



Issue Date March 06, 2009

Audit Report Number 2009-NY-1009

TO: Vincent Hom, Director, Community Planning and Development, 2AD

FROM: *Edgar Moore*
Edgar Moore, Regional Inspector General for Audit, 2AGA

SUBJECT: The City of Yonkers, New York, Had Weaknesses in the Administration of its Section 108 Loan Guarantee Program

HIGHLIGHTS

What We Audited and Why

We audited the City of Yonkers, New York's (the City) administration of its Section 108 Loan Guarantee program. We selected the City based upon a risk assessment of Section 108 loan recipients monitored by the U.S. Department of Housing and Urban Development (HUD) New York City Office of Community Planning and Development, and discussion with that office's director, who raised concerns about the City's program. The objectives of our audit were to determine whether the City (1) disbursed Section 108 loan program funds for eligible costs in accordance with applicable HUD rules and regulations, and (2) maintained a financial management system that adequately safeguarded funds and prevented misuse.

What We Found

The City disbursed program funds for Section 108 loan program eligible activities in accordance with HUD rules and regulations, and maintained a financial management system that adequately safeguarded funds. However, there were weaknesses in controls over the administration of the program that resulted in inadequate monitoring and reporting to HUD. Specifically, the City did not (1) adequately document data on compliance with the job creation and retention provisions of borrower loan agreements, (2) consistently monitor and report on

the use of loan proceeds, (3) properly maintain its loan repayment account, and (4) notify HUD when loan collateral was changed or loans defaulted. These deficiencies occurred because City officials were unaware of program requirements. As a result, the City lacked assurance that loan job creation and retention goals were achieved, loan disbursements were used for eligible purposes, and loan repayments would be sufficient to meet the City's future loan repayment obligations. In addition, HUD was not made aware of changes to loan collateral and defaulted loans, which could have affected its financial interest.

What We Recommend

We recommend that the director of HUD's New York Office of Community Planning and Development instruct the City to strengthen its controls to (1) monitor and verify loan recipients' compliance with job creation and retention requirements, (2) obtain and review borrower documentation for expenditure of loan proceeds to ensure loan proceeds are used for eligible purposes, (3) properly maintain loan repayment records, and (4) report changes in loan collateral and defaults to HUD.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We discussed the results of our review during the audit and at an exit conference held on February 20, 2009. We provided a copy of the draft report to City officials and requested their written comments by February 26, 2009, which we received on that date. City officials generally agreed with our findings and agreed to implement action responsive to the recommendations. The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

The Section 108 Loan Guarantee program is the loan guarantee provision of the Community Development Block Grant (CDBG) program. Section 108 loans provide a source of financing to cities and counties for economic development, housing rehabilitation, public facilities, and large-scale physical development projects. The principal security for the loan guarantee is a pledge by the grantee of current and future CDBG funds. Additional security can be required to assure repayment of guaranteed obligations, and is determined on a case-by-case basis and can include assets financed by the guaranteed loan. Section 108 loans may be for terms up to 20 years.

CDBG rules and requirements apply when determining project eligibility. All projects and activities must meet the CDBG primary objective that 70 percent of the funds used benefit low and moderate-income persons, as well as one of the following three national objectives: (a) principally benefit low- and moderate-income persons, (b) assist in eliminating or preventing slums and blight, or (c) assist with community development needs having a particular urgency.

The City of Yonkers' (the City), a CDBG entitlement recipient, established its Section 108 Loan Guarantee Program in 1996 in accordance with the CDBG objective to principally benefit low and moderate income persons through job creation and retention. The City established a five member loan committee consisting of the Commissioner of Finance, Commissioner of Planning and Development, Director of Economic Development, City Council Majority Leader, and City Council Minority Leader, to review and approve loan applications. The Office of Economic Development administers the City's Section 108 Program. This Office recently experienced staff turnover; consequently both the director and the loan manager have occupied their positions for less than two years and one year, respectively. The files and records related to the program are maintained in City Hall, located at 40 South Broadway, Yonkers, New York.

