



Issue Date	September 29, 2011
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Audit Report Number	2011-CH-1014
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TO: Jorgelle Lawson, Director of Community Planning and Development, 5ED

FROM: *Kelly Anderson*
Kelly Anderson, Regional Inspector General for Audit, 5AGA

SUBJECT: The City of Cleveland, OH, Lacked Adequate Controls Over Its HOME Investment Partnerships Program-Funded Housing Trust Fund Program Home-Buyer Activities

HIGHLIGHTS

What We Audited and Why

We audited the City of Cleveland's HOME Investment Partnerships Program. The audit was part of the activities in our fiscal year 2011 annual audit plan. We selected the City based upon our analysis of risk factors related to Program grantees in Region V's¹ jurisdiction, recent media coverage regarding the City's Program, and a request from the U.S. Department of Housing and Urban Development's (HUD) Columbus Office of Community Planning and Development. Our objectives were to determine whether the City complied with HUD's requirements in its use of Program funds to provide interest-free second mortgage loans to home buyers through its Housing Trust Fund program and its use of recapture provisions for Housing Trust Fund program home-buyer activities. This is the second of three audit reports on the City's Program.

What We Found

The City did not comply with HUD's requirements in its use of Program funds to provide interest-free second mortgage loans to home buyers through its Housing Trust Fund program and its use of recapture provisions for activities. It (1)

¹ Region V includes the States of Indiana, Illinois, Ohio, Michigan, Minnesota, and Wisconsin.

provided assistance for an ineligible activity, (2) lacked sufficient documentation to support that activities were eligible, (3) did not implement appropriate recapture provisions for all of the activities reviewed, and (4) did not ensure that its Program was reimbursed for Program funds used to assist a home buyer in purchasing a home that was later sold through a sheriff's sale and ownership of the home had been transferred.

As a result, it inappropriately provided \$20,000 in Program funds to assist a household that was not income eligible and was unable to support its use of \$795,000 in Program funds. Further, its Program was not reimbursed for \$20,000 in Program funds used for a home that was sold through a sheriff's sale and ownership of the home had been transferred. In addition, the City is at risk of being required to reimburse its Program additional non-Federal funds if the ownership of additional homes acquired under its Housing Trust Fund program is transferred through foreclosures.

We informed the Director of HUD's Columbus Office of Community Planning and Development and the director of the City's Department of Community Development of a minor deficiency through a memorandum dated September 29, 2011.

What We Recommend

We recommend that the Director of HUD's Columbus Office of Community Planning and Development require the City to (1) reimburse its Program from non-Federal funds for the \$20,000 in Program funds inappropriately used to assist an activity, (2) provide supporting documentation or reimburse its Program \$775,000 from non-Federal funds, (3) reimburse its Program \$20,000 from non-Federal funds for the home that had been sold through a sheriff's sale and ownership of the home had been transferred, and (4) implement adequate procedures and controls to address the findings cited in this audit report.

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

Auditee's Response

We provided our discussion draft audit report and supporting schedules to the director of the City's Department of Community Development and HUD's staff and our discussion draft audit report to the City's mayor during the audit. The City declined our offer to conduct an exit conference.

We asked the City's director to provide comments on our discussion draft audit report by September 2, 2011. The director provided written comments, dated September 2, 2011. The director did not agree with the findings. The complete text of the written comments, except for the eight appendixes of documentation that were not necessary for understanding the director's comments, along with our evaluation of that response, can be found in appendix B of this report. We provided the Director of HUD's Columbus Office of Community Planning and Development with a complete copy of the City's written comments plus the eight appendixes of documentation.

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BACKGROUND AND OBJECTIVES

The Program. Authorized under Title II of the Cranston-Gonzalez National Affordable Housing Act, as amended, the HOME Investment Partnerships Program is funded for the purpose of increasing the supply of affordable standard rental housing; improving substandard housing for existing homeowners; assisting new home buyers through acquisition, construction, and rehabilitation of housing; and providing tenant-based rental assistance.

The City. Organized under the laws of the State of Ohio, the City of Cleveland is governed by a mayor and a 19-member council, elected to 4-year terms. The City's Department of Community Development is responsible for planning, administering, and evaluating the City's U.S. Department of Housing and Urban Development (HUD) programs. The Department of Community Development's Housing Development Office administers the City's Program-funded Housing Trust Fund program, which helps low-income home buyers purchase homes by offering interest-free second mortgage loans. The overall mission of the Department is to improve the quality of life in the City by strengthening neighborhoods through successful housing and commercial rehabilitation efforts, new housing construction, home ownership, and community-focused human services. The City's Program records are located at 601 Lakeside Avenue, Cleveland, OH.

The following table shows the amount of Program funds HUD awarded the City for fiscal years 2006 through 2010. HUD had not awarded the City Program funds for fiscal year 2011 as of August 2, 2011.

Fiscal year	Program funds
2006	\$6,323,744
2007	6,268,729
2008	6,081,589
2009	6,763,777
2010	6,743,584
Totals	<u>\$32,181,423</u>

Our objectives were to determine whether the City complied with HUD's requirements in its use of Program funds to provide interest-free second mortgage loans to home buyers through its Housing Trust Fund program and its use of recapture provisions for Housing Trust Fund program home-buyer activities.

RESULTS OF AUDIT

Finding 1: The City Lacked Adequate Controls Over Its Activities To Ensure That Households and Homes Were Eligible for Assistance

The City did not comply with HUD's requirements in its use of Program funds to provide interest-free second mortgage loans to home buyers through its Housing Trust Fund program. It provided assistance for an ineligible household and lacked sufficient documentation to support that households and homes were eligible. These weaknesses occurred because the City lacked adequate procedures and controls regarding its Housing Trust Fund program home-buyer activities to ensure that it appropriately followed HUD's requirements. As a result, it inappropriately provided \$20,000 in Program funds to assist a household that was not income eligible and was unable to support its use of \$795,000 in Program funds.

The City Provided \$20,000 in Program Funds for an Ineligible Household

We reviewed all 44 households associated with the four Program-funded activities the City reported as complete in HUD's Integrated Disbursement and Information System from January 1, 2009, through November 30, 2010. The City used \$835,000 in Program funds for the 44 households.

HUD's regulations at 24 CFR (Code of Federal Regulations) 92.2 define a low-income household as a household with an annual income that does not exceed 80 percent of the median income for the area as determined by HUD. HUD's regulations at 24 CFR 92.217 state that a participating jurisdiction must invest Program funds made available during a fiscal year so that with respect to home ownership assistance, 100 percent of these funds are invested in dwelling units that are occupied by households that qualify as low-income households.

Contrary to HUD's regulations, the City drew down \$20,000 in Program funds on February 20, 2007, to assist a household that was not income eligible. The Program funds were used to provide an interest-free second mortgage loan to a home buyer for activity number (including the Office of Inspector General (OIG)-designated household number) 8917 (11). The City could not provide sufficient income documentation for activity number 8917 (11). However, it stated that the household was not income eligible.

The City Lacked Sufficient Documentation To Support Its Use of \$795,000 in Program Funds

The City lacked sufficient documentation for 42 of the 44 households and or homes reviewed to support that it used \$795,000 in Program funds for eligible households and homes.

HUD's regulations at 24 CFR 92.508(a) state that a participating jurisdiction must establish and maintain sufficient records to demonstrate that each household that receives Program funds is income eligible in accordance with 24 CFR 92.203 and meets the property standards of 24 CFR 92.251. HUD's "Building HOME: A Program Primer" states that all housing quality standards and code requirements must be met at the time of occupancy.

Contrary to HUD's requirements, the City lacked sufficient documentation to support that 42 of the 44 households were income eligible and 9 of the 44 homes acquired with Program funds met HUD's property standards requirements at the time of occupancy. The closing dates for the nine homes occurred from June 16, 2006, through March 5, 2009. The City had certificates of occupancy for all nine homes stating that the homes met the City's building and zoning codes. However, eight of the nine certificates of occupancy were dated from 286 to 787 days (at least 6 months) before the properties were purchased by the home buyers. Further, although the remaining certificate of occupancy was dated 271 days after the property was purchased by the home buyer, it was based on a final inspection that occurred 295 days (more than 6 months) before the property was purchased by the home buyer. We did not inspect the homes since they were purchased more than 21 months before the start of our audit and we would not be able to reasonably determine whether the homes met HUD's property standards requirements at the time of occupancy. Further, on August 30, 2011, and as a result of our audit, the City inspected three of the nine homes and provided affidavits for the three homes stating that the properties met all applicable State and local standards and code requirements. The table in appendix D of this report shows the activity number (including the OIG-designated household number) for the 42 households and homes for which the City did not have (1) sufficient income documentation to demonstrate that households were income eligible and or (2) final inspection reports or certifications supporting that homes met HUD's property standards requirements at the time of occupancy.

