



U. S. Department of Housing and Urban Development
Office of Inspector General
New York/New Jersey Office
26 Federal Plaza–Room 3430
New York, NY 10278-0068

Memorandum No. 2011-NY-1801

April 7, 2011

MEMORANDUM FOR : Anne Marie Uebbing, Director, Office of Community Planning and Development, 2FD

Edgar Moore

FROM: Edgar Moore, Regional Inspector General for Audit, New York/New Jersey, 2AGA

SUBJECT: The City of East Orange Did Not Always Comply With HOME Program Requirements, Federal Regulations, and HOME Grant Agreements

INTRODUCTION

As part of our audit of the East Orange Revitalization and Development Corporation (Corporation)¹, we reviewed the City of East Orange's (City) compliance with the HOME Investment Partnerships Program (HOME) in regard to the eligibility of an awarded capacity building grant and developer fees awarded to the Corporation. This review raised issues that we wish to bring to your attention in regard to the City's compliance with HOME program requirements, Federal regulations, and HOME grant agreements.

During the audit of the Corporation, we found that the City did not always comply with HOME program requirements, Federal regulations, and HOME grant agreements. Specifically, City officials authorized the Corporation to use HOME program funds for (1) an ineligible capacity building grant, and (2) developer fees in excess of limits imposed by a HOME grant agreement between the City and the Corporation.

For each recommendation without a management decision, please respond and provide status reports in accordance with U.S. Department of Housing and Urban Development (HUD) Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the review.

The draft memorandum report was provided to City officials on March 4, 2011, and City officials provided a written response on March 25, 2011. City officials generally disagreed with our findings and recommendations. The complete text of City officials' response, along with our evaluation of that response, can be found in appendix B of this memorandum.

¹ This memorandum will be issued in conjunction with an audit report on the operations of the East Orange Revitalization and Development Corporation's compliance with HOME program requirements and Federal regulations.

METHODOLOGY AND SCOPE

In determining whether the City had complied with HOME program requirements, Federal regulations, and HOME grant agreements, we (1) reviewed relevant HOME program requirements and Federal regulations; (2) interviewed staff from the New Jersey Office of Community Planning and Development, the City, and the Corporation; (3) reviewed predevelopment loan and HOME grant agreements between the City and the Corporation, as well as related documents such as the resolutions associated with the Corporation's board of trustees and the City Council; (4) examined incomplete documents associated with the initial certification of the Corporation to become a community housing development organization (CHDO); and (5) reviewed incomplete supporting documents associated with all disbursements from the City's HOME program grants to the Corporation.

The review generally covered the period from September 1, 2005, through December 31, 2009. We extended the period as needed to accomplish our objectives. We performed our on-site fieldwork from July through November 2010 at the City's Department of Policy, Planning, and Development located at 44 City Hall Plaza, East Orange, NJ.

The review was not conducted in accordance with the generally accepted government auditing standards because it was limited to issues noted during the audit of the Corporation. A full audit of the City's HOME program may be performed in the future. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our review objectives.

BACKGROUND

HUD allocated \$793,684 and \$882,374 in HOME program grants to the City during fiscal years 2008 and 2009, respectively. HOME program funds can be used as grants, direct loan guarantees, or other forms of assistance to create affordable housing for low-income households.

On January 20, 2005, City officials granted City-wide CHDO status to the Corporation. On March 28, 2006, the City awarded the Corporation a predevelopment loan, an operating grant, and a construction grant in the amounts of \$35,000, \$50,000, and \$1 million, respectively, to construct the Princeton Street Phase II homes, which consisted of 6 newly built affordable two-family homes consisting of 12 units.

RESULTS OF REVIEW

City officials did not always comply with HOME program requirements, Federal regulations, and a HOME grant agreement. Specifically, City officials authorized the Corporation to use HOME program funds for (1) an ineligible capacity building grant, and (2) developer fees in excess of limits imposed by the HOME grant agreement between the Corporation and the City.

1. An Ineligible Capacity Building Grant

Contrary to 24 CFR (Code of Federal Regulations) 92.300, City officials authorized the Corporation to use HOME program funds for an ineligible capacity building grant. According to 24 CFR 92.300(b), if during the first 24 months of its participation in the HOME program a participating entity cannot identify a sufficient number of capable CHDOs, funds may be

committed to develop the capacity of CHDOs in the jurisdiction. Therefore, program regulations allow capacity building grants to be awarded within 24 months of the City's initial participation in the HOME program.

