



The City of Richmond, CA
Neighborhood Stabilization Program



Issue Date: August 22, 2014

Audit Report Number: 2014-LA-1005

TO: Maria Cremer, Director, Office of Community Planning and Development, San Francisco, 9AD

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//SIGNED//

FROM: Tanya E. Schulze, Regional Inspector General for Audit, Los Angeles Region, 9DGA

SUBJECT: The City of Richmond, CA, Did Not Administer Its Neighborhood Stabilization Program in Accordance 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 City of Richmond's Neighborhood Stabilization 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 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 213-534-2471.



August 22, 2014

The City of Richmond, CA, Did Not Administer Its Neighborhood Stabilization Program in Accordance With Requirements

Highlights

Audit Report 2014-LA-1005

What We Audited and Why

We audited the City of Richmond's Neighborhood Stabilization Program 1 (NSP1) in response to the U.S. Department of Housing and Urban Development (HUD), Office of Community Planning and Development's concerns over the City's management of its NSP1. Our objective was to determine whether the City administered its NSP1 in accordance with requirements related to procurement and cost eligibility.

What We Recommend

We recommend that HUD require the City to (1) repay HUD the actual administrative costs charged or \$223,085 for mismanaging three developers and (2) repay HUD \$691,005 for ineligible or unreasonable costs and for work not performed. We also recommend that HUD review the City's remaining NSP1 activities and its \$1.1 million NSP3 grant and require the City to reimburse the programs for any ineligible or unreasonable costs.

We recommend that HUD's Associate General Counsel for Program Enforcement pursue civil and other administrative sanctions against the City, its developers, or both for allowing NSP1 funds to be used for ineligible costs.

What We Found

The City did not administer its NSP1 in accordance with requirements related to procurement and cost eligibility. Based on flawed procurement decision making, the City awarded contracts to developers that lacked the capacity and financial resources to administer the program. In addition, it did not monitor the rehabilitation progress or the quality of work performed by three developers. As a result, the rehabilitation of some properties suffered significant delays, while the rehabilitation of other properties had not been completed after more than 3 years. Further, the City paid \$691,005 for rehabilitation work that was not performed and other ineligible and unreasonable costs. Lastly, the City did not ensure that NSP1 properties were sold to eligible home buyers. These same issues likely occurred under the City's NSP3 and will continue unless HUD closely monitors the City to ensure compliance.

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BACKGROUND AND OBJECTIVE

The Neighborhood Stabilization Program (NSP) was authorized under Title III of the Housing and Economic Recovery Act of 2008. It provides grants to States and certain local communities to purchase foreclosed-upon or abandoned homes and rehabilitate, resell, or redevelop them to stabilize neighborhoods and stem the declining value of neighboring homes. The Act calls for allocating funds to “states and units of local governments with the greatest need.” In the first phase of the program, NSP1, the U.S. Department of Housing and Urban Development (HUD) allocated \$3.9 billion in program funds to assist in the redevelopment of abandoned and foreclosed-upon homes. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 provided HUD an additional \$1 billion in NSP funds (NSP3) to award to all States and select governments on a formula basis.

In March 2009, the City of Richmond signed an agreement with HUD for more than \$3.3 million in NSP1 funds. In March 2011, HUD awarded the City an additional \$1.1 million in NSP3 funds. As a grantee, the City is responsible for ensuring that NSP funds are used in accordance with program requirements. According to the City’s action plan, NSP1 funding will be used to purchase, rehabilitate, and redevelop foreclosed-upon and abandoned homes and residential properties to prevent blight and create affordable housing opportunities. Similarly, NSP3 funding will be used for the purchase and rehabilitation of single-family units. As of June 20, 2014, HUD’s Line of Credit Control System showed that the City had more than \$595,000 in NSP1 funds and more than \$35,000 in NSP3 funds remaining to be drawn down.

Under its NSP1, the City provided NSP loans to developers to purchase and rehabilitate foreclosed homes. Developers were to repay these loans in full upon the earlier occurrence of these events: (1) the sale of the property to an eligible home buyer, (2) the expiration of the loan term, (3) the transfer of the property, or (4) default as defined in the loan agreement.

Our audit objective was to determine whether the City administered its NSP1 in accordance with requirements related to procurement and cost eligibility.

RESULTS OF AUDIT

Finding 1: The City Did Not Administer Its Neighborhood Stabilization Program in Accordance With Requirements

The City awarded contracts to developers that lacked the capacity and financial resources to implement its NSP1. It also did not monitor three developers' rehabilitation work and did not verify home-buyer eligibility. These conditions occurred because the City disregarded HUD's NSP requirements and its own NSP policies and procedures. As a result, the rehabilitation of properties was significantly delayed or not completed; one property was sold to ineligible home buyers, and the eligibility of other home buyers was uncertain; and \$914,079 in NSP1 funds was used for ineligible and unreasonable costs.

