



City and County of Honolulu, Honolulu, HI

Community Development Block Grant Program



To: Mark A. Chandler, Community Planning and Development Director, 9CD

//SIGNED//

From: Tanya E. Schulze, Regional Inspector General for Audit, 9DGA

Subject: The City and County of Honolulu, HI, Did Not Administer Its Community Development Block Grant 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 and County of Honolulu's Community Development Block Grant 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.



Audit Report Number: 2016-LA-1009

Date: August 26, 2016

**The City and County of Honolulu, HI, Did Not Administer Its
Community Development Block Grant in Accordance With
Requirements**

Highlights

What We Audited and Why

We audited the City and County of Honolulu's (City) Community Development Block Grant (CDBG) program. We conducted the audit because the City was the largest Pacific island recipient of CDBG funds, the U.S. Department of Housing and Urban Development (HUD) had identified problems with the City's CDBG program, and the Office of Inspector General had never audited the City. Our objective was to determine whether the City administered its CDBG program in accordance with HUD requirements.

What We Found

The City did not comply with HUD requirements related to cost eligibility and procurement and its own award requirements. Specifically, it allowed the unnecessary acquisition and did not support the cost reasonableness of the Hibiscus Hill Apartments, allowed the unnecessary acquisition of the Kaneohe Elderly Apartments, allowed a subrecipient to award a contract to one of the property owner's affiliates, restricted competitive procurement, did not follow its award requirements, and did not review program income adequately. This noncompliance occurred because the City did not have an effective grant administration structure in place. As a result, it incurred grant costs of \$15.9 million that were unsupported.

What We Recommend

We recommend that HUD require the City to (1) support that the Hibiscus Hill acquisition was necessary and reasonable or repay its CDBG program line of credit \$10 million from non-Federal funds, (2) support that the Kaneohe Elderly Apartments acquisition was necessary or repay its CDBG program line of credit \$2.9 million from non-Federal funds, (3) support that the costs for a contract awarded to one of the property owner's affiliates was reasonable and the integrity of the procurement was not compromised by the relationship or repay its CDBG program line of credit \$1.45 million from non-Federal funds, (4) support that the noncompetitively procured fire apparatus costs were reasonable and that potential bidders were not harmed by the City's arbitrary action or repay its CDBG line of credit \$1.6 million from non-Federal funds, (5) review all current CDBG-funded projects for unreported program income and report any to HUD, and (6) implement adequate controls over its program, including consolidating the grant program into one department, and develop citywide written policies and procedures.

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Background and Objective

The City and County of Honolulu (City) is a consolidated city-county government located in the city of Honolulu on the island of Oahu, HI. Incorporated in 1907 and governed by the provisions of its charter and applicable State law, the City includes the island of Oahu and all other islands in the State of Hawaii that are not included in another Hawaiian county.

The Community Development Block Grant (CDBG) program provides communities with resources to address a wide range of unique community development needs. Beginning in 1974, the CDBG program is one of the U.S. Department of Housing and Urban Development's (HUD) longest continuously running programs. The CDBG program provides annual grants on a formula basis to 1,209 general units of local government and States. The CDBG entitlement program allocates annual grants to larger cities and urban counties to develop viable communities by providing decent housing, a suitable living environment, and opportunities to expand economic opportunities, principally for low- and moderate-income persons.

The City receives an annual CDBG grant. It received the following grant awards during the audit period:

Program year	Grant	Amount
2012 (7/1/12 – 6/30/13)	B-12-MC-15-0001	\$7,530,357
2013 (7/1/13 – 6/30/14)	B-13-MC-15-0001	7,817,498
2014 (7/1/14 – 6/30/15)	B-14-MC-15-0001	7,593,075
Total		\$22,940,930

Two City departments share the responsibility of overseeing administrative activities of the CDBG program. The Community Based Development Division of the Department of Community Services is primarily responsible for project implementation, while the Federal Grants Unit of the Department of Budget and Fiscal Services is responsible for planning, reporting, and post development monitoring. HUD considers the Department of Budget and Fiscal Services to be the “grantee” and the primary contact concerning CDBG grant matters.

For several years, the City has struggled to pass the CDBG timeliness test. The timeliness test requires that 60 days before the end of the program year, the amount of entitlement grant funds available to the recipient but undisbursed by the U.S. Treasury is not more than 1.5 times the entitlement grant for its current program year.¹ Failure to pass the test for 2 consecutive years may result in the loss of future funding. For several years, the City has had a pattern of passing the

¹ 24 CFR (Code of Federal Regulations) 570.902

timeliness test 1 year and not passing it the next year. Therefore, HUD and the City recently began meeting monthly to monitor the program progress, and HUD identified the City as a high-risk grantee that needs to improve program compliance.

In June 2013, HUD engaged the National Association for Latino Community Asset Builders to provide direct technical assistance to the City in connection with its administration of the CDBG program. The Association performed a high-level organizational assessment of the City's CDBG program administration, focusing primarily on the organization, staffing, and management structure in place. It concluded that "the problems the City continues to face in administering the CDBG program are hampered by the organizational structure and management practices utilized by the City in CDBG program administration." In July 2014, citing the organizational structure, the Association concluded that roles and responsibilities were unclear, policies and procedures were undocumented, human capital was not deployed in the most efficient manner, and serious issues of communication existed and had impacted staff morale and performance. The Association recommended that the City consider merging the functions of the Department of Community Services and Department of Budget and Fiscal Services in CDBG program administration and create a more efficient, accountable organizational structure for the management of the CDBG program. However, the City had not implemented the recommendation.

Our objective was to determine whether the City administered its CDBG program in accordance with HUD requirements.

Results of Audit

Finding 1: The City Did Not Administer Its Community Development Block Grant in Accordance With Requirements

The City did not comply with HUD requirements related to cost eligibility and procurement, and its own award requirements. Specifically, it did not support that the acquisition was necessary and did not support the cost reasonableness of the Hibiscus Hill Apartments, did not support that the acquisition of the Kaneohe Elderly Apartments was necessary, allowed a subrecipient to contract with one of the property owner's affiliates, restricted competitive procurement, did not follow its award requirements, and did not review program income adequately. This noncompliance occurred because the City did not have an effective grant administration structure in place. As a result, it incurred grant costs of \$15.9 million that were unsupported.

The Hibiscus Hill Apartments Acquisition Costs Were Unsupported

The acquisition costs of \$10 million for the Hibiscus Hill Apartments appeared unnecessary and unreasonable. In accordance with 2 CFR (Code of Federal Regulations) 200.403(a), the City was required to ensure that all costs charged to the grant were necessary and reasonable for the performance of the award. Regulations at 2 CFR 200.404 further define a cost as reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost.

In 2014, the year of the acquisition, the City was at risk of failing the CDBG timeliness test for the second year in a row. Therefore, if it failed the April 2014 test, it might have lost future grant funds. To ensure that it did not fail the next timeliness test, in December 2013, the City amended its consolidated plan to allow for an "alternative selection process" that would bypass its more structured, typical CDBG award process for certain projects such as capital improvement projects or acquisition projects. The new process had few requirements and was subjective. Then, the City conducted a brief request for proposals process in which it solicited a selection of entities to submit proposals for an acquisition project that could be completed within the time allowed. An acquisition project would allow the City to spend funds quickly to pass the timeliness test. Vitus Group, Inc., and EAH, Inc., submitted a proposal for the Hibiscus Hill Apartments in January 2014. The City awarded \$10 million for the Hibiscus Hill Apartments acquisition.

To provide the \$10 million for the acquisition, the City notified previously awarded recipients that it would reprogram their unspent funds. Although some projects were not ready to spend the funds immediately, one was counting on the award and had to delay services or improvements.

The \$10 million Hibiscus Hill Apartments awards consisted of an \$8.5 million grant and a \$1.5 million loan. With the City’s and HUD’s approval, the subrecipient loaned the CDBG funds to a newly created entity, A’ohe Pukana La Housing, LLC, which became the property’s owner. It used the award to partially fund the \$21 million acquisition.

Although the contract with the subrecipient stated that the project’s purpose was to acquire to rehabilitate, the rehabilitation budget was minor. The rehabilitation plan called for a budget of \$1 million to rehabilitate all 80 units. The budget included the replacement of roofs, interior cabinetry, and flooring. The \$1 million rehabilitation budget was small compared to the property purchase price of \$21 million. Vitus was to fund the rehabilitation. As of April 2016, almost 2 years after the purchase, the owner had rehabilitated only 8 of the 80 units at a cost of \$146,616, much less than the budgeted \$1 million. The relatively low rehabilitation budget and the lack of rehabilitation implementation did not support the stated purpose of the award.

Further, although the project proposal cited the potential loss of affordable housing, the seller did not plan to change the complex, convert it to condominiums, or sell it. Vitus approached the seller to purchase the complex. Before that, the complex was not actively marketed for sale, and the seller had not planned to sell it. Additionally, although the proposal stated, “Over the last 3 years the rents at the Project increased 40%,” the subrecipient could not support the claim. The appraiser found that before the sale, complex rents were below HUD’s maximum income threshold and were at the lower end of the local market rental range. The complex previously served low- to moderate-income tenants and was not actively marketed. Further, rents had increased, in some cases significantly, since the purchase. Therefore, the acquisition apparently did not serve a meaningful purpose and the City did not support that it was necessary. City management told us that the reason the City funded the Hibiscus Hill project was to pass the timeliness test. Because of the vague “alternative selection process” requirements, we could not determine the evaluation criteria used in the Hibiscus Hill Apartments award.

In addition, the City allowed the purchase of the Hibiscus Hill Apartments for more than its market value. In May 2014, CDBG funds were combined with other debt to acquire the property for \$21 million. The purchase price exceeded the appraised or market value by more than \$4 million. (See the table below.) The cost of the property exceeded the market value and was not reasonable.

The City determined that the subrecipient’s portion of the acquisition was 45 percent² and, therefore, its related share of the excess purchase price was \$1.9 million.

Hibiscus Hill Apartments acquisition	
Purchase price	\$21,000,000
Appraised amount	16,730,000
Excess purchase price	4,270,000
Subrecipient portion 45%	1,940,909

² \$10,000,000 investment/\$22,000,000 (\$21,000,000 cost plus \$1,000,000 rehabilitation) = 45 %

To account for the excess purchase price, the subrecipient agreed to increase the number of affordable housing units at the property by nine. Thus, of the 80 units, 50 would be affordable. However, as of July 2015, the City determined that the subrecipient had not met the 50 low- and moderate-income rental units required by the agreement. Since the subrecipient did not fulfill the additional units, HUD did not receive an alternative value for the excess cost.

Because the City did not support that the acquisition served its stated purpose or was necessary, the excess costs were reasonable, or it received an alternative value for the excess costs, HUD did not have adequate assurance that the City used grant funds in accordance with program requirements. The City appeared to have wastefully spent the funds on an unnecessary acquisition. The unnecessary associated acquisition costs of \$10 million, including more than \$1.9 million in unreasonable costs, were unsupported.

Kaneohe Elderly Apartments Acquisition Costs Were Unsupported

The acquisition costs of \$2.9 million for the Kaneohe Elderly Apartments appeared unnecessary. In accordance with 2 CFR 200.403(a), the City was required to ensure that all costs charged to the grant were necessary for the performance of the award.

The Kaneohe Elderly Apartments were acquired in 2015, in part using \$2.9 million CDBG funds. The proposal's project summary included, "The existing HAP [housing assistance payments] contracts expire in 2021 (6 years) and the affordability restrictions required under the Bond/LIHTC [low-income housing tax credit] program expire in 2028 (13 years). The property is currently being marketed for sale and, given the upcoming expiration of the HAP contract and affordability restrictions, the property is at significant risk of being converted to market rate housing in just 13 years. CDBG funds would secure the preservation of this valuable housing resource." However, a potential conversion to market rate housing in 13 years was not an immediate risk of losing affordable housing. The City did not document whether the project was necessary. Since the City receives CDBG funds annually, it is reasonable to believe that future funding would be available nearer the dates when the affordability restrictions expired. Some City staff members questioned the appropriateness of the project if there was no immediate need to acquire it. However, the City proceeded with the acquisition because it would mean that the City would pass the timeliness test for a second consecutive year.

Because the City did not support that the acquisition was necessary, HUD did not have adequate assurance that it used grant funds in accordance with program requirements.

A Subrecipient Awarded a Contract to One of the Property Owner's Affiliates

A subrecipient awarded a construction contract to one of the property owner's affiliated entity. The City approved the contract award. The subrecipient may not have complied with HUD requirements at 24 CFR 84.42 and 24 CFR 84.43 (appendix C) because it awarded a \$3.4 million construction contract to Hunt Building Company, Ltd. This entity may have had an organizational conflict of interest with HCP-ILP, LLC, an ownership entity. The two companies were affiliated through Hunt Companies, Inc. CDBG funded \$1.45 million of the contract.

The City did not have adequate policies and procedures in place to ensure that a potential organizational conflict of interest did not affect the integrity of the procurement process. If an affiliated entity bidding for a contract had access to inside information about the project or bidding process, the procurement may have been compromised.

Because of the contractor's affiliation with an owner, a real or apparent conflict of interest may have existed. HUD did not have adequate assurance that the City used grant funds in accordance with program requirements. Therefore, we determined that the \$1.45 million was unsupported.

The City Restricted Competitive Procurement

The City arbitrarily amended two requests for bids. Regulations at 24 CFR 85.36 required that the City conduct all procurement transactions in a manner to provide open and free competition. These regulations further identified arbitrary actions in the procurement process to be restrictive of competition.

The City did not comply with these requirements because it arbitrarily amended the requests for bids to eliminate further evaluation of additions to the brand or trade name section of the scope of work to allow the City to obligate Federal funds by a certain date. On the first request, the City solicited bids for five "Triple Combination Pumper Engine Apparatus with Compressed Air Foam Systems," or fire trucks. The City paid for one with CDBG funds. On the second request, the City solicited bids for a "Tiller Apparatus with Tractor-Drawn Heavy Duty Aerial Ladder" for the Honolulu Fire Department. The procurement process for both solicitations generally followed the same dates, involved the same bidders, and involved the same potential bidder.

The requests for bids issued on February 21, 2013, allowed submission of requests for clarification or substitution until March 15, 2013, and allowed the issuance of addenda through March 18, 2013. Later, the City changed the last addenda issuance date to March 22, 2013. For both solicitations, Fire Truck Headquarters, a potential bidder, submitted a request for substitution on March 15, 2013, asking to add the Smeal Sirius I and II cab and chassis to the list of preapproved cabs. On March 28, 2013, 6 days after the last date to issue addenda, the City issued addendum five, changing the last date to issue addenda to April 2, 2013. On April 2, 2013, the City issued addendum six to the brand or trade name section of the scope of work. Its sole change to the section was, "Due to the City is required to obligate Federal funds by April 30, 2013, the City is unable to complete any further evaluations and pre-qualify new manufacturers. Prospective bidders and manufacturers may submit complete specifications for evaluation by the City for future solicitations," and denied Fire Truck Headquarters' request. In the addendum, the City cited that the Smeal products did not meet certain specifications. Through addendum six, the City excluded the Smeal products offered by Fire Truck Headquarters as well as any other new manufacturers from further evaluation. In the end, Fire Truck Headquarters did not submit bids for either solicitation.

