



Issue Date January 20, 2010

Audit Report Number 2010-BO-1004

TO: Gary Reisine, Director Community Planning and Development, 1ED

FROM: 
John Dvorak, Regional Inspector General for Audit, Boston Region, 1AGA

SUBJECT: The City of Waterbury, Connecticut's Subrecipient, Waterbury Development Corporation, Needs to Improve Its Capacity to Effectively Administer Its Neighborhood Stabilization Program

HIGHLIGHTS

What We Audited and Why

In accordance with our goal to review and ensure the proper administration of Neighborhood Stabilization Program (NSP) funds provided under the Housing and Economic Recovery Act of 2008 (HERA) and the American Recovery and Reinvestment Act of 2009 (Recovery Act), we conducted a capacity review of the City of Waterbury's (subgrantee), Waterbury Development Corporation's, operations (subrecipient), who has responsibility for administering the City's NSP program. The City of Waterbury is a subgrantee of the State of Connecticut, Department of Economic and Community Development (grantee). Our objective was to determine whether the subrecipient had sufficient capacity to adequately administer the subgrantee's NSP funds.

What We Found

Our review found that the subrecipient needs to improve its capacity to effectively administer NSP funds provided through the HERA. We found that the

subrecipient 1) staffing was inadequate, 2) had an inadequate selection process for approving NSP applicants, 3) may have delays in completing projects, 4) had inadequate support for the scope of work developed for two projects, 5) had an inadequate procurement process, 6) will not meet performance goals for its rehabilitation activities, and 7) did not properly charge NSP expenses to the program. As a result, the subrecipient may not meet program requirements and its goals for the NSP.

What We Recommend

We recommend that the Hartford Connecticut Director of HUD's Office of Community Planning and Development require the grantee to ensure the subgrantee/subrecipient 1) implements adequate policies, procedures, and controls to ensure that NSP funds are used effectively and efficiently, and in accordance with applicable requirements, 2) hires additional staff, as needed, to assist in administrating the NSP to ensure that the subrecipient has sufficient capacity to effectively and efficiently administer program funds, 3) strengthens its procurement controls to ensure that they are following the subgrantee's policies and Federal policies when procuring services, 4) submits an amendment to its NSP local action plan reducing the number of units to be completed for its acquisition and rehabilitation activities. and 5) requests comments from the Connecticut State Historical Preservation Office for properties approved for NSP rehabilitation funding that are not in accordance with the Secretary of the Interior's Rehabilitation Standards and Guidelines.

We also recommend that the Hartford Connecticut Director of HUD's Office of Community Planning and Development 1) perform additional monitoring, and provide technical assistance to the subrecipient, as needed, to ensure that the subrecipient properly administers the NSP funding in accordance with federal requirements, and 2) review salaries charged by staff to determine whether costs were properly charged to HUD programs and require the subrecipient to make adjustments to its direct and indirect expenses as necessary.

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 provided the subrecipient the draft report on December 30, 2009, and held an exit conference on January 5, 2010. The subrecipient generally disagreed with our findings and recommendations.

We received the subrecipient's response on January 12, 2010. The complete text of the subrecipient's response, along with our evaluation of that response, can be found in appendix B of this report. In addition, we received comments from HUD program staff on January 11, 2010, for us to consider. HUD's comments, along with our evaluation of their comments, can be found in appendix C of this report.

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BACKGROUND AND OBJECTIVES

The NSP was established for the purpose of stabilizing communities that have suffered from foreclosures and abandonment. NSP-1, a term that references the NSP funds authorized under Division B, Title III of the Housing and Economic Recovery Act (HERA) of 2008, provides grants to all states and selected local governments on a formula basis. NSP-2, a term that references the NSP funds authorized under the American Recovery and Reinvestment Act (Recovery Act) of 2009, provides grants to states, local governments, nonprofits and a consortium of nonprofit entities on a competitive basis.

The Waterbury Development Corporation (subrecipient) is the City of Waterbury's (subgrantee) official economic and community development entity. The subrecipient is a 501(c)(3) non-stock corporation, organized and incorporated under the laws of Connecticut. The subrecipient was founded in May 2004, as a partnership of the public and private sectors to help the subgrantee, its businesses, and its residents revitalize their city, stimulate and support economic development, promote investment in education, rehabilitate and maintain the subgrantee's housing stock, eliminate urban blight and decay, and improve the overall quality of life.

The business and financial affairs of the subrecipient are managed by a 25-member Board of Directors, which consists of appointed volunteers from the government, neighborhood and business communities. The Board is responsible for electing from its own members an Executive Committee to supervise and manage the day-to-day activities of the subrecipient. Other committees elected by the Board of Directors are the Loan, Permitting, Transportation, downtown and Business Growth Committees.

The subrecipient has responsibility for oversight of \$8,456,458, of which \$3,486,000 is NSP-1 under HERA.¹

The following is a list of fiscal year 2009 HUD grant programs the subrecipient plans to administer:

Program	HUD Funding
Neighborhood Stabilization Fund (NSP-1)	\$3,486,000
Community Development Block Grant (CDBG)	\$2,282,284
HOME	\$1,048,678
Homelessness Prevention & Rapid Re-Housing Program (HPRP)	\$931,128
Emergency Shelter Grant (ESG)	\$99,820
Community Development Block Grant - Recovery (CDBG-R)	\$608,548
Total	\$8,456,458

¹ NSP-1 grant agreement between HUD and the grantee was issued in March 9, 2009. The grantee and subgrantee entered into an agreement on June 1, 2009. The subgrantee and subrecipient entered into an agreement for administration of NSP-1 funds on May 14, 2009.

