



U.S. DEPARTMENT OF
HOUSING AND URBAN DEVELOPMENT
OFFICE OF INSPECTOR GENERAL

September 30, 2015

MEMORANDUM NO:
2015-LA-1803

Memorandum

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

Dane M. Narode
Associate General Counsel for Program Enforcement, CACC

//SIGNED//

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

SUBJECT: The City of Richmond, CA, Did Not Adequately Support Its Use of HUD-Funded Expenses for Its Filbert Phase 1 and Filbert Phase 2 Activities

INTRODUCTION

We reviewed the City of Richmond's Filbert Phase 1 and Filbert Phase 2 activities in response to the U.S. Department of Housing and Urban Development's (HUD) San Francisco Office of Community Planning and Development's and HUD's Office of Program Enforcement's concerns over the City's administration of its HOME Investment Partnerships Program, Community Development Block Grant (CDBG), and CDBG Recovery (CDBG-R) funding of Filbert Phase 1 and Filbert Phase 2 activities. HUD alleged that the City misused HUD funds, created multiple activity numbers for the same activity, and falsely reported the completion of units in HUD's Integrated Disbursement and Information System (IDIS)¹. In addition, HUD alleged that the City repeatedly revised HOME voucher amounts in IDIS, a practice that HUD stated was usually not allowed without documented justification.

The objective of our review was to determine the validity of HUD's allegations and whether the City used its HOME, CDBG, and CDBG-R funds in accordance with HUD program requirements.

¹The Integrated Disbursement and Information System (IDIS) provides HUD with current information regarding the program activities underway across the Nation, including funding data. HUD uses this information to report to Congress and to monitor grantees. IDIS is the draw down and reporting system for the four CPD formula grant programs: Community Development Block Grant (CDBG), HOME Investment Partnerships (HOME), Emergency Solutions Grants (ESG), and Housing Opportunities for Persons With AIDS (HOPWA); and for the CPD competitive grant program HOPWA Competitive. Grantees also use IDIS for Consolidated Planning.

HUD Handbook 2000.06, REV-4, provides 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 review.

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

METHODOLOGY AND SCOPE

We performed our onsite audit work at the City from April 27 through August 14, 2015. Our audit generally covered the period July 1, 2010 through June 30, 2012. However, our review also included review of documentation for Filbert Phase 1, which included amounts charged in IDIS and agreements, dating back to January 2003.

To accomplish our objective, we reviewed

- Applicable laws, including HUD program requirements at 24 CFR (Code of Federal Regulations) Parts 85 and 92.
- IDIS activity screens and reports for Filbert Phase 1 and Filbert Phase 2.
- The City's action plan and consolidated plan.
- Documentation provided by HUD's San Francisco Office of Community Planning and Development, including monitoring reports, spreadsheets, and Line of Credit and Control System reports.
- Documentation provided by the City, including a narrative and descriptions of the Filbert activities, related contracts and amendments, invoices, statements, copies of checks, journal vouchers, and general ledger entries.
- Documentation from the City's developer, including invoices, bank statements, and copies of checks.

We interviewed management and staff from the City's Community Housing and Development and Finance divisions. We also interviewed management from the City's developer, Community Housing and Development Corporation.

Our audit sample consisted of the more than \$2.3 million in HOME, CDBG, and CDBG-R funds that the City disbursed on its Filbert Phase 1 and Filbert Phase 2 activities. The amount was related to five different IDIS activity numbers for Filbert Phase 1 and three IDIS activity numbers for Filbert Phase 2.

We conducted the audit in accordance with generally accepted government auditing standards, except that we did not consider the internal controls or information systems controls of the City. We did not follow standards in these areas because our primary objective was to determine the validity of HUD's concerns with respect to the Filbert Phase 1 and Filbert Phase 2 activities and whether charges that were made for these activities complied with HUD's program requirements. To meet our objective, it was not necessary to fully comply with the standards, nor did our approach negatively affect our review results.

BACKGROUND

The City's Housing and Community Development division administers its Affordable Housing program and provides community services for low- and moderate-income residents, which are funded in part by CDBG and HOME funds. The division's mission is to develop quality neighborhoods within Richmond by partnering with neighborhood residents and community groups. The division accomplishes this goal through assisting homeless and disabled individuals in obtaining housing, developing new affordable housing, expanding economic opportunities in business and employment for low- and moderate-income residents, and improving housing conditions.

