



State of Michigan

Neighborhood Stabilization Program Under the Recovery Act



Issue Date: September 15, 2013

Audit Report Number: 2013-CH-1006

TO: Keith Hernandez, Director of Community Development, 5FD

//signed//

FROM: Kelly Anderson, Regional Inspector General for Audit, Chicago Region, 5AGA

SUBJECT: The State of Michigan Lacked Adequate Controls Over Its Neighborhood Stabilization Program Under the American Recovery and Reinvestment Act of 2009

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General (OIG), results of our review of the State of Michigan's Neighborhood Stabilization Program under the American Recovery and Reinvestment Act of 2009.

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 Web site. 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 (312) 913-8684.



September 15, 2013

State of Michigan Lacked Adequate Controls Over Its Neighborhood Stabilization Program Under the American Recovery and Reinvestment Act of 2009

Highlights

Audit Report 2013-CH-1006

What We Audited and Why

We audited the State of Michigan's Neighborhood Stabilization Program under the American Recovery and Reinvestment Act of 2009 as part of the activities in our fiscal year 2013 annual audit plan. We selected the State's Program based upon our designation of the Program as high risk. Further, we received an anonymous complaint regarding the State's Program. Our objectives were to determine whether the Michigan State Housing Development Authority, the administrator of the State's Program, complied with Federal requirements in its use of Program funds for (1) increased construction costs for a new construction project and (2) consortium members' acquisition of residential properties. This is the third of three audit reports on the State's Program.

What We Recommend

We recommend that the Director of HUD's Detroit Office of Community Planning and Development require the State to (1) provide sufficient supporting documentation or reimburse its Program nearly \$184,000, (2) reimburse its Program nearly \$55,000, and (3) implement adequate procedures and controls to address the findings cited in this audit report.

What We Found

The Authority did not ensure that Federal requirements were followed in its administration of the State's Program. Specifically, the Authority (1) could not provide sufficient documentation to support that increased construction costs for a new construction project were necessary and reasonable and (2) did not ensure that consortium members acquired residential properties at a 1 percent discount from the properties' current market value.

As a result, the Authority (1) lacked sufficient documentation to support that its use of nearly \$184,000 in Program funds for increased project construction costs was necessary and reasonable and (2) inappropriately used nearly \$55,000 in Program funds for the acquisition of 12 properties.

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BACKGROUND AND OBJECTIVES

The Program. Authorized under Section 2301 of Title III of the Housing and Economic Recovery Act of 2008, as amended, Congress appropriated \$4 billion for the Neighborhood Stabilization Program to provide grants to every State and certain local communities to purchase foreclosed-upon or abandoned homes and rehabilitate, resell, or redevelop these homes to stabilize neighborhoods and stem the decline in value of neighboring homes. The Act states that amounts appropriated, revenues generated, or amounts otherwise made available to States and units of general local government under Section 2301 will be treated as though such funds were Community Development Block Grant funds under Title I of the Housing and Community Development Act of 1974.

Congress amended the Program and increased its funding as part of the American Recovery and Reinvestment Act of 2009. The Recovery Act provided the U.S. Department of Housing and Urban Development (HUD) an additional \$2 billion in Program funds to competitively award to States, local governments, nonprofit organizations, or consortia of nonprofit organizations, which could submit proposals in partnership with for-profit organizations. In January 2010, HUD awarded 56 organizations more than \$1.9 billion in funds through a competitive process.

The State. The Michigan State Housing Development Authority administers the State of Michigan's Program. The Authority was created by the Michigan Legislature in 1966 under the laws of the State. It is governed by an eight-member board consisting of the State's treasurer, the director of the State's Department of Human Services, and the director of the State's Department of Transportation. The board includes five other members appointed to 4-year terms by the State's governor and confirmed by the State Senate. The Authority's mission is to provide financial and technical assistance through public and private partnerships to create and preserve decent and affordable housing for low- and moderate-income residents and to engage in community economic development activities to revitalize urban and rural communities. The Authority's records are located at 735 East Michigan Avenue, Lansing, MI, and 3028 West Grand Boulevard, Detroit, MI.

As part of a consortium, the State submitted an application to HUD, dated July 13, 2009, which totaled \$290 million in Program funds under the Recovery Act. On January 14, 2010, HUD awarded nearly \$224 million in Program funds to the consortium. The Authority is the lead agency administering the Program.

An anonymous complaint to our office alleged that the Authority inappropriately used construction contingencies for phases IIIC and IIID of Gardenview Estates, a new construction project. We found that the Authority lacked sufficient documentation to support that its use of nearly \$184,000 in Program funds for increased construction costs (building concrete, earth work, builder's profit, general requirements, and builder's overhead) for phases IIIC and IIID of the project was necessary and reasonable. The Authority transferred funds budgeted for construction contingencies to cover the increases in the construction costs.