The City Awarded Contracts to Three Developers That Lacked the Capacity and Financial Resources to Administer Its NSP1

While the City's decision to use a competitive procurement process was acceptable, the actual implementation and decision making was flawed. This resulted in the award of contracts to three developers that lacked the capacity and financial resources to administer its NSP1. This condition occurred because the City chose to override certain aspects of the competitive procurement method during program implementation.

The City used the competitive proposal method of procurement to award NSP1 developer contracts. Under this procurement method, the City identified four evaluation factors. The four factors were (1) capacity, (2) soundness of approach, (3) strategic importance, and (4) cost and leveraging.

The City evaluated seven proposals and selected four developers to administer its NSP1. It entered into developer agreements with these four developers, which included a requirement that the developer leverage at least 50 percent of its NSP property budget from non-NSP funds. Leveraging was also one of the factors used to evaluate proposals. However, the City did not enforce the leverage requirement when administering its program. Instead, during program implementation, the City paid for all costs claimed by three of the four developers. Therefore, it effectively removed all risks for the three developers, contrary to an NSP policy alert that requires developers to assume some of the risk by investing some of their own money in the project (see appendix C).

Three of the four developer proposals included the same principal consultant, general contractor, and real estate broker. These three firms were Community First Development, LLC, MissionRich Development, LLC, and KL Hampton Group, LLC. When evaluating the capacity of these three developers, the City did not consider that using the same individuals could impact the capacity of the service providers to complete projects in a timely manner. The three developers also did not use the general contractor, Eastmont Builders, as specified in their proposals. In place of this contractor, the three developers hired another general contractor, Isamar Construction, which had certified to the Contractors State License Board that it had no employees for the past 7 years. The City did not question this substitution. Because the three developers were managed by the same principal consultant and all rehabilitation was performed by the same general contractor, the developers lacked the capacity to administer the program.

Since the developers did not have risk through leveraging and lacked the capacity to complete the rehabilitation work in a timely manner, there were unreasonable delays to the rehabilitation and resale of the properties. Some properties took up to 3 years to complete. After more than 3 years, rehabilitation on three properties had not been completed (see appendix D). This condition resulted in the City's having to take the unfinished properties back via the deed-in-lieu-of-foreclosure process¹.

The City Did Not Monitor Three Developers' Rehabilitation

The City used NSP1 funds to provide developers with acquisition loans to purchase foreclosed-upon or abandoned homes. After the properties were acquired, the City did not monitor the three developers, Community First Development, LLC, MissionRich Development, LLC, and KL Hampton Group, LLC. The City did not monitor the progress of the rehabilitation and did not receive quarterly reports from the developers as required by the City's NSP policies and procedures. Because of the City's lack of monitoring, the developers did not complete the rehabilitation of three properties, and there were significant delays with the rehabilitation of other properties. For the properties that were resold to home buyers, the City authorized the use of sales proceeds to pay for all rehabilitation costs claimed by the three developers through the resale escrows, regardless of cost eligibility or supporting documentation.

The developers also claimed that the properties had been broken into and vandalized, thereby requiring rehabilitation work to be redone. However, the City did not substantiate these claims or assess the damage to determine what additional repairs were necessary. In one instance, the City was unaware that a

¹ This is a process in which the developer conveys the property to the City to satisfy the defaulted NSP loan.

developer had received a vandalism-related insurance claim reimbursement for more than \$18,000.

The City Allowed the Use of Sales Proceeds to Pay Off Unauthorized Subordinate Liens

During the resale of the properties, the City learned that unauthorized subordinate liens had been placed on the properties purchased by developers Community First Development, LLC, and KL Hampton Group, LLC. The entity and individuals who filed these subordinate liens were investors affiliated with the owner of KL Hampton Group, LLC. The City assumed that these secondary finances were used to rehabilitate the properties and allowed the sales proceeds to be used to pay off these subordinate liens, with up to 12 percent interest, in addition to paying all other costs claimed by the developers. Although the NSP loans were recorded as first mortgage liens, the City allowed all subordinate liens and other costs, without supporting documentation, to be paid before taking repayments on its NSP loans. As a result, the City forgave significant portions of the developers’ NSP loans as there were few sales proceeds leftover to repay the City (see example below).

NSP loan example – property no. 6				
City NSP loan to developer	Payoffs to second & third liens	Other payments to developer	Payoff to City NSP loan	Portion of developer’s NSP loan forgiven by the City
\$119,249	\$65,000	\$78,615	\$0	\$119,249

As shown in the example above, the entire \$119,249 developer’s loan was forgiven since there were no sales proceeds.

The City Paid for Rehabilitation Work Not Performed

The City authorized sales proceeds to be used to pay for rehabilitation costs claimed by three developers, but the costs could not be supported. For the City to meet NSP policy alert requirements, it must ensure that the developers’ costs were reasonable and have records to demonstrate how it made this determination (see appendix C). Although the City approved a scope of work for each property, it did not monitor the properties during rehabilitation or at completion. Therefore, it could not have known which items on the scope of work had been completed.

