agricultural properties throughout the United States and its territories, including experience related to disaster programs and performing assignments in New York. The opinion of our appraiser, along with the results of audit work performed by an audit team with many years of experience in Federal auditing, including auditing disaster programs, presented an accurate representation of the State's Disaster Recovery-funded program.

Comment 2 The State explained that it should be afforded "maximum feasible deference" when interpreting requirements. We acknowledge that State grantees are afforded maximum feasible deference and believe that we afforded that to the State. Public Law 113-2 required the State to administer funds in accordance with all applicable laws and regulations, and the March 5, 2013, Federal Register notice required it to certify that activities would be administered consistent with its HUD-approved action plans. To administer this activity, the State needed to have procedures to verify the accuracy of the appraised fair market values used to determine award amounts under the program. The State used appraisals to determine the prestorm and poststorm fair market value of properties purchased, and it used contracts and a memorandum of understanding with the State agency that required compliance with USPAP, the Uniform Relocation Assistance and Real Property Acquisitions Policies Act (URA), Federal regulations at 49 CFR Part 24, and other common appraisal requirements. As part of our audit, we reviewed the appraisals against the appraisal criteria and methodology the State used, including other common appraisal requirements. In addition, we measured costs against Federal cost principle requirements, which the State was required to follow. Our review determined that the State could not provide justification for the excessive appraisal adjustments and the more than 400 deficiencies in the appraisals and addendum reports, including many that impacted the value determinations, found to be in noncompliance with applicable regulations, industry standards, the Federal National Mortgage Association's (Fannie Mae) Selling Guide, and HUD Handbook 4150.2. Further, we found that the State did

not ensure that appraisal costs complied with applicable Federal, State, and industry standards.

Comment 3 The State explained that conducting appraisals, although not required, provided the most fair, impartial, and cost-effective methodology for determining a property's fair market value. The State further explained that it entered into a memorandum of understanding with the State's Department of Transportation (agency) and together they partnered with an expert appraisal consultant that it considered uniquely qualified to determine the fair market values of properties. As discussed in the Followup on Prior Audits section, we previously identified concerns related to the procurement of the contractor used to appraise 13 of the 14 properties reviewed for this audit. However, we do not object to the fact that the State conducted appraisals to determine the fair market value of properties. Rather, while we recognize that it could have selected a different method to determine fair market values, once the State selected the appraisal method, it was important that the appraisals be carried out in accordance with the memorandum of understanding and contract and that the values be supported because they were used to determine how much the State paid to purchase the properties.

Comment 4 The State maintained that determining prestorm and poststorm home values proved to be a challenge, particularly because the geographic areas involved did not contain homogenous housing stock. It stated that property valuation data were forensically reassembled and its appraisal team was up to the challenge and ensured that property information and values were accurate and reasonable. We disagree. Multiple listing service data subpoenaed for Staten Island and Long Island showed that the housing stock contained in areas where buyouts occurred were homogenous. For example, we sorted the data by type and characteristic and concluded that the housing stock was similar. Further, as discussed in finding 1, our review of the sampled appraisals identified more than 400 deficiencies, including many that would have impacted the value determinations, and showed that the appraiser did not always follow the requirements laid out in the agreement and contract and other commonly used appraisal requirements.

Comment 5 The State noted that we audited its program three times, expressed concerns with the timeliness of the reviews and communication, and indicated that it had dedicated countless resources and hours in responding to our requests. The State is correct that we have conducted three audits. We issued the final report for the first audit in 2015 and for the second audit after the State provided its comments in 2019. The first audit report focused on participant eligibility under the buyout component of the program (audit report 2015-NY-1010, issued September 17, 2015). The second report focused on property eligibility under the acquisition component of the program (audit report 2019-NY-1001, issued March 29, 2019). This audit report focused on the appraised fair market values used to determine the amounts paid to purchase properties under both components and on the costs paid for appraisal services. Due to the size of the program, it is not unusual to initiate a series of audits for different reasons and with unique focuses. The State

is correct that there were some gaps in communication during the current audit. However, the State was provided preliminary and detailed results on multiple occasions and given ample opportunity to provide any additional documentation or information needed to clear the findings. While we appreciate the effort the State made throughout the audits, it had not provided a detailed response to the appraisal deficiencies as of the date of this report.

Comment 6 The State stated that it appeared that we did not fundamentally understand the difference between which Federal regulations were applicable and what the State used by developing its own policies, including using independent appraisals, to determine property fair market values. We acknowledge that the State was not required to use independent appraisals, but rather chose to use them for its program. Therefore, as discussed in comment 2, we conducted our review based upon the policies and procedures the State implemented to determine the fair market value of the buyout properties, including the independent appraisals.

Comment 7 The State explained that the program was voluntary in nature and that it would never exercise its power of eminent domain in the administration of the program. In addition, it stated that we relied heavily on the URA and its implementing requirements at 49 CFR 24.103, as well as Fannie Mae guidelines and HUD Handbook 4150.2, when reviewing appraisals. The State contended that these criteria were not applicable because the appraisals were not to be used in the mortgage-lending industry and the State's program was based on voluntary property acquisitions. We acknowledge that the State's program was based on voluntary property acquisitions and that the appraisals were not to be used on the mortgage-lending industry. However, we disagree with the State that we incorrectly used these criteria. As discussed in comment 2, the State used contracts and a memorandum of understanding with the agency that required compliance with USPAP, the URA, Federal regulations at 49 CFR Part 24, and other common appraisal requirements. As part of our audit, we reviewed the appraisals against the appraisal criteria and methodology the State used, including other common appraisal requirements, such as the Fannie Mae guidelines and HUD Handbook 4150.2. Regardless of whether the program was voluntary in nature or whether the appraisals would be used for mortgages, the State chose to include language regarding URA and other common appraisal requirements in its documents. Therefore, our use of these criteria was appropriate.

Comment 8 The State maintained that its fair market value determination methodology was approved by HUD's Office of Community Planning and Development and reasonable. It further stated that the program was fundamentally similar to the property valuation methodology used by the U.S. Department of Transportation for acquisitions of federally funded highway and bridge projects. We

acknowledge that the email chain provided by the State[26] shows that HUD indicated to the State that the use of independent appraisals to determine property values was reasonable and that while URA requirements for voluntary acquisitions do not include appraisals, they are encouraged and recommended to meet the requirement that a reasonable determination of value with supporting evidence be made by someone familiar with real estate values. However, the documentation provided did not show whether HUD had performed a detailed review of the sample appraisals and the State appraiser's process. Without such information, it is not possible to know whether HUD was aware of the detailed appraisal requirements laid out in the agreement and contract or that it was aware that the appraiser would fail to follow those requirements. For example, the appraiser made unsupported time adjustments to 422 of the 956 properties that were purchased during our audit period but could not provide required support for the adjustments or show that the regression model had been rigorously tested as required by the contract.