Although a potential bidder, Fire Truck Headquarters, submitted a timely request for a change to the materials, the City amended the requests for bids to eliminate further evaluations and prequalification of new manufacturers. It arbitrarily amended the requests after the allowable date so that it could obligate funds before a certain date. The City opened the bids on April 8, 2013, but did not award the contracts to the winning bidder, Kovatch Mobile Equipment Corp., until May 13, 2013, and May 17, 2013, and did not execute them until June 2013. Several

months after it opened the bids, the City issued the notices to proceed. Since it did not issue the notices until significantly later and it specifically cited the need to obligate funds by April 30, 2013, it appeared that the City’s motivation was to speed the award process. By doing so, it did not provide full and open competition as required.

Significant fire truck procurement dates	
Date	Description
2/21/13	The City issued the request for bids.
3/15/13	Requests for clarification or substitution were allowed through this date.
3/15/13	Fire Truck Headquarters submitted a request for substitution.
3/21/13 3/22/13	The City issued addendum three, changing the scope of work and specifications; some based on requests related to other brands
3/22/13	Last addenda issuance date
3/28/13	The City issued addendum five, changing the last date to issue addenda to 4/2/13.
4/2/13	The City issued addendum six to the brand or trade name section of the scope of work, saying, “Due to the City is required to obligate Federal funds by April 30, 2013, the City is unable to complete any further evaluations and pre-qualify new manufacturers. Prospective bidders and manufacturers may submit complete specifications for evaluation by the City for future solicitations,” and denied Fire Truck Headquarters’ request.
4/8/13	The City opened the bids.
4/30/13	The City claimed it needed to obligate Federal funds by this date.
5/13/13 and 5/17/13	Contracts were awarded to the winning bidder, Kovatch Mobile Equipment Corp.
6/13	Contracts were executed.
1/14	Notices to proceed were issued.

The City used CDBG funds of \$1.6 million for the inappropriately procured items. Because the City’s arbitrary actions restricted competition, HUD has no assurance that the costs complied with HUD requirements.

The City Did Not Follow Its Award Requirements

The City did not follow its award requirements when it made the Kaneohe Elderly Apartments award. The request for proposals required that submissions be stamped as received by the Purchasing Department on or before a given date and time.

Although the request for proposals was clear about the requirements, the Kaneohe Elderly Apartments proposal received did not have such a stamp and instead received a stamp from the Community Services Division. The submission guidelines stated that applications that were not received by the submission deadline, as evidenced by a valid Division of Purchasing date and time stamp, would not be considered for funding under the request for proposals. It further explained that it was the applicant’s responsibility to receive such a stamp.

The day after the submissions were due, the Department of Community Services requested that the Purchasing Department accept the proposal for consideration. In addition to not having the appropriate stamp, the proposal did not include all required documentation. However, although the Federal Grants Unit questioned the proposal's eligibility, the City awarded the requestor \$2.9 million for the proposal. In addition, the proposal requested only \$1 million. Another proposal, submitted by the same entity, requested \$1.9 million for a different project. City staff told us that the City decided to fund only one project and awarded the project \$2.9 million, nearly triple the amount requested, due to concerns of meeting timeliness requirements in closing two acquisitions. The project's budgeted cost did not change because of the increased CDBG funding; rather, the project borrowed less than it originally anticipated. The City was motivated to award funds to meet the upcoming timeliness deadline.

Because the City did not follow its award process, HUD did not have adequate assurance that the City awarded grant funds in accordance with program requirements.

Program Income Was Not Reviewed Adequately

The City did not review program income adequately. Regulations at 24 CFR 570.504 required that program income be recorded as part of the financial transactions of the grant program. Regulations at 24 CFR 85.20 required that the financial results of financially assisted activities be accurate, current, and complete.

According to City employees, the City did not review project activities for program income until the project was closed in HUD's records. In some cases, the projects would not be closed in HUD's records until the affordability restrictions of 10 years expired. Therefore, the program income, if applicable, would not have been reported currently. We reviewed an open project for unreported program income and found that for the 2 years we reviewed, there was none to report. City employees indicated that because program income was not reviewed, it may have been underreported.

Because the City did not review active projects for program income, HUD had no assurance that the City reported all program income. We did not determine whether the City reported all program income. Any unreported program income would have provided the City's CDBG program with additional funding that must be used before making additional cash withdrawals from the U.S. Treasury.

The City Lacked an Effective Grant Administration Structure

The problems discussed above occurred because the City did not have an effective grant administration structure in place. The City's decentralized grant administration process created dysfunction, inefficiency, and wasted grant funds. The dysfunction and inefficiency caused the City to be repeatedly at risk of failing the HUD timeliness test. The City made decisions based upon its need to spend grant funds, which resulted in noncompliance with requirements and wasting grant funds.

The two departments involved with the CDBG program did not function well with each other, and the additional layer of the second department slowed grant administration. For example, some aspects of project implementation, such as environmental compliance, had to be reviewed by both departments and frequently required excessive time. This process delayed

implementation, which then delayed cost reimbursements. Therefore, expenditures would not be as substantial as planned, leading to timeliness issues.

Due to unresolved issues that the two departments could not agree on, projects could sit idle for a significant length of time. The two departments' directors were supposed to resolve issues among the departments. However, the City had not clearly defined which department was responsible for specific program administration, the directors had equal authority, and there was no clear resolution process.

Further, the City's lack of current written policies and procedures for the grant program functions added to the CDBG administration problems. For example, the Department of Community Services did not have any written policies and procedures for reviewing backup documentation and drawing down subrecipient funds.

Although the National Association for Latino Community Asset Builders review³ identified similar issues in 2014, the issues continued. While the City has made recent improvements, it lacked procedures to ensure that funding decisions were objective, necessary, and reasonable. It did not have objective criteria for funding selections and did not evaluate whether projects were necessary and reasonable. There were no clear procedures to establish a method of dispute reconciliation or determine project necessity or reasonableness.

The City did not have effective controls in place to ensure that it complied with cost eligibility, procurement, and award requirements.

Conclusion

The City failed to follow cost eligibility, procurement, award, and program income requirements, resulting in unsupported CDBG grant costs totaling \$15.9 million. We attributed these deficiencies to the City's ineffective grant administration structure. Because the City did not have adequate documentation to support the eligibility of these costs, HUD did not have adequate assurance that the City used grant funds for eligible purposes in accordance with program requirements.

³ See Background and Objective section.

Recommendations

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

- 1A. Support that the Hibiscus Hill Apartments acquisition was necessary and served the purpose intended and support that the premium paid for the acquisition over the market value was reasonable and that HUD received an adequate value, or repay its CDBG program line of credit \$10,000,000 from non-Federal funds.
- 1B. Support that the Kaneohe Elderly Apartments acquisition was necessary or repay its CDBG program line of credit \$2,853,393 from non-Federal funds.
- 1C. Support that the costs for a contract awarded to one of the property owner's affiliates was reasonable and the integrity of the subrecipient's procurement was not compromised by the relationship or repay its CDBG program line of credit \$1,450,000 from non-Federal funds for the subrecipient's procurement violation.
- 1D. Support that the noncompetitively procured fire apparatus costs were reasonable and that potential bidders were not harmed by the City's arbitrary action or repay its CDBG program line of credit \$1,615,516 from non-Federal funds for the noncompetitively procured fire apparatus contracts.
- 1E. Review all current CDBG-funded projects, open CDBG projects, and projects subject to CDBG use restrictions for unreported program income. If the City and HUD determine that there was unreported program income for the audit period or CDBG use restriction period, the City should report the program income to HUD and record receipt of the CDBG program income in the Integrated Disbursement and Information System.
- 1F. Consolidate the grant program into one department under leadership with a proven record of compliance with clearly defined lines of authority and responsibility.
- 1G. Develop citywide written policies and procedures that govern the CDBG program and ensure compliance with CDBG requirements.
- 1H. Implement adequate controls to ensure compliance with applicable regulations related to cost eligibility, procurement, and program income for any further activities involving the use of CDBG funding.
- 1I. Implement adequate controls to ensure compliance with the City's own process for awarding HUD funding and to ensure that potential conflicts of interest are mitigated to protect procurement integrity.

Scope and Methodology

We performed our audit fieldwork at the City's offices in Honolulu, HI, our Phoenix, AZ, office, and our Los Angeles, CA, office from December 2015 to June 2016. Our audit covered grant activity from July 1, 2012, through June 30, 2015.

To accomplish our objective, we

- Reviewed relevant CDBG program requirements and applicable Federal regulations;
- Interviewed officials from the Honolulu, HI, Office of Community Planning and Development, City officials, subgrantees, contractor officials, and the seller of the Hibiscus Hill Apartments;
- Obtained an understanding of the City's management controls and procedures;
- Reviewed the City's CDBG-related organizational charts and written policies and procedures;
- Reviewed City agreements;
- Reviewed subrecipient payment requests and related supporting documentation;
- Reviewed the City's program income records and HUD's related Integrated Disbursement and Information System⁴ records;
- Visited subrecipient project sites;
- Reviewed available procurement documentation for the several transactions; and
- Researched the Accurint public records database and Hawaii Department of Commerce and Consumer Affairs Business Registration Division Web site for possible affiliations and conflicts of interest.

We selected a nonstatistical sample of 16 CDBG expenditures and 2 CDBG fund drawdowns for review. We selected our sample based on varying risk factors, such as (1) high dollar amounts; (2) type of activity, including construction, consulting, salaries and wages, contract workers, fringe benefits, rent, machinery allocations, and supplies; (3) potential sole-source procurement; and (4) other grants identified in the expense description. We intended the sample to provide a broad spectrum of CDBG activity for review. The results of the sample testing were limited to the expenditures and drawdowns reviewed and cannot be projected to the universe.

Additionally, we reviewed all awards during the audit period, all expenditures related to procurement exceptions identified in the sample review, and all wage expenditures for a subrecipient.

⁴ The 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 Community Development Block Grant program.

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 operations – Organizational structure, policies, and procedures that management has implemented to ensure that a program meets its objectives.
- Compliance with applicable laws and regulations – Policies and procedures that management has implemented to ensure that program participants comply with program 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 City lacked an effective organizational structure to ensure that program activities complied with HUD and City requirements (finding).
- The City lacked controls, including written policies and procedures to ensure effective, efficient, and timely operations (finding).
- The City lacked controls, including written policies and procedures to ensure that program activities complied with HUD and City requirements (finding).

Appendixes

Appendix A

Schedule of Questioned Costs

Recommendation number	Unsupported 1/
1A	\$10,000,000 ⁵
1B	2,853,393
1C	1,450,000
1D	1,615,516
Totals	\$15,918,909

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

⁵ The entire \$10,000,000 of unsupported costs was unnecessary; however, \$1,940,909 of this amount was also unreasonable. The \$1,940,909 was not double counted in the total unsupported cost.


Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

DEPARTMENT OF BUDGET AND FISCAL SERVICES
CITY AND COUNTY OF HONOLULU
530 SOUTH KING STREET, ROOM 209 • HONOLULU, HAWAII 96813
PHONE: (808) 768-3900 • FAX: (808) 768-3179 • INTERNET: www.honolulu.gov



July 31, 2016

VIA ELECTRONIC MAIL (Tschulze@hudoig.gov)

Ms. Tanya E. Schulze
Regional Inspector General for Audit
U. S. Department of Housing and Urban Development
Office of Inspector General
Office of Audit (Region 9)
300 N. Los Angeles Street, Suite 4070
Los Angeles, California 90012

Dear Ms. Schulze:

SUBJECT: U.S. Department of Housing and Urban
Development, Office of Inspector General
– Draft Audit Report No. 2016-LA-10XX, Re: City
and County of Honolulu's Community Development
Block Grant

Thank you for this opportunity to respond to the above-referenced draft audit report (the "**Draft Report**"), concerning the City and County of Honolulu's ("**City**") Community Development Block Grant ("**CDBG**") program efforts for Program Years 2012 - 2014. We appreciated your group's willingness to discuss the Draft Report at length during our July 13, 2016 exit conference, and to extend the due

KIRK CALDWELL
MAYOR

NELSON H. KOYANAGI, JR.
DIRECTOR

GARY T. KUROKAWA
DEPUTY DIRECTOR

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date for the City's formal comments to August 1 to allow the City to furnish a thorough and well-supported reply.

The concerns raised in the draft report involve projects and processes with extensive and complex background information. It is our hope that, by providing the U.S. Department of Housing and Urban Development ("HUD"), Office of Inspector General ("OIG"), with the background necessary to fully evaluate the City's actions, we may clear up apparent misperceptions and cause OIG to reconsider its draft findings and recommendations.

There are two threshold matters that the City would like to clarify.

Comment 1

A. There are certain fundamental facts that the Draft Report does not appear to substantially challenge. First, the Hibiscus Hills Apartments project and the Kaneohe Elderly Apartments project both meet a CDBG national objective under 24 CFR § 570.208(a)(3), an activity that provides or improves permanent residential structures that will be occupied by low and moderate income households. Second, both projects are CDBG eligible activities under 24 CFR § 570.202(b)(1), assistance to private individuals and entities, including profit-making and nonprofit organizations, to acquire for the purpose of rehabilitation, and to rehabilitate properties, for use or resale for residential purposes. Third, both projects were selected in compliance with the City's Consolidated Plan for Program Years 2011 – 2015 (the "**Consolidated Plan**"). Fourth, both projects were approved and included in the City's annual Action Plan. Fifth, both projects were closely reviewed by HUD's Honolulu Community Planning and Development program office ("**Local HUD**"), and the City addressed all comments and questions. The Kaneohe Elderly project was reviewed by HUD Headquarters as well, and the City addressed all of HUD Headquarters' information

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requests and comments to the project's documents. Sixth, of particular importance in Honolulu's housing market, it has always been the City's understanding that CDBG funds can be used to preserve, secure, and extend obligations in order to provide affordable housing, without any requirement that the City demonstrate that loss of affordable housing would otherwise be certain or imminent. Finally, as further demonstrated in this letter, both projects are fulfilling their CDBG purposes.

Under these circumstances, where the City has made every effort to strictly comply with CDBG requirements, both procedural and substantive, and where the projects are performing their CDBG-eligible activities, the City maintains that repayment is not justified, based upon what amounts to a disagreement over the City's legitimate exercise of its judgment.

B. While the City has made every effort to meet timeliness standards, the City has not, and will not, circumvent fair and impartial processes nor relegate other program requirements in order to do so. The City's attention to timeliness should not impugn the legitimacy or validity of the City's selection process, the selected projects, or the City's motives. The Draft Report seems to fault the City for making reprogramming decisions to meet timeliness standards when, in fact, the City is required, and has repeatedly been encouraged, to do so. The fact that the City made focused efforts to identify projects that would help the City meet timeliness standards does not make the resulting project selections noncompliant.

Comment 2

With these prefatory remarks, a summary of the City's responses to OIG's specific findings is as follows:

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1. The Alternative Selection Process (“ASP”) involves objective and detailed selection requirements and was the result of a comprehensive effort to develop and implement CDBG program modifications that would improve the City’s performance. The ASP was developed in close consultation with Local HUD and the National Association for Latino Community Asset Builders (“NALCAB”), an association referred to the City by Local HUD, over months of discussion and deliberation with multiple opportunities for public input. The ASP was ultimately formalized in the City’s Consolidated Plan and approved by the Honolulu City Council (the “City Council”) and HUD.