The City project manager responsible for monitoring the three developers admitted that she was not aware of the rehabilitation costs incurred until the

property was in escrow to be resold to a home buyer. Rehabilitation costs claimed by the three developers appeared on the estimated HUD-1 settlement statements when the properties were in escrow. The City project manager said she verified the rehabilitation costs on the estimated HUD-1 settlement statements by comparing them against supporting documentation provided by the developers. Based on her review, she approved the escrow disbursements, which included payoffs of subordinate liens and payments to developers and contractors.

Contrary to the City project manager's claim and NSP requirements, the City's files contained insufficient records to support the rehabilitation costs paid. Therefore, to determine the actual rehabilitation work performed, we inspected the properties that were resold to home buyers and confirmed that some rehabilitation work in the City-approved scope of work was not performed. Rehabilitation work that was not performed included but was not limited to the installation or replacement of dishwashers, tankless water heaters, energy-efficient furnaces, dual-pane windows, carpets, sump pumps, and low-flow toilets and repairs to plumbing and fences (see photographs). Based on our inspections, more than \$449,000 in rehabilitation costs paid off through subordinate liens or paid to the developers and contractors could not be supported. Not only were NSP1 funds misused, three home buyers had to pay out of pocket to repair items that should have been repaired by the developers. Below are photographs from our inspections that illustrate examples of rehabilitation work that was in the City-approved scope of work but not completed.



Dishwasher not installed at property no. 5



Fence not repaired and held up by a string attached to the shed at property no. 5

The City Paid for Ineligible Costs

In addition to paying for rehabilitation work not performed, the City authorized the use of sales proceeds for ineligible costs. Developers may earn a developer fee, which includes a reasonable profit margin. The purpose of the developer fee is to compensate the developer for related overhead expenses and provide a return on the developer's investment. When a developer fee is paid, NSP policy alert prohibits grantees from also paying a project management fee because doing so would be double-dipping (see appendix C). The City ignored NSP requirements and allowed sales proceeds to be used to pay \$103,806 in ineligible costs (see appendix D). These ineligible costs included the following:

Ineligible cost	Explanation
\$31,112 in seller credits to home buyers with Federal Housing Administration (FHA) loans	For-profit developers are prohibited from providing financial assistance under FHA (see appendix C).
\$21,759 in overhead & profit	Double-dipping
\$20,743 in developer fees paid to non-developers	Non-developers are not entitled to developer fees.
\$18,376 already reimbursed by developer's insurance for property vandalism	Double-dipping
\$10,750 in project management fees	Double-dipping
\$1,066 in non-developer expenses and duplicate payments	Expenses that did not belong to the developer were paid, and there were duplicate payments.

The City Paid for Unreasonable Costs

NSP policy alerts require grantees to ensure that costs and developer fees are reasonable (see appendix C). Cost reasonableness takes into account factors such as prudence, sound business practices, and arm’s-length bargaining. The City ignored NSP requirements and allowed sales proceeds to be used to pay \$137,601 in unreasonable costs (see appendix E). These costs included the following:

Unreasonable cost	Explanation
\$98,017 in cash to seller or developer	Allowing sales proceeds to be disbursed to the developers instead of using them to repay the City’s NSP loan was unreasonable.
\$17,866 in house sitter fees	Allowing developers to pay house sitters to live at the properties, which ranged from months to nearly 2 years, was unreasonable.
\$11,540 in interest on subordinate loans provided by the KL Hampton Group, LLC’s affiliates	Developers obtained subordinate loans from their affiliates without the City’s approval. Allowing interest to be paid on these unauthorized loans from affiliates was unreasonable.
\$10,178 in penalties & redemption fees for late payment of real estate taxes	Developers should have paid real estate taxes in a timely manner. Penalties and redemption fees resulting from late payments were unreasonable.

None of these costs met NSP cost reasonableness requirements. After these unreasonable costs were paid, there were few sales proceeds left to repay the City. As a result, the City forgave significant portions of the three developers’ NSP loans.

Home-Buyer Eligibility Was Not Adequately Verified

NSP properties were sold to home buyers whose eligibility was not adequately verified. The City did not ensure that the developers adequately documented, reviewed, and verified the eligibility of all household members as required by the City’s NSP policies and procedures (see appendix C). In one case, a property was sold to ineligible home buyers. The home buyers were not income-eligible, and one of the home buyers, who was also the real estate agent representing the buyers, certified that she would not occupy the property. This condition occurred because the City did not adequately monitor its developers and relied on the developers to select home buyers and determine home-buyer eligibility. As a result, the City could not assure HUD that other NSP properties were sold only to eligible home buyers.

