



Issue Date	June 2, 2010
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Audit Report Number	2010-LA-1011
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TO: Maria F. Cremer, Acting Director, San Francisco Office of Community Planning and Development, 9AD

Joan S. Hobbs

FROM: Joan S. Hobbs, Regional Inspector General for Audit, Region IX, 9DGA

SUBJECT: Sacramento Housing and Redevelopment Agency Did Not Always Administer the Neighborhood Stabilization Program in Accordance With HUD Rules and Regulations

HIGHLIGHTS

What We Audited and Why

We audited the Sacramento Housing and Redevelopment Agency (Agency) as a result of a hotline complaint, which alleged violations of Neighborhood Stabilization Program (program) funds provided through the Housing and Economic Recovery Act of 2008. Our objective was to determine whether the alleged violations had merit. The complaint alleged several instances where the Agency did not follow program rules and regulations, including but not limited to, rehabilitating residential properties that were not foreclosed upon or vacant and/or abandoned. We wanted to determine whether the Agency administered its program in accordance with U.S. Department of Housing and Urban Development (HUD) rules and regulations and whether program funds were used for eligible purposes.

What We Found

The Agency did not administer the program in accordance with HUD rules and regulations. Specifically, it

- Allowed ineligible properties to be rehabilitated.
- Did not adequately monitor projects, which resulted in ineligible costs.
- Permitted the developer to make unnecessary upgrades and overinflate the construction budget.
- Did not ensure that it met its reporting requirements when reporting to the Disaster Recovery Grant Reporting system.
- Lacked controls, which resulted in more than \$5.3 million dollars in funds that could be put to better use.

We attribute these deficiencies to the Agency's not following program requirements, compounded by a lack of policies and procedures and ineffective management controls over the program.

What We Recommend

We recommend that the Director of the San Francisco Office of Community Planning and Development require the Agency to repay from non-Federal funds more than \$1.1 million in ineligible expenditures. Additionally, we recommend that the Agency be required to establish and implement effective procedures and management controls to ensure that all program-assisted projects are adequately monitored and that budget allocations and expenditures are reasonable and necessary in accordance with HUD rules and regulations because such corrective actions would ensure that more than \$5.3 million in funds could be put to better use.

For each recommendation with 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 our discussion draft report to the Agency on May 6, 2010, and held an exit conference on May 13, 2010. The Agency generally disagreed with our report findings.

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 OBJECTIVE

The Neighborhood Stabilization Program (program) was authorized under Title III of the Housing and Economic Recovery Act of 2008 (Act) and provides grants to every State and certain local communities to purchase foreclosed-upon or abandoned homes and to rehabilitate, resell, or redevelop the homes to stabilize neighborhoods and stem declining values in neighboring homes. The Act calls for allocating funds “to states and units of general local government with the greatest need.” In the first phase of the program, the U.S. Department of Housing and Urban Development (HUD) allocated \$4 billion in program funds to assist in the redevelopment of abandoned and foreclosed-upon homes.

The housing authorities for the City and County of Sacramento are legal entities that operate under the umbrella organization of the Sacramento Housing and Redevelopment Agency (Agency). The Agency is a “joint powers authority” of the City and County of Sacramento to represent both jurisdictions for affordable housing and community redevelopment needs.

On January 30, 2009, HUD approved more than \$18.6 million for the County of Sacramento. These funds are being used to return foreclosed-upon or abandoned residential properties to occupancy as quickly as possible; revitalize neighborhoods through strategic redevelopment, rehabilitation, and reuse of vacant properties; and provide affordable homeownership and improved affordable rental opportunities.

Specifically, the Agency began implementing three HUD-approved activities with its program funds for the County of Sacramento, along with the use of funds for program administration.

Activity name	Description	Eligibility	Funds Allocated
Vacant Properties Program (VPP)	Designed to return vacant and blighted homes and properties to owner occupancy.	Section 2301(C)(3)(B)	\$5,500,000 (inclusive of the Pilot Preforeclosure Initiative)
Block Acquisition/ Rehabilitation (BAR)	Addresses some of the blighted conditions in specific targeted areas.	Section 2301(C)(3)(A) and 2301 (C)(3)(B)	\$8,000,000 (\$4 million for the Lerwick Project and \$4 million for the Norcade Circle Project)
Property Recycling Program (PRP)	Designed to either consist of a government, affiliate, or private entity.	Section 2301(C)(3)(A), 2301(C)(3)(B), and 2301(C)(3)(C)	\$3,305,460
Program administration	n/a	n/a	\$1,800,000
Total			\$18,605,460

Audit Objective

Our objective was to determine whether the alleged violations from a hotline complaint had merit. Specifically, we wanted to determine whether program funds were used for eligible purposes.

RESULTS OF AUDIT

Finding 1: The Agency Allowed Ineligible Properties To Be Rehabilitated Using Program Funds

Five ineligible properties were rehabilitated using program funds. This condition occurred because the Agency did not follow program requirements. As a result, nearly \$1 million was spent on the rehabilitation of properties that were acquired before submission of an action plan amendment.

Ineligible Properties

HUD's guidance and sections 2301 (c)(3)(A) and (c)(3)(B) of Public Law 110-289 require that properties be acquired after submission of an action plan substantial amendment (amendment) and be foreclosed upon or abandoned (see appendix C). The Agency submitted its amendment on November 26, 2008, and HUD approved more than \$18.6 million for the County of Sacramento on January 30, 2009. The Agency provided, in the form of a forgivable loan, more than 40 percent (\$8 million) of the grant to one developer without competition.

The developer was using the funds to rehabilitate 1 project involving 32 apartment units. The project involved 8 four-unit buildings consisting of 3,624 square feet per building. The developer planned and the Agency approved substantial renovations, including the replacement of siding, installing vinyl windows, resurfacing the parking lot, and replacing fencing. There would also be new electrical panels, insulation, exterior lighting, and roofing. In addition, the interior would include new appliances, flooring, countertops, and cabinets.

Five Properties Were Purchased Before the November 26, 2008 Amendment

The developer purchased five properties listed in the table below before the action plan amendment was submitted and approved by HUD. The purchase dates ranged between July 14 and September 19, 2008. The Agency budgeted and later obligated \$500,000 in rehabilitation¹ costs for each property for a total of \$2.5 million for all five. The amount obligated included costs for rehabilitating the interior and exterior of the buildings and other items such as dry rot repair, hazardous material mitigation, and demolition.

¹ At a later date, the Agency indicated that \$500,000 included soft costs.

According to Agency reports, \$982,820² had been expended related to the rehabilitation of the ineligible properties as of December 31, 2009.

	Parcel number	Purchase (recording) date	Allocation of program funds
1	254-0133-015-0	7/14/2008	\$500,000
2	254-0133-017-0	7/18/2008	\$500,000
3	254-0133-013-0	8/18/2008	\$500,000
4	254-0133-036-0	9/17/2008	\$500,000
5	254-0133-016-0	9/19/2008	\$500,000
		Total	\$2,500,000

One Property Was Not Foreclosed upon or Abandoned

In addition, one property that was not foreclosed upon or abandoned was rehabilitated. The property was purchased from an individual and the Agency obligated \$500,000 for rehabilitation (see table below). At the time of the review, acquiring properties from an individual was not allowed. However, on April 2, 2010, guidance was issued revising the definition of foreclosed and abandoned properties to allow this. This is included in the report since it was an ineligible acquisition at the time of the review.