Comment 9 The State explained that the fair market value estimate was not required to dictate the sales price and noted that because the acquisitions were voluntary, negotiations could happen and that it had an appraisal appeal process so that homeowners could challenge the appraised value by submitting their own independent appraisal for review by a third-party appraisal team. Further, it noted that while the appraisals tried to estimate fair market value, the negotiated sales price with the willing seller was a better indication of and reasonable basis for the fair market values. We do not fully agree with the State. As HUD's email to the State explained, while URA voluntary acquisition requirements allow for negotiation, the State must comply with reasonableness requirements, and Office of Management and Budget circulars on reasonableness made offers exceeding the market value established by the appraisal difficult to justify. HUD goes on to discuss how some grantees have a formal appraisal review process under which seller appraisals are reviewed to determine whether there is "market data" that would substantiate increasing the original offer. The review appraiser could then cite such market data in a written report and still comply with the reasonableness requirements. We found that the State did not always follow the appeal process it described in its response or HUD's guidance. As discussed on page 9 of the report, the State's appraiser made a $30,000 adjustment to the appraised value of one property after the homeowner claimed that the value should have been higher due to items such as brass doorknobs, wood and paneled doors, and Casablanca fans. However, there was no appraisal from the homeowner or documentation in the file to support these claims, nor was there a written report from the review appraiser documenting "market data" or other justification for increasing the value of the property.

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[26] The email chain provided by the State is shown on pages 64 and 65 of this report. Note that the redactions shown in the chain were on the copy provided by the State.

Comment 10 The State noted that as described in HUD Handbook 6509.2, two or more persons appraising the same property can, within reasonable limits, disagree with respect to their opinions of value and that the fact that our appraiser reached conclusions that were different from those of the State's appraisal team does not mean that the State's valuations were incorrect or unsupported. The State further stated that if any opinion of fair market value should be afforded more weight, professional deference should be given to the State's appraisal team due to its geographic competence and years of experience. It noted that USPAP Advisory Opinion 294 states that review assignments that include evaluating the selection and adjustments of comparable sales typically require geographical competence. As discussed in comment 1, our appraiser had more than 40 years of experience and training in appraising and reviewing appraisals for residential, commercial, and agricultural properties throughout the United States and its territories, including experience related to disaster programs and performing assignments in New York. Further, while we agree that two or more reasonable persons appraising the same property can, within reasonable limits, disagree with respect to their opinions of value, the deficiencies disclosed during our review generally showed clear deviations from the requirements the appraiser should have followed and were material in nature.

Comment 11 The State maintained that it was unable to determine our appraiser's involvement in the audit, it did not appear that the audit was objective, and we never fully explained the review conclusions. The State further contended that it made multiple offers to have its appraisal team discuss the valuation methodologies with our appraiser and we rejected these offers. We strongly disagree with the State. As discussed in the Background and Objectives section, the objectives of the audit were to determine whether the State ensured that (1) the appraised fair market values used to determine award amounts under its program were supported and (2) appraisal costs for its program complied with applicable requirements and were for services performed in accordance with Federal, State, and industry standards. In addition, the Scope and Methodology section clearly described how we accomplished the audit objectives. The conclusions of our review were discussed with the State at least five times between August 2016 and July 2017. Further, we provided written results six times between July 2016 and July 2017, and the State acknowledged receipt of the results via email within 2 weeks each time. The written results included detailed appraiser review reports for each of the 14 properties sampled, including the 400 deficiencies identified, and provided the appraiser's review of the sales brochures and economic land analysis studies. We did not receive a response from the State or its appraisers to the appraisal deficiency writeups provided. In addition, we did not receive an offer, verbally or in writing, from the State requesting to meet with our appraiser. After issuing the draft report in December 2018, we provided the State with an extension for the exit conference and to provide written comments so that its agency, appraiser, and additional procured expert could refamiliarize themselves with the issues and provide input to the response. Despite agreeing to the State's

request and its receiving additional time during the lapse in appropriations from December 2018 into January 2019, the State did not provide responses to the specific appraisal deficiencies identified, nor was its response clear regarding whether it had consulted with its agency, appraiser, and additional procured expert regarding the detailed deficiencies. This fact is important because the results we provided laid out details about each deficiency and the criteria it was measured against. Further, when we requested additional information regarding the meeting offers during the exit conference, the State did not provide when or how it made the offers.

Comment 12 The State disagreed with the sampling methodology and stated that we inappropriately extrapolated the results because the sampling approach was not statistically valid and representative of the population of properties. As discussed on page 23 in the Scope and Methodology section, we initially selected a statistical sample of 60 properties. From those 60 properties, we selected a random, representative sample of 14 properties. We systematically selected these properties to ensure a distribution across the range of settlement amounts and program components. Once we reviewed the 14 properties, we determined that a statistical projection was not necessary. The appraisal and internal control issues identified were pervasive and systemic rather than intermittent events. In such situations, statistical projections are neither helpful nor needed. Therefore, we did not review the remaining 46 properties, and the exception rate and actual confidence level were not applicable. As discussed in finding 1, due to the significant and widespread nature of the issues identified, we believe that the $361.4 million paid for the remaining 942 properties that were not selected for review was unsupported.

Comment 13 The State maintained that the draft audit report misrepresented the nature of the more than 400 deficiencies identified, we failed to provide a detailed breakdown of which issues would alter property values, and the wording of the report may have inflated the impact on the valuation. We disagree. As discussed in comment 11, we provided the State with appraiser review reports for each of the 14 properties sampled, explaining each of the 400 deficiencies identified. The State then created three categories by which it believed the deficiencies should have been sorted, and it provided examples for each category.

- Deficiencies with no impact to value – The State explained that our concerns with the poststorm addenda were a procedural or formatting deficiency that did not impact the value. We disagree. Page 10 of the report explains how the concerns with addenda move beyond formatting and into the level of work performed, the reliance on the prestorm appraisals, and the support for the figures cited in the addenda.

- Difference of opinion – The State explained that the subfinding related to excessive adjustments was an example of a difference of opinion regarding what criteria applied. As discussed in comment 2, the State

used contracts and a memorandum of understanding with the State agency that required compliance with USPAP, the URA, Federal regulations at 49 CFR Part 24, and other common appraisal requirements. We measured the State against such criteria and believe it provided a reasonable basis for our conclusions. Neither the appraisals, the State's files, nor the subpoenaed appraiser work files contained evidence or justifications for the adjustments. Further, the frequency and amount of adjustments made could indicate that the comparable sales were not truly representative of the subject properties, which could be considered a red flag regardless of the appraisal standards used.

- Factual deficiencies – The State explained that with the exception of a typographical error, the deficiencies listed were debatable at best, given the lack of information we provided. Further, it stated that the typographical issue appeared to be an anomaly and should not be extrapolated over the entire population. As discussed on page 11 of the report, the appraiser company later identified the error and stated that the property value was overstated, but the State did not take action. Therefore, even if the mistake was an anomaly, the State did not have sufficient controls to address known issues. This matter, along with other issues identified in finding 1, shows that there was a systemic problem with the appraisals and controls.