Conclusion

The City did not administer its NSP1 in accordance with requirements, from the procurement of the developers to the sale of the rehabilitated properties to the home buyers. Specifically, the City had an improper procurement process, which resulted in the award of contracts to three developers that lacked the capacity and financial resources to administer its NSP1. The City paid three developers \$449,598 for rehabilitation costs that could not be supported by the actual work performed. In addition, the City paid \$103,806 in ineligible costs and \$137,601 in unreasonable costs that did not meet NSP requirements. Lastly, the City sold at least one NSP property to ineligible home buyers. We attributed these issues to the City's disregard of HUD's NSP requirements and its own policies and procedures. As a result, total costs of the City's NSP1 were inflated, the three developers received undue enrichment, and there was no assurance that properties were sold to families that the program was intended to benefit. The City should return \$223,085 in administrative fees for mismanaging its program. These same issues likely occurred under the City's NSP3 and will continue unless HUD closely monitors the City to ensure compliance.

Recommendations

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

- 1A. Require the City to return to HUD, using non-Federal funds, the actual amount of administrative costs charged to the grant related to the three developers or \$223,085² because the City mismanaged its NSP1.
- 1B. Require the City to repay HUD, using non-Federal funds, \$449,598 paid to secondary lien holders, developers, and contractors for rehabilitation work not performed.
- 1C. Require the City to repay HUD, using non-Federal funds, \$103,806 for all other ineligible costs identified in the report.
- 1D. Require the City to repay HUD, using non-Federal funds, \$137,601 for the unreasonable costs identified in the report.
- 1E. Require the City to submit to HUD for review and approval of all remaining NSP1 activity, including documentation to justify and support all future NSP1 draw requests for the \$595,863 remaining in HUD's Line

² The City's NSP1 grant was \$3,346,105. 10 percent of the grant, or \$334,611, may be used for administrative costs. The City mismanaged three of the four developers. These 3 developers purchased 12 of the 18 properties, or 66.67 percent of the properties. Therefore, if actual costs cannot be determined, the City shall return \$223,085 (or 66.67 percent of \$334,611) in administrative costs to HUD.

of Credit Control System,³ home-buyer eligibility, and developer and contractor selection.

- 1F. Review all of the City's activities for its \$1,153,172 NSP3 grant and require the City to repay its NSP3 using non-Federal funds for any ineligible and unreasonable costs. This process should include a review of documentation to justify and support all expenditures, home-buyer eligibility, and developer and contractor selection.

We recommend that HUD's Associate General Counsel for Program Enforcement

- 1G. Determine legal sufficiency and if legally sufficient, pursue civil remedies (31 U.S.C. (United States Code), sections 3801-3812, 3729, or both), civil money penalties (24 CFR (Code of Federal Regulations) 30.35), or other administrative sanctions against the City, its developers, or both for allowing NSP funds to be used for ineligible and unreasonable costs.

³ As of June 20, 2014, the City had \$595,863 remaining in HUD's Line of Credit Control System.

SCOPE AND METHODOLOGY

We performed our onsite work at the City's office at 440 Civic Center Plaza, Richmond, CA, from November 2013 to February 2014. Our audit generally covered the period January 1, 2009, through June 30, 2013, and was expanded to other periods as necessary.

To accomplish our audit objective, we

- Reviewed applicable HUD requirements;
- Reviewed relevant background information related to the City and its NSP1 grant;
- Reviewed the City's policies and procedures for administering its NSP1;
- Interviewed HUD staff, City staff, and developers, as appropriate;
- Reviewed the City's records pertaining to property acquisition, rehabilitation, expenditures and disbursements, and property resale;
- Reviewed escrow files; and
- Inspected the properties that were purchased and rehabilitated under NSP1.

The City was awarded more than \$3.3 million in NSP1 funds. It provided loans to four developers to purchase a total of 18 properties. Initially, we selected a nonstatistical sample of four properties to review, which included one property for each of the four developers. Our initial review found that the City did not monitor rehabilitation performed by three developers managed by the same individual, which resulted in questionable costs. As a result, we expanded our review to include all nine remaining properties purchased by the three developers. Our overall sample included the purchase and rehabilitation of 13 properties that were financed by the City through NSP1 loans totaling more than \$2 million.

We determined that computer-processed data generated by the City were not used to materially support our audit findings, conclusions, and recommendations. Thus, we did not assess the reliability of the City's computer-processed data.

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 objective.

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 objective:

- Effectiveness and efficiency of program operations – Implementation of policies and procedures to ensure that program funds are used for eligible purposes.
- Reliability of financial information – Implementation of policies and procedures to reasonably ensure that relevant and reliable information is obtained to adequately support program expenditures.
- Compliance with applicable laws and regulations – Implementation of policies and procedures to ensure that monitoring and expenditures comply with applicable HUD requirements.

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 City had not implemented controls to monitor three developers to ensure that program funds were used in compliance with HUD requirements (finding).