For grant years 2009 through 2014, HUD awarded the City more than \$2.3 million in HOME funds, \$5.9 million in CDBG funds, and more than \$366,063 in CDBG-R funds. HOME and CDBG funds are awarded annually as formula grants to States and local governments. The HOME program allows recipients to use funds for grants, direct loans, loan guarantees or other forms of credit enhancements, or rental assistance or security deposits. CDBG funds can be used to address a wide range of community needs, including annual grants to develop decent housing, suitable living environments, and loan guarantees. CDBG-R funds were awarded to States and local governments under the American Recovery and Reinvestment Act of 2009, which appropriated \$1 billion in CDBG funds to carry out, on an expedited basis, eligible activities under the CDBG program.

In a memorandum, dated March 2015, The San Francisco Office of Community Planning and Development expressed concerns over the City's administration of its HOME, CDBG, and CDBG-R funding with respect to several affordable housing activities funded by these programs. It stated that it had concerns about all of the activities identified in its memorandum. However, after reviewing the memorandum attachments, we determined that the City had repaid program funds for all questioned activities except Filbert Phase 1 and Filbert Phase 2. Therefore, our review was limited to those activities.

In addition to the concerns stated in its memorandum, an Office of Community Planning and Development monitoring report stated that the City removed the 45 year resale restrictions that were originally imposed in its agreements with homebuyers for units constructed with HOME funds under Filbert Phase 1. HUD requires a low income family to occupy the property as their principal residence throughout the designated period of affordability. If the assisted housing does not continue to be occupied by the original purchasing family, the housing must be made available for subsequent purchase to another family who is low-income and who will use the property as their principal residence. The City removed the resale to a low-income family restriction and replaced it with a principal residency requirement and reduced the affordability period to 10 years, 5 years less than the minimum 15 years required based on the amount of HOME investment. A February 2015 monitoring report stated that the City drew funds for the Filbert Phase 2 project without an agreement, despite having certified in IDIS that it had one and used the funds for a purpose other than what was stated in the loan agreement between the City and its developer. Between 2010 and 2012, the City drew over \$1 million dollars in HOME, CDBG, and CDBG-R funding for Filbert Phase 2. However, the project remains incomplete.

RESULTS OF REVIEW

The City did not use its HOME, CDBG, and CDBG-R funds in accordance with HUD requirements. The City recorded inaccurate information in IDIS for Filbert Phase 1 and Filbert Phase 2 and removed the City's originally imposed resale restrictions that required the purchased property to be occupied by a low-income family for a period of 45 years. While housing was constructed for Filbert Phase 1, the land associated with Filbert Phase 2 remained vacant, and some of the funds were used for a purpose other than what was stated in the loan agreement between the City and the developer. This condition occurred due to a lack of oversight of IDIS administration and the City's concerns that loan funds provided by a private lender would be pulled if resale restrictions were not modified. As a result, it was unclear how much grant funding was spent on each activity. Therefore, HUD did not have assurance that all program funds were appropriately spent. In addition, HUD did not have assurance that long-term affordable housing objectives would be met due to the modification of resale restrictions for HOME assisted units.

The City Created Multiple IDIS Activity Numbers and Removed the Minimum Required Affordability Restrictions from HOME Agreements for Filbert Phase 1

The City created six different IDIS activity numbers for Filbert Phase 1 and drew HOME funds for the project under five of the six activity numbers. The City later shifted previously drawn funds for three activities to another activity and canceled the previous three activities without a documented explanation. Based on our analysis of IDIS identification numbers, we determined that the revisions and cancellations were recorded and approved by the City's previous HOME and CDBG coordinators. However, because these individuals no longer worked for the City, current staff was unable to explain the changes. During a site visit, we verified that eight Filbert townhomes (three were HOME funded) had been completed. The final amounts were drawn for the remaining Filbert Phase 1 activity numbers in 2001 and 2007, respectively. However, the activities remained open in IDIS with combined draws of more than \$1.2 million.