Comment 14 The State maintained that when rejecting its valuation methodologies, we did not provide a preferred or alternative approach that we believe should have been followed. Further, it stated that implying that all acquisitions were unsupported, the properties had zero value, and the State should repay all costs was nonsensical and unhelpful. We do not believe that the properties had zero value or that the State should repay all costs. We classified the costs as unsupported due to the significant and widespread nature of the issues identified. As explained in appendix A of this report, unsupported costs are those costs charged to a HUD-financed activity for which we cannot determine eligibility at the time of the audit. As discussed in finding 1, we identified more than 400 deficiencies during our review of appraisals for the 14 properties, and several of the deficiencies applied to hundreds more of the properties purchased. For these reasons and due to the State's lack of a response to the detailed deficiencies, we could not reasonably determine what the fair market values should be. As part of the normal audit resolution process, the State will have an opportunity to provide additional support or responses for the appraisal deficiencies identified, and HUD will need to make a determination regarding what amount of the unsupported costs are supported and what amount needs to be repaid.

Comment 15 The State explained that our approach in evaluating the gross living area was flawed as it did not provide the actual impact on value.

- For the first example, the State acknowledged that there appeared to be a typographical error regarding the actual property size and that while the upward adjustments associated with size might be unwarranted, the square footage range of the comparable sales used did not appear unreasonable. It further stated that the issue appeared to have been an anomaly and should not be extrapolated over the entire population. We believe that if the comparable sales in question were used, the adjustments for size should have been negative and that had the appraiser cited the correct square footage for the purchased property, it is possible that more relevant comparable properties could have been selected. Further, as discussed on page 11 of the report, the appraisal company later identified the error and stated that the property value was overstated. Therefore, even if the mistake was an anomaly, the State did not have sufficient controls to address known issues. This matter, along with other issues identified in finding 1, shows that there was a systemic problem with the appraisals and controls.

- For the next two examples, the State noted that a review of the appraisal reports did not suggest the errors we identified regarding below-grade basement space. However, the State did not provide support for its assertion or a detailed response to the deficiencies.

- For the final example, the State stated that public records in the geographic area were consistently inaccurate and that the appraiser used professional judgement. However, based on our review of the State's file and the appraiser's subpoenaed work file, the appraiser did not document the reasoning behind its decision to cite the square footage used in the appraisal.

Comment 16 The State maintained that we failed to consider the way in which the results of its regression analysis were used in determining fair market values, whereas the appraiser's statistician used a regression analysis to identify major value-influencing factors and to evaluate their impact on pricing. The State also stated that the draft report did not discuss the results of any model specification tests or assessment of the model performance. In addition, the State explained that we failed to recognize the differences between including and omitting extraneous and independent variables.

In reviewing the regression model used to support property values, we recognized the limitations inherent in area-specific real estate models. We understood that regression modeling was not the final word on individual price adjustments and the choice to use appraisers to make the final valuations of most elements that affected price. We observed, however, that property values included an adjustment for inflation over time and that inflation was said to occur only in the last few months, thereby imparting a price increase to most properties. We also noted that the list of variables used to estimate inflation appeared to be

incomplete. Given the wide impact of this variable on the amount of funds disbursed and the incomplete appearance of the inflation model, we sought to verify that there was price inflation due to the passage of time. Our review of the model data provided by the State found that this pervasive source of markup was unsupported.

While the variables in real estate pricing are fairly predictable, there is some variability in how one might construct a model. It was not within our mission to propose an alternate model, and we did not attempt to do so. We did, however, do extensive testing in search of evidence that inflation over time has a statistically significant role in predicting price when it is included with a full complement of relevant variables. To search for a statistically significant role, we used methods that cycle through various model combinations, seeking to apply inflation in a way that will sustain a low p-value. Without a low p-value (high t-factor), inflation is not statistically significant and has not been proven to contribute anything to the slope of the model or to price. In no case could we find the passage of time to both be statistically significant and show a meaningful increase in price over time.

The State's statistical model for price inflation did not include a good representation of variables. An inflation variable with weak significance, however, cannot be used to justify wide-reaching increases in grant amounts. Supporting material, such as residual tests and measures of fit, were needed to support a regression model. Possible examples include residual plots, Breusch-Pagan or White tests, VIF scores, and possibly leverage diagrams and outlier measures such as Cook's D. We requested supporting materials for the State's model but received none of these. We agree with the State that a model, which does not have a reasonable complement of basic, relevant variables, is going to be biased. Further, we believe that the States' description of its inflation model was far short of that reasonable complement of variables. The missing variables were – by the State's own description – statistically significant variables with a t-factor exceeding 2. It was not within our mission to provide a replacement model.

Comment 17 The State maintained that the adjustments made to the properties were appropriate and permissible under USPAP and indicated that our references to the Fannie Mae Selling Guide and HUD Handbook were not applicable. We disagree. While 2012-2013 USPAP Advisory Opinion 193 does not set limitations on the size of adjustments made in the sales comparison approach, USPAP also states that there may be assignment conditions addressing this issue. In this case, the memorandum of understanding indicates that the agency would comply with 49 CFR Part 24. Specifically, regulations at 49 CFR 24.103(a)(2) require agencies to ensure that the appraisals it obtains reflect established and commonly accepted Federal and federally assisted program appraisal practices. We followed criteria contained in Fannie Mae's Selling Guide and HUD Handbook 4150.2, which are commonly used to evaluate adjustments made to appraisals under Federal and federally assisted programs. As discussed on pages 8 and 9 of the report, the

percentages cited are simply benchmarks. In this case, the frequency and amount of adjustments made could indicate that the comparable sales were not truly representative of the subject properties. The 12 appraisals in question contained more than $9.5 million in adjustments to the 67 comparable properties, which averages to more than $140,000 in adjustments per comparable property. Neither the appraisals, the State's files, nor the subpoenaed appraiser work files contained evidence or justifications for the adjustments. Due to the frequency and amount of adjustments and the lack of evidence or justifications, the appraised fair market values were not considered supported.

Comment 18 The State maintained that the entire geographical area suffered devastating destruction and the appraisals were performed to establish an opinion of fair market value for the property as it existed before the storms and that significant adjustments were expected under such circumstances. Regarding the $30,000 adjustment made due to homeowner claims, the State maintained that making adjustments for features was industry practice. However, it appeared that the State did not confirm that the home had such features and that the appraiser relied solely on the homeowner's word that such items warranted the large increase. Federal cost principle requirements provide that costs must be reasonable, and the State could have ensured that large adjustments like these were supported by documentation and justifications from the appraiser. Regarding the $12,000 and $15,000 basement adjustments, the State claimed that USPAP does not dictate the valuation methodology for basements and that value is not nullified because a basement may not have the potential to be finished. However, the State could not provide support to show that the appraisals contained accurate and verified information regarding the types of basements the subject and comparable properties had in order for the appraiser to make such an adjustment determination. While the State claimed that the appraisers used their experience, cost information from Marshall and Swift, and conversations with contractors, the appraisal reports and subpoenaed appraiser work files did not provide sufficient support and explanations as required by USPAP.