APPENDIXES

Appendix A

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

Recommendation number	Ineligible 1/	Unreasonable 2/	Funds to be put to better use 3/
1A	\$223,085		
1B	\$449,598		
1C	<u>\$103,806</u>		
1D		<u>\$137,601</u>	
1E			<u>\$595,863</u>
Total	<u>\$776,489</u>	<u>\$137,601</u>	<u>\$595,863</u>

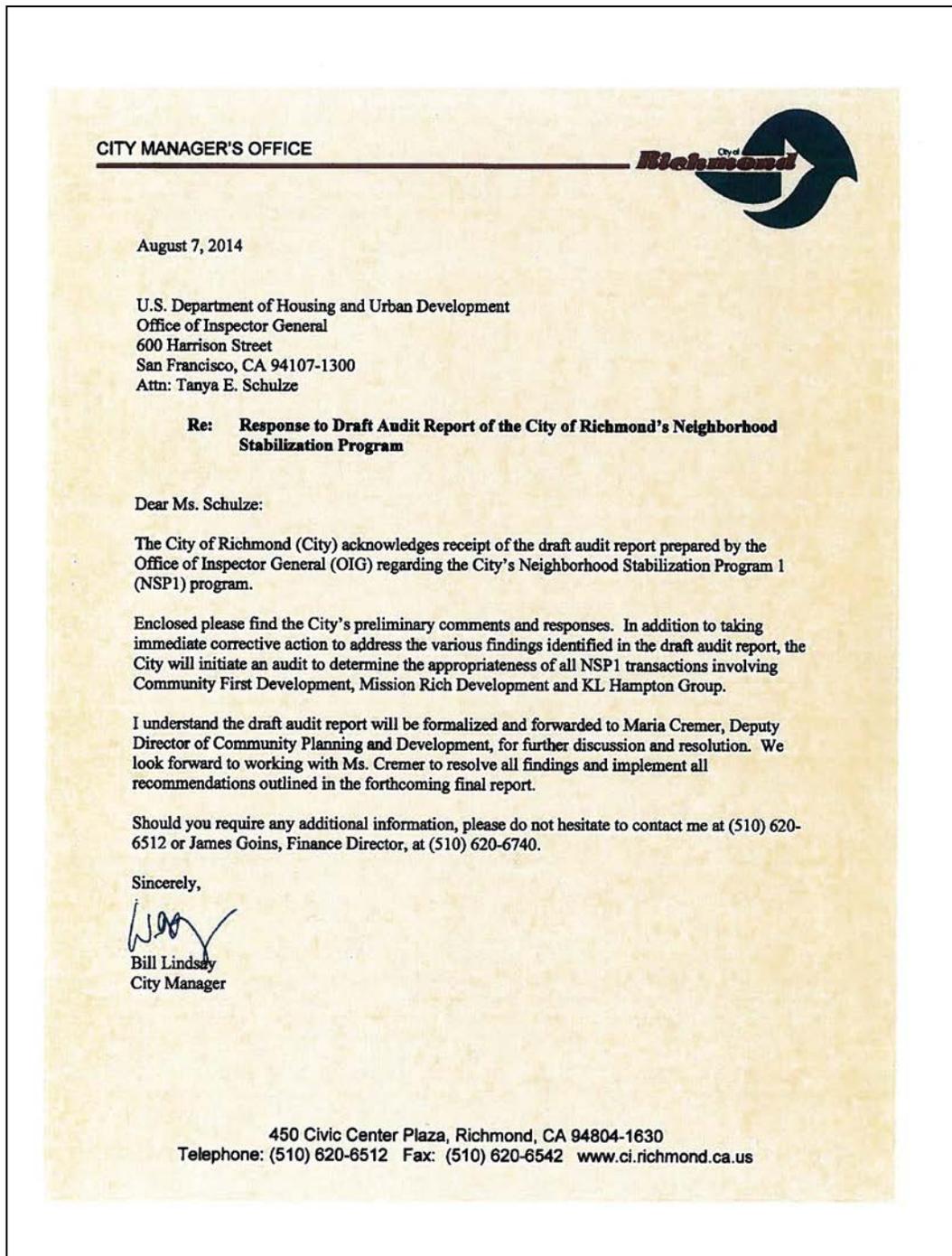
- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations. In this case, ineligible costs consist of administrative fees that the City was not entitled to receive for failing to monitor three developers, payments for rehabilitation work that was not performed, and other expenditures not allowed by NSP requirements.
- 2/ Unreasonable costs are those costs not generally recognized as ordinary, prudent, relevant, or necessary within established practices. Unreasonable costs exceed the costs that would be incurred by a prudent person in conducting a competitive business.
- 3/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (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. The \$595,863 represents the City's NSP1 funds remaining in HUD's Line of Credit Control System as of June 20, 2014.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments



**Responses to findings by U.S. Department of Housing and Urban Development
Office of Inspector General in their letter dated July 17, 2014**

Finding

The city awarded contracts to three developers that lacked the capacity and financial resources to administer its NSP1

Management Response:

The city believes that, while the initial procurement process utilized to retain the services of NSP1 developers was proper, the administration of this process resulted in poor selections of developers. Seven developers initially responded to the formal solicitation of proposals; however, three of these respondents withdrew from the selection process. Of the four remaining developers that were selected, three included the same principal consultant and lacked the capacity to complete the work (Community First Development, LLC; KL Hampton Group, LLC; and MissionRich Development, LLC). The city also failed to enforce its requirement that this developer leverage 50% of its NSP property budget from non-NSP funds. The fourth developer that was selected did, in fact, have the capacity to complete the work and was appropriately leveraged.