	Assessor parcel number	Purchased (recording) date	Allocation of program funds
1	254-0131-029-0	12/24/2008	\$500,000

The Agency was aware that this property was not eligible under its eligible uses detailed in its amendment. As a result, it changed the use without prior HUD³ approval to redevelop demolished or vacant properties (see appendix C).

Conclusion

The agency allowed the developer to use program funds for five ineligible properties. This condition occurred because the Agency failed to comply with program rules and regulations. Accordingly, nearly \$1 million was spent on rehabilitating the five ineligible properties. In addition, reprogramming the unspent obligated program funds allocated to the five properties would enable more than \$1.5 million in funds be put to better use (see appendix A-4).

² There have been seven properties purchased to date, and two were eligible. The amount reflects a prorated amount of program funds expended on 5 of the ineligible properties: According to Agency records, \$1,375,945 was spent / 7 properties = \$196,564 x 5 ineligible properties = \$982,820 (see appendix A-4). The prorated amount was used because the Agency did not maintain separate expenditures for each of the properties.

³ On December 9, 2009, we contacted the community planning and development representative for the program and were informed that other than revising its budget and making programmatic changes such as decreasing the numbers to be assisted, it did not change the content of the substantial amendment.

Recommendations

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

- 1A. Repay HUD from non-Federal sources \$982,820 spent on rehabilitating ineligible properties.
- 1B. Reallocate the unspent \$1,517,180 to other program-approved projects or return the funds to HUD.

Finding 2: The Agency Did Not Adequately Monitor Its Program Projects

The Agency did not adequately monitor its program projects. Specifically, it approved unreasonable and unnecessary upgrades and construction budgets, a loan with excessive finance costs, ineligible and unsupported costs, and did not ensure that appraisal and environmental reviews were performed in accordance with program requirements. These deficiencies occurred because the Agency lacked effective management controls to ensure compliance with all of the applicable HUD requirements. As a result, there was more than \$3.9 million in ineligible costs and funds to be put to better use.

Unnecessary Upgrades and Inflated Budget

Appendix A of 2 CFR 225 (c)(1)(a) state that costs must be necessary and reasonable for proper and efficient performance and administration of Federal awards (see appendix C). However, the agency approved \$500,000 to be allocated for the rehabilitation of each of the eight fourplexes. The unnecessary upgrades and inflated budgets were as follows:

Lerwick Road Properties

An individual certified by the California Department of Health Services prepared an environmental report on the Lerwick properties, which showed the following:

- Structure interior is in good condition and should remain so with good housekeeping and maintenance;
- Interior ceilings, walls, trims, baseboards, and door painted surfaces were in generally good to excellent condition;
- The general condition of the structures is good to excellent.

Below are pictures of a Lerwick unit that had not been rehabilitated and was used as an office by the developer. As shown in the photographs, the interior and exterior condition of the subject property was in fair to good condition. These items were included in the approved final construction budget to be replaced or reconfigured.



Norcade Circle Properties

In addition to the Lerwick Road properties, the developer was still preparing the final scope of work for the Norcade Circle properties involving 32 apartment units. The project involved four-unit buildings consisting of 3,476 square feet per building.

Although the final scope of work was still in progress as of the end of our field work, the Agency had approved each fourplex to be allocated \$500,000 in program funds for acquisition and rehabilitation. We determined that the budgeted amounts for the proposed rehabilitation were unreasonable and included unnecessary upgrades based on the market value. The market value was \$190,000 based on an average of the appraisals, most of which were performed after the purchases. At that time, the scope of work was planned to include replacing all countertops, sinks, and bathtubs and reconfiguring kitchen cabinets to make use of wasted space. Not all of the fourplexes (or units) required the upgrades. The pictures below were taken from various fourplexes during our site visit.



As shown in the above and below photographs, the building and its units were in good condition.



The flooring and kitchen cabinets from a unit in another building revealed that they did not need to be replaced.





The kitchen cabinets, bathtub, and refrigerator were all in fair condition and did not need to be replaced as suggested.

Based on the HUD Office of Inspector General (OIG) appraiser's inspection and evaluation, rehabilitation could be accomplished with less than \$100,000 per fourplex for each of the eight buildings. In addition, we proposed acquisition costs to be allocated no more than \$200,000 for each of the 3 buildings it planned to purchase with program funds. Therefore, we recommend that the Agency allocate no more than \$1.4 million for the entire Norcade project, to include sufficient funding for acquisition and rehabilitation to be performed by the developer under proper monitoring by the Agency and following all applicable regulations. Since it allocated \$4 million to the project, improvements to its controls would allow \$2.6 million in funds to be put to better use (see appendix A-1).

Excessive Profit and Overhead

The Agency approved the construction company (owned by the developer) to earn 20 percent in profit and overhead when the average for similar projects averaged about 9.62 percent for other developers. The Agency also did not reimburse the developer based on actual expenditures; rather, it was based on percentage of completion. This method provided the developer/construction company the opportunity to earn more profits by incurring more expenses (including some unnecessary expenses). Since the amount of

profit and overhead (20 percent) is calculated based on its expenses, the higher the costs incurred, the more profit the developer stood to gain.

Poor Monitoring

The Agency also allowed its finance analyst to fill in and approve labor and material costs when the construction technician was on leave. The analyst and immediate supervisor acknowledged that the analyst did not have construction experience nor an understanding of what costs were necessary and reasonable.

The approved Lerwick Road construction budget was not reasonable because the funds invested in each of the properties were disproportionate to the market value and included unnecessary upgrades. For the Lerwick Road properties, the market value for each fourplex was approximately \$250,000, which was determined by averaging the purchase price for each of the properties because only one appraisal was performed more than eight months after the purchase. Improvements to the Agency's management controls to ensure that construction budgets and costs are reasonable and necessary would enable \$1.2 million (see appendix A-1) in program funds to be put to better use in the future.

Excessive Finance Costs

According to Federal requirements cited previously, allowable costs for Federal awards must meet the general criteria of necessary and reasonable for proper and efficient performance and administration of Federal awards and be adequately documented (see appendix C). On June 11, 2008, the Agency approved a loan agreement which allowed the developer to borrow \$1.5 million from a private lender to purchase various parcels along Lerwick Road. However, it neglected to ensure that the finance cost of the loan was reasonable and necessary.

The loan permitted the lender to immediately earn 10 percent (\$150,000) as an origination fee, and, therefore, the loan was recorded at \$1.65 million. In addition, the loan amount accrued an annual interest rate of 12 percent compounded monthly. When the loan became overdue, the lender earned additional interest on the loan. Ultimately, the private lender earned \$392,500 in 15 months for a total return on investment rate of 26.17 percent. However, only \$107,053 was charged to program funds. Based on our analysis of the Agency's records, these funds were charged to the Norcade project. But, because the agreement was for the Lerwick property, \$107,053 was ineligible (see table below).