The subgrantee/subrecipient proposed to use the NSP funds for the full range of allowable activities, with exception of establishing land banks. The following is a breakdown of the activities the subgrantee planned to fund with NSP-1 funds:

- Establish financing mechanisms for purchase and redevelopment of foreclosed upon homes and residential properties, including such mechanisms as soft-second and shared-equity loans for low-, moderate- and middle-income (LMMI) homebuyers – \$1,220,000 (35%);
- Purchase and rehabilitate homes and residential properties that have been abandoned or foreclosed upon, in order to sell, rent or redevelop such homes and properties – \$1,500,000 (43%);
- Demolish blighted structures – \$500,000 (15%);
- Redevelop demolished or vacant properties – \$100,000 (3%); and
- Administration - \$166,000 (per Grantee allocation)
- Total NSP - \$3,486,000

Our objective was to determine whether the subrecipient had the necessary capacity to adequately administer the subgrantee's NSP funds.

RESULTS OF AUDIT

Finding 1: The City of Waterbury's Subrecipient Needs to Improve Its Capacity to Effectively Administer the NSP

Our review found that the subrecipient needs to improve its capacity to effectively administer NSP funds provided through the HERA. Specifically, our review found that the subrecipient

- did not have adequate staffing to run the NSP;
- did not have an open and objective process for selecting and approving applicants for NSP funding;
- may potentially have delays in completing rehabilitation projects;
- did not have adequate support for the scope of work developed for two projects;
- will not meet performance goals for its acquisition and rehabilitation activity ; and
- did not have an adequate procurement/contracting process.
- did not properly charge direct and indirect costs to the program

The causes of the deficiencies identified were that the subrecipient did not have adequate management procurement, and accounting controls to ensure that the program was administered effectively and efficiently and in accordance with requirements. Additionally, the subgrantee's and the subrecipient's employees lacked adequate knowledge of federal procurement requirements. As a result, the subrecipient may not meet program requirements and its goals for the NSP.

Inadequate Staffing

The subrecipient did not have adequate staffing to run the NSP. The subrecipient filled the Housing and Community Development Director position for its Neighborhood Reinvestment Unit in September 2009. This individual was new and was working on stimulus funding under Community Development Block Grant (CDBG-R) and Homeless Prevention and Rapid Re-Housing Program (HPRP) during our audit. However, she did have extensive experience working with HUD entitlement programs. The subrecipient's CDBG manager left in August 2009 and the subrecipient did not advertise the position until November 22, 2009. Only one person was running the day to day tasks of the NSP and in his job description, he also had other responsibilities/duties under the CDBG program. He previously worked on CDBG with the CDBG manager but stated NSP takes up all of his time now. He had 2 years of experience working with HUD programs. The subrecipient acknowledged that it needed to fill the CDBG manager position and planned to hire a monitoring person who will be responsible

for monitoring its HOME, CDBG, Emergency Shelter Grant (ESG), and the NSP program. The subrecipient advertised the monitoring position on November 22, 2009.

Selection and Approval Process Not Open and Objective

The subrecipient did not have an open and objective process for selecting and approving applicants for NSP funding. There was no evaluation process for the applications received, such as whether the applicant met the eligibility criteria, whether the project was cost effective, whether the funding would have an impact in that area, and there was no ranking of the applications. For example, a property was closed on and NSP agreements were signed, yet the subrecipient did not obtain income eligibility documentation to ensure the applicant met the eligibility criteria of the program. The subrecipient stated the bank would have this documentation; however, it did obtain the eligibility documentation once we inquired where it was.

The subrecipient based their approval on what the applicant put on their application for income. This process runs the risk that selected applicants may not be eligible. In another example, one investor was approved for \$300,000 in rehabilitation funding for a 3-unit project with no investment of rehabilitation funds required by the investor, and the loan will be forgiven after 15 years if the investor abides by NSP requirements. We question the cost effectiveness of such a project.

The subrecipient used a first come first serve approach whereby whoever was ready to close first on the property would receive funding up to the amount determined in the scope of work, as long as it was in a target area. Investors were approved for the majority of the acquisition and rehabilitation funding. Investors may have had an unfair advantage, using the subrecipient's current selection method. The investor previously discussed above applied for NSP funding on June 1, 2009, and the counter-offer to the bank for the property was also signed on the same day.

Additionally, the subrecipient's board of directors (Board) gave approval authorization for an NSP committee to approve NSP loans/projects instead of the Board in order to speed up the approval process since the Board only meets monthly. The committee consisted of the subrecipient's CEO, and two subrecipient employees. In discussions with subrecipient staff, the Board was updated at the monthly board meetings regarding the status of projects and funding. The updates were verbal and were a general summary of information. They do not give the Board specific project information, although it was available if the Board requested this information. By the Board not reviewing/approving NSP loans/projects, there was less oversight.

The subrecipient's process for selecting and approving NSP funding created a high risk for potential favoritism, conflicts of interests, potentially ineligible participants, and funding projects that were not cost effective.