Further, the City did not ensure that it properly projected households' annual income for at least 23 of the 44 households reviewed. For example, the City used gross year-to-date income in its calculation of projected annual income rather than using current circumstances to project future income for 10 of the 23 households. The City also lacked documentation to support its calculation of households'

annual income or that it calculated households' annual income for six additional households.

The City Lacked Adequate Procedures and Controls

The weaknesses regarding the City's providing Program funds to assist a household that was overincome and lack of sufficient documentation to support that households and homes were appropriate occurred because the City lacked adequate procedures and controls regarding its activities to ensure that it appropriately followed HUD's requirements.

The City's internal procedures for its activities only required two pay statements and an Internal Revenue Service Form W-2 wage and tax statement to be maintained for all income-producing members of a household. The manager of the Department of Community Development's Housing Development Office said that the City was not aware that HUD's requirements specified that participating jurisdictions were required to maintain 3 consecutive months' worth of income documentation on which to base a household's projected income calculation. However, the director of the Department believed that the City generally complied with the 3-month requirement since the majority of the household files contained at least 3 months' worth of income documentation through a combination of year-to-date pay statement information, W-2 statements, tax returns, Social Security information, employment verifications, and other items that were used to verify and substantiate households' income.

Further, the manager of the Housing Development Office said that she did not know why the certificates of occupancy for seven of the homes were dated more than 6 months before the properties were purchased and she believed that one of the certificates of occupancy was dated more than 6 months before the property was purchased because the home buyer had credit issues to resolve and was permitted to move in and lease the home until the issue was resolved. The director of the Department said that the certificate of occupancy for the remaining home was likely dated after the home buyer purchased the property because there was some work remaining to be done on the property. In some instances, a home buyer is permitted to move into a house with a temporary certificate of occupancy. This situation is typical if the home is completed during the winter but some exterior items cannot be completed due to inclement weather.

Conclusion

The City lacked adequate procedures and controls regarding its activities to ensure that it appropriately followed HUD's requirements. It inappropriately provided \$20,000 in Program funds to assist a household that was not income

eligible and was unable to support its use of \$795,000 in Program funds for 42 households and or homes without sufficient documentation supporting eligibility.

Recommendations

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

- 1A. Reimburse its Program from non-Federal funds for the \$20,000 in Program funds inappropriately used to assist activity number (including the OIG-designated household number) 8917 (11).
- 1B. Provide supporting documentation or reimburse its Program from non-Federal funds, as appropriate, for the \$775,000 in Program funds used for the 41 households and homes for which the City did not have (1) sufficient income documentation to demonstrate that households were income eligible and or (2) final inspection reports or certifications supporting that homes met HUD's property standards requirements at the time of occupancy. We did not include \$20,000 in Program funds used for activity number 9706 (02) for which the City did not have sufficient income documentation to demonstrate that the household was income eligible since we included it in recommendation 2A of this report.
- 1C. Implement adequate procedures and controls to ensure that Program funds are only used for eligible households and that it maintains documentation to sufficiently support the eligibility of households and homes in accordance with HUD's requirements.

Finding 2: The City Lacked Adequate Controls Over Its Housing Trust Fund Program To Ensure That Appropriate Recapture Provisions Were Used for Activities

The City did not comply with HUD's requirements in its use of recapture provisions for Housing Trust Fund program home-buyer activities. It did not (1) implement appropriate recapture provisions for all 44 of the households reviewed and (2) ensure that its Program was reimbursed for Program funds used to assist a home buyer in purchasing a home that was later sold through a sheriff's sale and ownership of the home had been transferred. These weaknesses occurred because the City lacked adequate procedures and controls regarding its activities to ensure that it appropriately followed HUD's requirements. As a result, its Program was not reimbursed for \$20,000 in Program funds used for a home that was sold through a sheriff's sale and ownership of the home had been transferred. Further, the City is at risk of being required to reimburse its Program additional non-Federal funds if the ownership of additional homes acquired under its Housing Trust Fund program is transferred through foreclosures.

The City Did Not Implement Appropriate Recapture Provisions for Its Activities and Did Not Reimburse Its Program \$20,000 From Non-Federal Funds

We reviewed all 44 households associated with the four Program-funded activities the City reported as complete in HUD's Integrated Disbursement and Information System from January 1, 2009, through November 30, 2010. The City used \$835,000 in Program funds for the 44 households.

HUD's regulations at 24 CFR 92.254(a)(4) state that Program-assisted housing must meet HUD's affordability requirements. Section 92.254(a)(5)(ii) states that in establishing its recapture provisions, the participating jurisdiction is subject to the limitation that when the recapture provision is triggered by a voluntary or involuntary sale of the housing unit and there are no net proceeds or the net proceeds are insufficient to repay the Program investment due, the participating jurisdiction may only recapture the net proceeds, if any. HUD's HOMEfires, volume 5, number 2, states that for Program-assisted home-buyer projects with recapture provisions, the amount of Program funds required to be repaid in the event of foreclosure is the amount that would be subject to recapture under the terms of the written agreement with the home buyer. If the recapture provisions require the entire amount of the Program investment from the home buyer or an amount reduced prorata based on the time the home buyer has owned and occupied the home measured against the affordability period, the amount required by the recapture provisions is the amount that must be recaptured by the

participating jurisdiction for the Program. If the participating jurisdiction is unable to recapture the funds from the household, it must reimburse its Program in the amount due pursuant to the recapture provisions in the written agreement with the home buyer.

Contrary to HUD’s requirements, the City did not ensure that it implemented appropriate recapture provisions for all 44 of the households reviewed. Although the mortgages and promissory notes between the City and the home buyers included affordability requirements, neither the mortgages nor the promissory notes contained language that limited the amount of Program funds the City could recapture to the net proceeds from the sale of a home. The mortgages and promissory notes required repayment of the full amount of the loan upon sale, lease, refinance, or transfer. An additional amount equal to the interest that would have accrued on the second mortgage loan if it had been made at the same interest rate as the first mortgage loan was also due and payable in the event that the borrower sold, leased, refinanced, or transferred the property within the initial 5 years of the execution of the mortgage and promissory note.

As previously stated, the mortgages and promissory notes required repayment of the entire amount of the Program investment upon sale. As of July 8, 2011, the City had received foreclosure notices for six homes associated with three of the activities completed from January 1, 2009, through November 30, 2010. Therefore, we reviewed the six households to determine whether the homes had been sold and ownership of the homes had been transferred. One of the homes had been sold through a sheriff’s sale, and ownership of the home had been transferred as of July 8, 2011. The City did not receive any net proceeds from the sale of the home, nor did it reimburse its Program for the \$20,000 in Program funds used for the home. The following table includes the activity number (including the OIG-designated household number), the date of closing, the date Program funds were drawn down for the household in HUD’s system, the date the home was sold through a sheriff’s sale, and the date ownership was transferred for the home.

Activity number	Date of closing	Date of drawdown	Date of sheriff’s sale	Date of ownership transfer
9706 (02)	June 25, 2007	Nov. 13, 2007	Dec. 7, 2009	Feb. 2, 2010

The City Lacked Adequate Procedures and Controls

The weaknesses regarding the City’s not (1) implementing appropriate recapture provisions for its activities and (2) ensuring that its Program was reimbursed for Program funds used to assist a home buyer in purchasing a home that was later sold through a sheriff’s sale and ownership of the home had been transferred

occurred because the City lacked adequate procedures and controls regarding its activities to ensure that it appropriately followed HUD's requirements.

The manager of the Department of Community Development's Housing Development Office stated that until the former assistant director of the Department notified the Office in January 2011, the Office was not aware that it was required to include language in its mortgages and promissory notes that limited recapture to the net proceeds from the sale of the homes. Further, the director of the Department stated that although the City was not aware that it had created an additional financial burden on itself, it complied with HUD's requirements and State law regarding foreclosure sales and did not recapture more than the net proceeds from the sale of the homes. The City was developing a revised mortgage and promissory note for its activities to include language that would limit the amount of Program funds the City could recapture to the net proceeds from the sale of a home.