Comment 4

2. The Hibiscus Hills project costs are fully justified in that the CDBG assistance: (a) secured affordable housing inventory that was, at the time of acquisition, at risk of sale for condominium development, and (b) is directly related to the number of units for low- and moderate-income households that the subrecipient is required to provide. Further, in this and other property acquisitions, Local HUD has instructed the City that CDBG funds may be invested in an amount equal to or less than the appraised value of the property, provided that the recipient of CDBG funds secures from another source the balance of funding for the acquisition. Hibiscus Hills is consistent with this guideline as the appraised value of the project exceeds the amount of CDBG funds invested in the project by more than \$6,000,000.

Comment 5

Comment 6

3. The Kaneohe Elderly project costs are fully justified in that the CDBG assistance initially secured 43 units of affordable housing for seniors for an additional 19 years beyond the existing affordability restrictions that will expire in 2028, which far exceeds the CDBG use restriction period. The lease was then extended to 2091, thereby extending the affordability restrictions for another 44 years. The CDBG

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assistance also allowed leveraged funding for much-needed rehabilitation work which is already underway.

4. CDBG subrecipient Kahuku Elderly Partners LP complied with City procurement requirements in that there was no conflict of interest in its award of a construction contract to Hunt Building Company, Ltd.

Comment 8

5. The City's bid solicitations for fire engine equipment fully complied in all respects with City competitive procurement rules, in that the City's Department of Budget and Fiscal Services ("BFS") Purchasing Division, gave due consideration to all timely requests for substitution submitted by prospective bidders and extended multiple deadlines in accordance with established rules to allow for full and open competition.

Comment 9

6. The City acted in full accordance with established award requirements in (a) accepting a Kaneohe Elderly Apartments proposal that was delivered to the City before the deadline stated in the Request for Proposals (RFP) but to the wrong City location; (b) handling missing documentation; and (b) awarding an amount in excess of the successful proposer's request but justified by the City's financial underwriting.

7. Though the risk of the City underreporting program income for its CDBG projects is very low, and procedures exist to review closed projects with regard to their affordability restriction periods whenever there is a monitoring, we are happy to continue to work in partnership with Local HUD to address any perceived shortcomings in that review process.

8. Although the City has made strong recent improvements in operating within its longtime grant administration structure (shaped by

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prior audits and HUD monitorings), we will continue to implement prior recommendations and reach out to Local HUD to achieve further improvements.

Each of the above responses is discussed in more detail below.

I. THE ALTERNATIVE SELECTION PROCESS INVOLVES OBJECTIVE AND DETAILED SELECTION REQUIREMENTS AND WAS THE RESULT OF A COMPREHENSIVE EFFORT.

In the spring of 2013, following a HUD monitoring and facing timeliness concerns as a result of an anticipated sale of the City's affordable housing portfolio, a working group that included the Directors and staff of the City Department of Community Services ("DCS") and BFS assembled to come up with ways to improve the City's program performance, which included developing a corrective action plan, reviewing the City's CDBG drawdown challenges and implementing measures that would eliminate or minimize deficiencies.

The City recognized the need for a process that would enable the City to respond expeditiously when subrecipients are unable to spend down their allocated funds. The process existing at the time provided for such funds to be reprogrammed to alternate projects identified in the City's Action Plan, but in almost all cases the proposers of the alternate projects (the "alternates") declined the reprogrammed funds due to their own inability to draw down funds in a timely manner. To address this impediment to timeliness, and in consultation with Local HUD and NALCAB, the City initiated an amendment to the Consolidated Plan that prescribed a structured process for identifying projects that could accept and expend reprogrammed funds in cases where neither the subrecipient

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nor the alternates could do so.¹ The Consolidated Plan amendment was then presented to the City Council. It was heard twice by the Budget Committee of the City Council² and once by the full City Council³ before its approval as Resolution No. 13-251, CD1, FD1.⁴ Pursuant to Hawaii's Sunshine Law (Chapter 92, Hawaii Revised Statutes), notice of each of these meetings was posted publicly and was open to public testimony. In addition, public notice of the Consolidated Plan amendment and a 30-day comment period was published in the *Honolulu Star-Advertiser* on October 2, 2013.⁵

The Consolidated Plan amendment formalizing the ASP was one of several changes the City implemented. Other changes included (1) modifications to the CDBG Request for Proposals (RFP) template to award more points for shovel-ready projects, and fewer points for projects involving time-consuming tasks like environmental assessments that would take a project longer to implement; and (2) process changes where staff would perform an initial screen of projects for eligibility, which would then be presented to the City's CDBG/HOME Selection Committee (the "**Selection Committee**"), whose selections are final.

The ASP was therefore developed and approved through the same process, with the same formalities, approvals, and opportunities for public input, as the Selection Committee award process. It was equally

¹ The City can arrange to have supporting statements submitted by City officials with personal knowledge of this background if desired.

² Exhibit 1 (minutes of October 30, 2013 committee meeting), available at <http://www4.honolulu.gov/docushare/dsweb/Get/Document-145637/89wn9j1k.pdf>; Exhibit 2 (committee report on November 20, 2013 meeting), available at <http://www4.honolulu.gov/docushare/dsweb/Get/Document-146007/8bzlb9rj.pdf>.

³ Exhibit 3 (journal of December 11, 2013 City Council regular meeting), available at <http://www4.honolulu.gov/docushare/dsweb/Get/Document-147021/121113%20Adopted%20Council%20Minutes.pdf>.

⁴ Exhibit 4, available at <http://www4.honolulu.gov/docushare/dsweb/Get/Document-146356/RES13-251.%20CD1.%20FD1.pdf>.

⁵ Exhibit 5.

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vettted, is equally valid, is of equal stature to the Selection Committee award process, list and applies only “[i]n the event that the alternative list is exhausted and/or it is determined that the projects on the alternate list are not feasible for funding in a timely manner or other issues are encountered, which will jeopardize current and future HUD entitlement programs funding.” The ASP does not “bypass” the City’s award process; the City has had no reason to suspect that the ASP is at all deficient or wrongful. To the contrary, all indications have been that this is a properly adopted process that proactively and responsibly addresses contingencies. Indeed, the City Council considered reserving to itself the authority to select the alternate projects⁶ but heeded the advice of Local HUD⁷ and refrained from doing so to avoid tainting the process. Moreover, the Draft Report does not assert that there were any deficiencies in the adoption of the Consolidated Plan amendment that authorizes the ASP, nor does it assert that the ASP was carried out in contravention of the Consolidated Plan. Under these circumstances, the City respectfully submits that it should not be penalized and made to repay CDBG funds awarded in good faith and reasonable reliance upon the legitimacy of this process.

II. THE HIBISCUS HILLS APARTMENTS PROJECT COSTS ARE FULLY JUSTIFIED.

A. The Hibiscus Hills Project Was Selected Through An Objective, Competitive Process.

On December 23, 2013, the City initiated the ASP process by sending letters to 22 agencies to solicit proposals for CDBG-eligible real

⁶ See Resolution No. 13-251, CD1, attached hereto as Exhibit 6 and available at [http://www4.honolulu.gov/docushare/dsweb/Get/Document-145629/DOC%20\(10\).pdf](http://www4.honolulu.gov/docushare/dsweb/Get/Document-145629/DOC%20(10).pdf).

⁷ Video of City Council Regular Meeting, December 11, 2013, at approximately 1 hr. 33 min., which will be labeled as Exhibit 7. Due to file size, it will be copied to a DVD and forwarded separately by mail. It is also on file at the City Clerk’s office and available upon request.

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property acquisition or rehabilitation projects that could expend up to \$10 million by April 15, 2014.⁸ The City started with agencies that had proposed projects that were previously vetted but not funded, and the small number of well-established nonprofit agencies that had the capacity and experience to consummate and execute large projects. The agencies were identified in accordance with the following structure:⁹

First Priority: Property acquisition projects that fulfill the CDBG National Objective of principally benefitting low- and moderate-income persons

a. City Projects:

- *Department of the Prosecuting Attorney, Family Justice Center*

b. Nonprofit projects previously deemed ineligible that could potentially cure deficiencies within a limited time frame:

- *Catholic Charities Housing Development Corporation: Meheula Vista Land Acquisition*
- *Hui Kauhale, Inc.: Wahiawa Medical Building Acquisition and Interior Renovation Project*

c. Agencies with a proven track record and organizational capacity to execute a large transaction within a limited time frame:

- *EAH – Hui Kauhale*
- *Mutual Housing Association of Hawaii*
- *Pacific Housing Assistance Corporation*
- *Vitus Group*
- *Pacific Gateway Center*

Comment 12

⁸ Exhibits 8A-8W.

⁹ Exhibit 9 (December 24, 2013 communication from DCS Director to City Council Chair).

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Second Priority: Reconsideration of previously deemed ineligible capital improvement projects of significant monetary value, with the potential to cure deficiencies within a limited time frame.

- *Kapiolani Medical Center for Women and Children: KMCWS Phase 1 Renovation*
- *Wahiawa Community Based Development Organization: Whitmore Agribusiness HUB*

Third Priority: The Honolulu Affordable Housing Preservation Initiative (“**HAHPI**”) RFP, Selection Committee Recommendations (Resolution No. 13-288, FD1, Exhibit A)¹⁰

- *Mental Health Kokua: Safe Haven Transitional Housing*
- *United States Veterans Initiative: Oahu Homeless Service Center*
- *IHS, The Institute for Human Services, Inc.: Iwilei “Freshen Up” Service Stop*
- *Gregory House Programs: Gregory House Renovation Phase 2*
- *United States Veterans Initiative: U.S. Vets Kahikolu Solar Conversion Project*
- *Hoomau Ke Ola: Lahilahi – Solar Power Plus*
- *Alternative Structures International: Ohana Ola O Kahumana Phase I Septic System*
- *St. Francis Healthcare Foundation Hawaii: Commercial Kitchen Renovations to Serve LMI Residents*

¹⁰ HAHPI involved a planned sale of a portfolio of the City's affordable housing projects. In anticipation of the sale, and the considerable program income that would accrue, the City issued a request for proposals to identify projects for funding. The projects were evaluated and ranked by a selection committee of members appointed by the City Council and the City Administration. See Resolution 13-288, FD1, attached hereto as Exhibit 10 and available at <http://www4.honolulu.gov/docushare/dsweb/Get/Document-146283/RES13-288,%20FD1.pdf>. While the HAHPI sale was cancelled, pursuant to the ASP the City approached the same agencies to see whether the projects they previously proposed, or different projects, might be appropriate for funding.

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- *Kokua Kalihi Valley Comprehensive Family Services: Gulick Elder Center Rehabilitation*
- *Kahi Mohala Hospital (Sutter Health Pacific): Hospital Admissions Area Renovation – Phase II*
- *Wahiawa General Hospital: Phase 2 Parking Area Upgrade to Serve LMI Residents*
- *Wahiawa Community Based Development Organization (CHDO): The NRSA Weed and Seed Project*
- *Parents and Children Together (PACT): Making It in the Real World, Business Start Up*

Thirteen proposals were received. Each proposal was evaluated and scored by a committee of nine persons, comprising staff of BFS and DCS. The committee applied a list of 17 objective, specific criteria for a possible total of 38 points.¹¹

Once the proposals were scored, two separate resolutions were submitted to the City Council for its consideration and approval. The first, Resolution No. 14-11,¹² was to reprogram the CDBG funds in accordance with the committee's ranking; the second, Resolution No. 14-12,¹³ was to make a conforming amendment to the City's Action Plan. Again, each measure was heard by the Budget Committee of the City Council, which made a recommendation to and then was again heard by the full City Council, and notice of each of these meetings was posted publicly and was open to public testimony. Once approved, public notice of the reprogramming action and a 30-day public comment period was published in the *Honolulu Star-Advertiser* on February 18,

¹¹ Exhibit 11 (Project Review Sheet).

¹² Exhibit 12 (adopted Resolution No. 14-11, FD1), available at

<http://www4.honolulu.gov/docushare/dsweb/Get/Document-147016/dspage01373592057480958849.pdf>.

¹³ Exhibit 13 (adopted Resolution No. 14-12, FD1), available at

<http://www4.honolulu.gov/docushare/dsweb/Get/Document-147017/dspage03262279400029229396.pdf>.

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2014.¹⁴ Following the close of the public comment period, the reprogramming was submitted by the City for Local HUD approval, which was granted.¹⁵

As reflected in Resolution No. 14-11, FD1, the City identified the Family Justice Center, a City project, as its first priority, with the Hibiscus Hills project having scored the highest as an alternative.¹⁶ The Resolution was approved by the City Council on January 29, 2014. Two days later, the City's Department of the Prosecuting Attorney declined the funding, stating it could not meet the CDBG requirements.¹⁷ Accordingly, the funds were awarded to the Hibiscus Hills project.

Given the deliberate, methodical manner in which the City identified the agencies it would solicit for proposals, contacted the agencies, evaluated and scored the proposals received, and then reprogrammed the funds and amended its Action Plan, we respectfully disagree with the Draft Report's characterization of this entire process as "brief" and "subjective" with "few requirements." The targeted solicitation of 22 entities based upon objective, articulated priorities involves more than "a select few entities" and the 13 proposals evaluated and scored amounts to more than a "few responses." The City went to great lengths to implement this process fairly, in order to identify a project that would successfully meet CDBG criteria and objectives while supporting the City's timely drawdown of funds.

¹⁴ Exhibit 14.

¹⁵ Exhibit 15 (letter from Local HUD to City dated April 3, 2014).

¹⁶ Exhibit 12.

¹⁷ Exhibit 16 (letter from Prosecuting Attorney to City Council Chair dated January 31, 2014).

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B. In Identifying Funds for Reprogramming, the City Obtained Express Written Confirmation That The Subrecipient's Services and/or Improvements Would Not Be Negatively Impacted.

Before the City reprogrammed any funds for open projects (three total), the City confirmed with each subrecipient that its respective project was delayed and that it was unable to spend down such funds until a later time.¹⁸ One subrecipient stated: "We understand the need to use our existing CDBG funding in a timely fashion and accept the reprogram[m]ing of our funds with the understanding that the City will restore our CDBG funding when [we are] in a better position to timely use them."¹⁹ Another subrecipient stated that it was "supportive to the City's request" to reprogram funds, and that in the meantime, the subrecipient and DCS would "continue to pursue gaining a formal determination on the Environmental Assessment requirement," highlighting a reason why their project was delayed.²⁰ The third and final subrecipient wrote to DCS on January 30, 2014, requesting that the City carry over CDBG project funds to the 2015-2016 fiscal year.²¹ Therefore, to the City's knowledge, the reprogramming did not operate to the detriment of any subrecipient. Without knowing which subrecipient the Draft Report refers to as "counting on the award and [having] to delay services or improvements," we are unable to clarify any misunderstanding.

¹⁸ The City identified nine agencies whose CDBG funds stood to be reprogrammed. One was DCS, one had a contract that had already expired and needed to be closed, one had a balance of funds to be lapsed, and three had projects cancelled in their entirety for other reasons. The remaining three subrecipients confirmed that reprogramming would not affect their project progress; they are discussed above.

¹⁹ Exhibit 17.

²⁰ Exhibit 18.