The City received its first HOME program grant in fiscal year 1992; therefore, it was not allowed to issue a capacity building grant after the year 1995. Nevertheless, City officials awarded a capacity building grant several years after this deadline. Specifically, on March 28, 2006, the Corporation was awarded a capacity building grant of \$200,000 to hire a consultant who assisted it in building its capacity to develop housing. Based on information provided by City officials, \$185,038 of the \$200,000 had been expended by Corporation officials on costs associated with the consultant; his assistant; and other costs such as equipment, utilities, and audits. There is a remaining balance of \$14,962 in the undisbursed portion of the capacity building grant that is available for the Corporation; however, this amount should be reprogrammed for other eligible HOME program activities.

This deficiency occurred because City officials were not able to find a local qualified CHDO to carry out the construction of the Princeton Street Phase II homes, and did not have adequate controls to ensure that HOME funds were only used for eligible activities. Therefore, \$200,000 in HOME program grants was awarded for this ineligible capacity building grant instead of being used for eligible HOME program activities.

2. Developer Fees in Excess of Limit Imposed by HOME Program Requirements

Contrary to a HOME grant agreement between the City and the Corporation, City officials authorized the Corporation to receive a developer fee of \$240,085, although its developer fee was not supposed to exceed \$108,500. Officials from the City and the Corporation incorrectly believed that the Corporation's developer fee was a percentage of total development costs instead of the total HOME funds awarded to the Corporation. The Corporation was awarded \$1.085 million in HOME funds; therefore, the total developer fee was limited to 10 percent of HOME funds awarded or \$108,500. Nevertheless, City officials awarded the Corporation a developer fee of \$240,085, which was \$131,585 in excess of the maximum allowed developer fee. City officials disbursed developer fees of \$203,327, which was \$94,827 in excess of limit imposed by the HOME grant agreement between the Corporation and the City and, therefore, ineligible. There is a remaining balance of \$36,758 in undistributed excess developer fees available for the Corporation; however, this amount should be reprogrammed for other eligible HOME program activities.

CONCLUSION

Contrary to HOME program requirements, Federal regulations, and HOME grant agreements, City officials authorized the Corporation to use (1) \$200,000 in HOME program funds for an ineligible capacity building grant, and (2) \$131,585 in HOME program funds for developer fees in excess of the limits imposed by a HOME grant agreement between the City and the Corporation. These deficiencies occurred because City officials (1) were not able to find a qualified CHDO to carry out the construction of the Princeton Street Phase II homes, (2) improperly awarded a HOME grant to an unqualified CHDO, (3) did not have adequate controls to ensure that HOME funds were only used for eligible activities, and (4) mistakenly thought that developer fees were a percentage of total development construction costs instead of HOME funds awarded to the Corporation.

RECOMMENDATIONS

We recommend that the Director of the New Jersey Office of Community Planning and Development instruct the City to

- 1A. Reimburse the HOME program's line of credit \$185,038 from non-Federal funds for the disbursed portion of the capacity building grant that should not have been awarded to the Corporation.
- 1B. Reprogram \$14,962 associated with the undisbursed portion of the capacity building grant to other eligible HOME program activities.
- 1C. Reimburse the HOME program's line of credit \$94,827 from non-Federal funds for the disbursed portion of the excessive developer fees.
- 1D. Reprogram \$36,758 associated with the undisbursed portion of the excessive developer fees.
- 1E. Establish and implement procedures to ensure that City officials comply with HOME program requirements, Federal regulations, and contractual agreements.

APPENDIXES

Appendix A

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

| <u>Recommendation Number</u> | <u>Ineligible 1/</u> | <u>Funds to be put to better use 2/</u> |
|----------------------------------|----------------------|---|
| 1A | \$185,038 | |
| 1B | | \$14,962 |
| 1C | \$94,827 | |
| 1D | | \$36,758 |
| Total | <u>\$279,865</u> | <u>\$51,720</u> |

- 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 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, if City officials cease making ineligible disbursements, these funds could be used for other eligible HOME program activities and HUD could be assured that these funds would be put to better use.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments



DEPARTMENT OF POLICY, PLANNING AND DEVELOPMENT
THE CITY OF EAST ORANGE, NEW JERSEY
44 CITY HALL PLAZA, EAST ORANGE, NEW JERSEY 07019
ROBERT L. BOWSER
MAYOR

Alex Dambach, AICP, PP
Acting Director

March 25, 2011

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

RE: Draft Audit and Memorandum Report of EORDC HOME-funded Activities

Dear Mr. Moore:

This office is in receipt of your March 3, 2011 correspondence concerning the above-referenced subject matter. The City of East Orange, New Jersey (City) takes exception to the findings of the HUD Office of Inspector General (OIG) that the City authorized the East Orange Revitalization and Development Corporation (EORDC) to use HOME program funds for "an ineligible capacity building grant, and for developer fees in excess of limits imposed by the HOME grant agreement between the EORDC and the City."