Conclusion

The City lacked adequate procedures and controls regarding its activities to ensure that it appropriately followed HUD's requirements. It did not implement appropriate recapture provisions for all 44 of the households reviewed and ensure that its Program was reimbursed for the \$20,000 in Program funds used for a home that was later sold through a sheriff's sale and ownership of the home had been transferred. Further, the City is at risk of being required to reimburse its Program additional non-Federal funds if the ownership of additional homes acquired under its Housing Trust Fund program is transferred through foreclosures.

Recommendations

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

- 2A. Reimburse its Program \$20,000 from non-Federal funds for the home that had been sold through a sheriff's sale and ownership of the home had been transferred.
- 2B. Implement adequate procedures and controls to ensure that if the ownership of additional homes acquired under its Housing Trust Fund program is transferred through foreclosures, the City recaptures the entire amount of the Program funds through the receipt of net proceeds from the sales of the homes or reimburses its Program from non-Federal funds for the Program funds provided to the home buyers as appropriate.

- 2C. Implement adequate procedures and controls to ensure that it includes appropriate recapture provisions in its written agreements with home buyers.

SCOPE AND METHODOLOGY

To accomplish our objectives, we reviewed

- Applicable laws; HUD’s regulations at 24 CFR Part 92; HUD’s “Building HOME: A Program Primer”; HUD’s HOMEfires, volume 5, numbers 2 and 5; HUD’s Technical Guide for Determining Income and Allowances for the Program; and HUD’s guidebook, “Fitting the Pieces Together.”
- The City’s accounting records; audited financial statements for the years ending December 31, 2007, 2008, and 2009; data from HUD’s Integrated Disbursement and Information System; Program activity files; policies and procedures; organizational chart; consolidated plan for 2005 through 2010; action plans for program years 2008 to 2009, 2009 to 2010, and 2010 to 2011; and consolidated annual performance and evaluation reports for program years 2008 and 2009.
- HUD’s files for the City.

In addition, we interviewed the City’s employees and HUD’s staff.

Findings 1 and 2

We selected all 44 of the City’s households associated with the four Program-funded Housing Trust Fund program home-buyer activities the City reported as complete in HUD’s system from January 1, 2009, through November 30, 2010. The City used \$835,000 in Program funds for the 44 households.

In addition, we relied in part on data in HUD’s system. Although we did not perform detailed assessments of the reliability of the data, we performed minimal levels of testing and found the data to be adequately reliable for our purposes.

We performed our onsite audit work from January through June 2011 at the City’s offices located at 601 Lakeside Avenue, Cleveland, OH. The audit covered the period January 2009 through November 2010 and was expanded as determined necessary.

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

INTERNAL CONTROLS

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

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

Relevant Internal Controls

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

- Effectiveness and efficiency of operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Reliability of financial reporting – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.
- Compliance with applicable laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness and efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws or regulations on a timely basis.

Significant Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- The City lacked adequate procedures and controls to ensure that (1) it used Program funds for Housing Trust Fund program home-buyer activities in accordance with HUD's requirements, (2) it implemented appropriate recapture provisions for activities, and (3) its Program was reimbursed for Program funds used to assist a home buyer in purchasing a home that was later sold through a sheriff's sale and ownership of the home had been transferred (see findings 1 and 2).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/	Unsupported 2/
1A	\$20,000	
1B		<u>\$775,000</u>
2A	<u>\$20,000</u>	
Totals	<u>\$40,000</u>	<u>\$775,000</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/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments



City of Cleveland

Frank G. Jackson, Mayor

Department of Community Development
Daryl P. Rush, Director
601 Lakeside Avenue, Room 320
Cleveland, Ohio 44114-1070
216/664-4000
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September 2, 2011

Via E-Mail

Brent G. Bowen,
Assistant Regional Inspector General for Audit
United States Department of HUD-Office of Inspector General
77 West Jackson Boulevard, Room 2646
Chicago, Illinois 60604

Re: Discussion Draft of the Audit Report City of Cleveland HOME Investment Partnership Program Dated August 11, 2011

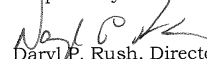
Dear Mr. Bowen:

I am writing to submit to you the management response of the City of Cleveland to the discussion draft audit report dated August 11, 2011.

During the audit, our staff provided your office with records related to the HOME Investment Partnership Program covering the period from January 1, 2009 to November 30, 2010.

Your review generated two (2) draft findings regarding the City's administration of the HOME Investment Partnership Program, for which the City of Cleveland's Management Responses are enclosed with this letter. While the City has reservations regarding the specifics of the findings and believes that it has met both the spirit and the letter of HUD regulations in its administration of the Housing trust fund program, I would like to express my appreciation to you and your staff for your thorough review. If you have any questions or require further information please feel free to contact me at (216) 664-4288.

Respectfully Submitted,


Daryl P. Rush, Director
Department of Community Development

Enclosure:

An Equal Opportunity Employer

Ref to OIG Evaluation

Auditee Comments

Comment 1

City Of Cleveland Management Response to OIG Discussion Draft
Dated August 11, 2011

The discussion draft audit of the City of Cleveland Housing Trust Fund Program sent on August 11, 2011 generated two (2) findings and made recommendations with respect to each of those findings. Below is the management's response to each finding and recommendation.

Finding 1: The City lacked adequate controls over its activities to ensure that households and/or homes were eligible for assistance.

Management Response – Disagree: HUD allows local governments to develop their own income verification procedures. The City's procedures were sufficient for verifying income. However, the City has strengthened its documentation requirements as recommended.

Comments 2, 3,
and 4

As to the only activity cited by the Office of Inspector General (OIG) as being over the income limits, the City will use non-HOME funds to meet its obligation to the homebuyer at the time of the auditor's review. As to the other 43 activities cited for issues related to income verification methods, the City re-examined the files to confirm income eligibility.

Comments 4
and 5

In summary, the City found:

1. For one (1) activity, the family had a fixed income from railroad retirement and workers compensation, and the benefit information in the files is sufficient to make an affirmative eligibility determination. Based on the City's calculations, the activity is within income guidelines.
2. For thirty-one (31) activities, the City followed one of the following processes:
 - Requiring two (2) pay stubs plus W2s¹ or the IRS Form 1040 (1040) for the previous year; or
 - Utilizing at least one pay stub with Year-to-Date (YTD) information going back three (3) or more months.
 - Utilizing one (1) pay stub issued during the first quarter of the calendar year. YTD information shown on these pay

¹ City income tax in the State of Ohio is imposed on *all* salaries, wages, commissions, other income, and other compensation earned and received. The income information on the W2 must include city income to be acceptable.

Ref to OIG Evaluation

Auditee Comments

Comments 6
and 7

stubs in addition to the previous year W2s provide documentation of income going back three (3) or more months.

Comment 8
Comments 8
and 9

HUD conducted monitoring visits in 2006, 2007, and 2008. The monitoring reports did not indicate an issue with the method the City used to calculate income eligibility. Nonetheless, the Draft Discussion report cites three (3) consecutive months of income documentation in the Technical Guide for Determining Income and Allowances for the HOME Program. In these thirty-one (31) activities the Year-To-Date (YTD) information shown on pay stubs in the file meets or exceeds this guideline. This YTD documentation shows that all thirty-one (31) households had incomes meeting HOME eligibility requirements.

Comments 3
and 4

3. For eleven (11) activities, additional information will be required to meet the HUD auditor's request that we gather three consecutive months of income documentation. The City is committed to seeking this additional information in order to complete its reexamination of these eleven (11) activities.
4. One (1) activity was determined to be over income. Non-HOME funds will be used to meet the City obligation to the homebuyer.

Comment 10

Recommendation 1A: Provide supporting documentation or reimburse its Program from non-Federal funds, as appropriate, for the \$815,000 in Program funds used for the 43 households and/or homes for which the City did not have (1) sufficient income documentation to demonstrate that households were income eligible and/or (2) final inspection reports or certifications supporting that homes met HUD's property standards requirements at the time of occupancy.