²¹ Exhibit 19 (follow-up letter from DCS to subrecipient dated February 6, 2014).

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C. The Previous Owner of Hibiscus Hills Was Seriously Considering Sale of the Property For Condominium Development.

The previous owner of Hibiscus Hills was Hibiscus Hill, LLC, a Hawaii limited liability company ("HLLC"). Its sole member is [REDACTED], a real estate broker whose real estate sales company, [REDACTED], Inc., served as the seller's broker for the sale. Mr. [REDACTED] readily confirmed the following:

- As a real estate investor, Mr. [REDACTED] properties are always available for sale at the right price.
- As an investor, Mr. [REDACTED] always has an exit strategy, be it through a sale or conversion to condominiums.
- Multiple local realtors had asked about the property.
- Multiple offers for the property had been received in the past.
- The property did not have a conventional broker listing, which for homeowners and other non-real estate professionals would be a part of active marketing. Because Mr. [REDACTED] is a broker himself, he saw no need to market in the conventional manner since he could handle the sale by himself.
- Several developers had looked at the property for conversion to a condominium property regime.²²

Mr. [REDACTED] statements should dispense with any doubt about his willingness and plans to sell Hibiscus Hills. Lending further support,

²² Exhibit 20 (email dated July 20, 2016).

* Names redacted for privacy reasons

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██████████ of ██████████, by email dated July 19, 2016, confirmed that Hibiscus Hills was a “hip pocket” deal – i.e., a property that was always available for sale but not formally listed or otherwise marketed for sale – and that “[i]t was well known in the industry that ██████████ would sell.”²³ In fact, ██████████ confirmed to the City that he had shown the property to several other parties over time (the majority of which were focused on condominium conversion), including one showing about a year before Vitus Group looked at the property. ██████████ also stated generally that ██████████ “knows a lot of people in the industry and fielded inquiries from numerous people” besides himself, and had gone so far as to prepare the documents for condominium conversion:

The majority of buyers I showed it to were indeed considering condo conversion. ██████████ had the Condo Docs and Declaration drafted and either submitted the Declaration for review but withdrew it, or completed the Declaration and then cancelled it as the real property tax impact on the property was quite substantial from submitting it to the CPR [Condominium Property Regime]. He did this CPR work to increase value to the potential buyers.²⁴

Another local broker, ██████████ confirmed to the City in an email dated July 18, 2016 that he was “in discussions with ██████████ regarding the sale of the Hibiscus Hill Apartments back in 2014.”²⁵ In addition, a third broker, ██████████, discussed the property with ██████████ on at least one occasion and commented that, although the

²³ Exhibit 21.

²⁴ Id.

²⁵ Exhibit 22.

* Names redacted for privacy reasons

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Hibiscus Hills property did not have a conventional broker listing, Mr. [REDACTED] "had said for years if he got his price he would sell."²⁶

Given the consistency among these first-hand sources, the Draft Report's statement that "the seller did not plan to change the complex, convert it to condominiums or sell it" is not accurate. The owner clearly did not intend to maintain Hibiscus Hills as affordable housing indefinitely, supporting the reasonableness of its acquisition.

Not only do multiple sources confirm that in fact, Hibiscus Hills was for sale, Mr. [REDACTED] was a motivated seller as a result of a significant increase in real property taxes beginning in 2012. In the course of an internal audit of the City's real property tax exemption for low-income rental housing,²⁷ the City notified HHLLC by letter dated December 14, 2012 that its exemption had been disallowed, due to "[n]o current, in force recorded regulatory agreement with a government agency."²⁸ Mr. [REDACTED] appeal was heard on August 27, 2013, and a decision was filed by the Board of Review on September 13, 2013, stating that "[e]vidence submitted by the appellant [HHLLC] did not demonstrate that the appellant is entitled to or qualified for the applicable exemption," and setting the net taxable value for the property at \$10,545,200.²⁹

As a result of losing his low-income rental housing tax exemption, Mr. [REDACTED] real property taxes for Hibiscus Hills jumped from \$300 in tax years 2010-2012, to \$36,908.20 in 2013 and \$37,543.10 in 2014 – a more than hundred-fold increase.³⁰

²⁶ Exhibit 23.

²⁷ See Sections 8-10.20 and 8-10.21 of the Revised Ordinances of Honolulu 1990, as amended ("ROH").

²⁸ Exhibit 24.

²⁹ Exhibit 25.

³⁰ Exhibit 26, available at

http://qpublic9.qpublic.net/hi_honolulu_display.php?KEY=940990740000&show_history=1&#hist_taxes.

* Names redacted for privacy reasons

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Under these circumstances, where the owner of Hibiscus Hills was poised to sell the property and prepared condominium documents to facilitate the sale, and incurred a steep increase in real property taxes, the acquisition of Hibiscus Hills to preserve it as affordable housing for low-to moderate-income households was reasonable.

D. The Purchase Price for Hibiscus Hills Was Reasonable and Unrelated to the Value of the CDBG Investment in the Property.

The Draft Report notes that the purchase price for Hibiscus Hills exceeded the value determined by a subsequent appraisal and automatically concludes that project costs were not reasonable. However, the appraisal reconciles the discrepancy between the appraised value and the purchase price, stating:

We are aware that a Purchase and Sale Agreement (PSA) has been negotiated between Hibiscus Hill, LLC (seller) and Vitus Group, Inc. (buyer) involving the subject property. The purchase price is \$21,000,000. Said price is higher than our market value estimate and reflects the motivation of the buyer to preserve affordable housing in this market as well as certain financing benefits that are not considered within the estimate of market value consistent with the definition of market value provided herein.³¹

This explanation supports the reasonableness of the purchase price. Moreover, CDBG monies did not fund the entire purchase price and,

³¹ Exhibit 27 (footnote omitted).

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therefore, the purchase price has little to no bearing on the reasonableness of the CDBG contribution to the acquisition. The reasonableness of the CDBG contribution should be evaluated instead based upon the CDBG requirements and commitments secured through the City's participation in the financing. In fact, to ensure that the value of the CDBG investment was protected, the discrepancy between the appraised value and purchase price was addressed by increasing the number of required CDBG-designated units from 41 to 50 of the 80 units. This methodology was approved by Local HUD prior to closing. The City submits that the CDBG subsidy to acquire Hibiscus Hills was reasonable, especially in light of this adjustment.

Comment 26

Prior to closing, it was the City's understanding that the amount of the CDBG award for Hibiscus Hills was considered justifiable and appropriate by Local HUD. The amount made available for Hibiscus Hills through reprogramming corresponded to the grant amount, \$8.5 million, and the City originally intended to award that amount. But at Local HUD's suggestion, for which the City is grateful, the City considered a float loan for the additional \$1.6 million. As noted in the email from Local HUD:

Yesterday, I spoke to Connie, Holly and Cheryl about the Hibiscus project and the City's draft reprogramming notice. I advised them that the City should add[] to the notice that it would float at least \$1.6 million for the Hibiscus project since it is anticipated that the project will obtain a \$1.6 million loan sometime before the closing of escrow. My suggestion is that the City goes with a float to ensure that the City can meet timeliness.

...

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By floating the \$1.6 million assuming closing happens by April 15th the City will ensure it is with[in] the safe zone of the timeliness requirement. As it stands now the City is still [at] risk of failing timeliness due to dependence on subrecipients that may or may not come through for the City on its CDBG expenditures.³²

The City had never implemented a float loan before, and therefore proceeded cautiously. This is confirmed in the City's response, which states:

Also, as discussed, this still needs to be discussed internally here to ensure we have the authority to proceed in this manner.

In the event we go forward with this and since we're trying to prepare for publication asap, please review to ensure this language meets HUD's requirements. Also, per our discussion and my concern about having to provide an alternate source of funds should we not receive the funds, I believe we still need to declare our plan in the Action Plan amendment, in the event that the program income (repayment) is delayed or somehow doesn't materialize... Were you able to confirm that this is no longer needed?³³

Local HUD's reply to the City's response ended with the following comment:

³² Exhibit 28 (Local HUD email dated February 7, 2014, 8:31am).

³³ *Id.* (City reply email dated February 7, 2014, 9:58am).

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FYI — Got word today that Hqtrs is going to collect on an untimely grantee that is in a similar situation as the City. Thus the float idea to assist the City in meeting timeliness becomes even more important. Hqtrs is not messing around with untimely grantees; the City needs to take all steps possible to ensure timeliness compliance.³⁴

The City wishes to be clear that it is *not* asserting that Local HUD is responsible for any actions or decisions by the City. The City greatly appreciates Local HUD's accessibility, guidance and direction. Rather, the City brings these collaborative conversations with Local HUD to OIG's attention to establish that the City intended to comply with CDBG requirements, took steps to obtain guidance from Local HUD and had every reason to believe that the amount awarded for Hibiscus Hills was reasonable and justified, given Local HUD's suggestion and assistance to actually *increase* the amount of the award. The City submits that Local HUD's facilitation and concurrence in fact *establishes* that the City's action were, by definition, reasonable.

The concern raised in the Draft Report is that the subrecipient did not meet the 50 low- and moderate-income rental units required and, therefore, HUD did not receive an alternative value for the excess costs. However, the Draft Report relies upon dated information. In actuality, the subrecipient has been complying with its requirement to provide at least 50 low- and moderate-income rental units and, therefore, HUD has been receiving its appropriate alternative value for the excess purchase price.

³⁴ *Id.*, Emphasis in original. (Local HUD reply email dated February 7, 2014, 11:28am).

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Month Ending	CDBG-Designated Units ³⁵		
	Total Units	Occupied Units	Vacant Units
October 2015	53	52	1
November 2015	53	53	0
December 2015	53	52	1
January 2016	53	51	2
February 2016	52	50	2
March 2016	50	43	7

HUD has also determined that 49 low- and moderate-income units were occupied in June.³⁶ In addition, based upon the rent rolls received for April, May, and July, the following numbers of units were occupied by low- to moderate-income households:

April 51³⁷
May 56³⁸
July 53³⁹

Due to the deadline for this response, we have not yet been able to confirm how these numbers correspond to CDBG-designated units, but present this as a strong, further indication that the project is consistently delivering its expected value in providing the required housing to low- and moderate-income households.

³⁵ Exhibit 29 (April 15, 2016 letter from City to Local HUD re: July 2015 on-site program monitoring).

³⁶ Exhibit 30 (July 15, 2016 Local HUD response to City letter).

³⁷ Exhibit 31 (April 2016 rent roll with affordable units highlighted and tenant names redacted; Units B202, D206, D207, and D208 were vacant).

³⁸ Exhibit 32 (May 2016 rent roll with affordable units highlighted and tenant names redacted; no vacancies).

³⁹ Exhibit 33 (June 2016 rent roll with affordable units highlighted and tenant names redacted; Unit C208 was vacant).

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E. The CDBG Award for Hibiscus Hills Was Tied Strictly to Acquisition, with Rehabilitation a Separate Activity Paid for with Non-CDBG Funds.

The City understands the concern raised in the Draft Report that, as a 24 CFR § 570.202(b)(1) eligible project, the subrecipient's rehabilitation commitment should be more firmly established. However, the City submits that rehabilitation is an enforceable requirement of the project but is not prescribed in detail for two reasons. First, the CDBG award was allocated exclusively for *acquisition* of the project, not for rehabilitation. The Subrecipient Grant Agreement and Subrecipient Loan Agreement each provide that (1) the CDBG award funds would be "used solely for the acquisition of the Real Property," (2) the rehabilitation work (with a Local HUD-approved budget of \$1,000,000) would be "undertaken by the Ownership Entity using funds provided by Vitus," and (3) the ownership entity would use "best efforts" to commence rehabilitation work within six months of closing.⁴⁰ These agreements focus on the terms of the acquisition funding, and devote less attention to rehabilitation. Second, the timing for the approvals, permits, reviews and actions that must precede any rehabilitation work, such as plan review by the Disability and Communication Access Board and financing institutions, are often beyond the City's and the subrecipient's control.

The City became aware last year (along with Local HUD, we believe) that HUD Headquarters will require firmer rehabilitation commitments as reflected in the Kaneohe Elderly transaction.⁴¹ However, the City did not have the benefit of this feedback prior to closing of the Hibiscus Hills transaction. While we understand HUD's

⁴⁰ Exhibits 34 (Subrecipient Grant Agreement) and 35 (Subrecipient Loan Agreement). See Section I, Paragraph 2.a(1) of each document.

⁴¹ Exhibit 36 (email trail between City and Local HUD, April-June 2015).

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interest in stronger, clearer rehabilitation obligations, the omission of such detail for the Hibiscus Hills project should not be grounds for requiring repayment. The facts are that there is no clear, defined rehabilitation requirement for a project to be an eligible activity under § 570.202(b)(1), and the Hibiscus Hills developer has renovated a portion of the affordable units at a cost of \$228,818.⁴² In addition, the nonprofit has been awarded \$1,480,000 for the renovation of Hibiscus Hills through an independent process.⁴³ The award will fully fund the renovations and require the ownership entity to convert an additional 17 market rate units to units affordable to households earning less than 50% of median income.⁴⁴ This would be in addition to the 50 required CDBG-designated units. We are confident that the rehabilitation work will bear out the purpose of the award. To demand repayment of the entire CDBG amount at this time due to a lack of progress in rehabilitation would seem premature, unduly severe, and without a clear basis.

F. The post-sale rent increases at Hibiscus Hills still fall within HUD's prescribed affordable rent limits.

The Draft Report asserts at page 6 that "rents had increased, in some cases significantly, since the purchase" and that, as a result, the project did not serve a meaningful purpose and was not necessary.

Nonprofit agencies owning and managing CDBG-assisted projects are not prohibited by CDBG regulations from raising rents, nor is prior City approval needed, so long as the rents of all CDBG-assisted units remain at or below the affordable rent limits established by HUD. As an asset management practice, many nonprofit agencies adjust rents

⁴² Exhibit 29, at Attachment 1, Page 3.

⁴³ Exhibit 37 (conditional award letter dated June 30, 2016).

⁴⁴ Exhibit 38 (renovation proposal excerpts).

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annually (1) to maintain a steady stream of revenue to fund operations and to deposit into their reserve accounts, and (2) to trigger the release of additional loan funds from the mortgagee to pay for renovations. A summary of the rent structure for Hibiscus Hills is shown below:⁴⁵

Rent Standard (max. CDBG rent)	\$1,810 / month
Hibiscus Hill Rents:	
New CDBG Tenants	\$1,500 / month
New Market Tenants	\$1,600 / month
Existing Tenants	\$1,200 - \$1,500 / month
Section 8	\$1,500 - \$1,810 / month

As shown above, Hibiscus Hills rents remain at or below the HUD rent standards established for the project. Rent increases for 2016 for existing tenants varied based on the rents that each tenant was paying. A summary of rent increases for CDBG units is shown below:

⁴⁵ The rent structure summary is based on the rent roll showing 2015 rents and increased 2016 rents, attached hereto as Exhibit 39.

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2015 Rent	2016 Rent (effective January 1, 2016) ⁴⁶
\$1,200	\$1,250
\$1,300	\$1,325 - \$1,400
\$1,325	\$1,375
\$1,350	\$1,400 - \$1,425
\$1,400	\$1,500

Hibiscus Hills was not subject to any income restrictions prior to the sale of the project, so prior management was not required to conduct income verifications.