FINDING 1: INELIGIBLE CAPACITY BUILDING GRANT

The City disputes this finding.

As the statute is written, 24 CFR 92.300(b) applies to participating jurisdictions (PJs) that are new and still within the first 24 months of its participation in the HOME Program. As you know the City has received HOME Program funds since 1992 and, therefore is not considered a new PJ. More to the point, 24 CFR 92.300(b), which is set forth at length below as it appears in the HOME Investment Partnerships Program Final Rule, 24 CFR 92, September 16, 1996 (updated through December 22, 2004), neither requires PJs beyond the first 24 months of participation in the HOME Program to commit funds to develop the capacity of community housing development organizations (CHDOs), nor does 24 CFR 92.300(b) make any mention that PJs are required to request a "capacity building grant" from the local HUD office, the national HUD office, or any HUD office, for that matter. Notably, the term "capacity building grant" does not appear anywhere in the HOME Final Rules 24 CFR 92.

Comment 1

§ 92.300 Set-aside for Community Housing Development Organizations (CHDO)
b. Each participating jurisdiction must make reasonable efforts to identify community housing development organizations that are capable, or can reasonably be expected to become capable, of carrying out elements of the jurisdiction's approved consolidated plan and to encourage such community housing development organizations to do so. If during the first 24 months of its participation in the HOME Program a participating jurisdiction cannot identify a sufficient number of capable community housing development organizations, up to 20 percent of the minimum community housing development organization set-aside of 15 percent specified in paragraph (a) of this section, above, (but not more than \$150,000 during the 24 month period) may be committed to develop the capacity of community housing development organizations in the jurisdiction.

Comment 2

Notwithstanding the foregoing, there are several examples that support the City's position that its actions did not constitute an award of an ineligible "capacity building grant". Chapter 3, page 3-10, of the *Building HOME: A HOME Program Primer* training manual, dated March 2008, in reference to CHDO capacity reads as follows:

CHDO capacity: CHDOs must demonstrate the capacity of their key staff to carry out the HOME-assisted activities they are planning. This means that CHDOs must have:

- Experienced key staff who have successfully completed projects *similar* to those proposed by the CHDO;

or

- Key staff with limited or no experience, and who will use experienced consultants for the planning and development activities, as long as there is a plan in place for the consultant to *train* the key staff. (Emphasis added)

Comment 2

Based on language in the second option, the City rationally believed that use of funding for an experienced consultant to train key staff of the CHDO was an appropriate and eligible expenditure.

Comments 2

Furthermore, on page 32 of the *CHDO Toolbox for HOME PJs*, under the Expanded Assessment of CHDO Qualifications & Capabilities tool checklist, the section called Development Capacity mimics the *Building HOME Primer* in that it provides the options of using experienced key staff or contracting with consultants who have relevant housing experience to train key staff. Given these options, the City made a rational decision to award funding to the CHDO to contract with experienced consultants to train key staff.

Comments 2

Considering the forgoing, the City believes that it had a rational basis for its actions and that the finding is a misinterpretation and a misapplication of the HOME Final Rules by the HUD OIG. The City therefore requests that the HUD Office of Community Planning and Development not support this finding.

Comment 3

FINDING 2: DEVELOPER FEES IN EXCESS OF LIMIT IMPOSED BY HOME PROGRAM REQUIREMENTS

While acknowledging that there was a typographical error in the Community Housing Development Organization (CHDO) Agreement with EORDC, the City disputes this finding on the basis that the CHDO Agreement shows conflicting information.

Section IV (B) of the CHDO Agreement between the City and EORDC reads as follows:

Section IV – Reimbursement of Expenses & Developer Fees

B. The CITY shall pay the AWARDEE, as maximum compensation or FEE for the developer services required pursuant to the Scope of Work thereof, Princeton Estates Phase II Project Developer Fee 10% maximum (\$240,085.00) of HOME Funds. Progress payments of FEES (if applicable) will not exceed the following cumulative maximum percentages of total developer fee at the following stages of project completion:

| Milestone | Max. Cumulative Developer Fee % |
|--|--|
| <i>Acquisition Closing</i> | <i>25%</i> |
| <i>Construction Closing / start of construction or rehab</i> | <i>40%</i> |
| <i>50% construction completion</i> | <i>60%</i> |
| <i>Construction completion (certificate of occupancy)</i> | <i>75%</i> |
| <i>Sustaining occupancy (or sale) % completion report</i> | <i>100%</i> |

Comment 3

This section of the agreement purports the intent of the City to make Developer Fees available to the non-profit up to ten percent (10%) of the total construction budget, which was \$2,408,500 at the time of the approval by the City governing body in 2006. What confuses the matter is the inclusion of the words “of HOME Funds.” This was an inadvertent oversight that was not identified in the editing of the document. Again, the City acknowledges that an inadvertent typographical error was made in the body of the CHDO Agreement, but it is clear from the numerical expression of the amount written into the agreement (specifically, \$240,850.00) that the intent was to make available the ten percent developers fee as part of the overall construction budget.