Comment 10

Management Response to 1A(1) – Disagree - The City collected information sufficient to verify and project income, and provided assistance to qualified families.

Comment 11

The City contends it has abided by HUD's guidelines found within chapter 2 of HUD's Technical Guide for Determining Income and Allowances for the HOME Program. The applicable guideline reads:

PJs may develop their own verification procedures provided they collect source documentation and that this

Ref to OIG Evaluation

Auditee Comments

Comment 11

documentation is sufficient for HUD to monitor program compliance.

Comments 8 and 11

Accordingly, the City had a procedure requiring the submission of two (2) pay stubs, previous year W2s, and previous year 1040 documents by the applicants. By reviewing YTD information on the pay stubs and/or the W2 or 1040 documents (especially important for income calculations conducted during the first quarter of a calendar year) the City procedure was designed to capture information documenting at least three consecutive months worth of income information.

The City has re-examined income documents on all forty-four (44) activities cited by HUD (including activity number 9706(02), which was excluded in this finding in the discussion draft because of its inclusion in recommendation 2A). Consistent with the summary provided above in the response to Finding #1, the following is a detailed case-by-case response:

1. Benefits-Based Income Determination – One (1) Activity

Comment 4

The City requires third-party verification for non-employment related income such as SSI, child support, or other benefits. Schedule 1 lists one (1) activity where the primary income source was from a benefits program and income could be projected accordingly. Appendix A contains the background material and income projections for this case. **The buyer listed in Schedule 1 is clearly income eligible as originally determined by City Staff:**

Schedule 1: Benefits-Based Determination

	<u>IDIS</u>	<u>Estimated Income</u>	<u>Qualifying Income</u>
1	8917(08)	\$31,308.40	\$39,300

Comment 12

2. Income Documentation With At Least Three (3) Consecutive Months In YTD Income Provided With Available Information – Thirty-One (31) Activities

In the period January 1, 2009 through November 30, 2010, the City required employment income documentation that included YTD information covering three or more consecutive months of

Ref to OIG Evaluation

Auditee Comments

Comment 8

Comments 8 and 9

Comments 5, 8, and 9
Comments 8 and 9

earned income. Those files included YTD information in one of the following forms:

- Two (2) pay stubs plus W2s or the IRS Form 1040 (1040) for the previous year; or
- At least one pay stub with Year-to-Date (YTD) information going back three (3) or more months.
- One (1) pay stub issued during the first quarter of the calendar year. YTD information shown on these pay stubs in addition to the previous year W2s provide documentation of income going back three (3) or more months.

In light of the auditor's comment, Schedule 2 lists thirty-one (31) activities where the YTD information on one or more of the pay stubs in the file, and/or combination of paystubs and W-2/1040, covers three or more consecutive months of earned income. The documentation gathered meets or exceeds the guideline. Appendix B contains the income calculations and YTD income documentation for each of these activities. City staff has re-examined its income projections for each of these activities. **All the buyers in Schedule 2 are income eligible as originally determined by City staff.**

Schedule 2: Three (3) Consecutive Months Of Income In YTD Statement (Paystubs and/or W-2/1040)

	IDIS	Estimated Income	Qualifying Income
1	7758(05)	\$24,550.70	\$34,350
2	8917(01)	\$29,754.40	\$39,300
3	8917(02)	\$33,185.36	\$44,200
4	8917(03)	\$36,049.52	\$44,750
5	8917(04)	\$33,408.96	\$39,300
6	8917(05)	\$32,651.60	\$34,350
7	8917(06)	\$35,323.50	\$39,300
8	8917(07)	\$41,600.00	\$44,200
9	8917(08)	\$34,009.20	\$44,200
10	8917(10)	\$24,759.02	\$39,300
11	8917(13)	\$34,671.60	\$39,300
12	8917(14)	\$31,753.80	\$39,300
13	8917(15)	\$39,620.10	\$44,200
14	8917(16)	\$27,974.46	\$49,700

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Comments 8 and 9

15	8917(17)	\$23,292.12	\$39,750
16	8917(18)	\$36,480.27	\$39,300
17	8917(19)	\$29,405.50	\$44,200
18	8917(22)	\$27,733.97	\$53,050
19	8917(23)	\$36,025.40	\$36,300
20	8917(24)	\$35,256.27	\$36,300
21	9706(01)	\$35,048.00	\$51,050
22	9706(02)	\$28,283.00	\$44,200
23	9723(01)	\$32,872.04	\$44,750
24	9723(02)	\$31,720.00	\$51,850
25	9723(05)	\$41,425.50	\$51,850
26	9723(07)	\$23,815.74	\$44,750
27	9723(09)	\$17,033.00	\$44,750
28	9723(10)	\$43,884.33	\$57,650
29	9723(11)	\$29,424.90	\$44,750
30	9723(12)	\$47,438.20	\$61,650
31	9723(13)	\$15,299.20	\$46,700

3. Files For Follow-Up Or Other Concerns – Eleven (11) Activities

Finally, the City proposes follow-up with developers, buyers, and buyer’s employers for the activities identified in Schedule 3 to collect additional earnings information where the pay stubs, W2s and 1040 information in the files do not clearly provide three months of *consecutive* income documentation. Based upon the auditor’s finding we are seeking supplemental information that would show consistency of earnings for the 3 month period leading up to application. This action will require the cooperation of multiple parties, and the City requests that it have sufficient time to provide information for the activities identified in Schedule 3. To the extent that this review and supplemental information confirms buyer eligibility shown on the schedule, we ask that these activities be deleted from the Finding.

Comment 13

Schedule 3: City To Seek Additional Information

	IDIS
1	7758(01)
2	7758(02)
3	7758(03)
4	7758(04)
5	8917(12)
6	8917(20)
7	8917(21)

Comment 14

Ref to OIG Evaluation

Auditee Comments

Comments 3
and 4

8	9723(04)
9	9723(06)
10	9723(08)
11	9723(10)

4. Found To Be Over-Income During Re-Examination – One (1) Activity

Finally, the City agrees that the projected income for activity 8917(11) exceeded HOME requirements. This activity will be removed from IDIS and the City will meet its second mortgage commitment to this buyer with non-federal funds.

Conclusion

Although the City has collected three consecutive months of income documentation, HUD regulations at 24 CFR 92.203(a)(2) state that a participating jurisdiction must determine household's annual income by examining source documentation evidencing households' annual income. The regulations do not mandate any particular number of pay stubs or other specific documentation for use in determining the income.

Comment 11

Chapter two of HUD's Technical Guide for Determining Income and Allowances for the HOME Program, dated January 2005, (Guide) states that a participating jurisdiction may develop its own income verification procedures. The Guide does not require any particular number of pay stubs or otherwise specifically require any particular document be used. Where income is deemed to be stable, it is suggested that three (3) month's of income documentation is an appropriate amount upon which to base a household's projected income calculation for the following twelve month period. "Income documentation" is not defined and the Guide does not state that three month's of pay stubs is required. In fact, the example given in the Determining Income and Allowances Training Manual, dated May 2007, (Manual) uses only three (3) pay stubs covering six consecutive weeks and showing YTD income information to calculate the income projection (please see the exercise from the Manual attached in Appendix C). The City required that applicants provide at least 2 pay stubs, the prior year's tax return, and prior year's W2(s). This documentation is consistent with the documentation required by the City's depository institutions to perform their

Comment 8

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Auditee Comments

Comment 8

income verification for underwriting a loan application. By using pay stubs, the YTD payment information on the pay stubs, the prior year's tax return and prior year's W2(s), the City was able to meet or exceed the three months of income documentation suggested.

Comment 7

The HUD Columbus office has completed yearly monitoring reviews of the City's various HUD funded programs. The monitoring reports did not indicate an issue with the method the City used to calculate income eligibility. Until the February, 2010 site visit, from the HUD Columbus Office, the City had no additional communication with the HUD Columbus Office to indicate there was a change in the procedure of how income eligibility must be calculated. The City has taken action since the February site visit follow-up letter and the OIG review to conform to the new requirements. The steps the City has taken to further strengthen its program are outlined in response to recommendation 1B below. Given these conditions the City should not be penalized for using calculations to determine income eligibility that were common for calculating income and for which no issue had been previously raised by the HUD Columbus Office.

Management Response to 1A(2) – Disagree: The properties in question met the requirements of 24 CFR 92.251.