Our objectives were to determine whether the Authority complied with Federal requirements in its use of Program funds for (1) increased construction costs for a new construction project and (2) consortium members' acquisition of residential properties. This is the third of three audit reports on the State's Program.

RESULTS OF AUDIT

Finding 1: The Authority Lacked Sufficient Documentation To Support Increases in Construction Costs for a New Construction Project

The Authority did not comply with Federal regulations in its use of Program funds for phases IIC and IID of Gardenvue Estates, a new construction project. It could not provide sufficient documentation to support that increased construction costs were necessary and reasonable. These weaknesses occurred because the Authority lacked adequate procedures and controls regarding the project to ensure that it appropriately followed Federal regulations. As a result, HUD and the Authority lacked assurance that the Authority's use of nearly \$184,000 in Program funds for increased project construction costs was necessary and reasonable.

The Authority Lacked Sufficient Documentation To Support Its Use of Nearly \$184,000 in Program Funds

We reviewed more than \$250,000 in construction costs (building concrete, earth work, builder's profit, general requirements, and builder's overhead) that the Authority transferred from the construction contingencies for phases IIC and IID of the project. As of June 24, 2013, the Authority had disbursed more than \$226,000 in Program funds for the increased costs.

On April 24, 2012, the lessees¹ entered into construction contracts for phases IIC and IID of the project with a general contractor which included construction cost trade payment breakdowns,² dated April 2, 2012. On November 8, 2012, the lessees and the contractor amended the trade payment breakdowns to increase construction costs for additional work that needed to be completed due to poor soil conditions. The Authority approved the amended trade payment breakdowns and transferred funds budgeted for construction contingencies to cover the increases in the construction costs. However, contrary to Federal regulations at appendix A, section C.1, of 2 CFR (Code of Federal Regulations) Part 225, the Authority had not been able to provide sufficient documentation to support that its use of nearly \$184,000 in Program funds for the increased construction costs was necessary and reasonable.

The following table shows the construction costs in the trade payment breakdowns, the increases in the construction costs, the amount of Program funds

¹ The lessees are leasing the property from the Detroit Housing Commission for 50 years for the development of phases IIC and IID of the project.

² A trade payment breakdown is an estimate of the cost of various components and quantities of work to be completed for the purpose of making partial payments.

disbursed for the construction costs, and the amount of Program funds disbursed for the construction costs for which the Authority could not provide sufficient documentation to support that the costs were necessary and reasonable.

Phase	Construction cost	Apr. 2, 2012	Nov. 8, 2012	Increase	Disbursed	Unsupported
IIIC	Building concrete	\$435,260	\$544,339	\$109,079	\$98,171	\$71,193
	Earth work	222,030	229,602	7,572	6,815	6,815
	Builder's profit	575,715	582,714	6,999	6,699	4,977
	General requirements	543,129	550,128	6,999	6,332	4,705
	Builder's overhead	191,905	194,238	2,333	2,233	1,659
IIID	Building concrete	410,728	513,567	102,839	92,555	82,212
	Builder's profit	562,917	569,087	6,170	5,919	5,258
	General requirements	531,054	537,224	6,170	5,585	4,960
	Builder's overhead	187,639	189,696	2,057	1,973	1,753
Totals		<u>\$3,660,377</u>	<u>\$3,910,595</u>	<u>\$250,218</u>	<u>\$226,282</u>	<u>\$183,532</u>

As of June 24, 2013, the Authority had not used the remaining \$23,936 in Program funds budgeted for the increased construction costs.

The Authority Lacked Adequate Procedures and Controls

These weaknesses occurred because the Authority lacked adequate procedures and controls to ensure that it used Program funds in accordance with Federal regulations.

The Authority's Rental Development Division's construction specialist for phases IIIC and IIID of the project was responsible for reviewing trade payment breakdowns and supporting documentation to ensure that the costs were reasonable and then submitting the trade payment breakdowns to the Division's construction manager for approval. However, the construction specialist stated that she did not receive supporting documentation for the amended trade payment breakdowns. The Division's construction manager approved the amended trade payment breakdowns without reviewing documentation supporting the need for the additional construction work. The construction manager stated that the Authority relied on an on-site third party soils engineer to ensure that the increased construction costs were accurate and the increased construction costs in the amended trade payment breakdowns appeared reasonable.

Conclusion

The Authority lacked adequate procedures and controls regarding its use of Program funds for phases IIIC and IIID of the project. As a result, it lacked sufficient documentation to support that its use of nearly \$184,000 in Program funds for the increased construction costs for phases IIIC and IIID of the project was necessary and reasonable.

Recommendations

We recommend that the Director of HUD's Detroit Office of Community Planning and Development require the State to

- 1A. Provide sufficient supporting documentation or reimburse its Program from non-Federal funds, as appropriate, for the \$183,532 in Program funds used for phases IIIC and IIID project construction costs for which the Authority did not have sufficient documentation to demonstrate that the costs were necessary and reasonable.
- 1B. Implement adequate procedures and controls to ensure that the Authority maintains documentation to sufficiently support increases in construction costs in accordance with Federal requirements.