The DRAFT Audit Memorandum from the HUD OIG appears to suggest that there is a statutory limit on the amount of developer fees insofar that the fees are “in excess of the limit imposed by HOME Program requirements.” The statute (HOME Final Rules 24 CFR 92) in no way establishes a limit on developer fees. To the contrary, page 17 of the *CHDO Toolbox for HOME PJs*, published in 2006 states:

Another common practice is to pay projects the same developer fee based on percentage of cost – say no more than 10% of total development cost excluding fee.

It is from this guidance that the City chose to make available developer fees up to 10% of the total project development cost.

Ref to OIG Evaluation

Auditee Comments

Comments 3

Based on the foregoing, the City believes that the finding/interpretation by the HUD OIG regarding the intent of the City to award developer fees in excess of limits imposed by HOME Program funding is incorrect and unsupported. Therefore, the City requests that the HUD Office of Community Planning and Development not support this finding.

In conclusion, the City requests that this response is considered particularly in light of the fact that the City made its decisions based on the statements made above.

As I'm sure you can imagine, the penalties imposed by the HUD OIG findings would place a substantial burden on the City of East Orange and its ability to serve its population in many important ways.

The City therefore requests that the HUD Office of Community Planning and Development not support the HUD OIG's findings in this matter.

The City of East Orange Policy, Planning and Development Department looks forward to working with you and with the HUD-Newark field office.

Sincerely yours,



Alex Dambach, AICP, PP
Acting Director
Policy, Planning and Development Department
City of East Orange, New Jersey

cc: Hon. Robert L. Bowser, Mayor
Jillian C. Barrick, City Administrator
Jason Holt, Esq., Corporation Counsel
Glenn K. Arnold, Manager, Neighborhood Housing & Revitalization Division
Keischa Harris, Redevelopment Project Coordinator
Joseph Vizer, HUD OIG
Mostafa Elhalo, HUD OIG

OIG Evaluation of Auditee Comments

- Comment 1 City officials disputed the finding and stated that the term “capacity building grant” does not appear in the regulations at 24 CFR 92 and that participating jurisdictions are not required to request HUD approval of a capacity building grant. However, regulations at 24 CFR Part 92.208 provide that HOME funds may be used for capacity building costs under the limitations noted in section 92.300(b). Also, documents provided by officials from the City of East Orange and East Orange Revitalization and Development Corporation(Corporation), show that the City awarded the Corporation a capacity building grant of \$200,000 to pay for the consultant's salary and other administrative costs. Therefore, the funds awarded did not comply with the restrictions in 24 CFR 92.300(b).
- Comment 2 City officials stated that the use of HOME funds for an experienced consultant to train key staff of the CHDO was an appropriate and eligible expenditure and that the OIG finding is a misinterpretation and misapplication of HOME Final Rules. However, program regulations only allow capacity building grants to be awarded within 24 months of the City’s initial participation in the HOME program. The City received HOME program funds for the first time in 1992; therefore, the City was no longer authorized to issue a capacity building grant or a grant to develop the capacity of community housing development organizations in the City after the year 1995. Further, documents provided by the City and the Corporation showed that the \$200,000 was awarded to the Corporation as a capacity building grant and was not included as part of the construction costs for the Princeton Street Phase II project. The \$200,000 was used to qualify a nonprofit entity, which would not have become a qualified CHDO without the training provided by the consultant. Therefore, the use of \$200,000 of HOME funds to develop the capacity of CHDO in the City of East Orange is in violation of the requirements at 24 CFR 92.300(b).
- Comment 3 City officials indicate the OIG finding related to the intent of the City to award developer fees in excess of limits imposed by HOME program funding is incorrect and unsupported. City officials stated that there was a typographical error in the CHDO agreement and their intent was to make available ten percent of the construction budget as a developer fee. However, City officials have not provided a revised HOME grant agreement, authorized by the City council, to show that they used the total construction budget instead of the total HOME funds as a base for determining the Corporation's developer fees. Also, program guidance in the “CHDO Toolbox” indicates that the developer fees should be based on total HOME funds and not construction costs. In addition, the ten percent limitation on developer fees was required by the HOME grant agreement; therefore, the report is correct in that there were excessive developer fees, which must be reimbursed to the HOME program.