Comment 15

As an initial matter, the discussion draft audit report identifies four (4) activities for which the file contained no Certificate of Occupancy. Those four (4) Certificates of Occupancy are identified in Schedule 4 have since been placed in the file.

Schedule 4: Files Previously Lacking Certificate of Occupancy (Now Corrected)

	IDIS	Inspection Sign-Off Date (When Available)	CofO Date	Settlement Statement	Time Between C of O and Transfer
1	7758(02)	4/21/04	4/21/04	4/16/04	5
2	7758(03)	2/24/04	9/3/04	2/27/04	187
3	8917(06)		6/28/06	5/24/07	332
4	8917(10)		10/22/04	6/16/06	559

The Certificate of Occupancy for 7758(02) establishes that the discussion draft's interpretation of 24 CFR 92.251 has been met.

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Auditee Comments

Comment 15

As to activity 7758(03), the Certificate of Occupancy was issued on September 3, 2004. The final inspection sign-off verifying code compliance occurred on February 24, 2004—three days before closing, as indicated in the settlement statement. This activity therefore also meets the discussion draft's interpretation of 24 CFR 92.251.

Comments 16 and 17

All 44 activities met the requirements of 24 CFR 92.251. Each of the houses was constructed to meet the HUD property standards. The 44 houses were new construction, and the city's process ensures they were built to a standard that meets the property standards.

A new house goes through a design review and plan review which, upon approval, determines that the house meets the housing code. The permits issued for construction are based upon the approved design and specifications in the design drawings/blueprints. The Building & Housing Department inspections during construction verify that the house is built to specification. The sign-off on the permits at the completion of constructions on what is referred to as the "goldenrod" indicates that the house was properly constructed to specification and meets code. The approvals on the goldenrod trigger the issuance of the Certificate of Occupancy.

Comment 17

The Certificate of Occupancy establishes that the house meets the housing code, and by meeting code—the house meets the HUD property standards. A Certificate of Occupancy remains in force until the use of the property is changed or the property is condemned.

Comment 17

A Certificate of Occupancy was issued for each of the 44 houses so each was constructed to satisfy the property standards. A copy of the certificates of occupancy for each of the houses is in Appendix D. In no case was the use of the property changed or the property condemned. Thus, the Certificate of Occupancy remains in effect.

Comment 18
Comments 17 and 18
Comments 16, 17, and 18

Although 24 CFR 92.251 requires only that the houses meet code standards at the time of project completion. There is no standard that the Certificate of Occupancy becomes "stale" after six (6) months. Despite the passage of more than six (6) months between issuance of the Certificate of Occupancy and project completion, the activities complied with 24 CFR 92.251.

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Auditee Comments

Comments 16
and 17

Several factors can cause a gap in time between issuing a Certificate of Occupancy and closing on the sale of a house, including some factors discussed during the audit process. Other factors are market conditions, particularly the slowdown in the housing market and the economic downturn.

None of the 44 houses failed to meet property standards. Each house had a Certificate of Occupancy establishing compliance with code. There is no indication of any deterioration of the condition of the house prior to closing on the sale. Deterioration would have adversely impacted the sale price when the house was appraised prior to closing. The appraisals and sale prices did not reflect a decline, nor have any buyers raised warranty issues.

To further reflect that there had been no decline in condition, each of the eight is being re-inspected. The inspections are being undertaken by a housing inspector and/or the City's contractor who performs inspections to ensure local and HUD standards are met.

Comment 15

Three houses were inspected by the Building & Housing inspector and the City's contractor as a team. Those activities are identified in Schedule 5. Each of the three houses for which the re-inspection was completed still meets code and property standards. Appendix E includes affidavits from Building & Housing Inspector Derrick Cooley attesting that the houses still meet code. The city will need additional time to verify that the other five (5) also still meet code. The same process will be undertaken for activities 8917(06) and 8917(10), which upon review of the C of O and the closing date the timeframe was greater than 180 days.

Schedule 5: Properties Verified as Still Meeting Code Standards as of August 31, 2011.

	IDIS
1	8917(16)
2	8917(17)
3	8917(23)

Comments 16
and 17

Of the nine (9) houses with a 180-day or greater period between the Certificate of Occupancy issuance and closing on the sale, each was built to code and therefore met HUD property standards. Each of the nine (9) houses continued to be code-

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Auditee Comments

Comment 15,
16, and 17

compliant as evidenced by the appraisals and the lack of warranty claims. And as described above, the three (3) completed re-inspections demonstrate that those houses still meet code and property standards. The properties therefore met the requirements of 24 CFR 92.251 at the time of project completion.

Recommendation 1B: Implement adequate procedures and controls to ensure that it maintains documentation to sufficiently support the eligibility of households and homes in accordance with HUD requirements.

Comment 1, 8,
and 11

Management Response – Disagree: The income verification method used in Cleveland’s Housing Trust Fund program meets or exceeds the guidelines provided by HUD. Consequently, the City’s procedures and controls for maintaining documentation to support eligibility in accordance with HUD requirements are not inadequate.

Comment 19

Nevertheless, the City has implemented new controls for the approval of Housing Trust Fund projects to further strengthen its program.

Comment 19

The City has already revised its income verification and income projection requirements. Beginning October 1, 2010, buyers assisted with second mortgage funds that have consistent incomes will need to provide three consecutive months of pay stubs to support income projections and confirm program eligibility. The revised policy and procedure is included in Appendix F. The revised policy also includes language for projecting income for families and individuals whose income is not consistent. We ask that HUD acknowledge the City’s good faith efforts in making these changes and that if, after review, HUD determines that modifications to the City’s policies are needed that all activities administered between October 1, 2010 and the date of a final policy agreement by the City and HUD be accepted as complying with HOME income verification rules.

Comment 19

The City has made significant progress in implementing changes and controls to the Programs over the past year, in accordance with Program rules and Regulations. Among these changes and controls are:

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Comment 19

1. Changes to Program file contents:
 - a. An eligibility form has been created and is now placed in all Program files. This form provides a concise format for collecting, organizing, and presenting documentation on how staff determined eligibility for the client, as well as providing a means for calculating income.
 - b. Documentation of applicable year income limits is now placed in all Program files.
 - c. Supplemental file forms such as calculation worksheets, clarification record sheets and notation to files sheets have been created and are now placed in all Program files.
 - d. A completed home inspection form (also known as the 'goldenrod') is now placed in all Program files. The goldenrod includes the signatures of the inspectors charged with determining the compliances with code for all systems needed for the Certificate of Occupancy. Certificates of Occupancy are also placed in all Program files at time of issuance from the Department of Building and Housing.
 - e. Complete copies of Settlement Statements are now placed in all Program files.
2. Homeowner contracts have been revised to include all necessary HOME regulations.
3. The Program application and supplemental application documents have been reviewed and revised. The application is attached as Appendix G.
4. The City has taken steps to increase staff and partner capacity relevant to income verification:
 - a. Staff attended the "Expert HOME and CDBG: Working Together to Create Affordable Housing" training sponsored by the U.S. Department of Housing and Urban Development.
 - b. Staff attended and passed the "Certified HOME Program Specialist - Regulations" course offered by the U.S. Department of Housing and Urban Development.

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Auditee Comments

Comment 19

c. Staff certified in the 'Certified HOME Program Specialist – Regulations' have provided Program eligibility training to departmental staff, ancillary departmental staff, and partner non-profit agencies and developers.

5. The City has engaged ICF International to provide two days of consultation to the City in September of 2011. The scope of work includes review of current client files, income and eligibility training, and review of current policies and procedures.

Finding 2: The City lacked adequate controls over its Housing Trust Fund Program to ensure that appropriate recapture provisions were used for activities.

Management Response – Disagree: Finding #2 states that the City of Cleveland “did not (1) implement appropriate recapture provisions for all 44 of the households reviewed and (2) ensure that the Program was reimbursed for Program funds used to assist a homebuyer in purchasing a home that was later sold through a sheriff’s sale and ownership of the home had been transferred.” This is attributed to the City’s lack of “adequate procedures and controls regarding the activities to ensure that it appropriately followed HUD’s requirements.” The City is being asked to reimburse its HOME account, from non-federal funds, the amount of HOME funds used to assist homes that have gone to Sheriff’s Sale, resulting in a transfer of ownership.