Potential Rehabilitation Project Delays

The subrecipient's environmental review process, particularly for checking historical significance of a property, was not in accordance with the Connecticut State Historical Preservation Office (SHPO) requirements and may cause delays in completing rehabilitation. Further, if the subrecipient completes a project not in accordance with environment requirements, HUD could determine the project costs to be ineligible.

The subrecipient did not notify SHPO of rehabilitation projects prior to approval, but was instead using a historical properties list included with its 1997 memorandum of understanding with SHPO to verify whether the property was on its list. According to discussions with SHPO, the subrecipient is required to request comments from SHPO for all federally funded projects, if the rehabilitation standards to be used are not in accordance with the Secretary of the Interiors Standards for Rehabilitation and Guidelines for historic buildings, even if the properties were not on the 1997 historical properties list.

For one project reviewed, SHPO was notified by the lead assessor of the planned rehabilitation work, and the subrecipient was then notified that the property had historical significance. As a result, the project, which was already approved and closed on July 14, 2009, had to have its scope of work revised, which increased the cost of the rehabilitation; a new as-is appraisal was performed; and a revised NSP agreement with the owner for the maximum approved funding amount needed to be signed.

As of November 19, 2009, the subrecipient's attorneys had not updated the agreement, and the rehabilitation work will not be put out to bid until the revised agreement has been executed. In addition, the subrecipient's process did not include contacting SHPO if the property when required. The subrecipient instructed the lead assessors not to forward its results to SHPO in the future. As a result, there is a risk that historical properties may be rehabilitated in violation of preservation laws, there may be additional NSP project delays, and all or some of the project costs could be determined to be ineligible by HUD once the project is completed.

Scope of Rehabilitation Work Was Unsupported

The scope of work developed by the construction specialist for two properties we reviewed was not supported. Estimates shown for various rehabilitation items for one project were generally rounded to the nearest five thousand. For example, various items would be estimated at \$5,000, \$10,000, \$15,000, and \$20,000. Various rehabilitation items on another project would be \$8,500, \$9,500, \$16,500, and \$22,500. The construction specialist's project file did not contain support for these figures and he advised that he rounds to the nearest \$500. Additionally, contingency amounts were included in the maximum approved funding amount to the applicant with no documented basis for the increase. Because the scope of work was not supported, cost reasonableness of bids received for construction work on these properties could not be determined.

Additionally, the scope of work for one project included approximately \$24,600 (\$8,900 of which has been completed, and \$15,700 remains) for items that were excessive and well above and beyond the extent necessary to comply with applicable laws, codes and other requirements relating to housing safety, quality, and habitability.

Under HERA², any rehabilitation of a foreclosed upon home or residential property shall be to the extent necessary to comply with applicable laws, codes, and other requirements relating to housing safety, quality, and habitability, in order to sell, rent, or redevelop such homes and properties. Rehabilitation may include improvements to increase the energy efficiency or conservation of such homes and properties or provide a renewable energy source or sources for such homes and properties.

This one project's scope of work and invitation for bid included a full bathroom, estimated at \$3,500 in the basement of a single-family home based on the homeowner's request. At this same property, the scope of work included a high-end vinyl fence that was estimated at \$14,000, skylights in the master bedroom with an estimated cost of \$1,100, and replacement of an eight foot by eight foot front porch with an eight foot by 25 foot front porch, which increased the costs by approximately \$6,000 (per the construction specialist). These excessive upgrades added significant cost increases resulting in a project that may not be cost effective.³

² Division B, Title III of the Housing and Economic Recovery Act (HERA) of 2008 §2301(d)(2)

³ The rehabilitation work for this started during our audit.

Performance Goals Will Not Be Met

The subrecipient will not meet its performance goals included in the subgrantee's action plan for acquisition and rehabilitation funds. Specifically, the goals were to fund 30 to 35 units under this activity, but the subrecipient approved all the funding under this activity for only 20 units. In addition, the local action plan includes \$1,220,000 under the financing mechanisms activity with a goal to help 25 to 30 households. As of November 16, 2009, they had only closed on five loans using funds totaling \$147,828 for this activity. Because of the slow process for funding financing mechanisms, these goals may not be achieved.

During discussions with subrecipient staff, they stated that they may revise the local action plan and move a majority of the financing mechanism activity funding to the acquisition and rehabilitation activity. However, with the funding amounts per project that it currently plans to provide to NSP participants, it will not meet its combined goal for these activities to help 55 to 65 households.

The subrecipient/grantee stated that rehabilitation costs were much higher than expected as other investors are purchasing the better properties quickly and they are ending up funding properties that require more rehabilitation funds because they need to be gutted. Since more funds will be required to rehab these projects, and fewer units will be completed than planned, we recommend that the subrecipient obtain an approved amendment to its NSP local action plan from the grantee. Additionally, by not funding unnecessary/excessive rehabilitation costs, more funds will be available to complete additional units.

Procurement Process Was Inadequate

The subgrantee's procurement process was inadequate. It did not adequately document the history of its procurements for its lead assessors and construction specialists, which were used for NSP activities. Specifically, it did not:

- specify the type of contract to be used,
- document the rationale for the method of procurement,
- document the contractor selection or rejection, or
- support the basis for the contract price.

The subgrantee's procurement files did not contain:

- award letters to the winning bidder/proposer,

- letters from the evaluation committee recommending who should be awarded the contract,
- evaluations from the committee members used in determining the winning proposer,
- contracts with the winning proposer, or
- cost or price analyses.