Comment 19 The State explained that the format of the poststorm appraisals did not impact the quality or substance of the appraisal. The poststorm report addenda contained additional appraisal analyses conducted to determine whether the prestorm property value had increased or decreased after the prestorm valuation, notably for properties that were damaged or where structures no longer existed. The State further stated that recognition of the previous valuation when appraising a property at two distinct times was entirely appropriate and complied with industry standards. We disagree. The memorandum of understanding and contract required separate appraisal reports. Further, according to 2012-2013 USPAP Advisory Opinion 3, regardless of the nomenclature used, when a client seeks a more current value or analysis of a property that was the subject of a prior assignment, this is not an extension of that prior assignment that was already completed; it is a new assignment. The format used for the addenda started at the appraised prestorm fair market value and then made negative adjustments for

market conditions and the estimated cost to cure and positive adjustments for poststorm improvements previously made by the homeowner. In this case, we believe the use of poststorm addendum reports and the lack of documentation supporting them impacted the quality or the substance of the appraisals. For example, the starting values were based on prestorm appraisals that had significant issues, and the addenda contained market adjustments ranging from $42,000 to $106,500 and cost to cure adjustments ranging from $30,000 to $100,000, but neither the reports nor the subpoenaed appraiser work files contained support to show how the market and cost to cure adjustments were determined.

Comment 20 The State maintained that it had a robust system of internal controls and appraisal reviews to ensure that appraisals were performed in accordance with applicable standards. It explained that although it was not contractually required to conduct formal appraiser reviews, its appraisal team performed a function similar to that of a review appraiser. It explained that under the USPAP Standards 3 criteria, the State's review appraisers were not required to ensure that the appraisal reports conformed to applicable USPAP standards or review the appraiser's file or data analysis. The State maintained that for the appraisals in question, desk reviews and onsite visits were thoroughly conducted in accordance with New York State agency procedures and that its appraiser team verbally addressed questions, concerns, and ambiguities during detailed phone calls and meetings. The State noted that as a result of these exchanges, changes were made to appraisals and the final appraisal reports did not contain substantive errors or deficiencies. However, the State was unable to show that it complied with USPAP Standards 3, which required its appraisal team to perform a function similar to that of a review appraiser governed under USPAP. Further, the desk reviews and onsite visits may not have been as thorough as claimed by the State, based on the widespread nature of deficiencies we identified and the State's failure to address several known issues as discussed on page 11 of our report. Further, at no point during or after our review did the State provide evidence or documentation to show that detailed calls and meetings occurred between the State's appraisal review team and the appraiser or that the appraisal reviews resulted in changes to the final appraisal reports unless the homeowner filed an appeal.

Comment 21 The State explained that all of its appraisal reviewers were real estate specialists or officers who met the advanced competency requirements, as classified under the New York State Civil Service Classification Standards. We do not object to the civil service classification of the State's appraisal reviewers. However, the State was unable to provide documentation to support the qualifications needed to complete the quality control review of at least six appraisals.

Comment 22 The State noted that while we reviewed only one property that was transferred from the City's program, we devoted a section in the finding to it. It stated that the use of the phrase "appraised values" was inflammatory. We disagree. As explained in the Background and Objectives section, properties transferred from

the City's program required both prestorm and poststorm appraisals. In this case, there were two distinct appraisals performed. Because each appraisal is a separate assignment under USPAP, "appraised values" is correct.

Comment 23 The State maintained that the City performed appraisals using a contracted appraiser and that the State accepted those appraisals as a reasonable basis for property values. It stated that such reliance was fair, reasonable, and allowable. Further, the State explained that it did not have a right to monitor the work performed or request procurement documentation since the City was not a vendor or a subrecipient. Rather, it stated that it only needed to have some reasonable basis for its determination of fair market value. The State chose to accept and rely on appraisals performed by the City's contractor as its basis for the fair market value determinations. However, as the grantee, the State was ultimately responsible for the administration of its program. The State needed to have adequate controls to ensure that the appraisals were performed in accordance with applicable standards and that the values were reasonable. Without some level of controls, we do not believe the State can support its statement that appraisals performed by the City's contractor were sufficient. Further, as discussed in comment 27, the State did not explain why it considered the City's Uniform Residential Appraisal Report (URAR) appraisals to be sufficient if it also believed that URAR appraisals were not appropriate for its program. (See pages 24 and 25 of its response.)

Comment 24 The State maintained that industry custom does not require an appraiser to verify and question the square footage of comparable properties. According to 2012-2013 USPAP, although appraisers are not required by USPAP to follow a specific standard of square footage measurement, appraisers are required by Standard Rule 1-1(b) to not commit a substantial error of omission or commission that significantly affects an appraisal. This rule requires the appraiser to gather factual information in a manner that is sufficiently diligent. Standard Rule 1-1(c) requires appraisers to not render appraisal services in a careless or negligent manner. Appraisers must use due diligence and due care in performing appraisal services, including gathering factual data such as square footage.

Comment 25 The State explained that its accounting records were supported by contract award documents and that it fully complied with applicable Federal requirements for supporting documentation. The State specifically noted that the agency's contract with the appraiser and subsequent supplements included budgeted hours and hourly rates per appraisal. It also stated that invoices were billed in accordance with budgeted hours and hourly rates, as provided in the contract, and that they were properly reviewed for reasonableness. The State later noted that any variations observed in the overall appraisal prices were based on the intricacies of the specific appraisal, the work-scope requirements proscribed within the contract supplement, and the number of hours required for each individual appraisal report. We do not agree that the State was in full compliance with requirements to provide sufficient support. For example, as discussed on page 16 of the report,

invoices did not always contain property listings, support for contractor consultant fees, and proper approvals. Further, if the charges for appraisals and addenda were intended to be based on an hourly rate and actual hours, the supporting documentation should have detailed the hours spent on each appraisal, and the State would have needed to obtain timekeeping or similar records to comply with Federal cost principle requirements. The State did not provide such documentation during the audit.

Comment 26 The State maintained that several factors existed in justifying that the appraisals were more complex than standard appraisals and may have warranted higher prices. Specifically, the State explained that (1) it was required to use appraisals only to inform homeowners of the fair market value of their properties, (2) it was not required to rely on appraisals to establish a purchase price, (3) appraisals were more reliable than other sources for establishing fair market value, (4) our appraiser lacked geographic competence and experience in navigating New York public records, and (5) the agency's appraisal services conformed to State procurement law and applicable provisions of regulations at 2 CFR Part 200. We agree that the appraisals were used to inform homeowners of the fair market values of their properties and can be a reliable method for establishing those values. However, we disagree with the State on several points and do not believe the explanation provided justifies higher appraisal prices.