We recommend that the Director of HUD's Detroit Office of Community Planning and Development

- 1C. Ensure that if the Authority uses Program funds for the remaining \$23,936 in increased construction costs for phases IIIC and IIID of the project that had not been used as of June 24, 2013, it can provide sufficient documentation to support that the construction costs are necessary and reasonable.

Finding 2: The Authority Did Not Ensure That Consortium Members Complied With Federal Requirements When Acquiring Residential Properties

The Authority did not always ensure that consortium members acquired residential properties at a 1 percent discount from the properties' current market value. These weaknesses occurred because the Authority needs to improve procedures and controls for its Program-funded activities involving acquisition to ensure compliance with Federal requirements. As a result, it inappropriately used nearly \$55,000 in Program funds for the acquisition of 12 properties.

The Authority Did Not Ensure That Residential Properties Were Acquired at a Discount of at Least 1 Percent From Current Market Value

We reviewed 92 Program-funded activities involving acquisition under the Recovery Act. The 92 activities totaled more than \$2.1 million in Program funds budgeted for acquisition.

Contrary to section 2301(d)(1) of Title III of the Act and section C of the notice of fund availability for the Program under the Recovery Act, dated June 11, 2009, the Authority inappropriately used \$54,993 in Program funds for the acquisition of 12 residential properties. It did not ensure that the State's consortium members acquired the properties at a 1 percent discount from the properties' current market value. The consortium members

- Did not acquire six properties (activity numbers 69310, 69496, 69578, 69581, 71955, and 72413) using the most recent state equalized value³ to determine the properties' current market value,
- Acquired three of the properties (activity numbers 72085, 75283, and 85153) for more than the average price of the comparable homes sold in the area that was included in the properties' comparable market analyses,
- Acquired one property (activity number 81021) for more than its appraised value,
- Acquired another property (activity number 74206) for more than the suggested value in the broker price opinion for the property, and
- Acquired the remaining property (activity number 74050) at its state equalized value times two.

³ According to the State, state equalized value, generally the same as assessed value, is one half of a property's true cash value, which is the fair market value or the usual selling price of a property.

The State Needed To Improve Procedures and Controls

These weaknesses occurred because the Authority needed to improve procedures and controls for its Program-funded activities involving acquisition to ensure compliance with Federal requirements.

The assistant director and housing coordinator of a consortium member's Community Development Department said that the consortium member was switching to a new operating system when the six properties (activity numbers 69310, 69496, 69578, 69581, 71955, and 72413) were purchased. Since the consortium member's staff still had access to and was more comfortable using the old operating system, the staff obtained the state equalized values for the six properties from the old system. However, the staff was not aware that the state equalized values for the current year were only updated in the new system.

The special assistant for program development of the Authority's Executive Office stated that although the consortium members acquired four properties (activity numbers 72085, 74206, 81021, and 85153) for more than the (1) average price of the comparable homes sold in the area, (2) appraised value, or (3) suggested value, the properties were acquired for less than the properties' state equalized value times two. HUD did not set a hierarchy as to which valuation method to use in establishing the current market value. Therefore, the costs to acquire the properties were reasonable. However, it was not reasonable to use the valuation method of state equalized value times two to support higher property acquisition costs. Further, the property associated with activity number 81021 was acquired for \$50,500. Therefore, the consortium member was required to acquire the property at a discount of at least 1 percent from the property's current market appraised value as established through an appraisal.

The program and policy manager of the Authority's Community Development Division provided an electronic mail from a consortium member's community resource planner stating that the acquisition of the property (activity number 74050) that was acquired at its state equalized value times two was due to an oversight.

Conclusion

The Authority needs to improve procedures and controls for its Program-funded activities involving acquisition to ensure compliance with Federal requirements. As a result, it inappropriately used nearly \$55,000 in Program funds for the acquisition of 12 properties.

Recommendations

We recommend that the Director of HUD's Detroit Office of Community Planning and Development require the State to

- 2A. Reimburse its Program \$54,993 from non-Federal funds for the Program funds used to acquire 12 properties in excess of a 1 percent discount from the properties' current market value.
- 2B. Implement revised procedures and controls to ensure that the Authority complies with Federal requirements in its use of Program funds for consortium members' property acquisitions.

SCOPE AND METHODOLOGY

We performed our onsite audit work from December 2012 through May 2013 at the Authority's office located at 735 East Michigan Avenue, Lansing, MI. The audit covered the period February 2010 through October 2012 and was expanded as determined necessary.