Norcade Circle project	Program funds
July 9, 2009	\$ 74,202.67
August 11, 2009	\$ 13,657.12
September 23, 2009	\$ 19,193.37
Total	\$ 107,053.16

Unsupported and Ineligible Costs

Labor and Material Costs

According to, Appendix B of 2 CFR 225(h)(1) charges to Federal awards for salaries and wages will be based on documented payrolls (see appendix C). We reviewed the agency documentation of Lerwick Road expenditures, including construction company payroll records, and determined that \$260,546⁴ spent for labor and material was unsupported (see appendix A-2). The process used by the Agency to review labor and materials was insufficient. It did not verify that the expenses submitted by the developer and/or its construction company were properly supported and for actual expenses as required. Instead, the Agency approved costs based on percentage of completion. There were few records showing actual expenditures as required. When records were available, they did not adequately track expenditures. The construction technician who administered the project stated that the spreadsheet he used was inaccurate and, thus, would not provide it. He also stated that he was not proficient in the spreadsheet software.

Administrative Costs

According to HUD's guidance, for-profit developers may not incur administrative costs but may charge fees and earn profits (see appendix C). The Agency allowed the developer to earn \$1,000 per week in administrative costs for the Norcade Circle projects where the developer's fee had been budgeted for \$425,000. The developer billed \$31,000 of which nearly 80 percent was charged to the program. Based upon our analysis of the Agency's records, \$24,714 (see appendix A-3) of the claimed cost was ineligible. The administrative invoices submitted by the developer did not detail any accomplishments; rather, it was an automatic payment to the developer for the Norcade Circle projects.

Appraisal and Environmental Requirements Not Met

According to 74 Federal Register 29225 and 73 Federal Register 58331 the purchase price of a foreclosed-upon home or residential property must reflect a discount from the current market value of the property and appraisals must be performed 60 days before an offer is made for the property (see appendix C). In addition, 24 CFR 58.30(b) states that the environmental review process should begin as soon as a recipient determines the project's use of HUD funding.

⁴ In finding 1, we determined that five of the Lerwick properties were ineligible. As a result, the unsupported costs of \$260,546 have been included in the ineligible expenses questioned in finding 1 and not included as questioned costs for finding 2 to avoid duplication.

Several properties were purchased without the required appraisals and environmental reviews. For example, the Agency used program funds for the acquisition of two Norcade Circle properties that had appraisals either conducted after or a day before the purchase (recording) date. See property number 2 in the table below. It is difficult to conclude the real current market value of a property when appraisal values are not known before the purchase.

	Assessor parcel number ⁵	Purchase amount	Acquisition amount charged to program funds	Purchased (recording date)	Appraisal date
1	075-0161-005-0	\$180,000	\$176,200	7/15/09	10/2/09
2	075-0161-007-0	\$203,000	\$207,719	10/20/09	10/19/09
	Total	\$383,000	\$383,919		

Conclusion

The Agency lacked effective management controls to monitor its program grant in accordance with pertinent grant requirements and regulations. Specifically, it failed to properly account for and manage its grant funds. These weaknesses resulted in more than \$3.9 million in ineligible costs and funds to be put to better use. Accordingly, HUD had no assurance that program funds were used only for authorized and allowable expenses.

⁵ The two properties were awaiting environmental reviews.

Recommendations

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

- 2A. Take action to implement management controls to ensure that funds budgeted and expended are reasonable and necessary. Such corrective action will ensure that \$3.8 million in program funds can be put to better use.
- 2B. Repay HUD from non-Federal sources \$107,053, which it expended on ineligible finance costs.
- 2C. Repay HUD \$24,714 from non-Federal sources for ineligible administrative costs.

Finding 3: The Agency Failed To Meet Its Reporting Requirements

The Agency failed to meet its reporting requirements for activities funded by the program. This condition is due to a decision made by management to not report any expenditure in the Disaster Recovery Grant Reporting system (reporting system) until the conclusion of this audit to ensure that funds reported did not include ineligible expenses. In addition, the Agency did not have policies and procedures to ensure proper reporting of program funds. As a result, HUD was unable to collect information to exercise proper oversight of the program to prevent fraud, waste, and abuse of funds.

The Agency Failed To Report Expenditures

Federal program requirements at 73 FR (Federal Register) 58331 state that each grantee must submit a quarterly performance report, as HUD prescribes, no later than 30 days following the end of each quarter. Each report will include information about the uses of funds, including but not limited to

- Project name, activity, location, national objective;
- Funds budgeted and expended; and
- Funding source and total amount of any nonprogram funds

Grantees must submit reports using HUD's Web-based reporting system and, at the time of submission, be posted prominently on the grantee's official Web site. Contrary to the requirements, not only did the Agency not upload the reports to its web site⁶, it also did not report essential information about the projects to HUD. Further, it withheld information when reporting on its quarterly progress reports; specifically the Block and Acquisition Rehabilitation program for the County of Sacramento. As of the second quarterly progress report, the Agency had not reported any expenditures even though expenses were already being incurred.

Consequently, the Agency was not being transparent to HUD and the public on how the funds were spent. The problem occurred because management decided not to report draw downs or expenditures until the audit was complete to ensure that funds reported in the system did not include ineligible expenses. It also did not have policies and procedures in place to ensure that reporting requirements are met as required by program requirements.

⁶ To date, the Agency has only published a "report card" on its Web site, dated October 2009. The Agency uses the report card as a system for distributing information to the public to show how the Agency is meeting its program and project goals. However, the information in the report card did not reflect up-to-date information and lacked the specific details on how the programs funds were allocated and expended.

Corrective Action

We informed agency management that it is a violation of program requirements to withhold information in its quarterly progress reports. The staff explained that the agency did not want to report any expenditure that could be ineligible. As a result, it decided to not report any expenditure in the system until the audit was complete. Since we determined that the Agency was noncompliant, management stated that it would report expenditures in its third quarterly progress report. We verified that the Agency had begun to comply with this requirement.

Conclusion

The Agency did not meet reporting requirements because it lacked policies and procedures to ensure proper reporting of its program-assisted projects as required. The problem was compounded by the fact that management decided not to report any expenditure until the audit was complete to ensure that program funds reported in the system did not include ineligible expenses. As a result, the Agency was not being transparent about its program funds used. Without proper reporting, HUD cannot adequately exercise proper oversight of the program to prevent fraud, waste, and abuse of funds.

Recommendation

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

- 3A. Develop and implement policies and procedure to ensure proper reporting in the reporting system and posting to its web site as required.

SCOPE AND METHODOLOGY

We performed our onsite audit work at the Agency, located in Sacramento, CA, between October and December 2009. Our audit generally covered the period from October 1, 2008, through October 31, 2009. We expanded our scope as necessary.

To accomplish our objective, we reviewed

- The Act
- The program bridge notice, dated June 19, 2009
- 73 FR 58331
- HUD regulations at 24 CFR Parts 85, 92, and 570
- 2 CFR 225
- The Davis-Bacon Act
- OMB Circular A-133
- The Agency's substantial amendment to its 2008-2009 action plan for the County of Sacramento
- The program grant agreement, approved January 30, 2009
- Organizational charts
- HUD monitoring reports
- HUD's reporting system
- The single audit report for the year ending December 31, 2008
- The Agency's internal policies and procedures that support program activities. We also reviewed the Agency's financial management, procurement, and monitoring policies and procedures
- The Agency's loan agreements, owner participation agreements, staff reports related to the review of our audit
- We did not use the Agency's computerized data with the exception of reports generated from its accounting system which we determined to be reasonably reliable. We reviewed expenditure reports, journal vouchers, and supporting documentation related to the projects selected for review
- We also interviewed Agency staff and HUD employees and conducted site visits.