The subrecipient used the subgrantee's purchasing department to procure services and construction/rehabilitation work. The subrecipient maintained the contract in its office and copies of the contract were forwarded to other offices in the City, but they were not forwarded to the subgrantee's purchasing department. This process creates a weakness in that the subrecipient could potentially not contract with the lowest qualified bidder as determined by the purchasing department. Additionally, contracts/purchase orders did not contain all required federal contract provisions and there was no contract administration system in place.

In addition, the subrecipient did not perform or document a price analysis for two procurements we reviewed prior to requesting that the purchasing department issue the request for proposal for services. It also did not perform a cost analysis when only one proposal was submitted, and did not document its evaluations of the proposals. This occurred because the subgrantee and subrecipient lacked adequate knowledge of federal procurement requirements.

Further, the subrecipient's contracting process was slow. For example, although it issued a request for proposal for lead assessors due August 4, 2009, it still had not awarded the contract/purchase order for these services as of November 16, 2009. Additionally, the subrecipient executed a contract with one of its construction specialist in April 2009; however, the proposal for that request for proposal was submitted in September 2008. Also, as of November 16, 2009, one project that needed a revised NSP agreement based on the SHPO changes to the rehabilitation work that was approved by the subrecipient at the beginning of August 2009, still had not been revised by the subrecipient's attorneys.

Accounting/Financial Controls and Computer Controls

The subrecipient had adequate documentation for NSP program expenses and had an adequate allocation plan for charging program costs. However, based on comments made at the exit conference regarding several staff working on the program besides the primary person, we reviewed additional payroll sheets and found that the main person working on the NSP program was not properly charging his time to NSP. Most of his time was charged to the CDBG program. Therefore, although the subrecipient had an adequate allocation plan for charging

program expenses, the plan was not followed. As a result, program costs were not properly charged.

Our limited review of computer controls did not disclose any concerns.

Conclusion

We are concerned about the subrecipient's ability to administer NSP-1 funding until such time it can satisfactorily address and demonstrate adequate management, accounting, and procurement controls, and adequate staffing levels. In addition, the subrecipient needs to improve its processes to effectively and efficiently utilize available NSP funds and meet program requirements and its goals for the NSP.

Recommendations

We recommend that the Hartford Connecticut Director of HUD's Office of Community Planning and Development require the grantee to ensure the subgrantee/subrecipient:

- 1A. Implements adequate policies, procedures, and controls to ensure that NSP funds are used effectively and efficiently, and in accordance with applicable requirements.
- 1B. Hires additional staff, as needed, to assist in administering the NSP to ensure that the subrecipient has sufficient capacity to effectively and efficiently administer program funds.
- 1C. Strengthens its procurement controls to ensure that they are following the subgrantee's policies and Federal policies when procuring services.
- 1D. Removes approximately \$15,700 in excessive upgrades from the approved rehabilitation plans for the single-family property for the basement bathroom, and high-end vinyl fence which have not been completed.
- 1E. Repays from non-federal sources \$8,900 in costs for the skylights and the extended porch that were determined to be unnecessary/unreasonable costs of the program.
- 1F. Submits an amendment to its NSP local action plan reducing the number of units to be completed for its acquisition and rehabilitation activities.

- 1G. Considers sending employees to training on Section 106 of the National Historic Preservation Act provided by the Advisory Council on Historic Preservation.
- 1H. Requests comments from the SHPO for properties approved for NSP rehabilitation funding that are not in accordance with the rehabilitation standards to ensure that the scope of work is in accordance with requirements.

We also recommend that the Hartford Connecticut Director of HUD's Office of Community Planning and Development:

- 1I. Performs additional monitoring, and provide technical assistance to the subrecipient, as needed, to ensure that the subrecipient properly administers the NSP funding in accordance with federal requirements.
- 1J. Review salaries charged by staff to determine whether costs were properly charged to HUD programs and require the subrecipient to make adjustments to its direct and indirect expenses as necessary.

SCOPE AND METHODOLOGY

We conducted our audit between September and November 2009. We completed our fieldwork at the subrecipient's office located at 24 Leavenworth Street, Waterbury, Connecticut and the subgrantee's office located at 236 Grand Street, Waterbury, Connecticut. Our audit covered the period July 1, 2008, through August 31, 2009, and was extended when necessary to meet our audit objectives.

To accomplish our audit objectives, we reviewed

- HERA regulations and guidance.
- The approved funding agreement between the grantee and the subgrantee.
- The agreement for pass through funding between the subgrantee and subrecipient.
- The subgrantee's local action plan.
- HUD monitoring reports and the subrecipient's financial statements for findings/ areas of concern with the subrecipient's administration of other programs.
- The procurement for a sample of two of eight service contracts for the NSP. We selected procurements for a construction specialist and lead assessor for review.
- A sample of two of the seven approved NSP acquisition and rehabilitation activity projects. We selected projects with the highest per unit funding amount. We also performed a site visit of these two properties to determine the condition of the properties (abandoned/foreclosed).
- The subrecipient's documentation such as policies and procedures, organizational charts, and job descriptions to obtain an understanding of the subrecipient's internal controls.
- The allocation plan and selected and tested a sample of 3 out of 6 expense types (rent, supplies, and insurance) for three months to ensure the subrecipient was following its plan.
- Verified that time sheets for five individuals agreed with the prorated salary charges for various programs for April and August 2009.
- Reviewed prorated salary charges for ten individuals from June to November 2009, to verify whether several employees were charged to NSP.
- A sample of two transactions out of 32 to test the process from request for payment to disbursement of payment to subrecipient/for-profit developer, including input into accounting system.

