



The City of Huntsville, AL

Community Planning and Development Community Development Block Grant and HOME Investment Partnerships Program



Issue Date: May 29, 2014

Audit Report Number: 2014-AT-1005

TO: Charles Franklin, Director, Community Planning and Development Division,
4CD

//signed//

FROM: Nikita N. Irons, Regional Inspector General for Audit, Atlanta Region, 4AGA

SUBJECT: The City of Huntsville, AL, Community Development Department, Did Not Adequately Account for and Administer the Mirabeau Apartments Project

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of the City of Huntsville's Community Development Block Grant and HOME Investment Partnerships Program.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at <http://www.hudoig.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at 404-331-3369.



Date of Issuance: May 29, 2014

The City of Huntsville, AL, Community Development Department, Did Not Adequately Account for and Administer the Mirabeau Apartments Project

Highlights

Audit Report 2014-AT-1005

What We Audited and Why

We audited the City of Huntsville's Community Development Department, which administers the Community Development Block Grant (CDBG) and HOME Investment Partnerships Program, at the request of the U.S. Department of Housing and Urban Development's (HUD) Alabama Office of Community Planning and Development. Our objectives were to determine whether the Department's commitment to use CDBG and HOME funds for the acquisition and rehabilitation of the Mirabeau Apartments was an eligible activity and whether the Department had adequate controls and procedures to ensure appropriate accountability for and administration of the project.

What We Recommend

We recommend that HUD require the City to (1) reimburse nearly \$2.4 million in ineligible costs and support more than \$1 million or reimburse unsupported amounts to the Department's CDBG and HOME program accounts from non-Federal funds, (2) inspect the project and correct all deficiencies, (3) review all participation agreements, and (4) prepare a cost allocation plan for HUD's review.

What We Found

The Department did not have adequate controls and procedures to ensure (1) appropriate accountability for and administration of the Mirabeau project and (2) that it used its HOME and CDBG funds for eligible activities. Specifically, the Department (1) inappropriately loaned more than \$932,000 in HOME funds, and more than \$250,000 in community housing development organization (CHDO) funds to a developer; (2) did not fully document the use of more than \$1 million in CDBG funds for five loans; (3) did not use \$772,000 in HOME funds as intended; and (4) did not recover collateral of more than \$323,000 in CDBG funds from its bank and \$100,000 in HOME funds from its CHDO.

In addition, the Department did not (1) realize potential income because 60 units were offline, (2) include all of the elements required by HUD regulations in its participation agreement with the developer of the Mirabeau Apartments, and (3) prepare a cost allocation plan to allocate the unit costs or identify the number of HOME-assisted units to support the HOME-assisted units in the project.

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BACKGROUND AND OBJECTIVES

The City of Huntsville's Community Development Department is responsible for administering several programs, including the Community Development Block Grant (CDBG) and the HOME Investment Partnerships Program. The mission of the Department is threefold: (1) stabilization of lower income neighborhoods, (2) economic empowerment of lower income persons and persons living in lower income neighborhoods, and (3) providing assistance to the special needs population.

The Department is governed by the mayor and a five-member city council. The mayor serves as the City's chief executive officer and is responsible for providing professional leadership in the administration and implementation of all City operations and the policies, goals, and vision set forth by the Office of the Mayor and the city council. The mayor appoints all City department heads and enforces all City operations, resolutions, and orders.

The Department received more than \$6.4 million in CDBG funds and more than \$3.5 million in HOME funds from 2007 to 2011 for the Mirabeau Apartments. The apartments were built between 1962 and 1967 and consisted of 39 individually owned buildings containing 4 to 8 units each. The various buildings were purchased in 1992 by a developer consisting of a partnership named Westland and were financed as one project with a \$3.1 million loan from a local bank. The Department invested \$1.8 million in CDBG and Urban Development Action Grant funds and pledged \$1.6 million of its own income-producing assets to guarantee the loan.

The bank foreclosed on the property on November 21, 2001. To protect its assets, the Department deposited CDBG funds of \$1 million with the bank to release the assets and renamed the project Mirabeau. The \$1 million included a portion of a \$1.2 million first acquisition loan and a portion of a \$950,000 bridge loan made to the developer. The deposit would be released if the project was redeemed. The project was redeemed by the owners on March 14, 2002, and financed with funds from a private bank loan, the CDBG deposit of \$1 million, and an additional \$130,000 in CDBG funds. The Department agreed to this arrangement, although it gave up its rights to the \$1.8 million owed to it by the developer.

The audit objectives were to determine whether the Department's commitment to use CDBG and HOME funds for the acquisition and rehabilitation of the Mirabeau Apartments was an eligible activity and whether the Department had adequate controls and procedures to ensure appropriate accountability for and administration of the project in accordance with HUD's policies and guidelines.