To accomplish our objectives, we reviewed

- Applicable laws; Federal regulations at 2 CFR Part 225; HUD's regulations at 24 CFR Part 570; the U.S. Department of Transportation's regulations at 49 CFR Part 24; notices of fund availability for the Program under the Recovery Act, dated May 4, 2009, June 11, 2009, November 9, 2009, and January 21, 2010; HUD's grant agreement with the Authority for the Program under the Recovery Act; and HUD's Detroit Office of Community Planning and Development's monitoring reports for the State's Program and Block Grant and HOME Investment Partnerships programs from 2008 through 2012.
- The State's consolidated plan for 2010, annual performance reports for 2010 and 2011, and Program data from HUD's Disaster Recovery Grant Reporting system and the Authority's On-line Project Administration Link system.
- The Authority's audited financial statements for 2010 through 2012, annual reports for 2009 through 2012, financial records, policies and procedures, agreements, Program application, activity files, organizational chart, and budget.

In addition, we interviewed the Authority's employees, the Detroit Housing Commission's personnel, and HUD's staff.

Finding 1

We reviewed the more than \$250,000 in construction costs (building concrete, earth work, builder's profit, general requirements, and builder's overhead) that the Authority transferred from the construction contingencies for phases IIIC and IIID of Gardenvue Estates, a new construction project. As of June 24, 2013, the Authority had disbursed more than \$226,000 in Program funds for the increases in construction costs.

Finding 2

We statistically selected and reviewed 90 of the 1,391 Program-funded activities involving acquisition under the Recovery Act set up in the Authority's Online-Project Administration Link system and in progress as of January 22, 2013. The 90 activities totaled more than \$1.3 million in Program funds budgeted for acquisition. We used a stratified Chromy sample⁴ with the

⁴ A sample designed to capture numbers across a range of number values but manage high-value, influential numbers to prevent random over-representation or under-representation from the high-value, influential numbers.

following criteria: (1) a 90 percent confidence interval, (2) a 30 percent error rate; (3) an achievable precision of 33 percent, and (4) a design effect of 0.80 for stratification and probability proportional to size sampling. We reviewed two additional Program-funded activities involving acquisition under the Recovery Act that were administered by the Authority's Rental Development Division. The two activities totaled \$800,000 in Program funds for acquisition.

We relied in part on data maintained by the Authority for the Program-funded activities involving acquisition under the Recovery Act and data in HUD's system. Although we did not perform detailed assessments of the reliability of the data, we performed minimal levels of testing and found the data to be adequately reliable for our purposes.

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 objectives. 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:

- Effectiveness and efficiency of operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Reliability of financial reporting – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.
- Compliance with applicable laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

We assessed the relevant controls identified above.

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

Significant Deficiencies

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

The Authority lacked adequate procedures and controls to ensure that

- Federal regulations were followed in its use of Program funds for increased construction costs of phases IIC and IID of Gardenvue Estates, a new construction project (see finding 1).
- Federal requirements were always followed in the consortium members' acquisition of residential properties under the Program at a 1 percent discount from the properties' current market value (see finding 2).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/	Unsupported 2/
1A		<u>\$183,532</u>
2A	<u>\$54,993</u>	
Totals	<u>\$54,993</u>	<u>\$183,532</u>


- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.
- 2/ 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.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments



STATE OF MICHIGAN
MICHIGAN STATE HOUSING DEVELOPMENT AUTHORITY
LANSING

RICK SNYDER
GOVERNORSCOTT WOOSLEY, CFA
EXECUTIVE DIRECTOR

MEMORANDUM

TO: Kelly Anderson, Regional Inspector General for Audit, HUD OIG
FROM: Scott Woosley, Executive Director, Michigan State Housing Development Authority /signed/
DATE: August 5, 2013
RE: Michigan State Housing Development Authority Response to HUD OIG Draft Audit Report of the State of Michigan's Neighborhood Stabilization Program Under the American Recovery and Reinvestment Act of 2009

DELIVERED VIA E-MAIL

The Michigan State Housing Development Authority has reviewed the U.S. Department of Housing and Urban Development Office of Inspector General Draft Audit Report dated July 24, 2013, and appreciates the opportunity to respond. As discussed, the Authority takes issue with Findings 1 and 2 and asks that you take into account the responses as described below as you finalize your report.

FINDING 1 RESPONSE: THE AUTHORITY HAD SUFFICIENT DOCUMENTATION TO SUPPORT INCREASES IN CONSTRUCTION COSTS FOR A NEW CONSTRUCTION PROJECT

More than 300 Pages Submitted Support Increases in Construction Costs


Comments 1

Comment 1

Comments 1 and 2

The Michigan State Housing Development Authority (hereafter the Authority) disagrees with the HUD Office of Inspector General (HUD OIG) finding related to the Authority lacking sufficient documentation to support increases in costs for a new construction project. In the more than 300 pages of documentation previously submitted to HUD OIG, there is sufficient support and justification of the additional cost (See Attachment A). Those pages show that construction procedures were well within industry standards in its reporting.