We also interviewed the subrecipient's management, staff members, construction specialist, the subgrantee's Purchasing Director, and a Review Compliance Associate at SHPO.

We obtained assistance from HUD's Office of Community Planning and Development (CPD) and requested a legal opinion from HUD-OIG's Office of Legal Counsel, regarding potential conflicts of interest.

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(s).

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.

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 (finding 1):

- The subrecipient lacked adequate management, procurement, and accounting controls to ensure that the program was administered effectively and efficiently and complied with Federal requirements. (see finding 1)

APPENDIXES

Appendix A

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

Recommendation number	Unreasonable or unnecessary 3/	Funds to be put to better use 1/
1D		\$15,700
1E	\$8,900	

1/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. In this instance, the funds to be put to better use amount represents unreasonable/unnecessary costs for excessive construction upgrades that would not be incurred if our recommendation is implemented.

3/ Unreasonable/unnecessary costs are those costs not generally recognized as ordinary, prudent, relevant, and/or necessary within established practices. Unreasonable costs exceed the costs that would be incurred by a prudent person in conducting a competitive business.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation



January 12, 2010

Mr. John Dvorak, Regional Inspector General for Audit
U.S. Department of HUD-Office of Inspector General for Audit
10 Causeway Street, Room 370
Boston, MA 02222-1092

RE: Formal Comments
Audit Report Number 2010-BO-1004

Dear Mr. Dvorak:

This letter is provided to you in order to transmit our formal written comments on the draft audit report Number 2010-BO-1004 on the Waterbury Connecticut Neighborhood Stabilization Program. These comments were discussed at length at the exit conference held at the Waterbury Development Corporation, 24 Leavenworth Street, Waterbury, CT on Tuesday, January 5, 2010 and attended by the Office of Inspector General; HUD Hartford CPD; CT Department of Community and Economic Development; counsel to Waterbury Development Corporation (WDC) and staff.

Per your request in your transmittal letter dated December 30, 2009, we have presented these comments to address each specific issue covered in the report.

• ***Waterbury Development Corporation Lacked Sufficient Capacity to Effectively Administer Its Neighborhood Stabilization Program***

We disagree with the conclusion reached. The Neighborhood Stabilization Program (NSP) was hastily created by Congress to try to meet the skyrocketing foreclosure crisis caused by a collapse of the real estate market; a worsening economic recession and the exposure of the subprime mortgage market. NSP is a complex program which had rule changes and misunderstandings right through the contract signing with DECD and beyond. Waterbury is one of ten communities receiving NSP funds from DECD. According to DECD, Waterbury is better than average with respect to implementing the program and committing the funds. DECD set forth an ambitious timeline with respect to the commitment and expenditure of these funds and Waterbury set about to meet them so we would not lose any funds. We have not ignored any of the regulations and we have crafted a program that works for our City. We have leveraged with partners that are committed to the stabilization and revitalization of the City. When our commitments are met with this initial round of funding, a significant number of housing units will be back on line for low to moderate income residents and neighborhoods will be stabilized by the acquisition and rehabilitation of these properties.

BUILDING WATERBURY'S FUTURE!

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Comment 1

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Comment 2

Mr. John Dvorak, Regional Inspector General for Audit
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The following responses will further illustrate that WDC has the capacity to effectively administer the NSP.

- *Staffing Was Inadequate*

We disagree with the finding. As DECD pointed out, they have ten NSP communities and each one of them operates and staffs the program differently. Several communities have a single person responsible for the program. We asked the OIG to explain what standards they used or to provide us with a best practices example but they were unable to do so. It appears that their finding is also influenced by HUD's previously expressed concern over the WDC staff. In response to HUD's previous concerns, the City funded from general funds the new position of Housing and Community Planning Director for WDC and that position was filled by a community and economic development professional with over thirty years of experience. The additional two staff positions which were discussed with HUD of a monitoring and evaluation specialist and the community development program specialist were advertised in November 2009 with a due date of December 4, 2009. A total of twenty-two resumes were received. Interviews have been scheduled for January 7th and January 8th and we anticipate filling the positions shortly thereafter.

The CEO of WDC has thirty-three years of experience dealing with real estate owned bank properties, foreclosures, property sales and construction lending, all elements of the NSP. He has worked closely with the staff member assigned to the NSP. A UCONN student was hired to assist on NSP during the peak time of the program, in addition to existing staff helping out. WDC is managing the program with its current staff which will be supplemented when the new positions are filled.

Comment 3

- *Potentials for Appearance of Conflicts of Interest*

We disagree with the finding. Please remove the number of shares of bank stock owned by the CEO. Your statements conclude that there was no conflict of interest for either the CEO or the WDC Board member because there was no tangible financial benefit as a result of the bank's partnership with the subrecipient. HUD CPD Director Reisine stated at the exit conference that the OIG concluded there was no financial gain and therefore no conflict. The resolution proposed to request a waiver from HUD would not be granted because there was no conflict. Please note that with respect to the WDC Board member who is an employee of the bank, he has always recused himself when matters concerning the bank and WDC are discussed and/or voted on. That is our standard practice for any of our board members who represent a wide variety of long time business, civic and nonprofit employers in the City and, may have business with the City and WDC.