For example, we disagree that the appraisals were not required to be used to establish a purchase price. The award amounts the State paid to purchase the properties were based on the appraised fair market values of the properties and then had adjustments, such as duplication of benefits or incentives established under the State's program. The State chose to establish the fair market values of the properties through the appraisal process, which then fed into its purchase price calculations.

Further, we strongly disagree with the State's assertion that our appraiser was geographically incompetent and inexperienced in navigating public records and its implication that he could not understand the complexity of the appraisals. As discussed in comment 1, our appraiser had more than 40 years of experience and training in appraising and reviewing appraisals for residential, commercial, and agricultural properties throughout the United States and its territories, including experience related to disaster programs and performing assignments in New York. Our appraiser was qualified to competently review appraisal reports and navigate public records in New York State, where he has performed work many times.

Comment 27 The State contended that we failed to consider the unique environment in which the appraisals were performed when considering the reasonableness of the prices. For example, it stated that simple URAR appraisals that may cost $350 to $450 would not be applicable to its program due to the extensive storm damage and additional work that was required to establish property conditions. Although we acknowledge that some of the State's appraisals may have been performed in a

unique environment, this fact alone does not justify the State's contention that the appraisals performed were more complex in nature, requiring substantially higher fees. Further, the State's assertion that URAR appraisals would not be applicable to its program does not align with the process used for the properties transferred from the City into the State's program. For each of the transfer properties, the State relied on URAR appraisals that cost no more than $450 and were performed by the City's contractor. The State did not explain why it considered the City's URAR appraisals to be sufficient if it believed URAR appraisals were not appropriate for its program. On the contrary, according to an October 2016 memorandum, the State indicated that the City's appraisal process closely mirrored its process for the other properties.

The State also provided the example of its agency often paying $1,000 to $1,200 for simple land acquisition appraisals for other projects. However, these prices were for eminent domain program appraisals that were subject to URA requirements for involuntary acquisitions, which the State claimed its program was not required to follow.

Comment 28 The State maintained that the contracted hourly labor rate was reasonable, established through competitive procurement, and awarded based on a best-value determination. Further, the State contended that its appraiser was the only appraisal firm with resources to complete the voluminous scope within the required timeframe and willing to do so. In addition, the State explained that structuring the contract to use an hourly rate was the only way to account for the variability of each property's condition and the varying time and effort necessary to complete an appraisal. As discussed in the Followup on Prior Audits section, we previously identified concerns related to the procurement of the contractor in question. However, we do not object to the State's use of a reasonable hourly contract. As discussed on page 16 of the report and in comment 25, the State should note that if the charges for appraisals and addenda were intended to be based on an hourly rate and actual hours, the supporting documentation should have detailed the hours spent on each appraisal, and the State would have needed to obtain timekeeping or similar records to comply with Federal cost principle requirements.

Comment 29 The State explained that the use of sales brochures and economic land analysis studies was directly supported and beneficial to the program goals. By cataloging comparable sales and creating economic land sales analyses, the State claimed that its appraisal team gained an administrative efficiency, resulting in an overall cost savings. It further explained that sales brochures were generally prepared when 10 or more properties were appraised in a project area and that the majority of the comparable properties came from the sales brochures. Lastly, the State maintained that the use of sales brochures and economic land analysis studies was a format comparable to eminent domain appraisals. While many appraisals reviewed included comparable properties that came from the sales brochures, the State did not support its claim that sales brochures and economic land analysis

studies provided overall cost and time savings. Some of the appraisals reviewed also contained comparable properties not on the sales brochures, which showed that the brochures did not contain the most relevant properties. Further, our review of appraisal costs showed that the State paid $990 to $4,950 for each appraisal and $908 for each appraisal addendum and that budgeted appraisal costs increased over time, which may not support the idea that these items resulted in cost savings. Further, the State did not provide support showing that the sales brochures and economic land analysis studies resulted in time savings. Lastly, while sales brochures and economic land analysis studies may be used for eminent domain appraisals, the State could not show that they were necessary in this case. Without such support, the State could not show that the $98,650 paid for sales brochures and $50,700 paid for economic land analysis studies were reasonable and necessary according to Federal cost principle requirements, and it should not have used Disaster Recovery funds to pay for these costs.

Comment 30 The State maintained that the $7,590 in appraisal consultant fees was (1) within the scope of the contract between the agency and appraiser; (2) billed at the correct hourly rate; and (3) necessary because it related to valuation inventory and mapping, model development reports, and various other tasks the appraiser was directed to conduct. However, the invoice did not show what services were provided, and there was no justification to show that those services were necessary. The invoice provided by the State showed only the total cost with a breakdown by general tasks, such as prepare Oakwood inventory mapping, prepare case writeups, prepare audit response, teleconferences, and administrative. The State did not explain and provide support showing why these services were necessary and whether the services were already covered under the appraisal charges. Further, if the fees were based on an hourly rate and actual hours worked, the State should have provided time records in accordance with Federal cost principle requirements. Without this information, we considered $7,590 to be unsupported costs.

Comment 31 The State noted that it previously provided payment vouchers for all invoices and that its "crosswalk" showed all invoices billed, the property addresses associated with the appraisals invoiced, and the funds paid for each appraisal, covering 136 invoices and 2,780 parcels. The State further noted that it substantiated the work for 2,775 of those parcels, or 99.8 percent. The State further maintained that it provided the property listings and support for the contractor consultant fees for 14 of the 136 contractor invoices it reimbursed. We disagree. The documentation provided for the invoices in question did not include property listings and other needed support. We provided the State a list of these vouchers many times, including in July 2017, and the State did not provide additional documentation or a response. Property listings ensure that the Disaster Recovery funds were used only for the cost of appraisals performed on properties within the scope of the contract and that the contractor billed and was paid only once for each appraisal. Without such support, as required by Federal cost principle requirements at 2

CFR Part 225, appendix A, paragraph C(2), the State should not have used Disaster Recovery funds for the invoices.

Comment 32 The State maintained that invoices were properly approved in accordance with the agency's documented payment process, under which program staff members documented their approval signatures and approval notes before sending payment requests to the State. We disagree. According to the agreement between the agency and appraiser, invoices were subject to the approval of the State's project director or his or her successor as identified by the State. Further, the agreement showed that the parties mutually agreed to designate individuals as their representatives for the purpose of receiving notices and that individuals could be designated in writing for purposes of implementation, administration, billing, resolving issues, and dispute resolution. As discussed in finding 2, the designated employee did not approve the 136 invoices reviewed. While 89 of the 136 invoices had corresponding vouchers, the approval sections had not been completed, and the only signatures were from a different employee, who inserted a handwritten note saying "ok to pay." The State could not show that this employee had written authorization to approve the invoices for payment. Further, the approvals violated the State requirements for segregation of duties because the employee was also responsible for performing quality control reviews of the contractor's work.