HUD approved three activities to be implemented with program funds. In order to determine whether the allegations in the complaint had merit, we selected a nonstatistical sample of projects under the Block Acquisition/Rehabilitation program for the County of Sacramento.

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 reasonable basis for our findings and conclusions based on our audit objective. 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 an integral component of an organization's management that provides reasonable assurance that the following objectives are achieved:

- Program operations,
- Relevance and reliability of information,
- Compliance with applicable laws and regulations,
- 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:

- Administering the Neighborhood Stabilization Program in compliance with HUD regulations.
- Performing appropriate monitoring of the program.
- Reporting obligations and expenditures of grant funds.

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 Agency lacked controls to ensure funds were reasonable, necessary, and eligible (Finding 1 and 2).
- The Agency lacked management controls to ensure proper monitoring of its program projects (Finding 2).
- The Agency lacked policies and procedures to ensure proper reporting of expenditures to HUD's reporting system (Finding 3).

APPENDIXES

Appendix A

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

Recommendation number	Ineligible <u>1/</u>	Funds to be put to better use <u>2/</u>
1A	\$982,820	
1B		\$1,517,180
2A		\$3,800,000
2B	\$107,053	
2C	\$24,714	
Total	\$1,114,587	\$5,317,180

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.

2/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an 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. Implementation of our recommendations and improvement of controls would ensure \$5.3 million in funds be put to better use that had not been spent as of December 31, 2009.

Appendix A-1

SCHEDULE OF FUNDS TO BE PUT TO BETTER USE

Calculation of \$3.8 million in funds to be put to better use.

Lerwick:

In finding 1, we determined that five of the eight Lerwick properties were ineligible for rehabilitation using program funds. Therefore, we recommended that nearly \$1 million be repaid from non-Federal funds and more than \$1.5 million be reprogrammed from eligible and approved program projects. Consequently, based on our review, the eligible properties located on Lerwick were assessor parcel numbers 254-0131-041-0000 and 254-0131-029-0000. There was another potential property that could be eligible for program funding as well, but it was yet to be acquired.

	Assessor parcel number	Budget amount (program funds)	Proposed rehabilitation costs by HUD OIG appraiser	Difference (funds to be put to better use)
		A	B	A-B
1	254-0131-041-0000	\$500,000	\$100,000	\$400,000
2	254-0131-029-0000	\$500,000	\$100,000	\$400,000
3	Yet to acquire	\$500,000	\$100,000	\$400,000
	Total	\$1,500,000	\$300,000	\$1,200,000

Norcade:

Based on the results from the HUD OIG appraiser’s evaluation, a proper rehabilitation could be accomplished with less than \$100,000 per fourplex. In addition, the market value for the properties located at Norcade Circle is about \$190,000. To be conservative, we proposed acquisition for each of the property to be \$200,000 per building. Consequently, we recommend the following as funds to be put to better use.

	Accessor parcel number	Acquisition program funds eligible (Y/N)	Rehabilitation program funds eligible (Y/N)	Program funds proposed budget per building by Agency	HUD OIG proposed acquisition	HUD OIG proposed rehabilitation
1	075-0162-006-0	Yes	Yes	\$500,000	Not applicable – purchased with non-Federal funds	\$100,000
2	075-0161-017-0	Yes	Yes	\$500,000	Not applicable – purchased with non-Federal funds	\$100,000
3	075-0161-006-0	Yes	Yes	\$500,000	Not applicable – purchased with non-Federal funds	\$100,000
4	075-0161-005-0	Yes	Yes	\$500,000	\$200,000	\$100,000
5	Yet to acquire	No	Yes	\$500,000	Not applicable	\$100,000
6	Yet to acquire	No	Yes	\$500,000	Not applicable	\$100,000
7	075-0161-007-0	Yes	Yes	\$500,000	\$200,000	\$100,000
8	Yet to acquire	Yes	yes	\$500,000	\$200,000	\$100,000
			Total	\$4,000,000	\$600,000	\$800,000
\$4,000,000 - \$1,400,000 = \$2,600,000						

Summary

Project	Funds to be put to better use
Lerwick	\$1,200,000
Norcade	\$2,600,000
Total	\$3,800,000

Appendix A-2

SCHEDULE OF UNSUPPORTED LABOR AND MATERIAL COSTS

Draw number	HUD OIG review		Total	Amount paid by Agency for each draw request	Total: unsupported costs
	Actual labor	Actual materials		Amount paid	
	A	B	C	D	E
			(A+B)		(D-C)
4+5	\$55,813.96	\$242,555.10	\$298,369.06	\$401,462.61	\$103,093.55
6	\$73,306.79	\$203,157.01	\$276,463.80	\$325,186	\$48,722.20
8	\$165,161.21	\$164,374.68	\$329,535.89	\$221,197	(\$108,338.89)
10	\$68,129.39	\$20,514.58	\$88,643.97	\$162,073.13	\$73,429.16
11	\$125,823.61	\$12,241.35	\$138,064.96	\$98,282.39	(\$39,782.57)
13	\$27,510.81	\$50,163.95	\$77,674.76	\$261,097.64	\$183,422.88
Total	\$515,745.77	\$693,006.67	\$1,208,752.44	\$1,469,298.77	\$260,546.33

Note: In finding 1, we determined that five Lerwick properties were ineligible. To avoid duplication of questioned costs, we did not include \$260,546 as unsupported costs but merely point out that the Agency lacked the necessary controls to administer its program.

Appendix A-3

SCHEDULE OF INELIGIBLE ADMINISTRATIVE COSTS

Date	Administrative costs charged to program funds
7/9/09	\$9,000
8/11/09	\$4,800
9/23/09	\$1,600
9/24/09	\$1,600
11/30/09	\$5,143
11/30/09	\$2,571
Total	\$24,714

Appendix A-4

SCHEDULE OF INELIGIBLE REHABILITATION COSTS FOR FIVE INELIGIBLE PROPERTIES AND FUNDS TO BE PUT TO BETTER USE

Amount expended on each property				
A	B	A/B = C		
Expended amount as of 12/31/09	Number of properties purchased	(Prorated) amount spent on each property		
\$1,375,945	7	\$196,564		
Ineligible costs				
A	B		A x B = C	
(Prorated) amount spent on each property	Ineligible properties for the rehabilitation: purchased before amendment	Ineligible property for rehabilitation: not foreclosed upon or abandoned	Ineligible rehabilitation costs	
\$196,564	5		\$982,820	
		Total	\$982,820	
Funds to be put to better use				
A	B	A X B = C	D	C - D = E
Budgeted amount per property	Number of ineligible properties for rehabilitation	Total	Ineligible expenses	Funds to be put to better use
\$500,000	5	\$2,500,000	\$982,820	\$1,517,180
As authorized by 24 CFR 570.910(b)(2)(iii), we recommend that more than \$1.5 million be reprogrammed to other eligible program activities for funds to be put to better use. If not, return funds to HUD.				