Regulations at 24 CFR 85.20(b)(2) require grantees and subgrantees to maintain records that adequately identify the source and application of funds provided for financially assisted activities.

Regulations at 24 CFR 92.502(d)(1) state that complete project completion information must be entered into the disbursement and information system, or otherwise provided, within 120 days of the final project drawdown. If satisfactory project completion information is not provided, HUD may suspend further project set-ups or take other corrective actions.

The City also reduced the resale restrictions on the HOME constructed units that would have required a low income family to occupy the property throughout a term of 45 years. The 45 year requirement was imposed by the City, and was not required by HUD. However, based on the amount invested by the City, the minimum period of affordability should have been 15 years. Instead, the City included a primary residence restriction, removed the resale restrictions and reduced the affordability period to 10 years. Since the minimum affordability period of 15 years was not maintained, the activity is ineligible for HOME funding according to program regulations.

24 CFR 92.254 (a)(4) further states that HOME assisted homeownership units must meet the long-term affordability requirements for the period of time required based on the amount of HOME investment. In addition, 24 CFR 92.254(a)(5) requires grant recipients to impose resale or recapture provisions, at its option, to ensure the long-term affordability of HOME funded projects.

24 CFR 92.503(b)(1) states that any HOME funds invested in housing that does not meet the affordability requirements for the period specified in 24 CFR 92.254, as applicable, must be repaid by the participating jurisdiction in accordance with paragraph (b)(3) of the section.

The City Drew Funds for Filbert Phase 2 Without an Agreement and Did Not Produce a Project

The City drew more than \$1 million in HOME, CDBG, and CDBG-R funds for its Filbert Phase 2 project. Over \$870,000 was drawn before the City executed a legally binding agreement with its developer. Since January 2010, HUD has required grant recipients to certify in IDIS that they had an agreement in place before withdrawing funds. Although the certification screen had no date or time stamp and no user name, the user would have to click the “I accept” button before proceeding to the IDIS draw screen.

24 CFR 92.504(b) states that before disbursing any HOME funds to any entity, the participating jurisdiction must enter into a written agreement with that entity.

Similar to Filbert Phase 1, the City created multiple activity numbers for Filbert Phase 2. There were three activity numbers created in IDIS for Filbert Phase 2.

Accomplishment data were entered into IDIS for one of the Filbert Phase 2 activity numbers, stating that people were living in completed properties. However, the addresses belonged to Filbert Phase 1. One of the three activity numbers was shown as completed in IDIS, and funds were drawn under two activity numbers in which the stated use of funds in the developer’s invoice documentation was repayment of the developer’s loan. However, the loan agreement between the City and the developer stated that project funds would be used to pay for predevelopment expenses.

Although accomplishment data had been entered in IDIS, the Filbert Phase 2 parcels of land remained vacant. The City stated that the project delay was due to problems with environmental remediation, securing entitlements, and securing additional funding. However, since 2010, the City disbursed more than \$1 million for Filbert Phase 2 and no project construction has been initiated. 24 CFR Part 92 states that a commitment to a specific local project means that the participating jurisdiction and project owner have executed a written legally binding agreement under which HOME assistance will be provided for a project that can reasonably be expected to start within 12 months of the agreement date. However, the Filbert Phase 2 project has been indefinitely delayed.

Because the project was misrepresented in IDIS and no project had been produced 7 years after the funding date, the associated funding should be repaid.

Conclusion

The City did not use its HUD funds for Filbert Phase 1 and Filbert Phase 2 activities in accordance with HUD requirements. The City constructed three HOME-funded townhomes and disbursed more than \$2 million in HOME, CDBG, and CDBG-R funding for both projects. In addition, the City (1) removed restrictions requiring a low income family to occupy HOME funded units for a minimum of 15 years (Filbert Phase 1); (2) entered inaccurate information that misrepresented the status of its project in IDIS; and (3) withdrew funds without an agreement in place (Filbert Phase 2). As a result of the City's actions, long-term affordability of HOME assisted units was not maintained, and HUD lacked assurance on how funding was used for the projects.