The Office of Economic Development administers both direct loans and loans from its economic development loan pool. To obtain HUD approval for a direct loan, the City submits an application containing information regarding a specific proposal for funding, including financial data related to the developer, project site, and discussion of how the proposed project meets national objectives and public benefit. The application is reviewed at both the HUD field and headquarters offices. To gain approval to use loan funds from the economic development loan pool, the City submits an abbreviated application to the HUD field office notifying HUD of the loan guarantee amount requested, along with program guidelines, such as maximum or minimum loan size, and how each project to be funded will be assessed for eligibility, national objectives, and public benefit. During the audit period from January 1, 2005 through December 31, 2007 the City awarded almost \$23 million in section 108 loan guarantee funds for 24 loans, 5 of which were direct loans and 19 were from the loan pool. Twelve of the 24 loans are current (see appendix A for the status of each loan).

We audited the City's Section 108 Loan Guarantee Program based upon a risk assessment of Section 108 Loan Guarantee Program recipients monitored by HUD's New York City Office of Community Planning and Development, and discussion with the field office director, who expressed concern about the City's program. The objectives of our audit were to determine whether the City (1) disbursed Section 108 loan program funds for eligible costs in accordance

with the applicable HUD rules and regulations, and (2) maintained a financial management system that adequately safeguarded funds and prevented misuse.

RESULTS OF AUDIT

Finding: The City had Weaknesses in the Administration of its Section 108 Loan Guarantee Program

Although, the City disbursed funds for eligible activities under the Section 108 Loan Guarantee Program, it had weaknesses in controls over the administration of its program that resulted in inadequate monitoring and reporting to HUD. Specifically, the City did not (1) adequately document data on compliance with the job creation and retention provisions of borrower loan agreements, (2) consistently monitor and report on the use of loan proceeds, (3) properly maintain its loan repayment account, and (4) notify HUD when loan collateral was sold or loans defaulted. These deficiencies occurred because City officials were unaware of program requirements. As a result, the City lacked assurance that loan job creation and retention goals were achieved, loan disbursements were used for eligible purposes, and loan repayments would be sufficient to meet future obligations. In addition, HUD was not made aware of changes to loan collateral and defaulted loans.

Inadequate data on jobs created

While a primary purpose of the City's Section 108 Loan Program is to create jobs, the City did not establish adequate procedures to obtain and verify documentation that loan recipients were complying with loan job creation and retention provisions. Regulations at 24 CFR (*Code of Federal Regulations*) 570.506(b) require that the City maintain records to demonstrate compliance with CDBG job creation and retention requirements. Regulations at 24 CFR (*Code of Federal Regulations*), Section 570.506(b)(5)(i) and Section 570.506 (b)(5)(ii) specify that when an activity is determined to benefit low and moderate income persons, documentation should include a written commitment from the business indicating that low and moderate income persons received first consideration for the jobs.

In July 2007 the HUD field office advised the City that its documentation to support the number of jobs created and retained in its Section 108 loan program was inadequate. At that time, the City had not implemented procedures to collect data from loan recipients on the number of jobs created and retained. As a result of HUD's observation, the City developed a form for loan recipients to report annually on the number of jobs created and retained. However, the data collected was inadequate because it did not distinguish between jobs created and retained, nor specify the various income levels of those individuals that benefitted from the jobs as required. Further, the City had not yet responded to HUD's August 6, 2008 letter requesting that the City review documentation for all Section 108 funded projects to determine the number of jobs created and retained. City records reported that the 24 loans administered by the City created and retained 209 of a planned 1,915 jobs; however, this data was not verified by the City.