Comment 1

The city acknowledges these errors and is taking steps to address them. In particular, administration of procurement activities has been reorganized, and, what had been a decentralized departmental process is now centralized under the city's Finance Department with more effective internal controls. The city will also take additional necessary measures outlined in HUD's NSP regulations and guidelines, and in the city's own NSP policies and procedures, to enforce leveraging and other program requirements.

Comment 2

Finding

The city did not monitor three developers' rehabilitation

Management Response:

While full monitoring of rehabilitation work was conducted in the case of Parkway Housing, the developer of seven properties, the city concurs with the finding that monitoring was inadequate in the case of three developers (Community First Development, LLC; KL Hampton Group, LLC; and MissionRich Development, LLC), and is taking the steps described below to improve its monitoring activities.

Comment 3

Since April 2014, city staff has received assistance and training from Training and Development Associates (TDA) in the area of monitoring and drafted a HOME Compliance Manual for pending submittal to HUD with TDA's assistance. The draft manual is attached for your reference. In addition to permit-related inspections

Comment 4

conducted by the city's building inspectors, the city is also in the process of procuring contracts to hire third party construction managers to perform construction monitoring.

The city will seek return of the funds paid to the developer for costs claimed due to vandalism, in that the developer did not disclose the receipt of the \$18,000 insurance claim for these costs.

Finding

The city allowed the use of sales proceeds to pay off unauthorized subordinate liens

Management Response:

The city has taken the steps described below to address the procedural deficiencies that give rise to this finding.

The city's Finance Director will now be included as the final authorized approver on all financial documents. Escrow documents will also be reviewed at two different levels (Program Manager and then Finance Director) in order to minimize errors and other irregularities in the transactions.

Comment 5

The city will investigate the circumstances regarding how the \$119,249 loan was forgiven on NSP property No. 6. If subordinate liens and other costs were not used to rehabilitate the property, the city will seek return of ineligible payments from the developer.

Finding

The city paid for rehabilitation work not performed

Management Response:

The city has taken the steps described below to address the procedural deficiencies that give rise to this finding.

As previously described, the city has instituted more effective monitoring procedures by having all NSP-related transactions recorded in the city's centralized financial management system. This allows for better tracking and payment of invoices, in addition to analysis of transactions before close of escrow. In addition, all NSP escrow documents will now be uploaded into the city's centralized financial management system for better internal controls.

Comment 6

The city will initiate an internal audit of itemized costs listed in Appendix D and E in order to determine the remedies available vis-à-vis the developers. The city is also requesting back-up documentation from the developers related to the \$449,598 that

was paid to secondary lien holders (Recommendation 1B), developers and contractors to conclusively determine how the monies were used. If the monies were not used to rehabilitate NSP properties, the city will seek return of ineligible payments.

Finding

The city paid for ineligible and unreasonable costs

Management Response:

The city is gathering documents for the ineligible costs of \$103,806 and unreasonable costs of \$137,601 that were paid on the NSP properties. The decision on the next course of action will be made upon detailed analysis of these documents. If the monies were not used to rehabilitate NSP properties, the city will seek return of ineligible payments.

Finding

Home-Buyer eligibility was not adequately verified

Management Response:

The city will investigate the income eligibility of all of its NSP buyers. The city will ensure that income eligibility verification is performed and has set up verification procedures for all NSP and HOME-assisted projects.

Comment 7

Comment 8

OIG Evaluation of Auditee Comments

- Comment 1** The City stated that three of the seven respondents withdrew from the selection process. However, during the audit, the City's Housing Director stated that one developer withdrew its proposal. In addition, the City did not provide documentation to support any respondent's withdrawal from the selection process. The number of developers that withdrew from the selection process did not impact the audit findings or recommendations.
- Comment 2** The City indicated that it is taking steps to address errors in its procurement activities and to follow NSP requirements. The City will work with HUD during the audit resolution process to further address these items.
- Comment 3** The City stated that since April 2014, City staff has received assistance and training from Training and Development Associates (TDA) in the area of monitoring and drafted a HOME Compliance Manual pending submittal to HUD. The City further stated that the draft manual was attached for reference. However, the City did not provide the draft manual as stated. Further, HOME and NSP are programs with different requirements. Therefore, a HOME Compliance Manual would be irrelevant for the administration of NSP.
- Comment 4** The City stated that it will seek return of the funds paid to the developer for costs claimed due to vandalism as it relates to the nondisclosure of the receipt of the \$18,000 insurance claim. This item is part of recommendation 1C. The City will work with HUD to resolve the recommendation.
- Comment 5** The City stated that it will investigate the circumstances regarding how the \$119,249 loan was forgiven on NSP property no. 6 and will seek return on ineligible payments from the developer. This item is part of recommendation 1B. The City will work with HUD to resolve the recommendation.
- Comment 6** The City stated that it is requesting back-up documentation from the developers related to the \$449,598 that was paid to secondary lien holders, developers, and contractors to determine how monies were used and will seek return of ineligible payments. This is responsive to recommendation 1B. The City will work with HUD to resolve the recommendation.
- Comment 7** The City stated that it is gathering documents for the ineligible costs of \$103,806 and unreasonable costs of \$137,601. This is responsive to recommendations 1C and 1D. The City will work with HUD to resolve the recommendations.
- Comment 8** The City stated that it will investigate the income eligibility of all of its NSP home buyers and ensure that verification procedures are set up and performed. This will need to be verified by HUD during the audit resolution process.