Comment 4

- *Solicitation of Interest Not Issued*

We disagree with the finding. WDC did considerably more in terms of public outreach than the publication of one newspaper ad would have generated. With the increased cost of newspaper advertisement and the decreased readership, a decision was made to publicize the program utilizing venues more likely to reach residents and potential consumers. WDC did public service announcements on the local radio station and public access television. The program was advertised on the City's website and on WDC's website. Direct mailings were done to the City's major employers, members of the Chamber of Commerce and all City employees, in addition to holding meetings with local developers and development organizations. All of these actions generated a great deal of interest in the program. In fact, so much so, that on July 31, 2009 the

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AUDITEE COMMENTS AND OIG'S EVALUATION

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WDC closed the taking of any further applications from investors due to the over subscription of the program. On September 15, 2009, the program was closed to potential homeowners as we had 85 applications in the pipeline at that point and will have nowhere near the amount of funds to handle the projects. We have no doubt that the methods we used to generate interest in the program went above and beyond the reach that one newspaper advertisement would have created.

Comment 5

- *Selection and Approval Process Not Open and Objective*

We disagree with the finding. Applicants once vetted for the program (determined eligible due to income; securing of property in the targeted areas) were handled on a first come first served basis. The requirements of purchasing foreclosed property in the manner prescribed by the guidelines did not lend itself to further evaluation as deals would be lost. Our experience to date and that of other NSP 1 communities bears out this fact. The addition of rating and ranking criteria would add significant time to a process that already takes 60 to 90 days to secure a property. The comments about the WDC Board's oversight and a high risk of potential favoritism is highly subjective and not true.

Comment 6

- *Minimum HOME Affordability Periods Used*

We agree with this finding. To suggest that WDC require affordability periods longer than the 15 years of the HOME Program is simply not practical. After the 15 years, the owner must be able to get equity out of the property in order to make capital expenditures that will be necessary. CPD Director Reisine agreed that the HOME Program standards were a safe harbor and we are in compliance through the use of them..

Comment 7

- *Potential Rehabilitation Project Delays*

We disagree with this finding. The City of Waterbury has two separate Memorandums of Understanding (MOU's) with the Connecticut State Historical Preservation Office (SHPO) and the Advisory Council on Historic Preservation (ACHP) that were executed in 1997. One is a Programmatic Agreement that covers the Community Development Block Grant Program and one is a Programmatic Agreement that covers the Lead-Based Paint Hazard Control Program. I regret that the auditors were not provided a copy of the Lead-Based Paint Hazard one since it would have explained in more detail the course of action which we took with respect to the property noted in the finding. A copy was provided to them at the exit conference. As stated in the finding, the City uses the historic buildings index dated April 29, 1997 and per the MOU, has agreed that projects concerning properties on the list that are NR (National Register Listed) and NRE (National Register Eligible) will be sent to Connecticut SHPO. The historic buildings index represents a complete listing of all Waterbury properties and is alphanumeric by street and number. Properties not on the list were determined by the expert consultant not to meet the criteria. Under the Lead - Based Paint MOU on page 2, under Section 1. Coverage of Programmatic Agreement, A. Exempt Properties, it states "For any property proposed for abatement under this Program that is not listed in the City of Waterbury's Historic Buildings Index, and any property included in the City's Historic Buildings Index that is not classified as NR or NRE, the City is not required to consult with SHPO or with the Council and no historic reviews or preservation measures are required". That is the process that is in place and one which the City follows. As a result of this report, we will begin a dialogue with the SHPO about updating the MOU's and have scheduled a meeting with them for January 20, 2010.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Comment 8

Mr. John Dvorak, Regional Inspector General for Audit
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- *Scope of Rehabilitation Work Was Unsupported*

We disagree with this finding. The construction specialist created scopes of work using commercially accepted practices (RS Means cost data). In some instances, their calculations did not include detail by category. We have since asked them to include the details in all their scopes of work so that a more exact estimate can be presented to the potential homeowner. With respect to the items listed in the audit as excessive costs, we looked to DECD for guidance on making the improvements that would give the properties more curb appeal, e.g. the creation of a larger front porch to eliminate the small stoop and provide more outdoor living area and the installation of a medium grade vinyl coated fence to separate the property from its active commercial neighbors. This type of fence would require less future maintenance by the income eligible homeowner. With respect to the installation of a skylight, it was our understanding from DECD staff that these were allowed in their rehabilitation programs and were not considered excessive. The installation of an additional bathroom in the basement was the request of the homeowner in anticipation of future needs. It did not appear to be an excessive cost. As a result of this report we will modify this contract to eliminate the installation of the vinyl fence, as the item was not yet purchased and installed. The installation of the bathroom in the basement will not go forward as the homeowner has decided to upgrade the furnace for a more energy efficient model. One skylight was installed and the front porch was completed for a total cost of \$8,900. We would ask you to reconsider these two items as reasonable given our understanding of the program's guidelines relative to curb appeal and the fact that skylights are allowable under the State's rehabilitation program. In addition, we will review every contract going forward and eliminate those items which were previously thought of as exterior enhancements or curb appeal. We will request additional technical assistance from DECD to review the principles of cost reasonableness in detail and re-examine each scope of work.