Inadequate monitoring and reporting on the use of loan proceeds

The City had weaknesses in the monitoring and reporting of the status of loans. First, the City did not consistently obtain and review documentation on the use of loan proceeds. Regulations at 24 CFR (*Code of Federal Regulations*) part 570.506 (h) provide that the City maintain documentation to support how the funds provided to an entity are expended. Review of each of the loan files for the 24 loans administered by the City disclosed that ten loan files did not have invoices, contracts or other supporting documentation to show how the loan proceeds were disbursed, and one loan file could not be found. The deficiency occurred because the City was unaware of the requirement to obtain and maintain such documentation. Without this documentation, the City cannot be assured that the loan proceeds were used for their intended purpose.

Second, the City did not routinely conduct site visits as required by its procedures. The City's Section 108 Policy and Procedures Manual, Section VIII, C 2 provides that a site visit to loan recipients be conducted at least annually. These visits are considered essential in checking levels of inventory or work-in-progress, observing work completed, and interviewing the borrower. Review of 24 loan files disclosed that two annual site visits were conducted prior to the start of our review. However, after the start of our review, between June 2008 and October 2008, the City completed site visits for 8 of the 12 current loans. City officials said that they will conduct site visits as required by section VIII, C2 of its policies and procedures.

Third, the City did not provide its loan committee with reports on the status of its loans. The City's Section 108 Policy and Procedures Manual, Section II, C 11, requires that the City report quarterly to the loan committee on the status and impact of the projects approved for Section 108 loans. However, the loan files lacked documentation that quarterly reports were prepared and provided. As a result, the loan committee is unaware of the status of the loans it approved. Further, while a City official advised that loan write-offs be approved by the loan committee, documentation of such approval was lacking for three loans that were written off. Also, one loan, which defaulted in 2002, had not been sent to the loan committee for approval to write-off its remaining balance. A city official said that approval to write off the loan would be on the agenda for the next loan committee meeting. This official further said that the loan committee meets on an as needed basis; however, the committee has not met since November 2006.

Fourth, regulations at 24 CFR (*Code of Federal Regulations*) part 570.506 provide that sufficient records be maintained to enable the secretary to determine whether the recipient has met the requirements of this part. However, the City did not maintain adequate Section 108 loan program records. In its July 2007 monitoring review HUD cited the City for having disorganized files, and as of the end of our field work, the City had not responded to HUD's August 6, 2008 letter, for which a response was due within 45 days, requesting that it confirm that its

loan files were reorganized. During our review, the City began to more efficiently organize its files; however, one file could not be found and officials had to contact the City's consultant and attorney for information about the loan.

Loan repayment account not properly maintained

Paragraph 6 of the contract between the City and HUD for loan guarantee assistance from the economic development loan pool and from each direct loan provides that the City should maintain a repayment account for each direct loan and one account for all economic development loan pool loans. All borrower repayments should be deposited into these accounts and funds for direct and economic loan pool loans should be maintained separately to ensure that there are sufficient funds to repay all obligations to HUD. However, the City maintained one repayment account into which all borrower payments were commingled. As a result, the City could not individually account for each economic development loan pool and direct loan in the repayment account. This occurred because the City was unaware of the requirement to maintain separate accounts. Without such an accounting, the City lacks assurance that funds from one direct loan are not being used to pay obligations on another direct or loan pool loan. For instance, during our audit period, the City paid HUD \$274,248 from this account to meet obligations due on a direct loan; however the borrower had made no payments to the City. In addition, the City received \$384,930 as a settlement on two loans that defaulted, for which the City will ultimately have to pay the full amount. Therefore, funds may be inadequate to meet the City's future repayment obligation on each of these loans, and the City may need to use its CDBG or other sources of funds.