The project was acquired to maintain affordability, and while rents did increase, the rents remain "affordable" as defined by HUD.

III. THE PROJECT COSTS FOR KANEOHE ELDERLY ARE FULLY JUSTIFIED

A. The Urgent Need For Preserving and Increasing Affordable Housing in Honolulu Must Be Considered When Evaluating the Appropriateness of Acquisition Projects.

In the City and County of Honolulu (of which the island of Oahu is a part), opportunities to preserve or secure affordable housing for low- and moderate-income households must be taken as they arise. This is especially true for affordable housing for low- to moderate-income

⁴⁶ Id.

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seniors. According to one recent study prepared for DCS, the projected unmet need for rental units for seniors is as follows:

PAST & FUTURE HOUSING NEED, PER AREA MEDIAN INCOME (AMI), SENIORS AGED 55+

AMI	Backlog 2000-2013	Upcoming 2013-2020	Cumulative Count
30%	612	494	1,106
50%	482	389	871
60%	221	178	399
80%	262	211	473
100%	195	157	352
120%	151	122	273
140%	110	88	198
Totals	2,033	1,638	3,671

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PAST & FUTURE HOUSING NEED, PER AMI, SENIORS AGED 65+

AMI	Backlog 2000-2013	Upcoming 2013-2020	Cumulative Count
30%	410	330	740
50%	311	251	562
60%	131	106	237
80%	136	110	246
100%	91	73	165
120%	66	53	120
140%	49	39	88
Totals	1,194	963	2,157 ⁴⁷

As the author of the study also notes:

The current stock of affordable rental housing will not always be available in the future, OR may not always be available in the future for two reasons: obsolescence, or the end of the term in which the unit's rent is contractually set at an affordable level, and maintenance. While two different issues, they are tied to the same consideration – making sure the stock of rental housing appropriate for low-income families is available.

⁴⁷ Rick Cassidy, Honolulu Rental Market Affordable Rental Housing Study Update, 2014, at 27, attached hereto as Exhibit 40 and available at <http://dbedt.hawaii.gov/hhfd/files/2015/02/RENTAL-HOUSING-STUDY-2014-UPDATE-CITY-COUNTY-OF-HONOLULU.pdf>.

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Given that units will leave the affordable housing pool, planning needs to be done now to insure that those units are replaced.⁴⁸

The City has similarly reported:

Oahu is experiencing a housing crisis. Our current housing policies, programs, and investments are fragmented and need updating to address escalating needs. The marketplace is not building enough affordable housing to keep up with demand. Many people live in overcrowded homes, spend more than 45% of their incomes on combined housing and transportation costs, or are homeless and living on the streets. Oahu would need more than 24,000 additional housing units to address pent-up demand combined with new household formation by 2016. Over 18,000 or 75% of the total projected demand is for households earning less than 80% of area median income (AMI), or \$76,650 for a family of four. This demand is largely for rental units. In contrast, only 2,080 residential building permits per year on average were issued over the last five years. Most homes built were for higher income households and for-sale units.⁴⁹

⁴⁸ *Id.* at 60 (emphasis added).

⁴⁹ Housing Oahu: Affordable Housing Strategy (Draft for Review and Discussion 2015) at 1, attached hereto as Exhibit 41 and available at https://www.honolulu.gov/rep/site/ohou/ohou_docs/Housing_Strategy_Draft_9-8-15.pdf.

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In the midst of this dire need for affordable housing and given competing, lucrative market-rate housing opportunities, it is imperative that the City be given some flexibility to evaluate the opportunities to secure, preserve and extend affordable housing commitments as they arise. To prevent the City from funding the acquisition of affordable housing projects unless it can demonstrate that the loss of that inventory would otherwise be certain or imminent would eliminate many cost-effective opportunities to ensure a stable inventory of affordable housing.

Comment 32

With respect to the Kaneohe Elderly project, the City's contribution of \$2.9 million toward acquisition of a \$10 million leasehold interest initially yielded a commitment of \$965,000 from other funds for much needed rehabilitation work, and an extended commitment to provide 43 units to seniors below 50% and 60% of AMI, from 2028 to 2047. This 19-year period is almost double the CDBG use restriction period required by HUD Headquarters for this transaction. The developer pursued an amendment to the City ordinances to allow the lease to be extended, which was passed in 2015.⁵⁰ The lease was then extended, with the affordability requirements, until 2091.⁵¹ If the City had been forced to wait until the lessee's existing affordability obligations expired in 2028, it is uncertain whether the City could have successfully negotiated an extension of the affordability requirements. In light of Oahu's robust housing market, it is reasonable and realistic to expect that, as expiration of the affordability restrictions draws closer, the owner of the leasehold estate would be incentivized to wait for expiration to occur and to have the freedom to sell or operate the project at full market rate with no affordability restrictions. Allowing the City

⁵⁰ Ordinance No. 15-43, attached hereto as Exhibit 42 and available at [http://www4.honolulu.gov/docushare/dsweb/Get/Document-169675/DOC005%20\(15\).PDF](http://www4.honolulu.gov/docushare/dsweb/Get/Document-169675/DOC005%20(15).PDF).

⁵¹ Exhibit 43 (Fourth Amendment and Restatement of Lease).

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to be proactive in preserving affordability before this seller incentive arises makes sense.

B. The City Undertook a Full Financial Review of the Proposed Acquisition, Which Was Presented to Local HUD and HUD Headquarters.

The City performed a financial evaluation of the Kaneohe Elderly project (the “**Financial Review**”), which was provided to Local HUD and HUD Headquarters during their review of the project.⁵² The Financial Review assessed the amount of CDBG funds to be invested in Kaneohe Elderly – \$2.853 million – for appropriateness. It concluded that the amount of CDBG funds was appropriate, not excessive. The Financial Review was provided to Local HUD at the request of HUD Headquarters in advance of closing; at no time did Local HUD or HUD Headquarters object to the level of funding or dispute the assumptions or results of the Financial Review.

C. HUD Headquarters Required a Ten-Year Use Restriction Period Specifically to Account for Cost Reasonableness.

HUD Headquarters reviewed the Kaneohe Elderly project and required certain revisions to the project documents.⁵³ In reviewing the Kaneohe Elderly transaction, HUD Headquarters directed the City to impose a ten-year use restriction period. The explanation at the time was “to meet the intent of the CDBG Program.”⁵⁴ Local HUD clarified that the direction from HUD Headquarters was that the use restriction period should consider cost reasonableness and be based on the amount invested in the project. Accordingly, the use restriction period was

⁵² Exhibit 44.

⁵³ Exhibit 36.

⁵⁴ *Id.* (Local HUD email to City dated June 8, 2015, 11:07am).

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extended specifically to account for the amount of the CDBG investment and to ensure cost reasonableness.

The review of this project by both HUD Headquarters and Local HUD, their acceptance of the City's financial review, and the imposition of a ten-year use restriction period precisely to ensure cost-reasonableness establishes that the CDBG investment in the acquisition of Kaneohe Elderly was reasonable.

IV. CITY SUBRECIPIENT KAHUKU ELDERLY PARTNERS LP ("KEP") COMPLIED WITH THE CITY'S PROCUREMENT REQUIREMENTS.

KEP, the subrecipient, awarded a construction contract in full accordance with required procurement procedures. The Draft Report asserts on page 7 that the City approved a contract award by KEP that did not comply with HUD requirements because:

1. KEP awarded the \$3,394,862 contract to Hunt Building Company, Ltd. ("**Hunt**").⁵⁵
2. HCP-ILP, LLC ("**HCP**") was supposedly an ownership entity of KEP at the time of award.
3. Hunt and HCP were supposedly affiliated through Hunt Companies, Inc. at the time of award.
4. Given the above claims, "a real or apparent conflict of interest existed" under 24 CFR §§ 84.42-84.43, attached to the Draft Report as Appendix C.

⁵⁵ Exhibit 47 (Agreement dated February 12, 2012).

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As an initial matter, since the contract has an effective date of February 12, 2012 and was signed on February 13-14, 2012,⁵⁶ the award took place prior to the official audit period of July 1, 2012 through June 30, 2015 (stated on page 3 of the Draft Report). Issues with the award thus appear to be outside the scope of this audit.

Comment 35

That being said, even if we assume that this Draft Report finding falls within the audit period, the argument fails because Statement 2 above is incorrect: HCP was *not* an ownership entity of KEP at the time of contract award. HCP did not become an ownership entity of KEP until execution of the Third Amended and Restated Limited Partnership Agreement for KEP, dated March 1, 2012 (the "**LP Agreement**")⁵⁷ – after the award. Accordingly, a conflict of interest did not exist between Hunt and HCP at the time of award.

Comment 36

In addition, although HCP took a 99.99% ownership interest in KEP during performance of the construction contract, the LP Agreement designated HCP as a passive "Investor Limited Partner" and "State Tax Credit Limited Partner." The LP Agreement expressly provides in the Article titled "Rights of the Limited Partner" that (a) "[n]o Limited Partner shall have the right to take part in the management or control of [KEP] or to transact any business in the name of [KEP]"; and (b) apart from capital contribution, "[n]o Limited Partner shall have any . . . liability to contribute money to, or in respect of the liabilities and obligations of, [KEP], nor shall any Limited Partner be personally liable for any obligations of [KEP], except as and to the extent provided in the Uniform Act."⁵⁸ Thus, HCP was effectively screened off from KEP's business affairs, and was unable to exercise any influence over the

⁵⁶ *Id.*

⁵⁷ *Exhibit 48.*

⁵⁸ *Id.*, at Sections 10.1-10.2.

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administration of the construction contract or any possible disputes between KEP and Hunt over performance of the contract.

For the reasons given above, a conflict of interest does not appear to exist with respect to this construction contract.

V. THE CITY'S REQUESTS FOR BIDS FOR FIRE ENGINE EQUIPMENT FULLY COMPLIED IN ALL RESPECTS WITH PROCUREMENT REQUIREMENTS.

Comment 38

The City's two bid solicitations involving Fire Truck Headquarters ("FTH") complied with the City's competitive procurement rules, because the City's Purchasing Division (a) maintained a consistent deadline for requests for substitution throughout the process, and (b) reviewed and made decisions on all timely submitted requests for substitution, including FTH's request, strictly on the merits.

The Draft Report asserts at pages 8-9 that the City arbitrarily amended two requests for bids, and that the City did not conduct procurement transactions in a manner to provide open and free competition. We respectfully disagree with those conclusions. The analysis below treats the two solicitations as one because the solicitations and their addenda are identical as to dates and content.

Comment 39

The five bid amendments were not arbitrary – they were issued for legitimate purposes, described below:

- Addendum No. 1, issued March 8, 2013,⁵⁹ disclosed that the procurement was to be federally funded.

⁵⁹ Exhibit 49.

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- Addendum No. 2, issued March 15, 2013,⁶⁰ extended the last date to issue an addendum from March 18, 2013 to March 22, 2013 to allow for due consideration of possible changes and questions.

- Addendum No. 3, issued March 21, 2013,⁶¹ made various changes to the specifications and responded to questions received from potential bidders.

- Addendum No. 4, issued March 22, 2013,⁶² also made various changes to the specifications and responded to questions received from potential bidders.

Comment 40

- Addendum No. 5, issued March 28, 2013,⁶³ postponed the last day to issue addenda from March 22, 2013 to April 2, 2013; postponed the deadline for bids from April 4, 2013 to April 8, 2013, to allow for due consideration of possible changes and questions; and reminded bidders that “[t]he City shall not accept any further submissions for questions, clarification, or request for substitutions,” since the March 15, 2013 deadline established in the original solicitation was well past. These time extensions were done not to accelerate the award process in any way, but to give due consideration to all remaining requests for clarifications/substitutions that were timely submitted by the March 15, 2013 deadline, and to make decisions on those requests based on their merits.

Comment 38

Although the Draft Report notes at page 8 that the addenda deadline of March 22, 2013 stated in Addendum No. 2 had already passed, the extension of that deadline by the City was allowed under the

⁶⁰ Exhibit 50.

⁶¹ Exhibit 51.

⁶² Exhibit 52.

⁶³ Exhibit 53.

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Hawaii Administrative Rules (“HAR”), Title 3 – Department of Accounting and General Services, Subtitle 11 – Procurement Policy Board, Chapter 122 – Source Selection and Contract Formation,⁶⁴ which governs over procurement awards not only for the State of Hawaii, but also for the City and all other counties in the State of Hawaii. HAR Section 3-122-16.06 provides that addenda for amendments, which include “any material changes to the solicitation” such as changes to “opening dates,” can be issued any time before submission of offers, so long as prospective offerors have time to account for the amendments in their offers to the extent applicable.⁶⁵ The HAR Section further provides that addenda for clarifications, which include “pre-bid or pre-proposal communications other than amendments,” may be issued “any time up to the scheduled deadline for receipt of offers.”⁶⁶ Under these controlling administrative rules, the City had clear and broad discretion to change any pre-submission deadlines, even after the fact.

Comment 38

- Addendum No. 6, issued April 2, 2013,⁶⁷ again reiterated to bidders that further evaluations of manufacturers would not be conducted, since the March 15, 2013 deadline to submit such requests as established in the original solicitation document was well past. However, bidders were encouraged to submit complete specifications to foster completion on future solicitations.

Comment 41

Most importantly, and what appears to be overlooked in the Draft Report, is that Addendum No. 6 then laid out the full rationale for denial of the Smeal Sirius I & II Cab and Chassis offered by FTH. The rationale included non-conforming cab dimensions, non-conforming rear suspension design, insufficient size of the Sirius II engine, and a front

⁶⁴ Exhibit 54, available at <http://spo.hawaii.gov/wp-content/uploads/2013/11/3-122.pdf>.

⁶⁵ Id.

⁶⁶ Id.

⁶⁷ Exhibit 55.

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axle warranty that failed to meet the five-year bumper-to-bumper warranty requirement.⁶⁸ Fire Truck Headquarters' request for substitution was given the same consideration as other requests, and denied on its merits. The City's clarification in Addendum No. 6 that it would not be able to complete any untimely requests for further evaluations or pre-qualification of new manufacturers had nothing to do with its decision on FTH's timely submitted request for substitution. To be clear, FTH's request for substitution was rejected because the Smeal Sirius I & II Cab and Chassis deviated from City specifications to an unacceptable degree, not because of timeliness concerns.

The Draft Report states that "through addendum three, on March 21, 2013, and March 22, 2013, the City amended specifications based on requests related to other brands. Because it adjusted specifications for other brands at the request of other bidders but not for Fire Truck Headquarters, it appeared that the City favored the other bidders over Fire Truck Headquarters." A review of Addendum No. 3, however, reveals many more rejections than acceptances of substitutions:

- Q1. Page 7, Item 10 — Front Suspension. The Rosenbauer front suspension is a Hendrickson 9 leaf suspension in lieu of the specified suspension. The Hendrickson suspension is a commercially available suspension, with parts and service easily available for years of uninterrupted service for the apparatus. The specified figure 8 grease groves are not included with the Hendrickson suspension package. Will this be acceptable?

⁶⁸ *Id.*

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R1. **No, Provide as specified.**

Q2. Page 7, Item 14 — Rear Suspension.
Rosenbauer provides a Reyco vari-rate self-leveling suspension as standard in lieu of the proprietary specified rear suspension. The suspension is a commercially available suspension with easy access to parts and service for years of easy accessibility to parts and service for the apparatus. Is this acceptable?