Comment 33 The State noted that for-profit prime contracts were not required to follow applicable Federal procurement requirements when subcontracting services such as the regression analysis. However, the language on page 16 of our report states that the State could not show that its contractor had followed contract requirements (not Federal appraisal requirements) when procuring the subcontractor that performed the regression analysis. The contracts between the State agency and contractors, along with appraiser subcontractors, require free and open competition when procuring subcontractors. The State did not provide documentation showing how the subcontractor was procured. As a result, we were unable to determine whether the contractor had properly procured the subcontractor.

Comment 34 The State maintained that its poststorm appraisal approach maximized the use of available funding by not duplicating a large portion of the work already performed and that it greatly reduced the timeframes needed to provide critical aid to storm-impacted families. However, as discussed in comment 19, we have concerns with the quality of the poststorm addendum reports. Further, the State did not provide support to show that its approach maximized the use of available funding, avoided duplication of costs, and reduced timeframes needed to provide the critical aid. In contrast, the State paid $908 for each addendum report. This is more than twice the price the City paid for appraisals and that other local appraisers cited for a full appraisal, and it was paid on top of the charge paid for the prestorm appraisal. If the State's approach saved time, it is logical to think that the fee for the addendum reports would have been lower.

Comment 35 The State explained that certain elements of contractual requirements were orally amended and the sales brochures were properly prepared and credible and met the core scope and intent of the contract. It further explained that the contract for appraisal services was not the only relevant guidance. The State maintained that its decision not to follow the standard contractual language to the letter when the language was not relevant to its needs should not necessitate a return or deobligation of $156,940 in funds. We disagree. According to section E of the memorandum of understanding between the State and the agency, the memorandum of understanding could be amended if such amendments made specific reference to the memorandum of understanding and complied with programmatic policies, procedures, and guidelines. Further, it required that amendments be executed in writing and signed by a duly authorized representative of each party and that if they resulted in a change in the grant funds or program description, such modifications would be incorporated into a written amendment signed by the parties. Controls such as this language help ensure that Federal funds are safeguarded against waste, loss, and misuse.

Comment 36 The State maintained that quality control reviews were adequately performed. We disagree with the State because it could not provide detailed work review files as evidence that the quality control appraisal reviews were adequate and documented in accordance with industry standards. Our review identified several issues with the quality control reviews and monitoring. For example, quality control reports (1) provided only summary-level information, (2) did not identify any deficiencies despite the many deficiencies identified during our review, and (3) did not include a review of the poststorm addendum reports discussed above. Further, the State was unable to provide documentation to support the qualifications needed to complete the quality control review of at least six appraisals.

Comment 37 The State maintained that the four contractor requisition invoices paid for appraisals performed by subcontractors were fully supported and that the documentation was provided to us. The State further noted that both it and the agency properly reviewed and approved invoices in accordance with established procedures and that approval of subcontractor invoices was documented through the prime contractor's payment requisition invoice. Lastly, it noted that neither Federal regulations nor the contract required contractor invoices to contain documentation showing payment to subcontractors. Our review showed that one of the four subcontractor invoices was not properly supported with a property listing. Specifically, the invoice showed five "pre-flood" reports without listing property addresses. As discussed in comment 31, without the support of property listings, there is no assurance that the appraisal costs associated with each eligible property were reimbursed only once. In addition, the State did not provide documentation to support that the contractor paid for these invoices as required by the subcontracts. In this case, it was the subcontract that required the contractor to have approved and paid subcontractor invoices. Such documentation helps to safeguard against waste, loss, and misuse.

Comment 38 The State explained that there was never a binding contractual relationship with the City and it never procured, paid for, oversaw, or managed the City's appraisal services contractor. Further, the State implied that this portion of the finding contained new information. We disagree with the State. In December 2013, the State executed a memorandum of understanding with the City for the Build It Back program. The State then relied on the appraisals conducted by the City's contractor to calculate the award amount for each of the 62 properties transferred from the City's Build It Back program and needed to ensure that the amount it paid was reasonable. Sometime in July 2015, the State verbally agreed with the City not to move forward with the memorandum of understanding that for all intents and purposes of the agreement was null and void. When we discussed the finding with the State during the course of our review as detailed in comment 11, the State noted that it was in the process of negotiating a new agreement with the City. Having an executed agreement with the City would place the State in a better position to ensure that contracts contained all required provisions, appraisals were performed properly, and the prices it paid to purchase the properties were reasonable and supported.

Appendix C

Summary of Adjustments to Sample Properties Reviewed

Sample property #1
Application number: OBBO-020-BA
Property type - location: Single-family home - Staten Island
Appraised value: $380,000

Comparable property number	1	2	3	4	5	6
Appraisal type	Prestorm appraisal – enhanced buyout					
Sales price	$410,000	$375,000	$380,000	$275,000	$450,000	$480,000
Date of sale	2/27/12	4/29/11	4/23/12	11/14/11	7/16/10	10/24/12
Number of days between date of sale and the storm	245	549	189	350	836	5
Time value adjustment[27]	$36,900	$20,200	$41,300	$17,300	$24,300	$9,000
Number of adjustments	6	6	4	7	10	8
Number of adjustments that exceeded 10 percent of sales price	1	1	1	2	2	2
Gross adjustment percentage	30.90%	30.37%	13.58%	56.58%	42.24%	35.65%
Net adjustment percentage	(4.07%)	(8.67%)	9.63%	28.07%	(29.04%)	(29.65%)
Net adjusted value	($16,700)	($32,500)	$36,600	$77,200	($130,700)	($142,300)
Indicated value[28]	$393,300	$342,500	$416,600	$352,200	$319,300	$337,700

Sample property #2
Application number: OBBO-168-BA
Property type - location: Single-family home - Staten Island
Appraised value: $270,000

Comparable property number	1	2	3	4	5	6
Appraisal type	Prestorm appraisal – enhanced buyout					
Sales price	$230,000	$250,000	$210,000	$245,000	$212,000	$155,000
Date of sale	7/19/11	2/24/11	11/18/11	1/6/11	5/4/11	12/3/10
Number of days between date of sale and the storm	468	613	346	662	544	696
Time value adjustment	$12,400	$13,500	$13,200	$13,200	$11,400	$8,400
Number of adjustments	4	7	6	6	7	5
Number of adjustments that exceeded 10 percent of sales price	1	1	1	0	2	2
Gross adjustment percentage	20.39%	39.36%	41.00%	33.14%	58.11%	53.29%
Net adjustment percentage	(5.70%)	8.32%	19.76%	23.18%	27.08%	53.29%
Net adjusted value	($13,100)	$20,800	$41,500	$56,800	$57,400	$82,600
Indicated value	$216,900	$270,800	$251,500	$301,800	$269,400	$237,600

[27] The time value adjustment was included in all later rows when applicable for each table.
[28] The indicated values listed on the appraisals are calculated by taking the sales prices plus or minus the adjustments made by the appraiser.