RECOMMENDATIONS

We recommend that the Director of the HUD San Francisco Office of Community Planning and Development require the City to

- 1A. Repay from non Federal funds \$1,290,264 for funds spent on Filbert Phase 1 due to the modification of the resale restrictions for HOME assisted units, which resulted in a failure to comply with HUD's minimum required period of affordability.
- 1B. Repay \$1,089,613 in ineligible costs for funds that were misrepresented in IDIS, funds that were drawn before a legally binding agreement was in place between the City and the developer, and did not produce a project (Filbert Phase 2).
- 1C. Implement policies and procedures that require HOME, CDBG, and CDBG-R program expenditures to be adequately supported, ensure proper oversight of IDIS administration and maintenance of support for grant expenditures, and ensure long-term affordability of HOME projects and activities.

We also recommend that the Associate Counsel for the Office of Program Enforcement

- 1D. Determine legal sufficiency and if legally sufficient, pursue civil and administrative remedies as appropriate for the City's inaccurate IDIS reporting and inappropriate draws.

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/
1A	\$1,290,264
1B	\$1,089,613
Totals	\$2,379,877


- 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. The ineligible costs for recommendation 1A represent funds used for the Filbert Phase 1 project which did not meet affordability requirements. The ineligible costs for recommendation 1B represent funds used for Filbert Phase 2. The City used funds for Filbert Phase 2 without securing an agreement and a project has not been constructed.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments



September 24, 2015

Ms. Tanya E. Schulze
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Office of the Inspector General – Office of Audit (Region #9)
611 W. Sixth Street
Suite 1160
Los Angeles, CA 90017

Re: Response to Office of Inspector General (OIG) Draft Audit No. 2015-LA-180X,
Amended Resolution of Audit Findings and Repayment Plan, Community Development
Block Grant (CDBG), Community Development Block Grant – Recovery (CDBG-R) and
HOME Investment Partnership Program (HOME)

Dear Ms. Schulze:

The City of Richmond (City) is in receipt of your letter dated September 10, 2015 and draft report with findings and recommendations of repayment in the total amount of \$2,163,075.

In response to the results of your staff's review, the City wishes to clarify certain factual misunderstanding regarding the two development projects in question, Scattered Sites In-fill Phase I or Filbert Phase I as it is identified in your draft report and Filbert Townhomes or Filbert Phase II as it is identified in your draft report.

Background:

The Scattered Sites In-Fill Phase 1 housing development project originally proposed 14 housing units available for sale to low- and moderate-income households (the "Project"). Of these 14 units, three were constructed using HOME Funds. These three units included: 1260 Filbert Street; 1350 Filbert Street; and 1356 Filbert Street (the "Filbert HOME Properties"). Six of the lots were lost to foreclosure during the mortgage meltdown, and these units remain unbuilt. However, the eight remaining units, including the three dwellings funded with HOME Funds, were constructed. The following presents a summary chronology.

In 2006, the City, Wood Development Corporation (the "Borrower") and the Richmond Community Redevelopment Agency (the "Agency") entered into a Loan Agreement in which the City and the Agency agreed to make a loan to the Borrower. This loan covered all 14 lots in the

Comment 1

amount of \$832,999.98. Of this amount, \$532,984.32 from HOME Funds was applied to the three Filbert HOME Properties. The balance of the loan funds (i.e., \$300,015.66) were City in-lieu funds.¹ HOME affordability restrictions were recorded against all 14 lots, subordinate to a first lien securing a loan from Bank of America.

In 2007, pursuant to a First Amendment to Loan Agreement, and a Second Amendment to Loan Agreement, the City and the Agency increased the total loan amount to \$1,653,000. The increase pursuant to the First Amendment was funded, in part, with HOME Funds, in the amount of \$320,000, and the balance of the loan was supported by City in-lieu funds and Agency low-mod funds and 2007B bond funds. Again, the Home Funds were applied only to the three Filbert HOME Properties. The increase pursuant to the Second Amendment was funded entirely with non-HOME funds (i.e., City in-lieu funds and Agency low-mod funds and 2007B bond funds).

Attached is a Fact Sheet which, among other things, summarizes the funding sources for the Loan and its components. As shown in the Fact Sheet, a total of \$852,984.32 in HOME Funds was invested into the Project for the three Filbert HOME Properties. Please see Attachment 1.