Comment 9

- *Performance Goals Will Not Be Met*

We disagree with this finding. The performance goals listed in our action plan to DECD and subsequently included in their application to HUD were based upon our best estimates assuming general rehabilitation scopes of work and an average condition of the properties. It has become apparent that the properties available for purchase are in far worse condition than anticipated which impacts the cost effectiveness of the program. According to DECD, Waterbury's costs are "middle of the road" for the State and HUD has agreed that the costs overall in Connecticut are excessive due to the influx of out of state and foreign investors cherry-picking the better properties and leaving those in worse condition. DECD stated that many of the properties need substantial or gut rehabilitation which adds to the cost and reduces the number of units that will be completed. The reduced goals are reasonable given the actual market and the conditions of the foreclosed properties. The estimates provided to DECD by activity line item were based upon a projection of what the City hoped to accomplish and what the City anticipated needing in each category. We will seek DECD's assistance to revise the local action plan to better reflect the program and the current market conditions.

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AUDITEE COMMENTS AND OIG'S EVALUATION

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• *Procurement Process Was Inadequate*

We agree with this finding. As a result of the audit we are reviewing the option of handling the procurement process internally with the City and counsel. The City's process is not always adequate for HUD related transactions. Regardless, we have instituted our own mirrored process so that we keep on file all of the required documents noted. We will work on streamlining and reducing the time delays for our contracts. We will seek DECD's and HUD's technical assistance to ensure that all federal requirements are met.

We trust that your review of the comments received from HUD, DECD and WDC management will allow the OIG to reconsider its draft conclusion that WDC lacked sufficient capacity and modify it to reflect WDC's need to improve its capacity.

Thank you for the opportunity to present our formal written comments on the audit of the Neighborhood Stabilization Program. The success of the Neighborhood Stabilization Program is very important to Waterbury which has the second highest number of foreclosures in Connecticut. These funds are critical to returning these properties to productive reuse as housing for our income eligible residents and stabilizing our neighborhoods. We look forward to working with DECD and HUD to make program improvements so that Waterbury's Neighborhood Stabilization Program can be a model to emulate.

Very truly yours,



Leo J. Frank, Chief Executive Officer
Waterbury Development Corporation

cc: Mayor Michael Jarjura

OIG Evaluation of Auditee Comments

- Comment 1** We considered your comments and have revised our conclusion to show that the subrecipient needs to improve its capacity rather than that it lacked the capacity. Although the subrecipient's response states that they disagree with many of our findings, several actions proposed by the subrecipient implement our recommendations and should strengthen WDC's capacity to administer the NSP.
- Comment 2** Our conclusions were based on discussions held with the subrecipient, as well as a review of job descriptions. Additionally, the subrecipient acknowledged during the audit that it needed to hire a monitoring person and CDBG manager, which had been vacant since August 2009. The staff member primarily responsible for NSP was responsible for both NSP and other HUD programs per his job description. The subrecipient stated at the exit conference and in its response that several staff members worked on the NSP program at the peak period. However, our review of additional payroll information obtained after the exit conference for this period did not show that several staff members charged time to the NSP program. Additionally, salary costs were not charged to NSP for the staff member primarily responsible for the day to day activities of the NSP, even though he was the primary person working with us during the audit. Based on additional review of payroll sheets provided after the exit conference, we revised our report to show that NSP expenses were not properly charged and have added a recommendation for HUD to monitor salary charges and determine what adjustments are necessary.
- Comment 3** The subrecipient's response that the board member recuses himself when matters concerning the bank and subrecipient were discussed and/or were voted on satisfies our concern. Because we did not determine there was an actual conflict of interest or apparent conflict of interest, we have removed this section from the report. However, HUD has expressed concerns regarding this area, and may pursue this issue further.
- Comment 4** Based on additional discussion with HUD, the grantee, and subrecipient, we have removed this section from the report.
- Comment 5** The practice of first come first served, with limited oversight by the Board for approved applicants, does create a high risk for favoritism and potential for conflicts of interests. There are less controls when the same staff who approve NSP funding for applicants are also responsible for reviewing the applications, requesting the appraisals, scope of work, tax clearances, etc. that are required in order to close on the property. Staff could potentially speed up certain steps for some applicants in order for them to be ready to close first.

Additionally, the subrecipient would be able to help more applicants, if it required investors to fund a percentage of the rehabilitation costs with private funds.

Comment 6 We have removed this issue from the report based on discussions with HUD.

Comment 7 We reviewed the programmatic agreements, including the lead based paint hazard agreement and held a discussion with SHPO regarding what the subrecipient was required to do per their programmatic agreements. Based on this discussion, we revised this section of the report. SHPO stated that the subrecipient is required to request comments on all federally funded projects that do not meet the Secretary of the Interior's "Standards for Rehabilitation", even if the 1997 historical inventory list does not show them as being historical or having historical significance (NR(National Register Listed/NRE (National Register Eligible)). As such, we did not remove this as a concern. The subrecipient should consult with SHPO regarding any steps they need to take for properties already approved for NSP funding that do not meet the "Standards for Rehabilitation" to ensure they are not in violation of preservation laws in regard to these projects and to clarify requirements under its programmatic agreements.

Comment 8 We requested the support behind the figures for the scope of work, and the construction specialist could not provide the details behind the estimate. In order to determine the cost reasonableness of bids received, the scope of work needs to be supportable. Additionally, per the construction specialist, a high end vinyl fence was included in the bid specifications, not a medium grade fence. Based on pictures provided at the exit conference, surrounding properties had stockade fences. This would be a more reasonable cost to allow. NSP funds should not be used for unnecessary improvements to the property. The owner/occupant was a single person moving into the home and therefore, we don't see the necessity of adding a bathroom in the basement, when after rehabilitation, the home would have 1 1/2 baths on the upper levels.