Essentially, the lack of “adequate procedures and controls” refers to the City’s failure to include in its HOME loan documents specific language that would limit the recapture of HOME funds to net proceeds in the event of a foreclosure action.

Comment 20

While the City of Cleveland acknowledges that the specific “net proceeds” language was not in its documents, at no time were we aware that HUD had adopted a policy that the lack of the appropriate wording could result in substantial financial liability. Had we known, we certainly would have made the required changes.

Finding #2 cites 24 CFR 92.254 and information posted in the HOMEfires technical assistance section of the HUD website in June 2003 as primary sources for the requirement violated by the City.

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Auditee Comments

Comment 20

The 24 CFR 92.254 program regulation states that “when the recapture requirement is triggered by a sale (voluntary or involuntary) of the housing unit, and there are no net proceeds or the net proceeds are insufficient to repay the HOME investment due, the participating jurisdiction can only recapture the net proceeds, if any.” It also provides several options for restructuring recapture agreements. At no point does it indicate that the City’s liability for repaying HOME funds on foreclosed properties will be determined by the lack of one specific provision in its loan documents.

Comment 20

In compliance with the above regulation, the City of Cleveland has never taken legal action to require persons that have lost their homes through foreclosure to repay HOME funds in excess of net proceeds.

The 2003 HOMEfires web posting does describe the financial risks to a participating jurisdiction of not including the “net proceeds” language in its program documents. To the best of our knowledge, no one on our staff was aware that this information had been made available at that time; nor did we see or hear it explained in any subsequent HUD publications or training sessions, in spite of the national foreclosure crisis that began several years after the 2003 website reference.

Comment 21

After this issue was brought to our attention as the result of the February 1-3, 2010 HUD Onsite Monitoring Review, new program documents were developed that contain the required language limiting the homeowner’s and the City’s financial liability to the available net proceeds, in the event of foreclosure. We believe that this has been an appropriate corrective action. We do not agree that it is appropriate to require the City of Cleveland to reimburse its HOME Program account with money from its general fund resources.

Comment 20

An important factor to consider in determining whether the requested reimbursement is an appropriate course of action is the following question:

What was the actual programmatic or financial impact of the City’s failure to include the required wording in its program documents?

Comments 20 and 22

The reality is that there has been no substantive impact.

- HOME assisted properties have gone to Sheriff’s Sale, which resulted in the termination of the affordability period. This would have been true whether or not the City’s documents contained the “net proceeds” provision.

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Auditee Comments

Comments 20
and 22

- In no cases that we are aware of did a Sheriff's sale result in any proceeds that exceeded the amount owed to the first mortgage holder. Had the "net proceeds" language been in the City documents, there still would have been no repayment to the homeowner or the City's HOME Program account.
- In conformance with 24 CFR 92.254, in no cases has the City taken legal action to require a foreclosed homeowner to repay HOME funds to the City from other sources.

The previously mentioned 2003 HOMEfires HUD web posting states:

"A PJ that was unaware that its homebuyer program design obligated it, in the event of foreclosure, to repay funds in excess of what would be available through the foreclosure and has changed the design to base recapture amounts on net proceeds may want to pursue a waiver of the repayment requirement at Section 92.503 (b) (1) for homeowners assisted under the original program design. HUD may grant a waiver on a program basis that, in the event of foreclosure involving homebuyers assisted under the previous program design, would limit the PJ's repayment obligation to the amount that it is able to obtain through the foreclosure."

Comment 20
Comment 21

The City of Cleveland was unaware of the financial liability it was incurring by the failure to add some additional wording to its program documents. Upon being notified of the issue after a 2010 HUD onsite monitoring review, we immediately corrected the problem with respect to all future HOME homebuyer loans.

On page 21 of our letter of July 30, 2010 to the HUD Columbus Field Office, in response to the onsite monitoring review, we specifically requested a waiver of any past financial obligations resulting from this specific issue, as referenced in above HOMEfires citation. Cleveland renewed this waiver request in a February 23, 2011 letter to the HUD Columbus Field Office. To date, we have not received a response to this request from HUD. For purposes of the discussion draft, the City of Cleveland renews its request for a waiver of any past financial obligation resulting from not having the specific net proceeds recapture language in the loan mortgage documents. A copy of the request is attached as Appendix H.

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Auditee Comments

Comments 20
and 22

Comment 21

In summary:

1. The City of Cleveland did not violate the 24 CFR 92.254 program regulations by recapturing HOME funds in excess of net proceeds on foreclosed properties.
2. The failure to include appropriate "net proceeds" recapture wording in our HOME loan documents did not cause any monetary loss to City of Cleveland's HOME Program account.
3. The City of Cleveland took immediate action to correct the problem when it was first made aware of it during a HUD monitoring review in early 2010. The City's current HOME homebuyer recapture provisions, including the required net proceeds language, are described on page 29 of our Consolidated Plan's 2011-2012 Action Plan and comply fully with Recommendation 2C of Finding 2.

In light of these factors, we believe that HUD approval of the HOMEfires referenced waiver would be the most appropriate resolution of the issue raised in Finding 2.

Conclusion

Comment 23

Comments 20
and 21

The City of Cleveland submits that it has processes and procedures that provide adequate control for the Housing Trust Fund Program, particularly in light of changes that have been put in place or are being made. Notwithstanding the City's belief on income documentation and calculation described above, the City will seek additional information so that the documentation aligns with the standard described by the auditor for ninety (90) days of consecutive paystubs. The City further maintains that, with respect to net proceeds and recapture, the City has complied with the intent of the guidelines and requests an affirmative determination regarding the request for a waiver.

OIG's Evaluation of Auditee Comments

Comment 1 The City lacked adequate procedures and controls regarding its Housing Trust Fund program home-buyer activities to ensure that it appropriately followed HUD's requirements. It provided assistance for an ineligible household and lacked sufficient documentation to support that households were income eligible. Further, it did not ensure that it properly projected households' annual income. For example, the City used gross year-to-date income in its calculation of projected annual income rather than using current circumstances to project future income for households. It also lacked documentation to support its calculation of households' annual income or that it calculated households' annual income.

Comment 2 We did not cite any households as being overincome in our discussion draft audit report.

Comment 3 We added the following to the report:

- Contrary to HUD's regulations, the City drew down \$20,000 in Program funds on February 20, 2007, to assist a household that was not income eligible. The Program funds were used to provide an interest-free second mortgage loan to a home buyer for activity number (including the OIG-designated household number) 8917 (11). The City could not provide sufficient income documentation for activity number 8917 (11). However, it stated that the household was not income eligible.

We also moved recommendations 1A and 1B to recommendations 1B and 1C, respectively, and added a new recommendation 1A to state the following:

- Reimburse its Program from non-Federal funds for the \$20,000 in Program funds inappropriately used to assist activity number (including the OIG-designated household number) 8917 (11).

Comment 4 We revised the report to state the following:

- The City lacked sufficient documentation for 42 of the 44 households and or homes reviewed to support that it used \$795,000 in Program funds for eligible households and homes.
- Contrary to HUD's requirements, the City lacked sufficient documentation to support that 42 of the 44 households were income eligible.
- The table in appendix D of this report shows the activity number (including the OIG-designated household number) for the 42 households and homes for which the City did not have (1) sufficient income documentation to demonstrate that households were income eligible and or (2) final inspection

reports or certifications supporting that homes met HUD's property standards requirements at the time of occupancy.

We also amended recommendation 1B to reflect these revisions.

Further, we revised the table in appendix D of this report by removing entries showing that the City had insufficient income documentation for activity numbers (including the OIG-designated household number) 8917 (09) and 8917 (11).

Comment 5 The City provided documentation to support that it calculated the households' annual income for activity numbers (including the OIG-designated household number) 8917 (08) and 8917 (09).

Therefore, we revised the report to state the following:

- The City also lacked documentation to support its calculation of households' annual income or that it calculated households' annual income for six additional households.

Comment 6 The City did not provide documentation to support that HUD found the City's method of calculating income eligibility for its Housing Trust Fund program to be sufficient. The City's method of calculating income eligibility for its Housing Trust Fund program was not reviewed as part of HUD's Columbus Office of Community Planning and Development's 2006, 2007, or 2008 monitoring reviews of the City. Further, just because HUD's Office's 2006, 2007, and 2008 monitoring reviews of the City did not result in any findings or concerns regarding the City's calculations used to determine income eligibility, does not mean that HUD approved the City's calculations used to determine income eligibility.