In 2008-2009, the housing crisis spawned by the mortgage meltdown hit the City of Richmond particularly hard. Indeed, the City has not yet recovered. Not surprisingly, the Borrower and the Project ran into difficulty. As a consequence of the housing crisis, the Borrower defaulted on the senior loan, and Bank of America, the senior creditor, commenced foreclosure. As per the HOME regulations, 24 CFR § 92.254(a)(5)(i)(A), foreclosure would terminate the affordability restrictions entirely.² Under this, the likely eventuality, all HOME Funds invested into the Project would be lost – with no production of any affordable units.

Facing impending foreclosure, the City had little negotiating room or bargaining power. As a condition to restructuring the senior loan and forbearing from foreclosing on eight lots, the senior creditor insisted that the resale restrictions be removed. The restructuring by the senior creditor and by the City (pursuant to a Third Amendment to Loan Agreement) permitted production of eight of the previously planned 14 homes. The other six lots were lost to foreclosure.

Notwithstanding removal of the prior resale restrictions, the City required purchasers of the three Filbert HOME Properties to enter into Homebuyer Agreements providing for a 10-year resale restriction to preserve affordability during that time; the Homebuyer Agreements are secured and made enforceable by Performance Deeds of Trust recorded in the land records (see below for detailed explanation).

¹ In-lieu funds are funds generated pursuant to the City's Inclusionary Housing Ordinance (RMC Section 15.04.810.061) and comprised of fees paid by developers in lieu of incorporating inclusionary housing into developments.

² The regulations provide in pertinent part that, "[a] affordability restrictions may terminate upon occurrence of... foreclosure..."(24 CFR 92.254(a)(5)(i)(A)).

Comment 2

Comment 3

As constructed, the Project consists of the three units which were funded, in part, with HOME Funds. An additional five homes were funded with the City "In-Lieu" funds and included no HOME funds. These five homes do not have affordability restrictions in the same way that the HOME-assisted units do. As noted in prior communications, and consistent with HUD's regulations at 24 CFR § 92.254(a)(5)(i)(B) (the "Presumption Provision"),³ the City has conducted a market analysis of the neighborhood in which the Project is located (see the City's 2008-2010 Consolidated Plan; see also Enterprise Zone Application, Eligible Area Criteria; see also 2011 NSP3 Action Plan), and has concluded that the five units in question meet the Presumption Provision. Therefore, all eight homes are long-term affordable, in accordance with the applicable HUD regulations.

Comment 2

In summary, the City's investment supported production of eight homes, all of which are long-term affordable. HOME funds were invested in three of those units, and each of those HOME-supported homes was committed to affordability for ten years pursuant to enforceable instruments recorded in the land records.

Discussion:

Except for the regulatory affordability time period, no waiver is required with respect to the resale restrictions in place for this Project.

The HOME Act provides as follows in pertinent part:

Housing that is for homeownership shall qualify as affordable housing under this subchapter only if the housing –

* * *

(3) is subject to resale restrictions that are established by the participating jurisdiction and determined by the Secretary to be appropriate to –

(A) allow for subsequent purchase of the property only by persons who meet the qualifications specified under paragraph (2) [principal residence of low-income family], ... or

³ The text of the Presumption Provision is as follows:

Certain housing may be presumed to meet the resale restrictions (i.e., the housing will be available and affordable to a reasonable range of low-income homebuyers; a low-income homebuyer will occupy the housing as the family's principal residence; and the original owner will be afforded a fair return on investment) during the period of affordability without the imposition of enforcement mechanisms by the participating jurisdiction.

24 CFR § 92.254(a)(5)(i)(B). Contrary to statements by HUD in prior communications, the regulation does not state that a grantee must, in advance, inform HUD of its intent to use the Presumption Provision. To the extent that HUD concludes that advance approval is required, the City requests a waiver of the advance approval requirements.

(B) recapture the investment provided under this subchapter in order to assist other persons in accordance with the requirements of this subchapter, except where there are no net proceeds or where the net proceeds are insufficient to repay the full amount of the assistance

42 USC § 12745(b) (emphasis added). Thus it is left to HUD to establish, in regulations, the minimum period of affordability and the details regarding resale or recapture affordability restrictions, and the enforcement thereof.