Sample property #3
Application number: OBBO-274-BA
Property type - location: Single-family home - Staten Island
Appraised value: $405,000

Comparable property number	1	2	3	4	5	6
Appraisal type	Prestorm appraisal – enhanced buyout					
Sales price	$345,000	$415,000	$425,000	$360,000	$420,000	$380,000
Date of sale	2/14/11	6/21/12	6/22/10	8/24/11	3/31/10	7/2/12
Number of days between date of sale and the storm	623	130	860	432	943	119
Time value adjustment	$18,600	$40,400	$22,900	$19,400	$22,600	$29,300
Number of adjustments	9	9	10	7	8	7
Number of adjustments that exceeded 10 percent of sales price	0	0	0	0	0	0
Gross adjustment percentage	27.42%	27.76%	26.68%	16.33%	18.12%	20.47%
Net adjustment percentage	4.00%	(3.28%)	(13.36%)	5.78%	(2.40%)	(2.84%)
Net adjusted value	$13,800	($13,600)	($56,800)	$20,800	($10,100)	($10,800)
Indicated value	$358,800	$401,400	$368,200	$380,800	$409,900	$369,200

Sample property #4
Application number: OBBO-361-BA
Property type - location: Single-family home - Staten Island
Appraised value: $450,000

Comparable property number	1	2	3	4	5	6
Appraisal type	Prestorm appraisal – enhanced buyout					
Sales price	$415,000	$425,000	$345,000	$420,000	$380,000	$358,800
Date of sale	6/21/12	6/22/10	2/14/11	3/31/10	7/2/12	10/13/11
Number of days between date of sale and the storm	130	860	623	943	119	382
Time value adjustment	$40,400	$22,900	$18,600	$22,600	$29,300	$19,300
Number of adjustments	4	5	11	5	6	7
Number of adjustments that exceeded 10 percent of sales price	0	0	1	0	0	0
Gross adjustment percentage	11.33%	10.45%	37.59%	11.88%	19.24%	20.85%
Net adjustment percentage	10.84%	0.33%	24.96%	11.40%	11.97%	20.29%
Net adjusted value	$45,000	$1,400	$86,100	$47,900	$45,500	$72,800
Indicated value	$460,000	$426,400	$431,100	$467,900	$425,500	$431,600

Sample property #5
Application number: OBZ-100-BA
Property type - location: Single-family home - Staten Island
Appraised value: $710,000

Comparable property number	1	2	3	4	5	6
Appraisal type	Prestorm appraisal – enhanced buyout					
Sales price	$515,000	$355,000	$375,000	$280,000	$275,000	$280,000
Date of sale	1/18/10	10/9/12	1/20/10	10/5/12	7/19/11	5/10/11
Number of days between date of sale and the storm	1,015	20	1,013	24	468	538
Time value adjustment	$27,743	$6,660	$20,201	$5,253	$14,814	$15,084
Number of adjustments	8	10	9	11	10	10
Number of adjustments that exceeded 10 percent of sales price	1	2	2	3	2	2
Gross adjustment percentage	51.48%	94.44%	112.53%	135.13%	134.04%	139.42%
Net adjustment percentage	39.45%	90.50%	88.00%	130.13%	130.41%	127.99%
Net adjusted value	$203,143	$321,260	$330,001	$364,353	$358,614	$358,384
Indicated value	$718,143	$676,260	$705,001	$644,353	$633,614	$638,384

Sample property #6
Application number: GRB-232-BA
Property type - location: Single-family home - Staten Island
Appraised value: $435,000[29]

Comparable property number	1	2	3	4
Appraisal type	Prestorm appraisal – enhanced buyout			
Sales price	$350,000	$317,500	$465,000	$270,300
Date of sale	8/24/12	12/20/10	10/12/10	6/30/10
Number of days between date of sale and the storm	66	679	748	852
Time value adjustment	$20,070	$17,104	$25,049	$14,561
Number of adjustments	5	9	9	10
Number of adjustments that exceeded 10 percent of sales price	0	0	0	2
Gross adjustment percentage	19.62%	31.69%	32.68%	45.49%
Net adjustment percentage	13.91%	31.69%	(6.42%)	43.27%
Net adjusted value	$48,670	$100,604	($29,851)	$116,961
Indicated value	$398,670	$418,104	$435,149	$387,261

[29] Note that the State later increased the appraised value to $475,000 after the homeowner filed an appeal.

Sample property #7
Application number: GRB-179-BA
Property type - location: Vacant lot[30] - Staten Island
Appraised value: $250,000

Comparable property number	1	2	3	4	5	6	7
Appraisal type	Prestorm appraisal – enhanced buyout						
Sales price	$285,000	$400,000	$220,000	$300,000	$273,000	$355,000	$225,000
Date of sale	6/12/12	2/28/12	9/22/10	11/8/11	7/28/10	4/27/12	7/29/10
Number of days between date of sale and the storm	139	244	768	356	824	185	823
Time value adjustment	Not applicable for vacant lots						
Number of adjustments	2	3	1	1	2	4	2
Gross adjustment percentage	15.00%	30.00%	5.00%	10.00%	25.00%	45.00%	15.00%
Net adjustment percentage	(5.00%)	(20.00%)	(5.00%)	(10.00%)	(5.00%)	(5.00%)	5.00%
Price per square foot based on sales price	$55.23	$66.67	$61.11	$62.50	$68.25	$51.45	$59.21
Adjusted price per square foot	$52.47	$54.67	$60.69	$56.25	$64.84	$50.25	$62.17

Sample property #8
Application number: LH-031-BA
Property type - location: Single-family home - Lindenhurst
Appraised value: $425,000

Comparable property number	1	2	3	4	5	6
Appraisal type	Prestorm appraisal – enhanced buyout					
Sales price	$282,500	$314,990	$335,000	$355,000	$390,000	$385,000
Date of sale	5/25/12	8/13/12	3/9/12	11/11/11	5/4/12	12/21/11
Number of days between date of sale and the storm	157	77	234	353	178	313
Time value adjustment	Not applicable for enhanced buyout properties in Long Island					
Number of adjustments	8	9	5	6	6	7
Number of adjustments that exceeded 10 percent of sales price	1	1	0	1	0	0
Gross adjustment percentage	42.12%	45.37%	26.33%	27.49%	21.05%	20.49%
Net adjustment percentage	37.17%	35.14%	24.66%	26.14%	8.28%	3.09%
Net adjusted value	$105,000	$110,700	$82,600	$92,800	$32,300	$11,900
Indicated value	$387,500	$425,690	$417,600	$447,800	$422,300	$396,900

[30] This property was a vacant lot versus a single-family home, so the data captured above are different.