Note: We prorated the amount because the Agency did not maintain separate expenditures for each of the properties.

Appendix B


AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

Comment 1

Comment 2



INVESTING IN COMMUNITIES

May 13, 2010

A Joint Powers Agency

MEMBERS

City of Sacramento
County of Sacramento
Redevelopment Agency of the City of Sacramento
Redevelopment Agency of the County of Sacramento
Housing Authority of the City of Sacramento
Housing Authority of the County of Sacramento

Joan S. Hobbs
Regional Inspector General for Audit
US Department of Housing and Urban Development
611 West Sixth Street, Suite 1160
Los Angeles, CA 90017-3101

Dear Ms. Hobbs:

The purpose of this letter is to transmit the Sacramento Housing and Redevelopment Agency's (Agency) formal written response to the Office of Inspector General's (OIG) Findings Report regarding the Neighborhood Stabilization Program (NSP). The Agency asserts that the OIG's Findings do not appropriately account for the intent of the Housing and Economic Recovery Act (HERA) legislation or the limitations of the DRGR system when citing the Agency for non-compliance. The OIG's Findings can be summarized as 1) assistance to ineligible properties, 2) inadequate monitoring, and 3) failure in meeting reporting requirements.

In response, the Agency maintains:

- Only NSP-eligible properties have been assisted with these federal funds;
- Appropriate staffing and monitoring of the Sacramento NSP is underway with adequate internal controls in place to ensure compliance; and,
- All federal reporting requirements have been met.

The NSP was established for the purpose of stabilizing communities that have suffered from foreclosures and abandonment. Sacramento's NSP, administered by the Agency, has targeted those areas hardest hit by foreclosure and some of the most challenging neighborhoods in Sacramento. The Agency's implementation of NSP has received national attention for our innovative programs and leveraged approach to stabilizing neighborhoods. We are providing tangible results in areas that were completely de-stabilized as a result of economic forces. To date, Sacramento has invested NSP funds to impact over 292 properties, allowed for 42 new homeowners, retained 320 construction jobs, enabled 47 new construction hires, leveraged \$20 million in nonfederal funds and is having an immeasurable stabilizing effect on challenged neighborhoods.

Sacramento Housing & Redevelopment Agency | 801 12th Street | Sacramento, CA 95814 | www.shra.org

SHRA response to OIG findings report re NSP
Page 2

Comment 3

The Agency maintains that information contained in the OIG Findings are without merit and are inconsistent with HUD's direction for the use of NSP funds. HUD encouraged each grantee in the Federal Register as part of the NSP Notice issued on October 6, 2008, "to carry out its NSP activities in the context of a comprehensive plan for the community's vision of how it can make its neighborhoods not only more stable, but also more sustainable, competitive, and integrated into the overall metropolitan fabric, including access to transit, affordable housing, employers, and services." The audit reviewed all the Agency's NSP programs but focused on a particular Agency NSP activity known as the Block Strategy. This activity utilized a public private partnership in which the Agency leveraged private capital, local redevelopment funds and NSP to acquire, rehabilitate, and operate long term, very-low income rental housing. The Block Strategy activity is targeted to two of our most notorious and crime-plagued areas in the County of Sacramento – Lerwick Road and Norcade Circle.

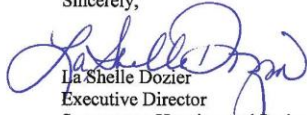
Comment 4

Comment 5

The stabilization of these two neighborhoods is of critical priority to the County of Sacramento and is consistent with HUD's written intent of implementing "a comprehensive plan to make neighborhoods more stable, sustainable, competitive and integrated into the overall metropolitan fabric." This highly targeted approach for the use of the NSP funds is consistent with the goals of the President, Congress, and HUD's goal of creating healthy sustainable neighborhoods, i.e. Choice Neighborhoods and Sustainable Communities.

Attached, is our response to the OIG's Findings. We are respectfully recommending that the OIG retract their Findings. If you have any additional questions please feel free to contact Geoffrey Ross at (916) 440-1357.

Sincerely,



LaShelle Dozier
Executive Director
Sacramento Housing and Redevelopment Agency

Attachment 1

OIG Finding #1: Agency allowed ineligible properties to be rehabilitated using Neighborhood Stabilization Program funds

Comment 6

The Agency disagrees with the OIG Finding and has determined that the Lerwick properties rehabilitated using NSP funds are program eligible. No NSP funds have been used to acquire or rehabilitate properties prior to the submittal of the Substantial Amendment. The Lerwick properties rehabilitated using NSP funds were vacant at the time they were acquired using private financing and local redevelopment funds. This was verified by independent third party real estate records and utility records from the Sacramento Municipal Utility District (SMUD).

Comment 7

The use of NSP funds for the rehabilitation of vacant properties at Lerwick Road is eligible under 2301(c)(3)(E) in accordance with the HUD guidance released on June 16, 2009. The Agency determined the rehabilitation of vacant Lerwick properties to be eligible for NSP upon release of the HUD guidelines. Listed below is a timeline of the Agency Block Strategy activity:

- June 3, 2008 Agency loan commitment to EPO Development with local funds.
- July 14, 2008 EPO Development begins purchasing vacant Lerwick properties for acquisition/rehabilitation utilizing private financing and local funds.
- October 21, 2008 Agency submits substantial amendment identifying Lerwick Road and other areas as potential Block strategy target areas.
- February 24, 2009 Agency amends Sacramento NSP and adds Lerwick Road to Block strategy.
- June 16, 2009 HUD issues clarification on use of NSP regarding eligible use (E). Agency makes determination that vacant properties may be rehabilitated under eligible use (E) with NSP funds.
- July 5, 2009 Agency began spending NSP funds for rehabilitation of eligible vacant properties per eligible use (E).

Comment 8

Pursuant to section 570.202, rehabilitation costs are an eligible activity eligible to be funded out of the NSP grant. The narrative description submitted as part of the Substantial Amendment and the subsequent amendments consistently have described the Block/Acquisition Rehabilitation Strategy as targeting “vacant and foreclosed homes.” The Agency has reviewed the OIG’s Finding and does not see the justification for ineligibility and the return of funds.

OIG Finding #2: Agency Did Not Adequately Monitor its Neighborhood Stabilization Projects

Comment 9

The Agency disagrees with the OIG’s Finding and asserts that adequate monitoring has taken place.

Comment 10

Recommendation 2A. The OIG assumptions regarding the condition of the Lerwick properties are based upon a limited scope lead based paint survey report of the vacant properties. The consultant that issued the lead-based survey report is identified as an inspector for childhood lead poisoning and is not a licensed contractor or appraiser.

Comment 11

The Lerwick construction budget is necessary and reasonable per OMB A-87 Attachment A. The funds allocated for the rehabilitation of the project are consistent with policies, regulations, and procedures that apply uniformly to both Federal awards and the activities of the local government, are accorded consistent treatment, and are adequately documented.