The HOME regulations state that the HOME affordability restrictions must be for a minimum of 15 years (the "period of affordability") where, as here, the HOME investment exceeds \$40,000 per unit. 24 CFR § 92.254(a)(4). Mirroring the statute, the regulations require either resale or recapture requirements, and HUD must determine that they are appropriate.⁶ 24 CFR § 92.254(a)(5).

As noted, the Homebuyer Agreements applicable to the three units built with HOME funds include resale restrictions.⁷ HUD's regulations require the following with respect to resale restrictions:

(i) *Resale*. Resale requirements must ensure, if the housing does not continue to be the principal residence of the family for the duration of the period of affordability that the housing is made available for subsequent purchase only to a buyer whose family qualifies as a low-income family and will use the property as the family's principal residence. The resale requirement must also ensure that the price at resale provides the original HOME-assisted owner a fair return on investment (including the homeowner's investment and any capital improvement) and ensure that the housing will remain affordable to a reasonable range of low- income homebuyers.⁸ The period of affordability is based on the total amount of HOME funds invested in the housing.

(A) ... [Deed restrictions, covenants running with the land, or other similar mechanisms must be used as the mechanism to impose the resale requirements. The affordability restrictions may terminate upon occurrence of any of the following termination events: foreclosure, transfer in lieu of foreclosure or assignment of an FHA

⁶ In 2013, HUD amended the regulations to require that "HUD must specifically approve [the resale/recapture provisions] in writing." 24 CFR § 92.254(a)(5), as amended at 78 Fed. Reg. 44674 (July 24, 2013). The issues addressed in this letter arose prior to the enactment of the amendments. Thus, the amended requirements do not apply.

⁷ The statute and regulations do not require both resale and recapture. Rather, they require only one or the other.

⁸ In 2013, HUD amended the regulation to add the following: "The participating jurisdiction must specifically define "fair return on investment" and "affordability to a reasonable range of low-income homebuyers," and specifically address how it will make the housing affordable to a low-income homebuyer in the event that the resale price necessary to provide fair return is not affordable to the subsequent buyer." As indicated in footnote 4 above, the issues addressed in this letter arose prior to the enactment of the amendments and thus the amended requirements do not apply.

Comment 2

insured mortgage to HUD. The participating jurisdiction may use purchase options, rights of first refusal or other preemptive rights to purchase the housing before foreclosure to preserve affordability. The affordability restrictions shall be revived according to the original terms if, during the original affordability period, the owner of record before the termination event, obtains an ownership interest in the housing. ...

24 CFR § 92.254(a)(5)(i) (emphasis added).

The purchasers of each of the three Filbert HOME Properties signed a Homebuyer Agreement, and a Performance Deed of Trust which was recorded in the land records. Please see Attachment 3. Each Homebuyer Agreement requires, among other things,

that Buyer shall occupy the Residence as the Buyer's principal place of residence for ten (10) years from the date Buyer closes escrow on his or her purchase of the Residence ... [and]

[that] [i]f Buyer sells the Residence prior to the ten (10) year period prescribed in Section 3, the new owner must occupy the Residence as such new owner's principal place of residence, for the remainder owner must occupy the Residence as such new owner's principal place of residence, for the remainder of the ten (10) year period. As a precondition to sale, Buyer shall require such new owner to enter into a Homebuyer Agreement and Performance Deed of Trust and Security Agreement with the Agency for such remaining period.

Each Homebuyer Agreement also includes leasing restrictions, and maintenance and insurance requirements.

A Performance Deed of Trust, recorded in the land records, secures each Homebuyer Agreement. Each Performance Deed of Trust provides, among other things, that the Homebuyer must

observe and perform all of the covenants and agreements of the Homebuyer Agreement and [the Performance] Deed of Trust.

If a breach of the Homebuyer Agreement or Performance Deed of Trust is not cured as provided, then the Agency, at the Agency's option, among other remedies,

may invoke the power of sale and any other remedies permitted by California law ... [or] commence an action to foreclose ... appoint a receiver, or specifically enforce any of the covenants [t]hereof ...