R2. **No, Provide as specified.**

Q3. Page 8, Item 19 — Air Compressor Systems.
Rosenbauer Motors recommends using the Wabco air dryer. It has a built in Governor, which reduces the number of air lines that need to be run, and it has a built in 200 cubic inch air reservoir for purging the system. This eliminates the need to use air already in the system when the dryer is purged. Is this acceptable?

R3. **No, Provide as specified.**

Q4. Page 9, Item 23 — Air Compressor, Brake.
Rosenbauer utilizes the pressure switch that comes with the air compressor, in lieu of the specified Square — D pressure switch. Is this acceptable?

R4. **No, Provide as specified.**

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Q5. Page 10, Item 27 — Transmission. Per application guidelines provided by Meritor, the transmission retarder activation is recommended to be 2/3 application with the dash mounted handle and 100% with brake pedal application. Is this acceptable?

R5. **No. As specified by Allison Transmission.**

Q6. Page 11, Item 27 — Transmission Cooler Warranty. Rosenbauer meets the warranty period for the transmission cooler warranty; however, Rosenbauer does not offer a collateral damage warranty. Is this acceptable?

R6. **No, Provide as specified.**

Q7. Page 11, Item 30 — Auxiliary Fuel Pump. An electric fuel pump is standard on all Rosenbauer Chassis; however, the engine manufacturer — Cummins — does not allow an auxiliary switch to be mounted in the cab. Is this acceptable?

R7. **No, Provide as specified.**

...

Q9. Page 15, Item 37 — Battery Charger. The battery charger provided as standard in the Commander chassis is a Kussmaul 1200, which comes with an integrated cooling fan, in lieu of the low profile Kussmaul that was specified. The charger indicator shall be

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located in the canopy side fixed window facing the outside of the apparatus so that it can be viewed through the window. Is this acceptable?

R9. **No, Provide as specified.**

Q10. Page 17, Item 39 — Diagnostic Panel. In the Commander chassis, this panel is located to the left of the steering wheel, in lieu of the specified right side of the steering wheel. Is this acceptable?

R10. **No, Provide as specified.**

...

Q12 Page 20, Item 43 AND Page 28, Item 63 — Air Compressor System. The specification calls for the air compressor system to be integral to the midship pump, driven via the pump transmission, utilizing a "hot-shift" pneumatic clutch and Polychain drive system. Has there been, or would there be, any consideration for a 200 CFM Compressed Air Foam System (CAFS) compressor that is PTO driven in lieu of one that is driven by the pump? This would be a lower cost and less maintenance item for consideration.

R12. **No, Provide as specified.**

...

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Q15. Page 42, Item 70 — EMS Compartment.
The EMS Compartment on the Rosenbauer
Commander Chassis is 42.00 inches tall x
23.00 inches wide x 25.00 inches deep as
standard, in lieu of specified dimensions.
The compartment shall have a regular door
handle in lieu of specified "D" ring. Is this
acceptable?

R15. **No, provide as specified.**⁶⁹

In retrospect, it appears that the City provided a fuller explanation for its rejection of the Smeal Sirius I & II Cab and Chassis in Addendum 6 than it provided for its numerous rejections in Addendum No. 3. Clearly, there was no favoritism involved.

The Draft Report also claims at page 8 that the City "arbitrarily amended the requests after the allowable date so that it could obligate the funds before a certain date." This is also incorrect. The terms of the original bid solicitation document, as issued on February 21, 2013, established March 15, 2013 as the deadline to submit requests for substitutions for evaluations and qualification of new manufacturers.⁷⁰ This requirement was never changed, and all requests submitted by this deadline were given full consideration.

In addition, the Draft Report alleges at page 8:

The City opened the bids on April 8, 2013, but did not award the contracts to the winning bidder, Kovatch Mobile Equipment Corp., until May 13, 2013, and May 17, 2013, and did not execute them until June 2013. Several months after it

⁶⁹ Exhibit 51.

⁷⁰ Exhibit 56.

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opened the bids, the City issued the notices to proceed. Since it did not issue the notices until significantly later and it specifically cited the need to obligate funds by April 30, 2013, it appeared that the City's motivation was to speed the award process. By doing so, it did not provide full and open competition as required.

This, too, is incorrect. As shown by the facts above and the chart on page 9 of the Draft Report, the City took the time to encourage full and open competition and to ensure proper award of these contracts. The original solicitation was issued on February 21, 2013. The last day to issue addenda was extended from March 18, 2013 to March 22, 2013, and further extended from March 22, 2013 to April 2, 2013, giving more time for the City to issue amendments and clarifications in order to more effectively administer the bid process and answer all timely submitted questions from potential bidders. The deadline for bids was extended from April 4, 2013 to April 8, 2013, giving more time for potential bidders to adjust their offers based on the City's amendments and clarifications. After over a month of careful deliberation by the City, awards were made in mid-May 2013. The awarded contracts were signed by the contractor as of May 17, 2013, and signed by the City in June 2013. The notices to proceed were issued in January 2014.

This chronology of events documents a lengthy, open and competitive procurement process that does not support the assertions in the Draft Report that "the City's motivation was to speed the award process" and that the City "did not provide for full and open competition."

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VI. THE CITY ACTED IN FULL ACCORDANCE WITH AWARD REQUIREMENTS IN ACCEPTING THE KANEOHE ELDERLY PROPOSAL.

A. The Hawaii Administrative Rules Expressly Allow for Acceptance of Proposals When Lateness Is Due to City Error.

The Draft Report notes that “[t]he [Request for Proposals, No. CDBG 15] submission guidelines stated that applications that were not received by the submission deadline, as evidenced by a valid Division of Purchasing date and time stamp would not be considered for funding under the request for proposals” (page 9), and that the proposals submitted by Trillium Housing Services -- one of which was for Kaneohe Elderly Apartments -- did not obtain valid stamps. The DCS memorandum to the BFS Purchasing Division dated January 29, 2015,⁷¹ requesting acceptance of the proposals, provides greater detail:

By way of background the subject Request for Proposals, required that all proposals be submitted to the Division of Purchasing by 4:00 p.m. on January 28, 2015. Trillium Housing Services (THS) submitted two proposals to the Department of Community Services (DCS) that were time stamped at 1:59 p.m. and 2:00 p.m. Unfortunately DCS staff did not inform THS that the proposals should have been submitted to the Division of Purchasing, nor did DCS staff transmit the proposals to the Division of Purchasing by the

⁷¹ Exhibit 57.

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4:00 p.m. deadline, although there was ample time to do so. Had DCS staff done either of these actions, it is likely that the THS proposals would have been submitted on time to the City.⁷²

In its memorandum to Purchasing, DCS admitted its unintentional error in handling the proposals. With this fact in mind, Purchasing turned to the Hawaii Administrative Rules that, as mentioned in Section V above, control not only State procurement awards, but also county (City) awards. The following rule applied:

§3-122-16.08 Late offer, late withdrawal, and late modification.

(a) Any notice of withdrawal, notice of modification of a bid or proposal with the actual modification, or any bid or proposal is late when received at the place designated for receipt and opening of an offer after the established due date, additionally defined in section 3-122-16.06(a), **except when received before contract award and would have been timely but for the action or inaction of personnel within the procurement activity.**⁷³

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Since the Kaneohe Elderly proposal would have been timely but for the inaction of DCS personnel, the proposal was not late under law. Thus, the City fully complied with its award requirements in accepting and processing the proposal.

⁷² Id.

⁷³ Exhibit 54.

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We readily acknowledge that the City has rejected multiple CDBG proposals in the past due to lateness. However, in each of those cases, the proposals were submitted to the City after the submission deadline posted in the RFP. As noted above, the proposals prepared by THS were submitted to and time-stamped by DCS two hours in advance of the submission deadline, and would have arrived at the BFS Purchasing Division on time had it not been for the inaction of City employees.

B. The City Had Discretion Under the RFP to Allow the Proposer to Submit Missing Documentation.

The Draft Report claims at page 9 that the Kaneohe Elderly proposal “did not include all required documentation.” No specifics are given, so we are unable to speak to the items that were identified as missing. However, the City had considerable flexibility under the CDBG RFP for Fiscal Year 2015⁷⁴ in handling proposals with gaps in documentation. The RFP provided that the City had the right, but not the obligation, to disqualify an application if it (1) “lacks a required attachment,” (2) “does not provide sufficient information necessary for the City to make an informed decision about a proposed project or program,” or (3) has any other issue “related to the completeness or incompleteness of the application.”⁷⁵ On the other hand, the City also had discretion to *accommodate* a proposal with missing information:

When in the best interests of the City, as determined by the City in its sole and absolute discretion, the City may request an applicant to promptly clarify or supplement its application

⁷⁴ Exhibit 58.

⁷⁵ *Id.* at 15.

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with additional information, and may defer a decision on accepting or disqualifying the application pending timely receipt thereof.⁷⁶

Given such broad discretion, it is difficult, if not impossible, to find fault in how the City chose to handle alleged documentation gaps in the Kaneohe Elderly proposal.

C. The City's Award in Excess of the Amount Requested by the Proposer Complies with Award Requirements.

The Draft Report asserts at pages 9-10 that "City staff told us that the City decided to fund only one project and awarded the project \$2.9 million, nearly triple the amount requested, due to concerns of meeting timeliness requirements in closing two acquisitions. The project's budgeted cost did not change because of the increased CDBG funding; rather, the project borrowed less than it originally anticipated. The City was motivated to award funds to meet the upcoming timeliness deadline." The Draft Report implies that the only reason for awarding the funds was to meet timeliness requirements.

While complying with the timeliness test is inherently a top priority for any participating CDBG jurisdiction, another reason for awarding the project a larger amount is to increase the project's readiness to proceed. Generally, a project that requires additional unsecured funds is riskier because a delay in receiving those funds will delay the project. This key consideration is accounted for in the City's standard RFP evaluation criteria, under "Readiness to Proceed/Complete Project."⁷⁷

⁷⁶ *Id.*
⁷⁷ *Id.* at 17.

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As noted in Section III.B above, the City conducted a Financial Review for the Kaneohe Elderly project and found that the \$2.853 million award was appropriate to achieve a successful outcome. The Financial Review was forwarded to Local HUD before closing of the transaction, and to HUD Headquarters for its own review of the project; to our knowledge, no disagreement was ever communicated by HUD to the City. As noted in Section III.A above, the City earned a significant return on its larger-than-requested CDBG investment by preserving affordability until the year 2091. Moreover, as noted in Section III.C above, HUD Headquarters required a ten-year use restriction period specifically based on the amount of the CDBG investment in the property. Accordingly, the use restriction period was extended specifically to account for the amount of the CDBG investment and to ensure cost reasonableness. We believe that the review and approval of the acquisition by HUD Headquarters and Local HUD as well as the ten-year use restriction period imposed by HUD and subsequent lease extension to 2091 demonstrate that measures were taken to ensure cost reasonableness and that a demand for repayment is not justified.

VII. THE RISK OF THE CITY UNDERREPORTING PROGRAM INCOME IS VERY LOW, AND POST-DEVELOPMENT MONITORING PROCEDURES EXIST TO REDUCE THE RISK FURTHER.

The Draft Report states at page 10 that, “[b]ecause the City did not review active [open] projects for program income, HUD had no assurance that the City reported all program income.” As an initial matter, we observe that the City’s CDBG projects have a low likelihood of generating any program income, due to the nature of the projects receiving funding – for example, low-income housing, special-needs housing and emergency shelters. For purposes of the Draft Report, OIG

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conducted a review of a single open project for unreported program income, and found that "there was none to report."

Furthermore, projects that have been closed and are within their affordability restriction period have their program income reviewed whenever monitored. The City's Post-Development Monitoring ("PDM") Policies & Procedures state that one objective of PDM is to "[e]nsure that nonprofits repay loans or program income to the City if required."⁷⁸

Notwithstanding the points made above, the City very much appreciates its ongoing positive working relationship with Local HUD, including its suggestions and recommendations to address perceived shortcomings in program income review.

VIII. ALTHOUGH THE CITY HAS MADE STRONG RECENT IMPROVEMENTS IN OPERATING WITHIN ITS PRE-SET GRANT ADMINISTRATION STRUCTURE, IT WILL CONTINUE TO CONSULT WITH LOCAL HUD TO ACHIEVE FURTHER IMPROVEMENTS.

A. The Current Division of Grant Administration Duties Between the DCS and BFS Is Largely Attributable to Previous HUD Monitoring Efforts and Audit Work.

The Draft Report at page 10 states that "[t]he two departments involved with the CDBG program [DCS and BFS] did not function well with each other, and the additional layer of the second department slowed grant administration. For example, some aspects of project implementation, such as environmental compliance, had to be reviewed

⁷⁸ Exhibit 59.

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by both departments and frequently required excessive time.” The current two-department structure of the CDBG program was put in place following (a) a performance audit of the CDBG program in 1984, commissioned by the Finance, Expenditures and Operations Committee of the Honolulu City Council; and (b) a 1984 HUD on-site monitoring of the CDBG program.

The performance audit report (the “**1984 Audit Report**”)⁷⁹ found that the CDBG Branch had a conflict-of-interest situation regarding monitoring performance of participating agencies. At that time, the CDBG branch was located in the former City Department of Housing and Community Development (“**DHCD**”), which received about 50 percent of the City’s CDBG funding. There was a conflict between the monitoring function and the project execution function, because DHCD was responsible for monitoring and seeking correction of its own problems. The auditors recommended that the administration and monitoring functions be moved outside of the department that performed the program activities.⁸⁰

In addition, the HUD 1984 On-Site Monitoring Report (the “**1984 HUD Monitoring Report**”)⁸¹ specifically addressed the location of the CDBG program administration within the City’s organizational structure. The HUD report concluded that “DHCD’s organizational structure, staffing pattern, lines of authority, and weak management systems appear to contribute to its poor CDBG performance.”⁸²

Owing to the recommendations of the 1984 Audit Report and the 1984 HUD Monitoring Report, CDBG program administration is now

⁷⁹ An executive summary of the 1984 Audit Report is attached hereto as [Exhibit 60](#).

⁸⁰ [Exhibit 61](#) (excerpt from 1984 Audit Report).

⁸¹ [Exhibit 62](#).

⁸² *Id.* at 6.

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located in BFS, and the project management functions for human services projects are located in DCS, which is the successor agency to DHCD. Combining the administrative/monitoring and program implementation functions in the same City department could again present a segregation-of-duties issue and result in conflicts of interest that may undermine the effectiveness of the CDBG program.

In addition, the current structure of the CDBG program is consistent with the powers, duties and functions of BFS and DCS as defined by the Revised Charter of the City & County of Honolulu 1973 (2000 ed.), as amended (the “**Charter**”).⁸³ According to the Charter, BFS analyzes plans from a City-wide perspective covering funding for all City functions and agencies.⁸⁴ DCS is responsible for developing and administering human services and related programs.⁸⁵ CDBG monies are multipurpose funds that can be used by the City for any eligible purposes, including construction of public facilities improvements. For example, the City’s Fiscal Year 2017 Action Plan includes a City park project and funding for fire equipment.⁸⁶ These types of projects fall outside of DCS’s duties as defined in the Charter. In such cases, it is appropriate for BFS to handle program administration, due to BFS’s responsibility to analyze, prioritize and allocate funds from a City-wide perspective.