Comment 12

The Agency's construction standards are derived from its Multifamily Lending and Mortgage Revenue Bond Policies (MF Lending Policies)¹. The MF Lending Policies are local policies adopted by the Board of Supervisors of the County of Sacramento and City Council of the City of Sacramento indicative of current market conditions. Section 4.10 of the Agency's MF Lending Policy states: "The project must meet the Agency's minimum construction standards in which all major systems have an expected life of at least fifteen years upon completion of the renovation." The MF Lending Policies are consistent with and comply with OMB A-87 Attachment A because they detail the restraints or requirements for acquisition rehabilitation projects, consider market prices for comparable goods and services, were adopted by the local jurisdictions governing board and uniformly makes applicable the construction standards to all developers so that there are no significant deviations from the established practices.

The Agency's construction standards are derived from the Agency's core business of financing housing developments with long-term affordability restrictions, such as Lerwick Road, which is subject to a 55-year regulatory agreement. The Agency's construction standards are consistent with the HERA statute wherein "rehabilitation of a residential property shall be to the extent necessary to comply with applicable laws, codes, and other requirements relating to housing safety, quality and habitability and wherein rehabilitation may include improvements to increase energy efficiency or conservation."²

The affordability restrictions significantly reduce a project's cash flow and limit the developer's ability to refinance to pay for future improvements. The threshold of a 15-year useful life ensures that a project remains viable for at least 15 years. All developers working with the Agency are required to establish a scope of work and budget that is consistent with the 15 year requirement. Accordingly, the Agency has established management controls as represented by the MF Lending Policies to ensure that funds budgeted and expended are reasonable and necessary.

Comment 13

Recommendation 2B. As documented by Agency records, no conventional lender was willing to provide financing for property acquisition given the challenging location, size, value and physical conditions of the structures. As a result, EPO had to secure private financing and pay a one-time origination fee in the form of 10 points to undertake the project. The interest rate was 12 percent. The higher interest rate was due to market conditions requiring non-conventional lending, but necessary to proceed with the project. Notably, the loan agreement for private financing was originally for the Lerwick Road project; however, after the Norcade Circle project was approved, the lender, at its discretion, allowed funds to be used for Norcade as well. During the time period between the fall of 2008 and the fall of 2009, all of the Agency's Multifamily rehabilitation projects were stalled because they could not secure conventional financing. The result was that many projects did not move forward and or had to be restructured.

The only exceptions being the Lerwick and Norcade projects. The \$107,053 financing expense incurred by EPO was appropriate and reasonable given the volatile economic market conditions and nature of the project (location size, value, physical condition, etc.), the financing provided by the lender was for both projects, and accordingly the finance expenses are an eligible NSP expenditure. No repayment should be required.

¹ Adopted by resolution in 1999 and revised in 2005 and 2009.

www.shar.org/content/housing/housingdevelopment/mrb/shramultifamilylendingpolicies.pdf

² PUBLIC LAW 110-289—JULY 30, 2008, 122 STAT. 2851; Title III (d) Limitations, (2) Rehabilitation

Comment 14

Recommendation 2C. The \$24,714 administrative costs identified by the OIG were inappropriately categorized by the developer on an invoice as an administrative cost instead of a developer fee. The \$24,714 is eligible as a developer fee because it is related to draws and record keeping associated with the requirements of the NSP and Agency construction procedures. The Agency appropriately charged these cost to the developer fee and not as administrative. As such, no repayment should be required.

Comment 15

Recommendation 2D. The final settlement statement for Norcade Circle, dated October 21, 2009, provides adequate support for the closing costs associated with the transaction. Per your recommendation the supporting documentation for cost is attached.

Comment 16

OIG Finding #3: The Agency Failed to Meet its Reporting Requirements

The Agency disagrees with the OIG Finding and maintains it has been and remains both transparent and accountable with its use of NSP funding. The Agency held numerous public meetings regarding NSP in an effort to conduct business in an open and transparent manner.

Further, the statement that expenditures were not being reported until after the audit to ensure that funds reported did not include ineligible expenses is misleading. The Agency reported all obligations and expenditures for the NSP program in the quarter for which access to the DRGR system was granted.

Comment 17

Prior to **October 15, 2009**, HUD had not provided the Agency access to the DRGR system for reporting obligations, expenditures or for processing draw downs of NSP funding. The lack of access to DRGR prohibited the Agency from completing quarterly progress reporting for June 2009 and September 2009. The DRGR system does not allow the reporting of activities, expenditures, obligations or draw downs for prior quarters. Once the Agency was granted system access the Agency immediately commenced with the set up of NSP programs in DRGR. Within 45 days, the Agency was inputting NSP obligations, expenditures and draw downs.

The Agency has adopted all of HUD's policies and procedures as demonstrated in the completion of the December 2009 and March 2010 Quarterly Reports. However, as noted in the HUD OIG audit report of the DRGR system (2009-DP-0007) issued **September, 30 2009**, the DRGR system lacked proper access controls, user manuals and policies and procedures. Despite the difficulty accessing the system and the absence of detailed user manuals, the Agency began DRGR reporting at the first available opportunity and in a timely manner. The OIG's assertions are misleading. The Agency remains fully committed to ensuring the successful implementation of the NSP programs in full compliance with the regulations and spirit of HERA.



Fidelity National Title Company
OF CALIFORNIA

105 W. El Portal Drive, Merced, CA 95340
209 722-3911 • FAX 209 723-1958

DATE: October 21, 2009
ESCROW NO.: 09-3004047-JC
LOCATE NO.: CAFNT0934-0924-0001-0001107679
ESCROW OFFICER: Judy Caplan

TIME: 10:12 AM

CLOSING DATE: October 20, 2009

BUYER FINAL CLOSING STATEMENT

SELLER: Deutsche Bank National Trust Company as trustee under pooling and servicing agreement dated as of August 1, 2005 Morgan
BUYER: EPO Norcade, LLC
PROPERTY: 2920 Norcade Circle, Sacramento, CA 95826

	\$ DEBITS	\$ CREDITS
FINANCIAL:		
Total Consideration	203,000.00	
Deposit - EPO Norcade, LLC		5,000.00
Deposit - SACRAMENTO HOUSING & REDEV		207,718.99
PRORATIONS/ADJUSTMENTS:		
Prepaid County Taxes at \$4,269.29 Annual from 10/20/2009 to 7/1/2010	2,976.63	
Home Owners Association Dues at \$259.00 Monthly from 10/20/2009 to 11/1/2009	94.97	
TITLE CHARGES:		
Recording Deed	15.00	
ESCROW CHARGES:		
Escrow Fee to Fidelity National Title	325.00	
Overnight Delivery Fee	25.00	
MISCELLANEOUS:		
Fulbridge Construction for Course of Construction Insurance	590.00	
<hr/>		
BUYERS REFUND	\$5,692.39	
TOTALS	\$212,718.99	\$212,718.99