Comment 7 Further, HUD's Columbus Office of Community Planning and Development's February 2010 monitoring review identified that the City lacked sufficient documentation to support that households were income eligible and its calculations of households' annual income for activities. In addition, HUD's Office requested that we conduct an audit of the City's Program due to the issues uncovered during its monitoring review.

Comment 8 Chapter two of HUD's Technical Guide for Determining Income and Allowances for the Program, dated January 2005, states that a participating jurisdiction must project a household's future income by using the household's current income circumstances. The year-to-date pay statement, Internal Revenue Service Form W-2 wage and tax statement, and tax return information may not reflect the household's current income circumstances.

Comment 9 Contrary to HUD's requirements, the City lacked sufficient documentation to support that the 31 households were income eligible.

Comment 10 The City provided assistance for an ineligible activity and lacked sufficient documentation to support that activities were eligible. As a result, it inappropriately provided \$20,000 in Program funds to assist a household that was not income eligible and was unable to support its use of \$795,000 in Program funds.

Comment 11 Chapter two of HUD's Technical Guide for Determining Income and Allowances for the Program, dated January 2005 also states that a participating jurisdiction must project a household's future income by using the household's current income circumstances. Exhibit 2.1 states that a participating jurisdiction must include hourly wage figures, overtime figures, bonuses, anticipated raises, cost-of-living adjustments, or other anticipated changes in income in an applicant household's projected income calculation. For households with jobs providing steady employment, it can be assumed that there will only be slight variations in the amount of income earned. Therefore, 3 consecutive months' worth of income documentation is an appropriate amount upon which to base a household's projected income calculation for the following 12-month period. For those households with jobs providing employment that is less stable or does not conform to a 12-month schedule (such as seasonal laborers), income documentation that covers the entire previous 12-month period should be examined. In addition to hourly earnings, participating jurisdictions must account for all earned income. This income will include annual cost-of-living adjustments, bonuses, raises, and overtime pay in addition to base salary. In the case of overtime, it is important to determine whether overtime is sporadic or predictable. If a participating jurisdiction determines that a household will continue to earn overtime pay on a regular basis, it should calculate the average amount of overtime pay earned by the household over the past 3 months. This average should then be added to the total amount of projected earned income for the following 12-month period. Appropriate income documentation includes pay statements, third-party verification, bank statements, or certified copies of tax returns.

Comment 12 The activity number (including the OIG-designated household number) for the household that had a benefits-based income determination was 8917 (09) rather than 8917 (08).

Comment 13 Contrary to HUD's requirements, the City lacked sufficient documentation to support that the households for the 11 activities were income eligible.

Comment 14 The City previously provided documentation to support that it properly projected the household's annual income for activity number (including the OIG-designated household number) 8917 (21).

Therefore, we revised the report to state the following:

- Further, the City did not ensure that it properly projected households' annual income for at least 23 of the 44 households reviewed. For example, the City used gross year-to-date income in its calculation of projected annual income rather than using current circumstances to project future income for 10 of the 23 households.

Comment 15 We revised the report to state the following:

- Contrary to HUD's requirements, the City lacked sufficient documentation to support that 9 of the 44 homes acquired with Program funds met HUD's property standards requirements at the time of occupancy. The closing dates for the nine homes occurred from June 16, 2006, through March 5, 2009. The City had certificates of occupancy for all nine homes stating that the homes met the City's building and zoning codes. However, eight of the nine certificates of occupancy were dated from 286 to 787 days (at least 6 months) before the properties were purchased by the home buyers.

We added the following to the report:

- Further, on August 30, 2011, and as a result of our audit, the City inspected three of the nine homes and provided affidavits for the three homes stating that the properties met all applicable State and local standards and code requirements.

We also removed the following from the report:

- The manager of the Housing Development Office stated that she believed that the City lacked certificates of occupancy for the four homes because the property developers did not pay the fee to obtain the certificates of occupancy.

In addition, we revised the table in appendix D of this report by removing entries showing that the City had insufficient final inspection reports or certifications supporting that homes met HUD's property standards requirements at the time of occupancy for activity numbers (including the OIG-designated household number) 7758 (02), 7758 (03), 8917 (06), 8917 (16), 8917 (17), and 8917 (23).

The settlement statement date for activity number (including the OIG-designated household number) 8917 (06) is May 24, 2006, rather than May 24, 2007.

Comment 16 Contrary to HUD's requirements, the City lacked sufficient documentation to support that 9 of the 44 homes acquired with Program funds met HUD's property standards requirements at the time of occupancy.

Comment 17 Certificates of occupancy based on inspections that occurred more than 6 months before properties were purchased by home buyers do not support that homes met HUD's property standards requirements at the time of occupancy.

- Comment 18** HUD’s regulations at 24 CFR 92.251(a)(2) state that housing acquired with Program funds must meet all applicable State and local housing quality standards and code requirements. Chapter five, part I, of HUD’s “Building HOME: A Program Primer,” dated March 2008, states that all housing quality standards and code requirements must be met at the time of occupancy.
- Comment 19** The City’s commitment to new procedures and controls, if fully implemented, should improve the City’s management of its Program.
- Comment 20** HUD’s HOMEfires, volume 5, number 2, which has been in effect since June 2003, states that for Program-assisted home-buyer projects with recapture provisions, the amount of Program funds required to be repaid in the event of foreclosure is the amount that would be subject to recapture under the terms of the written agreement with the home buyer. If the recapture provisions require the entire amount of the Program investment from the home buyer, the amount required by the recapture provisions is the amount that must be recaptured by the participating jurisdiction for the Program. If the participating jurisdiction is unable to recapture the funds from the household, it must reimburse its Program in the amount due pursuant to the recapture provisions in the written agreement with the home buyer.
- Comment 21** On July 19, 2011, the director of the City’s Department of Community Development stated that the City was developing a revised mortgage and promissory note for its activities to include language that would limit the amount of Program funds the City could recapture to the net proceeds from the sale of a home. The City did not provide documentation to support that it developed a revised mortgage and promissory note for its activities to include language that would limit the amount of Program funds the City could recapture to the net proceeds from the sale of a home through foreclosure.
- Comment 22** The City did not comply with HUD’s requirements in its use of recapture provisions for activities. Neither the mortgages nor promissory notes between the City and the home buyers contained language that limited the amount of Program funds the City could recapture to the net proceeds from the sale of a home. The mortgages and promissory notes required repayment of the full amount of the loan upon sale, lease, refinance, or transfer. The City did not implement appropriate recapture provisions for all 44 of the households reviewed and did not ensure that its Program was reimbursed for Program funds used to assist a home buyer in purchasing a home that was later sold through a sheriff’s sale and ownership of the home had been transferred. As a result, its Program was not reimbursed for \$20,000 in Program funds used for the home that was sold through a sheriff’s sale and ownership of the home had been transferred. Further, the City is at risk of being required to reimburse its Program additional non-Federal funds if the ownership of additional homes acquired under its Housing Trust Fund program is transferred through foreclosures.

Comment 23 The City lacked adequate procedures and controls to ensure that (1) it used Program funds for activities in accordance with HUD's requirements, (2) it implemented appropriate recapture provisions for activities, and (3) its Program was reimbursed for Program funds used to assist a home buyer in purchasing a home that was later sold through a sheriff's sale and ownership of the home had been transferred.

Appendix C

HUD'S REQUIREMENTS

Finding 1

HUD's regulations at 24 CFR 92.2 define a low-income household as a household with an annual income that does not exceed 80 percent of the median income for the area as determined by HUD.

HUD's regulations at 24 CFR 92.203(a) state that a participating jurisdiction must determine whether each household is income eligible by determining the household's annual income. Section 92.203(a)(2) states that a participating jurisdiction must determine households' annual income by examining source documentation evidencing households' annual income. Section 92.203(d)(1) states that a participating jurisdiction must calculate a household's annual income by projecting the prevailing rate of the household's income at the time the participating jurisdiction determines the household to be income eligible. Annual income must include income from all household members.

HUD's regulations at 24 CFR 92.217 state that a participating jurisdiction must invest Program funds made available during a fiscal year so that with respect to home ownership assistance, 100 percent of these funds are invested in dwelling units that are occupied by households that qualify as low-income households.