Thus the Homebuyer Agreement, coupled with the Performance Deed of Trust, constitutes affordability restrictions which burden the real estate and which permit the Agency to foreclose and/or to specifically enforce the homeowner's affordability covenants. To the extent that the foregoing do not, in the strictest sense, constitute a "deed restriction" or "covenant running with the land" as contemplated by HUD regulations, the City requests that HUD interpret its regulations to conclude that the Homebuyer Agreement, coupled with the Performance Deed of Trust, constitutes a "similar mechanism" sufficient to satisfy the applicable regulation.

Comment 2

Comment 2

Comment 4

The City requests that HUD waive the minimum affordability requirement of 15 years and accept the ten-year period of affordability in the case of this Project. HUD has authority to waive the 15 year requirement, as the provision is regulatory and not statutory, and HUD has granted such waivers upon good cause in the past. See, Waiver of Affordability Period for 31 HOME-assisted projects that were destroyed during Hurricane Katrina and Rita in 2005 and Gustav in 2008. FR Doc. 2013-29828 (Dec. 13, 2013).

A waiver is merited under the circumstances, as the City had no authority to control the senior creditor's actions. The senior creditor, Bank of America, had the independent right and ability to foreclose on all 14 Scattered Sites In-Fill lots based on the Borrower's default. Had it foreclosed, under HOME regulations, Bank of America would have terminated the affordability restrictions entirely. 24 CFR § 92.254(a)(5)(i)(A). This would have deprived real families in need the opportunity for safe, quality, affordable housing. Instead, the City was able to keep 8 of 14 units under development and ensured that the three dwellings that utilized HOME funds had enforceable affordability requirements.⁹

Comment 5

Without the City's intervention, which was in no way required, no affordable units would have been constructed, and the City and HUD would have lost their respective, considerable investments in the Project. Moreover, based on the absence of any development on the six foreclosed parcels in all likelihood no units would have been constructed. In short, without intervention, no houses would have been built, the City's and HUD's local housing mission would have been defeated, and the community would have been left blighted. Only the City's prompt and successful negotiation averted a complete and bad outcome. Under these circumstances, HUD should exercise its discretion in granting the waiver.

Regarding Filbert Townhomes or referenced in your draft report as Filbert Phase II, the City, Agency and Community Housing Development Corporation of North Richmond (the "Borrower") entered into a Loan Agreement in September 2010 in which the City and the Agency agreed to make a loan to the Borrower in the amount of \$1,198,013. The loan was for predevelopment activities in connection with the construction of thirty-six (36) townhomes designated for very low and low income households. The loan consisted of \$193,457 in Community Development Block Grant Recovery funds (CDBG-R), \$266,000 in Community Development Block Grant funds (CDBG) and \$738,556 in HOME Investment Partnership Program funds (HOME). Based on documentation provided by the development project manager, a wire transfer request dated September 29, 2010 was prepared for the first draw in the amount of \$729,739, which was wired directly to Old Republic Title Company for the escrow closing of five parcels along Filbert Street. In addition to a copy of the final closing statement, copies of the escrow instructions, invoices, preliminary title report and emails were made available for the OIG auditors to review. Subsequent draws 2-9 totaling \$505,855.01, which include supporting documentation in the form of copies of individual wire transfer requests, invoices, checks, and additional back-up documentation were also made available for the OIG

⁹ As noted in footnote 1 and the associated text, the remaining 5 dwellings meet the affordability requirements under the Presumption Provisions.

auditors to review. In addition to the \$1,198,013 loan, the City and Agency made a \$136,000 grant to CHDC with CDBG-R funds. The grant was to assist with demolition and asbestos removal on the parcels where needed. In total, the City has on file supporting documentation for draws 1-9 in the amount of \$1,235,594.01. The total funding commitment made to CHDC for the Filbert Townhomes development was \$1,334,013.

Comment 6

In conclusion, regarding recommendation 1A for the repayment of \$1,290,264, which was determined to be ineligible, we are of the opinion that the information provided in this response substantiates a waiver of the 15-year period of affordability and the acceptance of the 10-year period of affordability, therefore determining that the full amount of \$1,290,264 is an eligible expense of CDBG funds.