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Comment 1

Multiple Expert Reviews and Acknowledgments Demonstrate the Need for the Cost Increase to Ensure Sound Construction

The projects in question, Gardenview Estates phases IIIC and IIID, represent significant enhancements to the affordable housing stock on the west side of the City of Detroit and additionally meet HUD's goals for replacement of housing units on former public housing program sites. The Authority is pleased to partner with HUD and the Detroit Housing Commission on the redevelopment of this site, which represent a combined investment of more than \$20 million in hard construction costs in this west Detroit neighborhood.

Prior to starting construction on this urban renewal site, it was expected that there would be debris at varying depths during the installation of the footings and foundations; however, the exact soil composition could not be determined until the site was fully excavated and soil compression testing could be done in the precise areas of the footings and trench walls. So, the buildings were initially planned and designed to have building footings laid at a 42 inch depth, pursuant to Michigan Building Code requirements that seek to provide frost protection to the structure foundation and thereby ensure the buildings are soundly constructed. (See Michigan Administrative Code Section 408.30449(1) which provides for the 42 inch depth requirement.)

As expected, upon excavation and soil compaction testing, the projects' General Contractor, Concrete Sub-contractor, Soil Engineer and Architect determined the additional footing depth required to ensure that the buildings were soundly constructed. (See additionally Michigan Administrative Code Section 408.30449(2)(b) which provides for downward deviation/additional footing depth from the 42 inch requirement based on soil type.) Those same construction, engineering and design professionals determined that soil conditions where these footings were to be laid dictated a depth anywhere from 60 to 84 inches beyond/below the 42 inch depth specified in the building plans and specifications to ensure sound construction. They field-adjusted the plans and specifications based on these observations, the Soil Engineer noted the conditions in the applicable reports on the buildings, and the construction team proceeded to

Comment 1

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construct the foundations at the new and adjusted depths. Given the additional footing depth, costs related to the excavation, preparatory work, form placement, and concrete volume all increased in accordance with the additional footing depth.

The Authority, the project sponsor, and the project's General Contractor started construction on the two properties in June of 2012. As identified in the HUD OIG audit finding, as a part of this construction process, the General Contractor sought amendments to each project's Trade Payment Breakdown related to anticipated but previously unquantifiable costs for concrete foundation work at each construction project.

Comment 4

When the Authority's Construction Manager reviewed the General Contractor's request for adjustment to the Trade Payment Breakdown to compensate for these additional costs, he reviewed the General Contractor's request, the Soil Engineer's report, and the Concrete Sub-contractor's proposed billings and determined that based on his review of those materials, his knowledge of the construction projects in question, and his more than 30-years' residential and commercial construction experience that the requested upward adjustments in the construction costs related to the building foundations were necessary and reasonable to complete the foundation construction related to the proposed residential buildings.

Comment 5

Questioned Costs Are Only 1.13% of the \$20 Million in Hard Construction Costs

Comment 5

It is important to note that the amount in question in this finding represents 1.13% of the total hard construction costs. While this may seem like a small amount, the Authority takes every audit seriously and sought supporting documentation that would refute HUD OIG's claim that it lacked sufficient documentation to support increases in construction costs.

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**The Process Complies with Federal
Requirements of Cost Reasonableness**

Comment 6
Comment 1

The Authority believes that the above process fully comports with the requirements of 2 CFR Part 225 related to cost reasonableness including 2 CFR 225 (C)(1)(a), 2 CFR 225(C)(2)(d), and 2 CFR 225(D)(2)(b) and (c). The Authority further attests that it has provided sufficient supporting documentation to support increases in costs for this new construction project – following standards set by the industry –and it asks that HUD OIG adjust its audit findings and recommendations accordingly.

Note: Please also see the more than 300 pages in documentation related to the Gardenview IIIC and IIID Multi-family Housing projects provided to the HUD OIG and incorporated into this response for reference.

RESPONSE TO FINDING 2 BEGINS ON NEXT PAGE

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FINDING 2 RESPONSE: THE AUTHORITY DID ENSURE THAT CONSORTIUM MEMBERS COMPLIED WITH FEDERAL REQUIREMENTS WHEN ACQUIRING RESIDENTIAL PROPERTIES

Comment 7

The Authority disagrees with the HUD Office of Inspector General (HUD OIG) finding that the Authority did not ensure that Consortium Members complied with federal requirements when acquiring residential properties. The assertion that “the State lacked Adequate Procedures and Controls” is unreasonable based on the OIG’s own findings.

Comments 7 and 8

Questioned Costs Total Only 0.04% of Total Program Costs and 3.7% of the Activities Reviewed

Comment 8

The audit reviewed more than \$2.1 million worth of acquisition activities within the broader \$223 million program and found a little more than \$78,000 which is about 0.04% of the total program or 3.7% of the activities reviewed by the OIG. Far from a lack of controls, it is the strong program management and procedures that are in place that limited the errors given the incredibly complex, fast paced and constantly changing environment in which the program was being administered.