HUD's regulations at 24 CFR 92.251(a)(2) state that housing acquired with Program funds must meet all applicable State and local housing quality standards and code requirements. If there are no such housing quality standards or code requirements, the housing must meet HUD's housing quality standards.

HUD's regulations at 24 CFR 92.508(a) state that a participating jurisdiction must establish and maintain sufficient records to enable HUD to determine whether it has met the requirements of 24 CFR Part 92. The participating jurisdiction must maintain records demonstrating the following:

- ❖ Each household is income eligible in accordance with 24 CFR 92.203.
- ❖ Each activity meets the property standards of 24 CFR 92.251.

Chapter two, part I, of HUD's "Building HOME: A Program Primer," dated March 2008, states that income eligibility is based on anticipated income. Therefore, the previous year's tax return does not establish anticipated income and is not adequate source documentation. Chapter five, part I, states that all housing quality standards and code requirements must be met at the time of occupancy.

Chapter two of HUD's Technical Guide for Determining Income and Allowances for the Program, dated January 2005, states that a participating jurisdiction may develop its own income

verification procedures provided that it collects source documentation and that this documentation is sufficient to enable HUD to monitor Program compliance. A participating jurisdiction must project a household's future income by using the household's current income circumstances. Exhibit 2.1 states that a participating jurisdiction must include hourly wage figures, overtime figures, bonuses, anticipated raises, cost-of-living adjustments, or other anticipated changes in income in an applicant household's projected income calculation. For households with jobs providing steady employment, it can be assumed that there will only be slight variations in the amount of income earned. Therefore, 3 consecutive months' worth of income documentation is an appropriate amount upon which to base a household's projected income calculation for the following 12-month period. For those households with jobs providing employment that is less stable or does not conform to a 12-month schedule (such as seasonal laborers), income documentation that covers the entire previous 12-month period should be examined. In addition to hourly earnings, participating jurisdictions must account for all earned income. This income will include annual cost of living adjustments, bonuses, raises, and overtime pay in addition to base salary. In the case of overtime, it is important to determine whether overtime is sporadic or predictable. If a participating jurisdiction determines that a household will continue to earn overtime pay on a regular basis, it should calculate the average amount of overtime pay earned by the household over the past 3 months. This average should then be added to the total amount of projected earned income for the following 12-month period. Appropriate income documentation includes pay statements, third-party verification, bank statements, or certified copies of tax returns.

Finding 2

Section 215(b) of Title II of the Cranston-Gonzalez National Affordable Housing Act, as amended, states that housing that is for home ownership shall qualify as affordable housing under Title II of the Act only if the housing is subject to resale restrictions that are established by the participating jurisdiction and determined by HUD's Secretary to be appropriate to (1) allow for the later purchase of the property only by a low-income household at a price which will provide the owner a fair return on investment and ensure that the housing will remain affordable to a reasonable range of low-income home buyers or (2) recapture the Program investment to assist other persons in accordance with the requirements of Title II of the Act, except when there are no net proceeds or when the net proceeds are insufficient to repay the full amount of the assistance.

HUD's regulations at 24 CFR 92.254(a)(4) state that Program-assisted housing must meet the affordability requirements for not less than the applicable period beginning after activity completion. Home-ownership activities that receive less than \$15,000 in Program assistance must remain affordable for at least 5 years. Section 92.254(a)(5) states that to ensure affordability, a participating jurisdiction must impose either resale or recapture provisions that comply with the standards of section 92.254(a)(5) and include the provisions in its consolidated plan. Section 92.254(a)(5)(ii) states that a participating jurisdiction's recapture provisions must ensure that the participating jurisdiction recoups all or a portion of the Program assistance to the home buyers if the housing does not continue to be the principal residence of the household for the duration of the period of affordability. In establishing its recapture provisions, the participating jurisdiction is subject to the limitation that when the recapture provision is triggered

by a voluntary or involuntary sale of the housing unit and there are no net proceeds or the net proceeds are insufficient to repay the Program investment due, the participating jurisdiction may only recapture the net proceeds, if any. The recaptured funds must be used to carry out Program-eligible activities in accordance with the requirements of 24 CFR Part 92.

HUD's regulations at 24 CFR 92.502(c)(3) state that a participating jurisdiction must disburse Program funds, including Program income and recaptured Program funds, in its HOME investment trust fund local account before requesting Program funds from its treasury account. Section 92.503(c) states that Program funds recaptured in accordance with 24 CFR 92.254(a)(5)(ii) must be deposited into the participating jurisdiction's local account and used in accordance with the requirements of 24 CFR Part 92.

HUD's regulations at 24 CFR 92.504(b) state that before disbursing any Program funds to any entity, a participating jurisdiction must enter into a written agreement with that entity. Section 92.504(c)(5)(i) states that when a participating jurisdiction provides assistance to a home buyer, the written agreement must conform to the requirements in 24 CFR 92.254(a) regarding resale or recapture provisions.

HUD's HOMEfires, volume 5, number 2, states that for Program-assisted home-buyer projects with recapture provisions, the amount of Program funds required to be repaid in the event of foreclosure is the amount that would be subject to recapture under the terms of the written agreement with the home buyer. If the recapture provisions provide for shared net proceeds, the amount subject to recapture is based on the amount of net proceeds, if any, from the foreclosure sale. If the recapture provisions require the entire amount of the Program investment from the home buyer or an amount reduced prorata based on the time the home buyer has owned and occupied the home measured against the affordability period, the amount required by the recapture provisions is the amount that must be recaptured by the participating jurisdiction for the Program. If the participating jurisdiction is unable to recapture the funds from the household, the participating jurisdiction must reimburse its Program in the amount due pursuant to the recapture provisions in the written agreement with the home buyer.

HUD's HOMEfires, volume 5, number 5, requires a participating jurisdiction to select either resale or recapture provisions for its Program-assisted home-buyer projects. The participating jurisdiction may select resale or recapture provisions for all of its home-buyer projects or resale or recapture provisions on a case-by-case basis. However, the participating jurisdiction must select whether resale or recapture will be imposed for each home-buyer project at the time the assistance is provided. A participating jurisdiction may adopt any one of four options in designing its recapture provisions. All of the options the participating jurisdiction will employ must be identified in its consolidated plan and approved by HUD.

Appendix D

SCHEDULE OF ACTIVITIES WITH INSUFFICIENT DOCUMENTATION

<i>Activity number</i>	<i>Income documentation</i>	<i>Final inspections or certifications</i>	<i>Assistance amount</i>
7758 (01)	X		\$20,000
7758 (02)	X		20,000
7758 (03)	X		20,000
7758 (04)	X		20,000
7758 (05)	X	X	20,000
8917 (01)	X		20,000
8917 (02)	X		20,000
8917 (03)	X		20,000
8917 (04)	X	X	20,000
8917 (05)	X		10,000
8917 (06)	X		10,000
8917 (07)	X		10,000
8917 (08)	X		20,000
8917 (10)	X	X	15,000
8917 (12)	X	X	20,000
8917 (13)	X		20,000
8917 (14)	X		20,000
8917 (15)	X		20,000
8917 (16)	X		20,000
8917 (17)	X		20,000
8917 (18)	X		20,000
8917 (19)	X		10,000
8917 (20)	X		20,000
8917 (21)	X		20,000
8917 (22)	X		20,000
8917 (23)	X		20,000
8917 (24)	X		20,000
9706 (01)	X	X	20,000
9706 (02)	X		20,000
9723 (01)	X		20,000
9723 (02)	X		20,000
9723 (03)	X	X	20,000
9723 (04)	X		20,000
9723 (05)	X		20,000
9723 (06)	X		20,000
9723 (07)	X		20,000
9723 (08)	X		20,000
9723 (09)	X		20,000
9723 (10)	X		20,000

SCHEDULE OF ACTIVITIES WITH INSUFFICIENT DOCUMENTATION (CONT.)

<i>Activity number</i>	<i>Income documentation</i>	<i>Final inspections or certifications</i>	<i>Assistance amount</i>
9723 (11)	X		20,000
9723 (12)	X		20,000
9723 (13)	<u>X</u>		<u>20,000</u>
Totals	<u>42</u>	<u>6</u>	<u>\$795,000</u>