Appendix C

CRITERIA

The NSP1 Federal Register Bridge Notice, also known as Revisions to Neighborhood Stabilization Program (NSP) and Technical Corrections, dated June 19, 2009, states:

Revenue generated from the use of NSP funds and received by a private individual or other entity that is not a subrecipient is not required to be returned to the grantee as was required by section 2301(d)(4). Notwithstanding the elimination of this requirement, grantees are strongly encouraged to avoid the undue enrichment of entities that are not subrecipients.

HUD NSP Policy Alert: Guidance on FHA [Federal Housing Administration] Mortgage Insurance for NSP Grantees, dated May 23, 2010, states:

FHA will allow a public NSP grantee (city, county, or state) to work with another entity, such as a non-profit, to make the downpayment assistance. Only the public entity may provide the downpayment assistance on an FHA-insured mortgage, provided that the non-profit is not an instrumentality of that public entity, holds title to the subject property, and will be the seller of record.

Non-profit subrecipients or non-profit developers working in the NSP program are required to register and be approved to make second mortgages, pay closing costs, or other forms of NSP Homeownership Assistance in conjunction with FHA insurance. (For-profit developers may not offer financial assistance under FHA.)

HUD NSP Policy Alert: Guidance on Allocating Real Estate Development Costs in the Neighborhood Stabilization Program, originally issued on January 13, 2011, and updated on September 16, 2011, states:

The purpose of allowing the developer's fee to be included in the cost of a project is to compensate the developer for related overhead expenses and to provide a return on the developer's investment (which return may be referred to as "profit" for simplicity's sake).

HUD NSP Policy Alert: Guidance on Developers, Subrecipients, and Contractors, originally issued on August 27, 2010, and updated on November 16, 2011, states:

Grantees and subrecipients may not earn a developer's fee. An entity may charge developer's fees only under 24 CFR 570.202(b)(1), which allows a grantee to provide CDBG [Community Development Block Grant] funds (or NSP funds) to assist in the acquisition and rehabilitation/reconstruction of property by private individuals or entities. The right to charge a developer's fee is available only to an entity that receives assistance

from the grantee or the subrecipient and assumes some of the risk of the project, which the developer does by investing some of his/her own money in the project.

When negotiating a developer fee, it is crucial for grantees to clearly specify what project costs can and cannot be paid with NSP fees. For example, if a developer's budget called for directly paying a project manager and also a developer fee that would be double-dipping and would not be allowed. Direct costs or indirect costs of a developer related to project management should be paid only through the fee. Grantees may also require a developer to pay some of the holding costs and receive reimbursement through the fee.

HUD NSP Policy Alert: Guidance on NSP Appraisals: Voluntary Acquisitions, originally issued on November 5, 2009, and updated on March 15, 2012, states:

2. Current and Cost Reasonableness Requirements.

A fundamental requirement in the OMB [Office of Management and Budget] Circulars is that costs charged to an NSP grant must be reasonable. Cost reasonableness takes into account factors such as prudence, sound business practices, and arm's length bargaining.

HUD NSP Policy Alert: Guidance on the Procurement of Developers and Subrecipients, dated June 1, 2012, states:

In order for a grantee to meet its NSP requirements, it must ensure that the developer's costs are reasonable and have records to demonstrate how they made this determination.

The developer in turn must demonstrate that costs are reasonable and that any in-house staff or subcontractors with whom it works are employing principles of cost reasonableness.

In the case of entities who are directly affiliated with a developer (an identity of interest situation) the grantee should be careful in reviewing the eligibility and reasonableness of costs, especially the developer's profit and overhead. The grantee should look at all of the types of return that the developer is earning (developer's fee, builder's profit, rental income, etc.) and ensure that, in sum, the return is reasonable for the type of construction and local market.

The City's NSP Policies and Procedures Manual, revised 2011, states:

The Developer shall make a good faith effort to leverage NSP funds with other private and public funds. The goal of the Program is to leverage at least fifty percent (50%) of the NSP Property Budget from non-NSP funds.

In the submittal of the NSP Property Budget, the Developer must identify all non-NSP funds which it intends to use in connection with the Unit Property. The Developer must provide an explanation for any Unit Property in which it is unable to meet the leverage requirement.

The Developer shall submit regular progress reports to the City in the form, content, and frequency required by the City. The progress reports must be submitted at least quarterly, unless otherwise directed by the City.