Multiple Changes in HUD Guidance Throughout Program Implementation

During the course of the NSP Program, HUD issued no less than 60 separate notices, policy alerts and bulletins. Many of these resulted in the need to communicate changes or clarifications in policy with several hundred sub-recipients, developers, contractors, non-profit organizations, staff and other stakeholders. Not only was the project workforce large, but it was also ever changing as communities were hit with the devastating workforce reductions and management changes that resulted from Michigan’s foreclosure crisis. The constantly evolving federal guidance and work in Michigan’s most distressed cities was orchestrated all while MSHDA staff was managing over one billion dollars in combined work associated with federal housing programs under very

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tight time constraints.

An error rate of 3.7% would be called a success by most reasonable standards given the conditions in place during this program. Simply stated, the statement represents lack of understanding of the practical realities and complexity of the NSP program.

**Consortium Members Used
Methodologies Consistent with the
Intent of HUD Guidance**

Comment 9

City of Hamtramck

The Authority disagrees with the HUD OIG finding on activity number 75283. Attached is documentation that supports the \$23,400 as outlined in the Buyer's Statement dated August 11, 2011 (See Attachment B). The SEV value of activity number 75283 was \$26,200 in 2011, multiplying this number by two would result in the market value at the time being a maximum of \$52,400. The comparable information provided was used to establish the fair market value of the property in order to prepare the voluntary sale notification to seller purchase price offer and is a second method utilized to ensure that the 1% purchase discount was met. The attached documentation from Contracting Resources states the square footage, siding, etc. (See Attachment B). Based on the comparable previously provided of other two- bedroom, two-story homes in the area with similar square footage and housing characteristics, it was determined that the average sale price was within the range of \$21,000 and \$25,500 and subsequently a purchase offer for \$23,725 was made.

Comment 9

The Authority contends that based on the SEV documentation and the comparable information that the city has demonstrated that purchase discount requirement was met and that the \$23,400 purchase was reasonable.

Comment 10

Berrien County Land Bank

The Authority disagrees with the OIG's findings on activity numbers 69581, 72413, 69496, 69578, 69310, and 71955. The properties purchased by the Berrien County Land Bank (BCLB) were done in keeping with the established local

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Comment 10

process and did in fact reflect a 1% purchase price discount. The attached memorandum from the Berrien County Treasurer establishes two critical facts. First, that local policies required the Consortium to make their purchase decisions in April of 2011 (See Attachment C). Secondly, that the State Equalized Value records in Berrien County at the time were always a year behind and unavailable until August or September of 2011, after the purchase date.

Comment 10

In calculating the purchase price with requisite discount, on activity numbers 69581, 72413, 69496, 69578, 69310, and 71955), BCLB relied on the 2010 SEV, which was the best information available at the time. Both the election to purchase as well as the closing itself occurred in advance of the August 2011 date that the County Treasurer indicated the updated figures were available.

Michigan Land Bank Fast Track Authority

Comment 11

The Authority disagrees with the OIG's findings on activity numbers 74206, 85153, and 72085, completed by the Michigan Land Bank Fast Track Authority. Local program officials, with years of experience working in real estate within the local neighborhoods, believed each of these properties was critical to the implementation of the program, and found the initial property valuation reviewed by the OIG to be flawed.

Comments 11
and 12

The attached documentation shows that the SEV for each of these properties was well in excess of the purchase price and incorporated the requisite 1% discount (See Attachments D, E, and F). It is common practice in federal housing programs to use a third valuation mechanism to reconcile a discrepancy between two differing price points. The State of Michigan Department of Licensing and Regulatory Affairs clearly defines the SEV as equal to one-half of your property's actual value. In this case of these properties, the SEV was used to settle a dispute between the Broker's Price Opinion and the requested purchase price.

Comment 13

When program officials reviewed the appraisal on activity number 81021 they found it to be severely out of line with local market conditions and known conditions within that historic neighborhood. The slate roof and other historically significant architectural features alone were known to be valued at well over \$50,000. Program officials again relied on the SEV to settle the dispute between the appraisal and the requested purchase price.

Comment 14

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Given the constantly evolving federal guidance in the NSP program, specific shift in rules surrounding purchase price and valuation when coupled with changes in program personnel – current staff at the time relied on the SEV alone on this property. The Authority does acknowledge that given the purchase price on this property, Land Bank officials should have ordered a new appraisal to settle the discrepancy, however, if a second appraisal would have been conducted, the Authority believes it would have supported a purchase price far in excess of the \$50,500 price.

Genesee County Land Bank

The Authority agrees with the conclusion reached on activity 74050. The \$134 difference was as a result of human error on the part of local officials in calculating the purchase price discount.

OIG's Evaluation of Auditee Comments

Comment 1 We reviewed the documentation provided by the Authority with its response and revised the report to state:

However, contrary to Federal regulations at appendix A, section C.1, of 2 CFR Part 225, the Authority had not been able to provide sufficient documentation to support that its use of nearly \$184,000 in Program funds for increased construction costs was necessary and reasonable.