SAVE THIS STATEMENT FOR INCOME TAX PURPOSES

OIG Evaluation of Auditee Comments

- Comment 1** We disagree that the findings do not appropriately account for the intent of the Housing and Economic Recovery Act (HERA) legislation and our review did take into account the limitations of HUD's reporting system when citing the Agency for non-compliance. In addition to initially not reporting program data, we identified rehabilitation of ineligible properties, unreasonable and unnecessary expenditures and a lack of adequate monitoring.
- Comment 2** We agree that the NSP was established for the purpose of stabilizing communities that have suffered from foreclosures and abandonment. However, the Agency was responsible for ensuring that program funds were used in accordance with all program requirements, as required by 24 CFR 570.501(b). In addition, in order to be allowable under federal awards, costs must have been necessary and reasonable for proper and efficient performance and administration of Federal awards as required by Appendix A of 2 CFR 225 (c)(1)(a). Based on our audit fieldwork and as shown in this report, it was apparent that the Agency did not administer the program in accordance with HUD rules and regulations.
- Comment 3** We disagree. Our findings are based on the results of our audit work.
- Comment 4** In order to determine whether the allegations in the hotline complaint had merit, we selected a nonstatistical sample of projects under the Block Acquisition Rehabilitation program for the County of Sacramento.
- Comment 5** We disagree that implementing "...a comprehensive plan to make neighborhoods more stable, sustainable, competitive and integrated..." involves unnecessary and unreasonable rehabilitation costs for the two projects.
- Comment 6** We disagree. As outlined in finding 1, properties were purchased prior to the submission of an action plan (amendment); thus, no longer foreclosed-upon or abandoned, as required. As a result, the ineligible properties were not eligible for rehabilitation using program funds. In addition, according to HUD's guidance, NSP acquisitions are not authorized to begin until the grantee has submitted an action plan amendment to HUD which was determined to be November 26, 2008.
- Comment 7** According to the Agency's substantial amendment, eligible use for the HUD-approved program Block Acquisition/Rehabilitation program for both Lerwick and Norcade Circle was under eligible use sections 2301 (c)(3)(A) and (c)(3)(B) of Public Law 110-289. This required that the properties be foreclosed upon or abandoned. As stated in Comment 6, properties purchased prior to submission of an amendment were considered no longer foreclosed-upon or abandoned. In addition, HUD approved \$18.6 million based on the Agency's substantial amendment of eligible use sections 2301(c)(3)(A) and (c)(3)(B).

According to program regulation 24 CFR 570.463(a), "applicants must submit to the HUD Area Office and to Central Office all revisions to the application. A revision is considered significant if it alters the scope..." In addition, 24 CFR Part 91.505(a)(3) states that the jurisdiction shall amend its approved plan whenever it makes a change to the purpose, scope, location, or beneficiaries of an activity. This was not done according to HUD representatives.

- Comment 8** We agree that section 570.202, rehabilitation costs are an eligible activity. However, the costs to rehabilitate ineligible properties are not eligible. See comment 6.
- Comment 9** We disagree. Our review identified numerous instances of ineffective management controls to monitor its program grant in accordance with pertinent grant requirements and regulations. Contrary to the requirement, the Agency approved unreasonable and unnecessary upgrades and construction budgets, a loan with excessive finance costs, ineligible and unsupported costs, and did not ensure that appraisal and environmental reviews were performed in accordance with program requirements.
- Comment 10** The consultant that issued the report inspected the properties on September 29, 2008 which was at least five months before the rehabilitation started. Although the consultant performed a limited review, his comments are based on visual inspections of the buildings before any rehabilitation had taken place. As required by section 58.40(a), the environmental assessment must "determine existing conditions and describe the character, features and resources of the project area and its surroundings..." which the consultant did. The consultant described the general condition, at the time, which includes exterior walls as well as interior ceilings, walls, trims, baseboards, and door painted surfaces. In addition, the consultant indicated that the condition of the structures was good to excellent. The Agency failed to have appraisals performed 60 days prior to an offer made. In fact, only one of the Lerwick properties had an appraisal performed which occurred eight months after the purchase. Thus, the only accurate depiction of the properties would be by the consultant who conducted the environmental review.
- Comment 11** We disagree. According to Appendix A of 2 CFR 225(c)(2), a cost is reasonable if, in its nature and amount it does not exceed what a prudent person would incur under the circumstances prevailing at the time the decision was made (see appendix C). The approved Lerwick Road construction budget was not reasonable because the funds invested in each of the properties were disproportionate to the market value and included unnecessary upgrades.
- Comment 12** According to the Agency's Multifamily Lending Policies Exhibit 5: Rental Property Minimum Construction Standards: General Conditions - It is not the intent of the Agency to replace systems that appear to have some economic life remaining and appear to be maintained and functioning effectively.

Based on our site inspections, there were appliances, kitchen cabinets, bathroom and kitchen accessories that did not require upgrades. At the time of our inspection, most of the items had been removed by the developer and there was no documentation indicating the condition and functioning capability of any of them at the time of removal. No records were provided to support that funds used for replacement of the items were reasonable and necessary.

Comment 13 We disagree. According to 2 CFR 225(c)(1)(a) and 225(c)(1)(j), costs must be necessary and reasonable for proper and efficient performance and administration of federal awards and be adequately documented. As stated in the audit report, the Agency approved a loan agreement which allowed the developer to borrow \$1.5 million from a private lender to purchase various parcels along the Lerwick Road. However, it neglected to ensure that the finance costs of the loan were reasonable and necessary because it permitted the private lender to earn \$392,500 in 15 months for a total return on investment rate of over 26 percent. The agreement was for the Lerwick property and not the Norcade property; thus, \$107,053 was ineligible.

Comment 14 According to HUD's guidance, for profit developers may not incur administrative costs but may charge fees and earn profits. As discussed in the audit report, the administrative invoices submitted by the developer did not detail any accomplishments; rather it was an automatic payment to the developer for the Norcade Circle projects. Documentation in the files showed the developer had already submitted and received reimbursement for developer fees.

Comment 15 We reviewed the final closing costs statement provided by the Agency and have removed \$4,719 as an unsupported cost in Finding 2.

Comment 16 We disagree. Agency senior management stated in various interviews that it would not report expenditures until the audit was complete to ensure funds reported in HUD's system did not include ineligible expenses. In addition, its quarterly progress reports were not posted prominently to its website after the reports were submitted in HUD's system, as required. Instead, all of the quarterly reports were posted on April 1, 2010.

Comment 17 We recognized and took into account the delays with access to the DRGR system.

Appendix C

CRITERIA

Public Law 110–289—JULY 30, 2008

- **Section 2301(c)(3)(A):** Establish financing mechanisms for purchase and redevelopment of foreclosed upon homes and residential properties...
- **Section 2301(c)(3)(B):** 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.

Guidance on NSP [program]-Eligible Acquisition and Rehabilitation Activities obtained from HUD's Web site

- NSP1 acquisitions are not authorized to begin until the grantee has submitted an action plan amendment to HUD. For most NSP1 grantees, the earliest acquisition start date would be December 1, 2008. For most NSP1 grantees, the earliest acquisition start date would be December 1, 2008, but for those grantees that submitted an action plan amendment prior to December 1, 2008, an earlier date could be acceptable.
- In addition to submitting an action plan amendment, NSP1 grantees must comply with the environmental review, purchase discount and other eligible-use criteria discussed in the Guidance on Eligible uses prior to acquiring properties under NSP1. If the acquisition is performed by a subrecipient, private developer or homebuyer, the grantee must give permission or enter into an agreement prior [to] the acquisition.
- Properties acquired out of foreclosure before these requirements have been met are not eligible for NSP1 assistance.
- Developers may not incur administrative costs but may charge fees and earn profits.