Sample property #9
Application number: SI-001915-AFR
Property type - location: Single-family home - Staten Island
Appraised value: $475,000[31]

Comparable property number	1	2	3	4	5
Appraisal type	Prestorm appraisal – acquisition for redevelopment				
Sales price	$500,000	$495,000	$425,000	$410,000	$500,000
Date of sale	1/13/12	8/16/12	3/30/12	6/12/16	9/18/12
Number of days between date of sale and the storm	290	74	213	(1,322)	41
Time value adjustment	Not applicable for acquisition for redevelopment properties				
Number of adjustments	5	7	8	10	8
Number of adjustments that exceeded 10 percent of sales price	0	0	0	0	0
Gross adjustment percentage	4.20%	11.31%	11.06%	15.85%	12.40%
Net adjustment percentage	(2.80%)	(1.82%)	6.12%	5.61%	(4.20%)
Net adjusted value	($14,000)	($9,000)	$26,000	$23,000	($21,000)
Indicated value	$486,000	$486,000	$451,000	$433,000	$479,000

Sample property #9
Application number: SI-001915-AFR
Property type - location: Single-family home - Staten Island
Appraised value: $490,000

Comparable property number	1	2	3	4	5
Appraisal type	Poststorm appraisal – acquisition for redevelopment				
Sales price	$515,000	$510,000	$515,000	$505,000	$470,000
Date of sale	7/8/14	2/20/15	7/14/14	3/18/15	10/10/14
Number of days between date of sale and the storm	(617)	(844)	(623)	(870)	(711)
Time value adjustment	Not applicable for acquisition for redevelopment properties				
Number of adjustments	3	4	5	4	3
Number of adjustments that exceeded 10 percent of sales price	0	0	0	0	0
Gross adjustment percentage	2.43%	3.73%	3.40%	3.96%	2.02%
Net adjustment percentage	(2.43%)	(2.94%)	(2.62%)	(3.96%)	(0.11%)
Net adjusted value	($12,500)	($15,000)	($13,500)	($20,000)	($500)
Indicated value	$502,500	$495,000	$501,500	$485,000	$469,500

[31] Note that the State later increased the appraised value to $495,000 after the homeowner filed an appeal.

Sample property #10
Application number: EF-142-AQ
Property type - location: Single-family home - Lindenhurst
Appraised value: $525,000

Comparable property number	1	2	3	4	5	6
Appraisal type	Prestorm appraisal – acquisition					
Sales price	$315,000	$450,000	$336,000	$445,000	$435,000	$380,000
Date of sale	10/17/11	10/31/11	10/4/11	1/26/12	12/22/11	8/13/12
Number of days between date of sale and the storm	378	364	391	277	312	77
Time value adjustment	Not applicable for acquisition properties					
Number of adjustments	12	4	10	7	9	10
Number of adjustments that exceeded 10 percent of sales price	2	1	2	2	2	1
Gross adjustment percentage	56.70%	20.38%	56.01%	36.34%	40.92%	36.82%
Net adjustment percentage	52.89%	16.82%	51.25%	24.11%	21.15%	31.03%
Net adjusted value	$166,600	$75,700	$172,200	$107,300	$92,000	$117,900
Indicated value	$481,600	$525,700	$508,200	$552,300	$527,000	$497,900

Sample property #11
Application number: EF-171-AQ
Property type - location: Single-family home - Island Park
Appraised value: $350,000

Comparable property number	1	2	3	4	5	6
Appraisal type	Prestorm appraisal – acquisition					
Sales price	$400,000	$310,000	$315,000	$307,500	$475,000	$350,000
Date of sale	9/19/11	3/26/12	1/10/12	4/26/12	6/29/12	6/11/12
Number of days between date of sale and the storm	406	217	293	186	122	140
Time value adjustment	Not applicable for acquisition properties					
Number of adjustments	8	6	6	7	10	8
Number of adjustments that exceeded 10 percent of sales price	0	0	0	0	0	0
Gross adjustment percentage	16.88%	15.48%	17.43%	17.50%	29.28%	26.06%
Net adjustment percentage	(9.88%)	8.71%	4.92%	6.44%	(17.75%)	3.37%
Net adjusted value	($39,500)	$27,000	$15,500	$19,800	($84,300)	$11,800
Indicated value	$360,500	$337,000	$330,500	$327,300	$390,700	$361,800

Sample property #12
Application number: EF-261-AQ
Property type - location: Single-family home - Babylon
Appraised value: $420,000

Comparable property number	1	2	3	4	5
Appraisal type	Prestorm appraisal - acquisition				
Sales price	$330,000	$325,000	$440,000	$405,000	$565,000
Date of sale	10/1/12	8/1/12	9/27/12	6/18/12	12/10/12
Number of days between date of sale and the storm	28	89	32	133	(42)
Time value adjustment	Not applicable for acquisition properties				
Number of adjustments	7	7	8	9	13
Number of adjustments that exceeded 10 percent of sales price	0	0	0	0	1
Gross adjustment percentage	23.30%	23.26%	30.75%	31.46%	43.95%
Net adjustment percentage	19.06%	18.58%	4.16%	3.06%	(18.11%)
Net adjusted value	$62,900	$60,400	$18,300	$12,400	($102,300)
Indicated value	$392,900	$385,400	$458,300	$417,400	$462,700

Sample property #13
Application number: EF-573-AQ
Property type - location: Single-family home - Lindenhurst
Appraised value: $290,000

Comparable property number	1	2	3	4	5	6
Appraisal type	Prestorm appraisal – acquisition					
Sales price	$249,000	$225,000	$269,000	$275,000	$280,000	$326,500
Date of sale	5/10/12	7/16/12	2/10/12	7/30/12	10/3/12	3/1/12
Number of days between date of sale and the storm	172	105	262	91	26	242
Time value adjustment	Not applicable for acquisition properties					
Number of adjustments	5	6	7	5	8	7
Number of adjustments that exceeded 10 percent of sales price	1	1	1	1	1	0
Gross adjustment percentage	28.88%	33.42%	38.77%	31.20%	30.32%	29.71%
Net adjustment percentage	11.20%	24.53%	11.34%	(0.36%)	5.32%	(14.46%)
Net adjusted value	$27,900	$55,200	$30,500	($1,000)	$14,900	($47,200)
Indicated value	$276,900	$280,200	$299,500	$274,000	$294,900	$279,300

Sample property #14
Application number: EF-599-AQ
Property type - location: Single-family home - Lindenhurst
Appraised value: $710,000

Comparable property number	1	2	3	4
Appraisal type	Prestorm appraisal - acquisition			
Sales price	$350,000	$450,000	$380,000	$315,000
Date of sale	12/29/11	12/19/11	10/25/12	12/1/11
Number of days between date of sale and the storm	305	315	4	333
Time value adjustment	Not applicable for acquisition properties			
Number of adjustments	14	10	12	12
Number of adjustments that exceeded 10 percent of the sales price	3	3	4	5
Gross adjustment percentage	110.46%	73.69%	109.45%	121.14%
Net adjustment percentage	95.60%	69.02%	89.18%	118.92%
Net adjusted value	$334,600	$310,600	$338,900	$374,600
Indicated value	$684,600	$760,600	$718,900	$689,600