We also revised the table in finding 1 of this report to include the amount of Program funds disbursed for the construction costs for which the Authority could not provide sufficient documentation to support that the costs were necessary and reasonable.

Further, we amended recommendation 1A to reflect these revisions.

Comment 2 The documentation provided by the Authority included field engineers' daily reports and drawings, construction specifications, and subcontractors' proposed billings for the increased construction costs. The Authority provided this documentation during the audit as part of change orders that were submitted for the increased construction costs. However, it did not review, approve, or process the change orders. Therefore, we did not review the change orders or the documentation contained within the change orders.

Comment 3 The additional construction costs were for building concrete, earth work, builder's profit, general requirements, and builder's overhead.

Comment 4 The Authority's Rental Development Division's construction manager stated that he approved the amended trade payment breakdowns after reviewing an estimate and accounting of additional construction costs for building concrete and earth work, along with a summary of the additional costs. The construction manager also stated that the Authority relied on an onsite third-party soils engineer to ensure that the increased construction costs were accurate, and the increased construction costs in the amended trade payment breakdowns appeared reasonable. Therefore, the construction manager did not base his approval of the amended trade payment breakdowns on a review of the field engineers' daily reports and drawings and construction specifications.

We revised the report to state the following:

The Division's construction manager approved the amended trade payment breakdowns without reviewing documentation supporting the need for the additional construction work.

Comment 5 The nearly \$184,000 in Program funds for the increased construction costs, which the Authority was not able to provide sufficient documentation to support, was 81.1 percent of the more than \$226,000 in Program funds disbursed for the increased construction costs that we reviewed.

Comment 6 Contrary to Federal regulations at appendix A, section C.1, of 2 CFR Part 225, the Authority had not been able to provide sufficient documentation to support that its use of nearly \$184,000 in Program funds for the increased construction costs was necessary and reasonable.

These weaknesses occurred because the Authority lacked adequate procedures and controls to ensure that it used Program funds in accordance with Federal regulations.

Comment 7 We revised the report to state:

The Authority needs to improve procedures and controls for its Program-funded activities involving acquisition to ensure compliance with Federal requirements.

Comment 8 However, the 12 residential properties for which the Authority did not ensure that the State's consortium members acquired the properties at a 1 percent discount from the properties' current market value was 13 percent of the 92 Program-funded activities involving acquisition that we reviewed.

Comment 9 We revised the report to state:

Contrary to section 2301(d)(1) of Title III of the Act and section C of the notice of fund availability for the Program under the Recovery Act, dated June 11, 2009, the Authority inappropriately used \$54,993 in Program funds for the acquisition of 12 residential properties.

The consortium members acquired three of the properties (activity numbers 72085, 75283, and 85153) for more than the average price of the comparable homes sold in the area that was included in the properties' comparable market analyses.

We also removed the following from the report:

Further, contrary to Federal regulations at appendix A, section C.1, of 2 CFR Part 225 and appendix A to the U.S. Department of Transportation's regulations at 49 CFR Part 24, the Authority lacked sufficient documentation to support that its use of \$23,400 in Program funds for the acquisition of a residential property (activity number 75283) was reasonable. The market value analysis did not include sufficient information regarding the acquired

property, such as square footage, year built, and type of exterior, to support that the listed properties were comparable.

Further, we amended recommendation 2A, deleted recommendation 2B, and moved recommendation 2C to recommendation 2B to reflect these revisions.

Comment 10 The deputy director of Berrien County's Equalization Department stated and provided documentation to support that the state equalized values for tax year 2011 were available for activity numbers 69310, 69496, 69578, 69581, 71955, and 72413 as of April 1, 2011. Further, the assistant director and housing coordinator of a consortium member's Community Development Department said that the consortium member was switching to a new operating system when the six properties (activity numbers 69310, 69496, 69578, 69581, 71955, and 72413) were purchased. Since the consortium member's staff still had access to and was more comfortable using the old operating system, the staff obtained the state equalized values for the six properties from the old system. However, the staff was not aware that the state equalized values for the current year were only updated in the new system. Therefore, the consortium member did not acquire the six properties using the most recent state equalized value to determine the properties' current market value.

Comment 11 The Authority did not provide documentation to support that the comparable market analyses completed for the two properties (activity numbers 72085 and 85153) and the broker price opinion completed for the remaining property (activity number 74206) were flawed.

Comment 12 The Authority did not provide documentation to support that the state equalized value times two was a more accurate valuation method for determining the fair market value than the comparable market analyses completed for the two properties (activity numbers 72085 and 85153) and the broker price opinion completed for the remaining property (activity number 74206). Therefore, it was not reasonable to use the valuation method of state equalized value times two to support higher property acquisition costs.

Comment 13 The Authority did not provide documentation to support that the appraised value of the property (activity number 81021) was not in line with local market conditions.

Comment 14 The consortium member was required to acquire the property at a discount of at least 1 percent from the property's current market appraised value as established through an appraisal.