With respect to environmental compliance, dual review by BFS and DCS was a response to a specific HUD monitoring, to ensure compliance with federal environmental requirements. In a November 9, 2012 letter concerning an environmental monitoring for Fiscal Years

⁸³ Exhibit 63, available at http://www.honolulu.gov/rep/site/cor/rch/Online_Charter_v02.25.16.pdf.

⁸⁴ *Id.* at Section 6-203.

⁸⁵ *Id.* at Section 6-302.

⁸⁶ For the Action Plan as approved by the City Council, see Resolution No. 16-76, CD1, FD1, attached hereto as Exhibit 64 and available at <http://www4.honolulu.gov/docushare/dsweb/Get/Document-180303/RES16-076%2c%20CD1%2c%20FD1.pdf>.

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2008-2010,⁸⁷ the City responded in part to HUD's request for stronger documentation of environmental compliance as follows:

All environmental review records (ERR's) will be reviewed by the City staff to ensure that the ERR addresses the federal environmental requirements. ERR documents prepared by consultants, shall be submitted to the Department of Community Services (DCS) for review. The DCS will ensure that each compliance factor has been appropriately addressed, source material being utilized is current, describes existing conditions and is adequately documented. The DCS will also ensure that deficiencies have been addressed and corrected before forwarding to the Department of Budget and Fiscal Services (BFS) for its review and approval and subsequent submittal to HUD.⁸⁸

This dual review process was approved by HUD in 2015.⁸⁹

In some cases, dual review results in recommendations to make changes to a subrecipient's environmental assessment in order to comply with federal requirements and the process of review and discussion with the subrecipient can take considerable additional time, often depending on the ability of the subrecipient to make the changes in a timely manner. Thus, the dual-review process in itself is not necessarily the reason for delays in grant administration. Moreover, the vast majority of CDBG public service projects are designated as Exempt Activities under the National Environmental Protection Act (NEPA) and are not subject

⁸⁷ Exhibit 65.

⁸⁸ Id. at Attachment A, Finding #1, City's Response.

⁸⁹ Exhibit 66 (letter from HUD Region IX Environmental Director to City, dated July 15, 2015).

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to the procedural requirements of an environmental review, and most CDBG-funded public facility projects that do not involve new construction, substantial renovation, or a change in use are "categorically excluded" from NEPA review. Thus, the environmental review procedural requirements that the Draft Report suggests is responsible for the delays in project implementation are applicable only to a small percentage of CDBG-assisted projects.

B. The City Has Developed a Substantial Number of CDBG Policies and Procedures.

The Draft Report at page 11 states in very general terms that "the City's lack of written policies and procedures for the grant program added to the CDBG administration problems," but as far as specific omissions, notes only that DCS "did not have any written policies and procedures for reviewing backup documentation and drawing down subrecipient funds." Please note that the City actually has a wide range of CDBG policies and procedures, as listed below:

Document Title	Date
Capital Improvement Projects (CIP) Supplemental Policies and Procedures ⁹⁰	4/16/2013
CDBG Program Policy and Procedures Manual ⁹¹	2/14/1986
Lead-Based Paint Policy ⁹²	7/2/2009
Loan Conversion Policies and Procedures ⁹³	5/1/2012

⁹⁰ Exhibit 67.

⁹¹ Exhibit 68.

⁹² Exhibit 69.

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Department of Community Services - Monitoring Policies and Procedures ⁹⁴	5/13/2015
National Objective Period Compliance – Revised Policy ⁹⁵	4/22/2014
Policies and Procedures on Subrecipient Documentation Required to Support Salaries and Wages Allocated to CDBG ⁹⁶	4/14/2015
Policy on the Use of Self-Certification of Income Forms by Subrecipient Agencies ⁹⁷	5/14/2014
Post Development Monitoring Policies & Procedures ⁹⁸	undated
Rehabilitation Loan Program Policies and Procedures ⁹⁹	10/9/1990
Tenant Based Rental Assistance (TBRA) Program Policies and Procedures ¹⁰⁰	3/3/2009

⁹³ Exhibit 70.

⁹⁴ Exhibit 71.

⁹⁵ Exhibit 72.

⁹⁶ Exhibit 73.

⁹⁷ Exhibit 74.

⁹⁸ Exhibit 59.

⁹⁹ Exhibit 75.

¹⁰⁰ Exhibit 76.

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The City will gladly reach out to Local HUD to develop the policies and procedures identified in the Draft Report and address any other concerns in this area.

C. The City Is Implementing Multiple Recommendations from a July 2014 NALCAB Assessment.

The Draft Report states on page 11 that “the City had not clearly defined which department was responsible for specific program administration, the directors had equal authority, and there was no clear resolution process.” In July 2014, the City received the “Organizational Assessment of the City’s CDBG Program Administration” (the “**Organizational Assessment**”) from NALCAB, the technical assistance provider assigned to the City by HUD.¹⁰¹ Although the Draft Report makes reference to the Organizational Assessment, what is not made clear is that the City is still in the process of discussing and implementing changes to address issues raised in the Organizational Assessment, including the finding that roles and responsibilities are unclear. Certain functions that are currently shared by both BFS and DCS will be assigned to one department, to reduce overlapping responsibilities and increase efficiency.

In addition to taking heed of NALCAB’s recommendations on project selection, the City has acted on recommendations with respect to timeliness and compliance, in the following areas:

1. Pre-Qualification of Project Proposals in the Selection Process: One of the major impediments to efficient implementation of CDBG projects was that City staff, many of whom had a decade or more of experience in managing CDBG projects, had a limited role in the

¹⁰¹ Exhibit 77.

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project selection process that was left in the hands of the Selection Committee. As a result, City staff were left to implement projects with which they may have had issues and concerns.

Since late 2013, City staff, who had previously summarized proposals and areas of issues or concerns for the Selection Committee, have screened proposals before they are provided to the Selection Committee.¹⁰² Projects that do not meet minimum threshold requirements, including environmental requirements and timely project completion, are not recommended to the Selection Committee for approval.¹⁰³ The City's initial vetting of problematic projects will help reduce the time required for internal monitoring over the long term.

2. Training for Project Selection Review Committee: This year, as shown by the meeting agenda and minutes for the initial Selection Committee meeting,¹⁰⁴ BFS and DCS staff gave the Selection Committee a presentation on CDBG program rules and regulations, including national objective compliance. The importance of picking projects that can spend funds in a timely manner was stressed to the Selection Committee. A list of risks and past problem areas (issues and concerns) was also provided as part of the presentation. In addition, the City's Ethics Commission provided a presentation on conflicts of interest, and answered questions pertaining to the City's Volunteer Agreement.¹⁰⁵

¹⁰² Exhibit 78 (letters transmitted to certain proposers in November 2013, noting that the proposal "was not recommended to the Selection Committee" and stating the primary reason for exclusion.

¹⁰³ Exhibit 79 (CDBG RFP No. 2014-HAHPI, dated September 3, 2013), at 18-19 -- "Initial Screening of Projects."

¹⁰⁴ Exhibits 80 (March 8, 2016 meeting agenda) and 81 (meeting minutes).

¹⁰⁵ Id.

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3. Strategic Funding of Projects: The application included a scoring system which emphasized readiness to proceed in order to avoid projects that were not ready to proceed in a timely manner.¹⁰⁶

The City will continue to review the recommendations from NALCAB and recommendations moving forward from Local HUD, and implement as appropriate.

IX. CONCLUSION.

The foregoing facts establish:

1. The City at all times properly followed CDBG processes in selecting the Hibiscus Hills and Kaneohe Elderly projects.
2. The City at all times kept HUD informed and followed HUD direction and guidance with respect to the Hibiscus Hills and Kaneohe Elderly projects.
3. The Hibiscus Hills and Kaneohe Elderly projects are eligible projects under CDBG criteria.
4. The fact that the Hibiscus Hills and Kaneohe Elderly projects were identified through a process that helped the City to meet timeliness does not negate the propriety of their selection.
5. Hibiscus Hills was selected pursuant to a very public, transparent process that involved a targeted but broad solicitation for proposals, evaluation and scoring based on objective criteria, City Council approval, and HUD approval.

¹⁰⁶ Exhibit 82 (CDBG RFP FY17 excerpt – scoring criteria).

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6. The Hibiscus Hills project secured 50 units of urgently needed low and moderate income housing which would otherwise have likely been sold for condominium conversion.
7. The Kaneohe Elderly project secured 43 units of affordable housing for low- and moderate-income seniors until 2091.
8. The City and HUD specifically ensured that the CDBG investments in the Hibiscus Hills and Kaneohe Elderly projects were well-justified, based not only on the nature of the acquisitions, but also on the City's negotiation of key details such as (a) the number of units that would be CDBG-restricted, and (b) the duration of the affordability restrictions.
9. While OIG might question the judgment exercised in selecting the Hibiscus Hills and Kaneohe Elderly projects, Local HUD's facilitation of the Hibiscus Hills project and its prior review of the Kaneohe Elderly project, as well as HUD Headquarters' prior review of the Kaneohe Elderly project, demonstrate at a minimum that the projects were reasonable.
10. There was no conflict of interest arising from a common affiliation between a subrecipient's contractor and a limited partner of the subrecipient's parent.
11. The City fully and fairly followed its procurement processes in its solicitations for fire trucks and equipment.
12. The City followed its award processes when the Kaneohe Elderly proposal was erroneously but timely delivered to the

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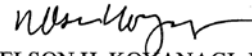
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Department of Community Services, and when the Kaneohe Elderly project was given an amount supported by the City's Financial Review.

As a result, the City maintains that the demand for repayment is not justified and asks that it be deleted from the final audit, along with findings and recommendations that are not supported by the facts discussed in this letter. The City will continue to work with Local HUD on any remaining concerns regarding reporting of program income, and on any additional improvements to improve its internal structure and processes.

Sincerely,



NELSON H. KOYANAGI, JR.
Director of Budget and Fiscal Services



GARY K. NAKATA
Director of Community Services

* Exhibits and attachments available upon request

OIG Evaluation of Auditee Comments

- Comment 1 We do not agree that these items are facts. Our comments below address our specific disagreements with the City's statements.
- Comment 2 We do not fault the City for making reprogramming decisions. Rather, our finding specifically cites noncompliance with program criteria.
- Comment 3 We disagree. The alternative selection process does not provide detailed selection requirements and is, therefore, subjective.
- Comment 4 We disagree. The seller had told us that at the time of the sale, the seller was not considering a conversion to condominiums, the property was not actively listed, and there were no other contending purchasers.
- Comment 5 The City's statement does not address the excessive purchase price. As mentioned in the report, Federal cost principles require that costs be reasonable and necessary. We questioned the reasonableness of paying significantly more than the professionally appraised value of a property, as was the case with Hibiscus Hills.
- Comment 6 We do not disagree that the affordability restrictions were extended. We questioned the necessity of the acquisition, given the extended period before the property would be at risk.
- Comment 7 As detailed in the finding above, the organizational relationships may have affected the integrity of the procurement.
- Comment 8 The issue is compliance with the Federal procurement rules, not the City's.
- Comment 9 We disagree. The City's request for proposal clearly states that the submission deadline was January 28, 2015, at 4:00 p.m. and that "All proposals must be received by the City's Purchasing Division located at: Honolulu Hale [,] 530 South King Street, Room 115[,], Honolulu, Hawaii...Applications that are not received by the submission deadline, as evidenced by a valid Division of Purchasing date and time stamp, will not be considered for funding under this RFP [request for proposal]." Therefore, the City did not act in accordance with its established award requirements when it accepted the proposal received by a department other than the Division of Purchasing.
- Comment 10 In the cases of capital improvement projects or acquisition projects, under the alternative selection process, they do not go through the normal CDBG award process and are not required to have been previously approved through that process. Therefore, in those instances, the typical CDBG award process is bypassed. We have added additional language to the report to clarify that the award process is bypassed in certain cases.

- Comment 11 The recommendations that the City repay funds were not based on the alternative selection process. Rather, we based them on conformance with Federal regulations specifically cited throughout the report.
- Comment 12 The City says that it “started with agencies that had proposed projects that were vetted but not funded, and the small number of well-established nonprofit agencies that had the capacity and experience to consummate and execute large projects.” It also identifies Vitus Group as one of those agencies. However, according to our interviews, at that time, Vitus Group had not proposed a project that was vetted but not funded, and it was not a nonprofit agency.
- Comment 13 Although the City claims that resolution 14-11 reprogrammed funds based on the committee’s ranking, it did not. The Family Justice Center received a much lower score than 11 of the 13 submissions. However, through the resolution, the City awarded the project \$8.5 million. Thus, the City did not base the award on objective criteria equally applied to all proposals. Additionally, the proposal requested only \$6.8 million, \$1.7 million less than awarded.
- Comment 14 The receiving department declined the award because the project had an incomplete environmental assessment and could not meet the CDBG timeliness deadline. Therefore, the City did not identify a project that would meet CDBG objectives while supporting a timely drawdown of funds. This is another example of the problems with the City’s award process. The project had not been effectively vetted by the City before the award.
- Comment 15 Since the letters requesting proposals went out on December 23, 2013, a written response was due December 31, 2013, and proposals were due January 6, 2014, we categorized the process as brief. Adding to the brief number of days to submit a lengthy proposal, such as the 178-page document submitted by Vitus, the proposal period fell over the holiday season. As shown by the items discussed in comments 10 and 13, the process was subjective and did not have many requirements.
- Comment 16 According to the City’s own response, it selected the agencies that could apply for the funding, and it was not open to all.
- Comment 17 We agree. The City pointed out that it received 13 responses. Therefore, we removed our statement that it received few responses.
- Comment 18 We can provide the City and HUD with the specific information upon request.
- Comment 19 A property that is always available for sale “at the right price” is different from an actively marketed property. “The right price” might mean that the price is significantly higher than the market value. In that situation, many owners would likely be willing to sell.

- Comment 20 Offers in the past do not equate to current competing offers. According to both the buyer and the seller, the property was not actively marketed, and there were no competing offers at the time of the purchase agreement.
- Comment 21 The seller had listed the property on the open market in the past. However, he changed his mind and withdrew the listing, deciding to leave it as an affordable housing project. Therefore, if the seller had desired to sell the property, there would be no reason not to relist it. The seller informed us that he was not looking to sell, which corresponds to the fact that the property was not listed.
- Comment 22 We stand by our statement that the property was not actively marketed, which also corresponds to our discussions with the parties involved in the transaction.
- Comment 23 We disagree. Through our interview with the seller, the seller stated that when contacted by Vitus, the property was not for sale and there was no active listing. This statement was confirmed with the buyer. Further, although the seller considered condominium conversions in prior years, it was not considered during the time immediately before the sale.
- Comment 24 The information provided does not support that the excess price difference of \$4.3 million, or 25.5 percent, was reasonable. The regulations partially define reasonableness as whether a prudent person would incur the cost. The item cited by the City in the appraisal alludes only to the motivation of the buyer, not the reasonableness of the price.
- Comment 25 As discussed in the report, the agreed number of designated units had not been met as of July 2015.
- Comment 26 The local HUD office was not aware of all of the facts surrounding the purchase. For example, the staff was unaware that the property was not actively listed. If the staff had been informed of the circumstances, the HUD response may have been different.
- Comment 27 HUD has an open finding from its 2015 fiscal year monitoring that the number of units required has not been met. In a July 2016 letter to the City, regarding the open finding HUD states, “The City needs to ensure that Hibiscus Hill Apartments complies with the CDBG national objective requirements by renting at least 50 of its units to low and moderate income households in accordance with the written agreement.” The documentation provided by the City does not support that the subrecipient met the required occupancy. For example, the documentation shows that in March 2016, only 43 CDBG-designated units were occupied.
- Comment 28 HUD allows assistance to profit entities to acquire property for the purpose of rehabilitation. The profit entity, Vitus, agreed to rehabilitate the Hibiscus Hills property with its own funds of \$1 million. Since it has not done so, it has not complied with the contract. According to HUD, a preliminary determination of

compliance with a national objective may be based on the planned use of the activity. However, the final determination must be based on the actual use of the property. Therefore, since the actual use of the property does not support that the purpose was to rehabilitate according to the agreement, HUD may consider the activity not in compliance with a national objective.