The subrecipient should also be reviewing its current contracts for unnecessary/unreasonable costs where the rehabilitation work has not begun yet as these costs could later be determined to be unnecessary/unreasonable and the program would have to be reimbursed with nonfederal funds for these costs. Based on the subrecipient's response that the porch and skylights have been completed with a cost of \$8,900, we revised the recommendations from \$24,600 in funds to be put to better use to \$15,700 and have included the \$8,900 in costs for the completed porch and skylights as unnecessary/unreasonable costs.

Comment 9 We considered the subrecipient's comments, as well as HUD and the grantee's comments, and have revised this section and the corresponding recommendation. We consider this an issue since the subrecipient /subgrantee could be determined by the grantee to be in default under its agreement due to it not meeting performance measures as indicated in its local action plan. Also, although the

subrecipient states that they disagree, the proposed actions support our finding and proposed recommendation for corrective action.

Appendix C

HUD COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation



New England

U.S. Department of Housing and Urban Development

Office of Community Planning and Development
Hartford Field Office
One Corporate Center 19th Floor
Hartford, Connecticut 06103-3220
Telephone (860) 240-9770
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January 11, 2010

MEMORANDUM FOR: John Dvorak, Regional Inspector General for Audit, Boston Region,
1AGA

FROM: Gary Reisine, Director, Community Planning and Development

SUBJECT: The City of Waterbury, Connecticut's Subrecipient, Waterbury Development
Corporation, Lacked Sufficient Capacity to Effectively Administer Its
Neighborhood Stabilization Program

Thank you for providing the Office of Community Planning and Development (CPD) at the Hartford Field Office the opportunity to comment on the Audit Report on Waterbury Development Corporation's (WDC) capacity to administer the Neighborhood Stabilization Program (NSP). We appreciated the chance to attend the exit conference and meet with members of the Office of Inspector General (OIG), WDC, and the Department of Economic and Community Development (DECD). After reviewing the OIG's audit, we concur with the finding that the City of Waterbury and WDC have administrative deficiencies that have limited their capacity to administer the program effectively. We also believe that the regimen of recommendations you have made will substantially address those deficiencies. Further, we have some remaining comments we wish to make on Conflict of Interest and the performance goals.

This Office thanks you for the revision of your draft Audit Report. We believe those revisions have strengthened the report. We note that you continue to have a concern over the appearance of a Conflict of Interest for a board member of Waterbury Development Corporation, because he currently works for a partnering bank. The OIG determined that there was no financial benefit to the board member, but stated its recommendation that the board member recuse himself from any voting involving NSP funds. This office understands there is no basis for a Conflict of Interest if there is no financial interest or benefit. If your conclusion stands that there was no financial benefit, we point out that recusal is not called for by CDBG/NSP rules, although the practice might increase public confidence in the process. However, it is not obvious to us that there is no financial interest or benefit if the board member is a current employee of the bank. We recommend you continue to explore and to discuss with your Office of Counsel whether the board member might have received a financial benefit within the meaning of the Conflict of Interest rules at 24 CFR 570.611. In addition, we also suggest you continue to review WDC's partnership with the bank and whether it violated procurement standards based upon a Memorandum of Understanding between WDC and the bank (see attached). If OIG concludes

Comment 1

Appendix C

HUD COMMENTS AND OIG'S EVALUATION

**Ref to OIG
Evaluation**

Comment 2

that there was no procurement, it is then our intent to further explore this issue as an administrative matter.

This Office would also like to comment on an additional concern the OIG had about the ability for WDC to meet its performance goals. WDC's goal for acquisition and rehabilitation was 30 to 35 units, but it only approved funding for 20 units. The OIG is concerned with high levels of funding for each project causing a decrease in the amount of units that can be assisted. This Office understands that by including unnecessary luxury items in the rehabilitation scope of work, WDC, in effect, lowered the amount of units it could assist. It is important to also note, however, that due to harsh economic circumstances, the houses that WDC is able to purchase have been stripped of everything, including copper pipes and wiring. Therefore, these properties require significant gut rehabilitation work, and subsequently have resulted in a higher funding amount per project than originally anticipated. We understand that this trend is consistent throughout other communities in Connecticut. We are not yet in a position to determine whether market conditions might have allowed higher productivity, but we recommend you consider whether high levels of deterioration and vandalism might have pushed costs beyond WDC's and the State's reasonable contemplation.

Thank you for your consideration of our comments now and over the course of your audit review. Your office has produced a report that will be of great help to us and to all parties in improving the administration of the Neighborhood Stabilization Program in Waterbury and elsewhere in Connecticut.

OIG Evaluation of HUD Comments

- Comment 1** We removed this section from the report and the corresponding recommendation that the Board Member recues himself from voting. Since HUD is ultimately responsible for making the final determination, and has concerns that there may in fact be a financial interest or benefit to the board member and that a procurement violation may exist, HUD should follow up with their regional counsel as deemed necessary, and take corrective action, as appropriate.
- Comment 2** We considered HUD's, the grantee's, and the subrecipient's comments on this issue and have revised this section and the corresponding recommendation accordingly.