Comment 7

In regards to recommendation 1B to repay \$872,811, the City's records indicate that a legally binding agreement was executed on September 30, 2010 and the first draw was made on September 9, 2010. Whereas the funds may have been wired prior to the execution of the legally binding agreement, escrow did not close until September 30, 2010. The practice of having the required funds in escrow prior to close is not unusual for a real estate transaction such as this. Therefore we are of the opinion that the full amount of \$872,811 was an eligible cost considering the close of escrow occurred several days after the funds were drawn.

Comment 8

In regards to recommendation 1C to repay \$39,265 for funds spent on Filbert Phase II activity without complete support for expenditures and without a completed project, the City agrees with the recommendation of repayment.

Comment 9

In regards to recommendation 1D, to implement policies and procedures that require HOME, CDBG, and CDBG-R program expenditures to be adequately supported, ensure proper oversight of IDIS administration and maintenance of support for grant expenditures, and ensure long-term affordability of HOME projects and activities, the City agrees with the recommendation.

Comment 10

In closing, while the initial findings of this audit indicate that the City did not use its HUD funds for Filbert Phase I and Filbert Phase II activities in accordance with HUD requirements; the information submitted in this response provides tangible evidence to the contrary and substantial information to determine that the City did in fact use the CDBG, CDBG-R and HOME funds in accordance with the regulation and exercised reasonable discretion in its program administration.

Very truly yours,



Timothy Jones
Housing Director (Acting)

Attachment

OIG EVALUATION OF AUDITEE COMMENTS

- Comment 1 We acknowledge the background information provided by the City. We are aware of the circumstances and market conditions that contributed to the project running into difficulties.
- Comment 2 While we recognize that a 10 year principal residency restriction was placed in the homebuyer agreements, the restriction does not ensure long-term affordability of a minimum of 15 years and occupancy by a low-income family. Therefore, the 10 year restriction does not comply with the requirements of 24 CFR 92.254(a)(5)(i).
- Comment 3 We discussed the lack of proper affordability restrictions for the three HOME assisted units in Comment 2.
- Comment 4 The City's revision of the affordability requirements go beyond reducing the period of affordability below the minimum of 15 years based on the amount of HOME investment. The City also removed the resale restriction that would have required the property to be occupied by a low income family during the prescribed time period. These changes are in violation of the affordability requirements 24 CFR 92.254(a)(4) and 92.254(a)(5)(i). The City will need to work with HUD during the audit resolution process regarding the possibility of a waiver pertaining to affordability requirements.
- Comment 5 We acknowledge that the City was in a difficult position and faced with the potential loss of the project, and took actions that it believed were most prudent considering the circumstances at that time. However, HOME program regulations are clear in that they require that long-term affordability time periods are preserved based on the amount of HOME investment. In addition, the affordability requirements also stipulate that the property will be occupied by a low income family during the prescribed period of time (see Comment 2). Although the City's actions contributed to saving the project, it still did not comply with HUD's requirements. The HOME regulations at 24 CFR 92.503(b)(1) state that if the project fails to meet long term affordability, the HOME investment must be repaid. The City will need to work with HUD during the audit resolution process to discuss the possibility of a waiver of the affordability requirements.
- Comment 6 Based on our review, we recommend repayment of the \$1,290,264 used for Filbert Phase 1 since it did not meet HOME affordability requirements. The City will need to work with HUD during the audit resolution process regarding repayment or the possibility of a waiver of the affordability requirements.
- Comment 7 The legally binding agreement between the City and its Developer was a contract dated September 30, 2010. The City should not have committed HOME funds until an agreement was in place. We acknowledge that funds would be put into escrow before closing, but not before a legally binding agreement was in place.

- Comment 8 Since the release of the draft report, we combined recommendations 1B and 1C. No units were constructed, the project was misrepresented in IDIS, and funds were drawn without an agreement in place. Therefore, all \$1,089,613 in HOME, CDBG, and CDBG-R funds disbursed for the project were considered to be ineligible.
- Comment 9 We acknowledge the City's agreement with recommendation 1D. The City will need to work with HUD during the audit resolution process to resolve the recommendation.
- Comment 10 We maintain that the City did not use its HUD funds in accordance with the related program requirements. The City did not comply with HOME affordability requirements, drew funds without having a legally binding agreement in place, misrepresented the project in IDIS, and did not produce a project. While the City used its discretion when faced with the potential loss of one of its projects, the actions still did not provide a result that met HUD requirements.