Following the rehabilitation of a Unit Property, the Developer shall use reasonable efforts to cause the Unit Property to be sold to an Eligible Purchaser.

The City of Richmond Consolidated Plan has established a priority to increase homeownership opportunities for very-low and low-income households in the target area. Projects designed to increase neighborhood stability and improve the quality of housing through an increased incidence of homeownership in an identified target area is an identified priority in the Consolidated Plan. For the purposes of NSP assisted housing, households must have an income no greater than 120 percent of the area median income. All assisted households must agree to occupy the acquired unit as their principle place of residence throughout the loan period; no temporary subleases will be permitted.

The City's loan agreement with developers, section 1.1, Definitions, defines "eligible purchaser" as a person who "(i) qualifies as a Low Income Household (with household annual income equal to or less than 50% of the Median Income), Moderate Income Household (with household annual income that does not exceed 80% of the Median Income), or Middle Income Household (with household annual income that does not exceed 120% of the Median Income), (ii) will occupy the renovated Property as his or her primary residence, and (iii) has completed at least eight hours of pre-purchase counseling through a counseling agency certified by HUD."

The City's loan agreement with developers, section 2.6, Repayment of Loan, states "the Loan shall be due in full upon earlier to occur of the following events: (i) the date of sale of the Property to an Eligible Purchaser; (ii) the date of expiration of the Term; (iii) the date of an authorized or unauthorized Transfer of the Property; (iv) the date of any Default hereunder."

Appendix D

TABLE OF INELIGIBLE COSTS BY PROPERTY

Prop. no.	Developer	Seller credits to home buyers with FHA loans	Overhead & profit	Developer fee paid to non-developer	Insurance claim	Project management fee	Non-developer expense & duplicate payments	Total other ineligible costs
1	Community First Development	-	-	-	-	-	-	-
2	Community First Development	\$4,551	-	-	-	-	-	\$4,551
3	Community First Development	-	-	-	-	-	-	-
4 ⁴	KL Hampton Group	\$2,921	-	-	-	-	-	\$2,921
5	KL Hampton Group	\$4,565	\$5,961	-	-	-	-	\$10,526
6	KL Hampton Group	\$5,100	\$15,798	-	-	-	-	\$20,898
7	KL Hampton Group	\$9,550	-	-	-	-	-	\$9,550
8	MissionRich Development	\$805	-	\$10,500	\$18,376	-	-	\$29,681
9 ⁵	MissionRich Development	-	-	-	-	-	-	-
10 ⁵	MissionRich Development	-	-	-	-	-	-	-
11	MissionRich Development	\$3,620	-	\$10,243	-	\$10,750	-	\$24,613
12 ⁵	MissionRich Development	-	-	-	-	-	-	-
13	Parkway Housing	-	-	-	-	-	\$1,066	\$1,066
	Total	\$31,112	\$21,759	\$20,743	\$18,376	\$10,750	\$1,066	\$103,806

⁴ This property was in escrow to be resold to a home buyer. The sale was pending as of July 1, 2014. HUD will determine ineligible costs by addressing recommendation 1E of this report during the audit resolution process.

⁵ Rehabilitation of these three properties had not been completed as of the date of our inspection on February 28, 2014. HUD will determine ineligible costs by addressing recommendation 1E of this report during the audit resolution process.

Appendix E

TABLE OF UNREASONABLE COSTS BY PROPERTY

Prop. no.	Developer	Cash to seller	House sitter fees	Interest on subordinate loans	Penalties & redemption fees on real estate taxes	Total unreasonable costs
1	Community First Development	\$88	-	\$2,972	\$215	\$3,275
2	Community First Development	-	\$2,300	-	\$115	\$2,415
3	Community First Development	-	-	-	-	-
4 ⁶	KL Hampton Group	-	-	3,485	\$321	\$3,806
5	KL Hampton Group	-	-	5,083	\$839	\$5,922
6	KL Hampton Group	\$846	-	-	\$1,883	\$2,729
7	KL Hampton Group	\$96,943	-	-	\$2,155	\$99,098
8	MissionRich Development	-	\$14,166	-	\$1,242	\$15,408
9 ⁷	MissionRich Development	-	-	-	-	-
10 ⁷	MissionRich Development	-	-	-	-	-
11	MissionRich Development	-	\$1,400	-	\$1,056	\$2,456
12 ⁷	MissionRich Development	-	-	-	\$2,352	\$2,352
13	Parkway Housing	\$140	-	-	-	\$140
	Total	\$98,017	\$17,866	\$11,540	\$10,178	\$137,601

⁶ This property was in escrow to be resold to a home buyer. The sale was pending as of July 1, 2014. HUD will determine unreasonable costs by addressing recommendation 1E of this report during the audit resolution process.

⁷ Rehabilitation of these three properties had not been completed as of the date of our inspection on February 28, 2014. HUD will determine unreasonable costs by addressing recommendation 1E of this report during the audit resolution process.