HUD not notified of collateral changes and defaults

The City did not inform HUD when collateral on two loans was changed. Regulations at 24 CFR (*Code of Federal Regulations*) 570.705(b) (3) require that any additional security pledged on a loan be identified in the loan guarantee assistance contract between HUD and the City. However, the City did not notify HUD when it sold property that was pledged as collateral for a loan to a new borrower. Additionally, section 15 (c) (D) of the contract for loan guarantee assistance between HUD and the City requires that HUD approve any alternative collateral or security arrangements implemented after loan approval. Contrary to this, the City allowed a borrower on a loan executed through the loan pool to substitute a pledge of common stock in place of the previously approved collateral of a security interest in the property, and a mortgage on a vacant waterfront parcel, without notifying HUD. This occurred because the City lacked controls to ensure that HUD was notified. As a result, HUD was unaware of the change in collateral and was unable to evaluate whether its interest was adequately protected.

In addition, Section 15 (e) of the contract for loan guarantee assistance between the City and HUD requires the City to promptly notify HUD in writing whenever an event occurs which constitutes a default under any of the security documents pertaining to a business loan. However, the City did not notify HUD as required when any of its eight loans defaulted. This occurred because the City was unaware of the requirement to notify HUD. As a result, HUD was unaware of the defaults and could not assess the extent to which its interest may have been harmed.

Conclusion

The City generally disbursed Section 108 loan program funds for program intended activity in accordance with HUD rules and regulations, and maintained a financial management system that adequately safeguarded funds; however, the City had weaknesses in controls over administration of the program. Strengthening these controls would provide greater assurance that loan job creation and retention provisions are being achieved, loan disbursements are used for eligible purposes, loan repayments would be sufficient to meet its obligations, and HUD is made aware of changes to loan collateral and defaulted loans. These weaknesses are attributed to the City being unaware of the program regulations.

Recommendations

We recommend that the director of HUD's New York Office of Community Planning and Development instruct the City of Yonkers to strengthen controls by developing procedures to:

- 1A. Require loan recipients to report on, and provide supporting documentation to verify, the number of jobs created and retained by income level for each loan awarded.
- 1B. Consistently obtain and review documentation on the use of loan proceeds to ensure that loan recipients are using loan funds for eligible purposes.
- 1C. Ensure compliance with its own procedures that require quarterly reports to the City's loan committee so that the committee is aware of the status of loans outstanding.
- 1D. Ensure that documentation is maintained to support the approval and write-off of loan balances.
- 1E. Establish and maintain adequate loan files and records, and provide assurance to HUD that the issues in its August 6, 2008 letter to the City regarding loan files and job creation documentation were properly addressed.

- 1F. Maintain separate bank accounts for each direct loan and one account for the loan pool as required to ensure that borrower repayments are appropriately accounted for and safeguarded.
- 1G. Report any sales or changes in loan collateral, as well as any loan defaults, to HUD as required so that HUD can be aware of conditions affecting its interest in the loans.

SCOPE AND METHODOLOGY

We performed our audit work from April 2008 through November 2008 at the City's Office of Economic Development located at 40 South Broadway, Yonkers, New York. The review covered the period January 1, 2005 through December 31, 2007, and was extended as necessary. To accomplish our objectives, we

- Reviewed HUD regulations at 24 CFR 570 Sub part M to gain an understanding of the Section 108 Loan Guaranteed Program history, objectives, and policies and procedures.
- Reviewed the City's Section 108 Loan Guaranteed Program policies and procedures, consolidated plan, and independent auditor's report for fiscal year ended 2007, to determine compliance with HUD regulations.
- Interviewed officials from the City's Office of Economic Development, Finance Department, and the City's consultant for the Section 108 program.
- Reconciled loans recorded on the City's records with that of HUD to ensure the City's record of loans matched HUD's records.
- Reviewed files for each of the 24 loans the City administered during our audit period to document the basis upon which loans were approved, assess the effectiveness of the City's monitoring of loan activity, and compliance with HUD regulations and its own procedures.
- Reviewed bank statements, bank reconciliations, and general ledgers related to the City's section 108 loan program, to ensure that the City's bank balance reconciled with the City's general ledger balance.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following controls are achieved:

- Program operations,
- Relevance and reliability of information,
- Compliance with applicable laws and regulations, and
- Safeguarding of assets and resources.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. They include the processes and procedures for planning, organizing, directing, and controlling program operations, as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objectives:

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

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weaknesses

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

- The City did not have adequate controls over the validity and reliability of data when its officials did not collect information and documents to verify jobs created and retained, the income levels of those that benefitted from the jobs, and documentation to substantiate the use of loan proceeds (See finding).
- The City did not have adequate controls over compliance with laws and regulations when loan files and records were not adequately maintained, HUD approval for the substitution of collateral on two Section 108 loans was not requested, and bank accounts were not maintained as required (See finding).

APPENDIXES

Appendix A

Section 108 Loans Administered by the City

Loan	Loan Type <u>1/</u>	HUD Approval Date	Loan Amount	Project	Current Status	Jobs to be created and retained	Jobs reported	Job Goals Met
1	D	5/29/2001	\$1,000,000	Purchase equipment	Current	45	52	Yes
2	D	7/18/2002	\$3,000,000	Construct a Plaza	Current	115	4	No
3	D	9/27/2001	\$3,000,000	Renovate a building	Paid In Full	N/A	N/A	N/A
4	D	3/3/2004	\$3,000,000	Additional funds for loan 3	Current	250	60	No
5	D	8/17/2007	\$950,000	Develop restaurant and ferry landing	Current	45	0	N/A <u>2/</u>
6	LP	2/16/1999	\$800,000	Acquire land for a technology facility	Current	580	14	No
7	LP	7/17/2000	\$125,000	Expand restaurant	Current	10	8	No
8	LP	5/31/2000	\$105,000	Purchase equipment	Current	3	6	Yes
9	LP	5/22/2000	\$130,000	Construct an office	Current	4	4	Yes
10	LP	6/8/2000	\$265,000	Acquire a building	Current	14	2	No
11	LP	3/28/2002	\$700,000	Purchase equipment	Current	20	18	No
12	LP	5/25/1999	\$2,850,000	Develop a restaurant and office space	Current	65	28	No
13	LP	4/1/2000	\$250,000	Additional funds for loan 12	Current	N/A	N/A	N/A
14	LP	7/25/1997	\$200,000	Purchase current premises	Paid In Full	11	12	Yes
15	LP	4/3/2001	\$112,500	Buy out partners	Paid In Full	3	0	No
16	LP	10/1/1996	\$375,000	Expand business	Default Settled(\$284,930)	30	0	No
17	LP	4/1/1997	\$180,000	Expand business	Default-Settled(\$100,000)	9	0	No
18	LP	12/12/1997	\$99,000	Purchase equipment	Default (unpaid \$72,000)	5	0	No
19	LP	4/28/03	\$950,000	Acquire a building and land	Default-Paid In Full	19	0	No
20	LP	2/1/2002	\$165,000	Purchase inventory and equipment	Default-unpaid (\$165,000)	90	0	No
21	LP	11/1/2000	\$3,400,000	Acquire property	Paid In Full	520	1	No
22	LP	8/10/2001	\$800,000	Acquire property	Default-in court	100	0	No
23	LP	6/11/1998	\$270,000	Purchase equipment	Default-in collection	14	0	No
24	LP	4/22/2002	\$250,000	Acquire additional inventory	Default-in collection	8	0	No
	Total		\$22,976,500			1,915	209	

1/ D= direct loan; LP= loan pool loan

2/ Timeframe to create jobs has not expired; goal is not included in the 1,915 total

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

PHILIP A. AMICONE
MAYOR

LOUIS C. KIRVEN III
COMMISSIONER



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DEPARTMENT OF PLANNING AND DEVELOPMENT
CITY OF YONKERS

February 26, 2009

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

Reference: *The City of Yonkers Section 108 Loan Guarantee
Program Auditing Responses*

Dear Mr. Moore:

I would like to take this opportunity to thank you and your Assistant Inspector, Mr. John Harrison along with his staff and the staff from HUD's regional field office for the very thorough exit conference of the findings development during the review of the City of Yonkers administration of its Section 108 Loan Guarantee Program.