73 FR 58331

- **II. Alternative Requirements and Regulatory Waivers** The NSP grant is a special CDBG [Community Development Block Grant] allocation to address the problem of abandoned and foreclosed homes.
- **II(A) Definitions for Purposes of the CDBG Neighborhood Stabilization Program**
 1. **Abandoned.** A home is abandoned when mortgage or tax foreclosure proceedings have been initiated for that property, no mortgage or tax payments have been made by the property owner [in] at least 90 days, and the property has been vacant for at least 90 days.
 2. **Current market appraised value.** The current market appraised value means the value of a foreclosed upon home or residential property that is established through an appraisal made in conformity with the appraisal requirements of the URA [Uniform Relocation Assistance and Real Property Acquisition Policies

Act] at 49 CFR 24.103 and completed within 60 days prior to an offer made for the property by a grantee, subrecipient, developer, or individual homebuyer.

3. **Foreclosed.** A property “has been foreclosed upon” at the point that, under state or local law, the mortgage or tax foreclosure is complete. HUD generally will not consider a foreclosure to be complete until after the title for the property has been transferred from the former homeowner under some type of foreclosure proceeding or transfer in lieu of foreclosure, in accordance with state or local law.
- **Paragraph H Eligibility and Allowable Costs (3)(b):** HUD will not consider requests to allow foreclosure prevention activities, or to allow demolition of structures that are not blighted, or to allow purchase of residential properties and homes that have not been abandoned or foreclosed upon as provided in HERA [the Act] and defined in this notice. HUD does not have the authority to permit uses or activities not authorized by HERA.
 - **Paragraph O Reporting (1)(b)(i):** Each grantee must submit a quarterly performance report, as HUD prescribes, no later than 30 days following the end of each quarter, beginning 30 days after the completion of the first full calendar quarter after grant award and continuing until the end of the 15th month after initial receipt of grant funds. In addition to this quarterly performance reporting, each grantee will report monthly on its NSP obligations and expenditures beginning 30 days after the end of the 15th month following receipt of funds, and continuing until reported total obligations are equal to or greater than the total NSP grant. After HUD has accepted a report from a grantee showing such obligation of funds, the monthly reporting requirement will end and quarterly reports will continue until all NSP funds (including program income) have been expended and those expenditures are included in a report to HUD, or until HUD issues other instructions..... Each report will include information about the uses of funds including, but not limited to, the project name, activity, location, national objective, funds budgeted and expended, the funding source and total amount of any non-NSP funds, numbers of properties and housing units, beginning and ending dates of activities, and numbers of low- and moderate-income persons or households benefiting. Reports must be submitted using HUD’s web-based DRGR [reporting] system and, at the time of submission, be posted prominently on the grantee’s official Web site.

74 FR 29225 The address, appraised value, purchase offer amount, and discount amount of each property purchase must be documented in the grantee’s program records. As noted in the discussion of the NSP purchase discount requirements, section 2301(d)(1) of HERA required that the purchase price of a foreclosed upon home or residential property must reflect a discount from the current market appraised value of the property. The October 6, 2008, notice defined “current market appraised value” to mean the value of the property established through an appraisal made in conformity with URA appraisal requirements.

Federal (HUD) regulations at 24 CFR

24 CFR Part 570

- **570.463(a) Pre-approval revisions to the application.** Applicants must submit to the HUD Area Office and to Central Office all revisions to the application. A revision is considered significant if it alters the scope, location, or scale of the project or changes the beneficiaries' population. The applicant must hold at least one public hearing prior to making a significant revision to the application.
- **570.463(b) Post preliminary approval amendments.** Applicants receiving preliminary approval must submit to the HUD Central Office, a request for approval of any significant amendment. A copy of the request must also be submitted to the Area Office. A significant amendment involves new activities or alterations thereof which will change the scope, location, scale, or beneficiaries of such activities or which, as a result of a number of smaller changes, add up to an amount that exceeds ten percent of the grant.
- **570.501(b)** states that 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 actions when performance problems arise...
- **570.506** require each recipient to establish and maintain sufficient records to enable the [HUD] Secretary to determine whether the recipient has met the requirements of this part.
 - (a) The recipient shall maintain records which will provide a full description of each activity assisted with CDBG funds, including its location, the amount of CDBG funds budgeted, obligated, and expended for the activity.
 - (h) Recipients shall maintain evidence to support how the CDBG funds provided to such entities are expended. Such documentation must include, to the extent applicable, invoices, schedules containing comparisons of budgeted amounts and actual expenditures, construction progress schedules signed by appropriate parties, and/or other documentation appropriate to the nature of the activity.

24 CFR 58.30(b) states that the environmental review process should begin as soon as a recipient determines the projected use of HUD assistance.

24 CFR 58.40(a) states that in preparing the environmental assessment for a particular project, the responsible entity must determine existing conditions and describe the character, features and resources of the project are and its surroundings...

24 CFR Part 85

- **24 CFR 85.20(b)(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.

- **24 CFR 85.30(d)** Grantees or subgrantees must obtain the prior approval of the awarding agency whenever any of the following actions is anticipated:
 - **24 CFR 85.30(d)(1)** Any revision of the scope or objectives of the project (regardless of whether there is an associated budget revision requiring prior approval).
- **85.40(a)** states that grantees are responsible for managing the day-to-day operations of grant- and subgrant-supported activities. Grantees must monitor grant- and subgrant-supported activities to assure compliance with applicable federal requirements and that performance goals are being achieved. Grantee monitoring must cover each program, function, or activity.

24 CFR 91.505 Amendments to the consolidated plan.

- **91.505(a) Amendments to the plan.** The jurisdiction shall amend its approved plan whenever it makes one of the following decisions:
 - (3) To change the purpose, scope, location, or beneficiaries of an activity.

2 CFR 225

- Appendix A of 2 CFR 225 (c)(1) states that to be allowable under federal awards, costs must meet the following general criteria:
 - a. Be necessary and reasonable for proper and efficient performance and administration of Federal awards.
 - j. Be adequately documented.
- Appendix A of 2 CFR 225 (c)(2) A cost is reasonable if, in its nature and amount, it does not exceed what a prudent person would incur under the circumstances prevailing at the time the decision was made. In determining reasonableness of a given cost, consideration shall be given to:
 - a. Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the governmental unit or the performance of the federal award.
 - b. The restraints or requirements imposed by such factors as: sound business practices: arms 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.
 - d. Whether the individuals concerned acted with prudence in the circumstances considering their responsibilities to the governmental unit, its employees, the public at large, and the federal government.

- e. Significant deviations from the established practices of the governmental unit which may unjustifiably increase the Federal award's cost.
- Appendix B of 2 CFR 225 (h) Support of salaries and wages. These standards regarding time distribution are in addition to the standards for payroll documentation.
 - (1) Charges to Federal awards for salaries and wages, whether treated as direct or indirect costs, will be based on payrolls documented in accordance with generally accepted practice of the governmental unit and approved by a responsible official(s) of the governmental unit.

OMB Circular A-133, Subpart C (.300b). The auditee shall: ... (b) maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.