Appendix C

FEDERAL REQUIREMENTS

Findings 1 and 2

HUD's grant agreement with the Authority for the Program under the Recovery Act, dated February 11, 2010, states that the following are part of the grant agreement: the notices of fund availability for the Program under the Recovery Act, dated May 4, 2009, June 11, 2009, November 9, 2009, and January 21, 2010; the Recovery Act; the Housing and Economic Recovery Act of 2008; the State's application for Program assistance under the Recovery Act; HUD's regulations at 24 CFR Part 570; and the funding approval.

HUD's regulations at 24 CFR 570.501(b) state that a recipient is responsible for ensuring that Block Grant funds are used in accordance with all program requirements. The use of designated public agencies, subrecipients, or contractors does not relieve the recipient of this responsibility. The recipient is also responsible for determining the adequacy of performance under subrecipient agreements and procurement contracts and for taking appropriate action when performance problems arise.

HUD's regulations at 24 CFR 570.502(a) state that recipients and subrecipients that are governmental entities, including public agencies, must comply with Office of Management and Budget Circular A-87.

Finding 1

Appendix A, section C.1, of 2 CFR Part 225⁵ requires all costs to be necessary, reasonable, and adequately documented. Section C.2 states that a cost is reasonable if, in its nature or 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. In determining reasonableness of a given cost, consideration must be given to (1) the restraints or requirements imposed by such factors as sound business practices and Federal, State, and other laws and regulations; (2) market prices for comparable goods or services; (3) whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the organization, its employees, the public at large, and the Federal Government; and (4) significant deviations from the established practices of the governmental unit which may unjustifiably increase the Federal award's cost.

Finding 2

Section 2301(d)(1) of Title III of the Act states that any purchase of a foreclosed upon home or residential property under this section must be at a discount from the current market appraised

⁵ Office of Management and Budget Circular A-87 was relocated to 2 CFR Part 225.

value of the home or property, taking into account its current condition, and such discount must ensure that purchasers are paying below-market value for the home or property.

Section I.D.2.c of the notice of fund availability for the Program under the Recovery Act, dated May 4, 2009, states that except as described in this notice and its appendixes, statutory and regulatory provisions governing the Block Grant program, including the provisions in subparts A, C, D, J, K, I, and O of 24 CFR Part 570, as appropriate, should apply to the use of Program funds. Section I.D.2.g states that the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 applies as required in 24 CFR Part 570 and appendix 1, paragraph K, of the notice. Paragraph A of appendix 1 defines current market appraised value as the value of a foreclosed-upon home or residential property that is established through an appraisal made in conformity with the appraisal requirements of the Uniform Relocation Act at 49 CFR 24.103 and completed within 60 days before an offer is made for the property by a recipient, subrecipient, developer, or individual homebuyer. However, if the anticipated value of the proposed acquisition is estimated at \$25,000 or less, the current market appraised value of the property may be established by a valuation of the property that is based on a review of available data and is made by a person the recipient determines is qualified to make the valuation.

Section C of the notice of fund availability for the Program under the Recovery Act, dated June 11, 2009, states that each foreclosed-upon home or residential property must be purchased at a discount of at least 1 percent from the current market-appraised value of the home or property. The address, appraised value, purchase offer amount, and discount amount of each property purchased must be documented in the recipient's Program records.

HUD's regulations at 24 CFR 570.606(b) state that 49 CFR Part 24 contains the government-wide regulations implementing the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970. Paragraph 570.606(e) states that the acquisition of real property for an assisted activity is subject to subpart B of 49 CFR Part 24. Paragraph 570.606(g)(1) states that a grantee is responsible for ensuring compliance with the requirements of 24 CFR 570.606, despite any third party's contractual obligation to the grantee to comply with the provisions of 24 CFR 570.606. For purposes of the State's Block Grant program, the State should require recipients to certify that they will comply with the requirements of 24 CFR 570.606.

The U.S. Department of Transportation's regulations at 49 CFR 24.101(b)(2) state that the requirements of subpart B do not apply to acquisitions for programs or projects undertaken by an agency or person that receives Federal financial assistance but does not have authority to acquire property by eminent domain, provided that such agency or person should, before making an offer for the property, clearly advise the owner that the agency or person is unable to acquire the property if negotiations fail to result in an agreement and inform the owner in writing of what the agency or person believes to be the market value of the property. Appendix A, additional information to explain sections 24.101(b)(1)(iv) and (2)(ii), to 49 CFR Part 24 states that for programs and projects receiving Federal financial assistance described in 49 CFR 24.101(b)(2), an agency is to inform the owner(s) in writing of the agency's estimate of the fair market value for the property to be acquired. While section 24.101(b)(2) does not require an appraisal for these transactions, an agency may decide that an appraisal is necessary to support its

determination of the fair market value of these properties, and in any event, an agency must have some reasonable basis for its determination of the fair market value. After an agency 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 agency may negotiate freely with the owner to reach agreement.