This completed review has given us the opportunity to improve and incorporate some positive enhancements to our operations and no doubt will improve the effectiveness of this vital program. As you know, the HUD 108 Loan Program has been instrumental in the many successful efforts to revitalize Yonkers over the past 13 years. The 108 Loan Program has assisted in bringing new development, business, residents and jobs to our downtown. We have created new residential opportunities along our waterfront and re-opened it to the community for the first time in decades and allowed us to be presently building one of the largest mixed use developments in the country.

Attached you will find our responses to the findings and we do look forward to working with our regional HUD office staff to improve and enhance the overall administration of our Section 108 Loan Guarantee Program.

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

If you have any questions or comments regarding our responses please do not hesitate to contact, Helen Tvedt at (914)377-6156.

Sincerely,



Louis C. Kirven III

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

The City of Yonkers
Department of Planning and Development
Response to HUD's OIG Drafted Audit Report #2009-NY-10XX
February 26, 2009

1) Inadequate data on jobs created

Comment 1

The City will establish adequate procedures to obtain and verify documentation that loan recipients are complying with loan job creation and retention provisions. The City is working with our local Workforce Investment Board (WIB) to put into action a First Consideration Agreement. This type of procedure, once implemented with our borrowers, will enable us to collect verifiable job creation and retention statistics. This recommended procedure will be presented to the Loan Committee and upon their approval the City hopes to have it in place in 2009.

Comment 2

The City did respond by telephone to HUD's August 6, 2008 correspondence and as requested all 108 projects were reviewed and City staff verbally briefed William Miccuna.

2) Inadequate monitoring and reporting on the use of loan proceeds

Comment 1

The City will strengthen monitoring and reporting of the status of loans. The City will ensure that going forward all loan proceed documentation are obtained and maintained.

Comment 3

The City will ensure that routine site visits are conducted going forward. One clarification, however, in your February 4, 2009 correspondence noted that the City completed site visits for four out of twelve current loans. This information was not accurate and the program manager provided proof to the auditor that she did conduct ten site visits out of fourteen of the city's current loans. The four site visits that were not conducted were four loans currently in default. Two of those borrowers have gone out of business and the other two are loans under review by our Law Department.

Comment 4

The City does provide its loan committee with a status update on its loans during committee meetings. The City will hold a loan committee meeting before the end of the 1st quarter of 2009.

Comment 1

The City will ensure that sufficient records are maintained to ensure that program requirements are met. The City's 108 Files have been re-organized and this fact was communicated to HUD staff in response to the HUD's July 2007 monitoring review.

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

Comment 1

3) Loan repayment account not properly maintained

The City will implement a procedure to maintain a repayment account for each direct loan and one account for all economic development loan pool loans.

Comment 1

4) HUD was not notified of collateral changes and defaults

The City will put into its Policies and Procedure Manual the requirement to notify HUD when collateral changes have been requested by the borrower. The City will also update its Manual to require notification to HUD of any Section 108 loans that default.

OIG Evaluation of Auditee Comments

- Comment 1** The actions of City officials are responsive to our audit recommendations.
- Comment 2** HUD's correspondence requested a response within 45 days and support for the number of jobs reported as created and retained. There was no documentation that such a response and documentation was provided and at the exit conference HUD officials did not acknowledge a telephone response.
- Comment 3** City officials agreed with the recommendation, but noted that 10 site visits had been completed. Accordingly, since two site visits were prior to the start of our field work the report has been changed to reflect that 8 site visits were completed after the start of our review.
- Comment 4** The City's procedures provide that the loan committee be provided quarterly loan status reports. City officials stated that a loan status update is provided at loan committee meetings, however, the committee has not met since November 2006 and there was no evidence that status reports were provided to the committee since that time.