- Comment 29 The amount provided by the City differs from the amount determined through our audit work. As indicated in the finding, the information provided to us during audit fieldwork identifies the rehabilitation costs as \$146,616.
- Comment 30 We do not dispute that the rents were within the allowable range. Our discussion of the increased rents relates to the statements made by the subrecipient before the award in the proposal. The proposal states, “An acquisition of the Hibiscus Hills using CDBG will... insulate the residents from the escalating rental market.” However, the subrecipient did not insulate the residents from escalating rents.
- Comment 31 When we asked the City during audit fieldwork whether it determined that a potential conversion in 13 years justified the cost, it responded, “The City did not do a specific analysis to consider the merits of a conversion.”
- Comment 32 The lease extension related to other financing, not to the CDBG funding. In addition, providing more funding than necessary or requested for an acquisition results in less funding being available for eligible CDBG activities with more immediate needs.
- Comment 33 The documentation provided by the City did not show that the City assessed the amount of CDBG funds for appropriateness. There was no indication that HUD was informed that more funds were provided than had been requested.
- Comment 34 Although the contract date may have been before the audit period, CDBG funds were spent for the contract during the audit period. Our review considered the procurement related to the transactions during the audit period. Therefore, the issues identified were within the audit scope. In addition, although we did not expand our scope in this instance, OIG has the discretion to expand its scope as necessary during the course of an audit.
- Comment 35 While technically HCP-ILP LLC may not have been an owner until March 1, 2012, it had a financial interest in the project before that date as shown by a payoff of a \$360,000 “PreDev Loan” to Hunt Capital Partners cited on the financing documents. Further, before the executed partnership, Vitus entered into a letter of intent. It is clear that the subrecipient knew that HCP-ILP LLC would be the tax credit investor before the partnership was executed. The City approved the contract on May 14, 2012, well after HCP-ILP LLC formally became an owner.

- Comment 36 Although HCP-ILP LLC may have been technically a limited partner, its 99.99 percent ownership and investment of \$9.4 million for the \$12.3 million project indicate that it had a significant financial interest in the project.
- Comment 37 We disagree. A real or apparent organizational conflict of interest may have existed. Further, the procurement documentation does not show that the subrecipient attempted to mitigate a possible conflict of interest. Additionally, the Hunt Building procurement documentation does not agree with other procurement documentation. For example, the bid itself was a lump sum bid of \$3,720,600. However, the contract totaled \$3,394,862. The schedule of values used for payment requests shows an original contract of \$3,394,862 and change order 2 of \$325,738 totaling \$3,720,600. It is unusual that the contract amount would be less than the bid and then that a change order would increase the contract value back to the bid amount. This issue further gives the appearance of a conflict of interest. However, we changed our categorization of the costs from ineligible to unsupported and adjusted the recommendations accordingly.
- Comment 38 We compared the procurement to the Federal criteria required by the CDBG program, not the City's. Regulations at 24 CFR 85.36(b) required that the City use its own procurement procedures, which reflect applicable State and local laws and regulations, provided that the procurements conform to applicable Federal law and the standards identified in this section. Therefore, any City requirements should conform to the Federal requirements.
- Comment 39 Although the City discusses five bid amendments here, two pages later it discusses six. As noted on page 35 of the City's response, there were six bid amendments.
- Comment 40 The City had 7 days between the March 15, 2013, deadline and the March 22, 2013, last date to issue addenda deadline. As the City states, the March 15, 2013, deadline was well past. Therefore, there was no need to remind bidders that "[t]he City shall not accept any further submissions for questions, clarification, or request for substitutions." We asked the City for all related procurement documentation. The City did not indicate that there were requests for clarification or substitution that it received during that time, nor did it provide any such documentation. Therefore, unless it received requests during this timeframe that it did not provide to us, all requests should have been received before March 15, and a reminder based on late submissions would not be necessary.
- Comment 41 The draft report states that the addendum cited that the Smeal products did not meet certain specifications.
- Comment 42 The City's implication that the unchanged March 15, 2013, date should affect our statement that "[it] arbitrarily amended the requests after the allowable date so that it could obligate funds before a certain date" is incorrect. The sole addendum that followed addendum 5 was addendum 6. The arbitrary change of the last addenda issuance date was solely for the City to amend the solicitation via

addendum 6 to say, “Due to the City is required to obligate Federal funds by April 30, 2013, the City is unable to complete any further evaluations and pre-qualify new manufacturers. Prospective bidders and manufacturers may submit complete specifications for evaluation by the City for future solicitations.” Addendum 6 included the response to the Smeal request for clarification purposes. Its sole change to the solicitation was guided by the Federal funds obligation date. However, we changed our categorization of the costs from ineligible to unsupported and adjusted the recommendations accordingly.

- Comment 43 While the Department of Community Services (DCS) claimed it made an error, the responsibility of the submission was solely on the submitter, not DCS. The request for proposal submission guidelines explicitly state, “Agencies must submit their completed application to the Division of Purchasing by Wednesday, January 28, 2015 at 4:00 p.m.” The proposal was late according to the City’s requirements as identified in the request for proposal.
- Comment 44 The City had previously identified the subrecipient as, “...with a proven track record and the organizational capacity to execute a large transaction within a limited time frame...” This seems to conflict with the City’s statement.
- Comment 45 In relation to program income, we amended recommendation 1E to include open CDBG projects and CDBG use restricted projects.
- Comment 46 We cannot speak to the administration issues that existed in 1984 as they are out of our audit scope. However, as detailed in the finding above, the City has significant issues with its current organizational structure. In accordance with recommendation 1F, the City can work with HUD through the audit resolution process to improve its grant administration.
- Comment 47 With its comments to the draft report, the City provided a “CDBG Program Policy and Procedures Manual” with a revision date of 1986. Some City processes do not agree with the manual. Throughout the audit, we repeatedly requested written policies and procedures governing the CDBG activity but were told, “The process works and [are] institutionalized, so it doesn’t need to be written down” and “[the City] does not have written policies and procedures for routine stuff that are largely institutionalized.” We amended the report accordingly.
- Comment 48 We agree that the City has made recent improvements and added a statement to that effect to the report.
- Comment 49 We disagree. We would not categorize the solicitation as broad. Further, since the City could not provide the scoring sheet used for the Hibiscus Hills project, we could not determine whether the score it received was objective and reasonable.

Appendix C

Criteria

24 CFR Part 570, Community Development Block Grants

§570.200, General policies

(a) *Determination of eligibility.* An activity may be assisted in whole or in part with CDBG funds only if all of the following requirements are met:

(5) *Cost principles.* Costs incurred, whether charged on a direct or an indirect basis, must be in conformance with OMB [Office of Management and Budget] Circulars A-87, “Cost Principles for State, Local and Indian Tribal Governments”; A-122, “Cost Principles for Non-profit Organizations”; or A-21, “Cost Principles for Educational Institutions,” as applicable. All items of cost listed in Attachment B of these Circulars that require prior Federal agency approval are allowable without prior approval of HUD to the extent they comply with the general policies and principles stated in Attachment A of such circulars and are otherwise eligible under this subpart C, except for the following:

(f) *Means of carrying out eligible activities.* (1) Activities eligible under this subpart, other than those authorized under §570.204(a), may be undertaken, subject to local law:

(i) By the recipient through:

(A) Its employees, or

(B) Procurement contracts governed by the requirements of 24 CFR 85.36;
or

(ii) Through loans or grants under agreements with subrecipients, as defined at §570.500(c);

§570.501, Responsibility for grant administration

(b) The recipient is responsible for ensuring that CDBG 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...

§570.502, Applicability of uniform administrative requirements

(a) Recipients and subrecipients that are governmental entities (including public agencies) shall comply with the requirements and standards of OMB Circular No. A-87, “Cost Principles for State, Local, and Indian Tribal Governments”; OMB Circular A-128, “Audits of State and Local Governments” (implemented at 24 CFR part 44); and with the following sections of 24 CFR part 85 “Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments” or the related CDBG provision, as specified in this paragraph:

(1) Section 85.3, “Definitions”;

- (4) Section 85.20, “Standards for financial management systems,” except paragraph (a);
 - (6) Section 85.22, “Allowable costs”;
 - (12) Section 85.36, “Procurement,” except paragraph (a);
 - (14) Section 85.40, “Monitoring and reporting program performance,” except paragraphs (b) through (d) and paragraph (f);
- (b) Subrecipients, except subrecipients that are governmental entities, shall comply with the requirements and standards of OMB Circular No. A-122, “Cost Principles for Non-profit Organizations,” or OMB Circular No. A-21, “Cost Principles for Educational Institutions,” as applicable, and OMB Circular A-133, “Audits of Institutions of Higher Education and Other Nonprofit Institutions” (as set forth in 24 CFR part 45). Audits shall be conducted annually. Such subrecipients shall also comply with the following provisions of the Uniform Administrative requirements of OMB Circular A-110 (implemented at 24 CFR part 84, “Uniform Administrative Requirements for Grants and Agreements With Institutions of Higher Education, Hospitals and Other Non-Profit Organizations”) or the related CDBG provision, as specified in this paragraph:
- (1) Subpart A—“General”;
 - (2) Subpart B—“Pre-Award Requirements,” except for §84.12, “Forms for Applying for Federal Assistance”;
 - (3) Subpart C—“Post-Award Requirements,” except for:
 - (iii) Section 84.24, “Program Income.” In lieu of §84.24, CDBG subrecipients shall follow §570.504;

§570.504, Program income

- (a) *Recording program income.* The receipt and expenditure of program income as defined in §570.500(a) shall be recorded as part of the financial transactions of the grant program.
- (b) *Disposition of program income received by recipients.* (1) Program income received before grant closeout may be retained by the recipient if the income is treated as additional CDBG funds subject to all applicable requirements governing the use of CDBG funds.

§ 570.902, Review to determine if CDBG-funded activities are being carried out in a timely manner

HUD will review the performance of each entitlement, HUD-administered small cities, and Insular Areas recipient to determine whether each recipient is carrying out its CDBG-assisted activities in a timely manner.

- (a) Entitlement recipients and Non-entitlement CDBG grantees in Hawaii. (1) Before the funding of the next annual grant and absent contrary evidence satisfactory to HUD, HUD will consider an entitlement recipient or a non-entitlement CDBG grantee in Hawaii to be failing to carry out its CDBG activities in a timely manner if:
 - (i) Sixty days prior to the end of the grantee’s current program year, the amount of entitlement grant funds available to the recipient under grant agreements but undisbursed by the U.S. Treasury is more than 1.5 times the entitlement grant amount for its current program year; and

- (ii) The grantee fails to demonstrate to HUD's satisfaction that the lack of timeliness has resulted from factors beyond the grantee's reasonable control.

2 CFR Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards

§200.403, Factors affecting allowability of costs

Except where otherwise authorized by statute, costs must meet the following general criteria in order to be allowable under Federal awards:

- (a) Be necessary and reasonable for the performance of the Federal award and be allocable thereto under these principles.
- (g) Be adequately documented.

§200.404, Reasonable costs

A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. The question of reasonableness is particularly important when the non-Federal entity is predominantly federally-funded. In determining reasonableness of a given cost, consideration must be given to:

- (a) Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the non-Federal entity or the proper and efficient performance of the Federal award.
- (b) The restraints or requirements imposed by such factors as: sound business practices; arm's length bargaining; Federal, state and other laws and regulations; and terms and conditions of the Federal award.
- (c) Market prices for comparable goods or services for the geographic area.
- (d) Whether the individuals concerned acted with prudence in the circumstances considering their responsibilities to the non-Federal entity, its employees, where applicable its students or membership, the public at large, and the Federal government.
- (e) Whether the non-Federal entity significantly deviates from its established practices and policies regarding the incurrence of costs, which may unjustifiably increase the Federal award's cost.

24 CFR Part 84, Uniform Administrative Requirements for Grants and Agreements With Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations

§84.42, Codes of conduct

No employee, officer, or agent shall participate in the selection, award, or administration of a contract supported by Federal funds if a real or apparent conflict of interest would be involved. Such a conflict would arise when the employee, officer, or agent, any member of his or her immediate family, his or her partner, or an organization which employs or is about to employ any of the parties indicated herein, has a financial or other interest in the firm selected for an award.

§84.43, Competition

All procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition. The recipient shall be alert to organizational conflicts of interest as well as noncompetitive practices among contractors that may restrict or eliminate competition or otherwise restrain trade.

24 CFR Part 85, Administrative Requirements for Grants and Cooperative Agreements to State, Local and Federally Recognized Indian Tribal Governments

§85.20, Standards for financial management systems

(a) A State must expand and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contractors, must be sufficient to—

(b) The financial management systems of other grantees and subgrantees must meet the following standards:

(1) *Financial reporting.* Accurate, current, and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant or subgrant.

(2) *Accounting records.* Grantees and subgrantees must maintain records which adequately identify the source and application of funds provided for financially-assisted activities. These records must contain information pertaining to grant or subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income.

(3) *Internal control.* Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes.

§85.36, Procurement

(b) *Procurement standards.* (1) Grantees and subgrantees will use their own procurement procedures which reflect applicable State and local laws and regulations, provided that the procurements conform to applicable Federal law and the standards identified in this section.

(c) *Competition.* (1) All procurement transactions will be conducted in a manner providing full and open competition consistent with the standards of §85.36. Some of the situations considered to be restrictive of competition include but are not limited to:

(i) Placing unreasonable requirements on firms in order for them to qualify to do business,

(iii) Noncompetitive pricing practices between firms or between affiliated companies,

(v) Organizational conflicts of interest,

(vii) Any arbitrary action in the procurement process.

(f) *Contract cost and price.* (1) Grantees and subgrantees must perform a cost or price analysis in connection with every procurement action including contract modifications.

HUD's CDBG Guide to National Objectives & Eligible Activities for Entitlement Communities

Complying with National Objectives – Acquisition of Real Property

A preliminary determination of compliance may be based on the planned use. The final determination must be based on the actual use of the property, excluding any short-term, temporary use.

Rehabilitation

Eligible Activities - CDBG funds may be used to finance the costs of rehabilitation as shown below.

Eligible types of assistance

Property acquisition—Assistance to private individuals and entities (whether profit or not-for-profit) to acquire for the purpose of rehabilitation and to rehabilitate properties *for use or resale for residential purposes*.