RESULTS OF AUDIT

Finding 1: The Department Made Inappropriate and Unsupported Loans to the Developer

The Department inappropriately loaned nearly \$1.2 million in HOME and community housing development organization (CHDO)¹ funds to the developer to refinance the balance owed on the Mirabeau Apartments' mortgage. In addition, the Department could not provide documentation to support the use of more than \$1 million in CDBG funds it loaned to the developer. These conditions occurred because the City's former mayor and staff allowed the former community development director to approve all transactions without obtaining further approval. Also, the Department did not review and document the developer's use of the funds. As a result, it was not able to use nearly \$1.2 million for other eligible community activities when it used nearly \$1.2 million in HOME, and CHDO funds for ineligible activities, and neither the Department nor HUD had assurance that more than \$1 million in CDBG funds was expended for eligible activities.

Inappropriate Refinance Loans Were Made From HOME and CHDO Funds

The Department inappropriately used nearly \$1.2 million of its HOME and CHDO funds to pay on the mortgage debt for the Mirabeau Apartments. From these funds, the Department loaned \$932,831 in HOME funds (see appendix C) to the developer that was unallowable because Mirabeau did not meet HOME requirements necessary to constitute the project as an eligible HOME activity.

- Mirabeau's ongoing property condition did not meet the requirements of 24 CFR 92.251(c)(3), which require the owner of rental housing to maintain the property in compliance with all applicable State and local housing quality standards and codes, or if there are no such standards, with HUD's Housing Quality Standards (see discussion in Finding 3).
- The project's property standards did not meet all applicable local codes, rehabilitation standards, ordinances, and zoning ordinances at the time of project completion as required by 24 CFR 92.251(a)(1). The City lacked documentation to support that Mirabeau met these standards and the condition of the property did not support that adequate rehabilitation was

¹ CHDO is a special status defined by the HOME program for an organization, the primary purpose of which is to provide and develop affordable housing for the community it serves.

performed to bring the property into compliance with the applicable codes and standards (see discussion in Finding 4).

- Mirabeau did not qualify as affordable housing because the City did not impose the HOME affordability restrictions (rents and income targeting) on the project by deed restrictions or covenants running with the land as required in 24 CFR 92.252(e)(1)(ii). Also, City did not determine the minimum number of HOME units that had to be designated as HOME units and meet affordability requirements (see discussion in Finding 5).

The Department used \$250,811 of its CHDO set-aside funds (see appendix C) to refinance the developer's mortgage. It made the payment to the CHDO on October 29, 2004, and documented the payment as acquisition of real property. The CHDO, however, did not purchase property with the funds. Instead, it loaned the funds to the developer, who used the funds to refinance the Mirabeau Apartments' mortgage on November 4, 2004. The loan was identified in a promissory note, also dated November 4, 2004, among the developer, the Department, and the CHDO.

The CHDO's use of the funds either to make a loan to refinance the developer's mortgage or to purchase property was not an eligible activity. Regulations at 24 CFR 92.300(a)(1) stipulate that the funds must be provided to a CHDO, its subsidiary, or a partnership of which it or its wholly owned subsidiary is a managing general partner. If acting in any of these capacities, the CHDO must have effective project control. However, the CHDO was not a managing general partner of Mirabeau Apartments, nor did it have effective project control.

The City's former mayor allowed its former community development director to approve all transactions without obtaining its approval. There was no contract agreement to loan the developer funds, and as of July 2011, the developer owed the Department more than \$3.4 million with little prospect that the loans would be repaid. The use of the funds to pay on the debt was ineligible, and it was not reasonable or necessary.

\$300,000 in Bridge Loan Funds Was Paid to the Developer

The Department provided a \$950,000 bridge loan (see appendix C) to the developer. The bridge loan agreement stated that \$950,000 in CDBG funds was for the redemption of the project from the bank. However, only \$650,000 was used for redemption; the remaining \$300,000 was paid directly to the developer. The agreement was not amended to reflect the change in the use of the funds. The Department's staff could not explain how the developer used the \$300,000; thus, the \$300,000 was unsupported and failed to meet OMB Circular A-87 requirements that costs be fully documented.

\$200,000 of a First Acquisition Loan Was Not Used as Intended

A first acquisition loan agreement provided a \$1.2 million CDBG loan (see appendix C) for the redemption of the project from the bank. However, only \$1 million was used for that purpose. The developer used the remaining \$200,000 to repay a portion of the \$950,000 bridge loan that that was paid directly to the developer. Consequently, this \$200,000 remained unsupported.

\$41,000 of a Mezzanine Loan Was Not Used as Intended

A mezzanine loan agreement stated that \$171,000 in CDBG loan funds (see appendix C) was to acquire the project after foreclosure and fund financing costs, such as appraisals, environmental studies, and fees and legal costs associated with the closing. The developer used \$130,000 of the loan at closing, which was held on March 14, 2002. The remaining \$41,000 was paid directly to the developer on March 20, 2002. The Department did not provide documentation to show that the developer used the \$41,000 as required by the loan agreement and failed to meet OMB A-87 requirements that costs be fully documented.

A \$390,000 Second Acquisition Loan Was Not Used as Intended

A second acquisition loan agreement provided that a \$390,000 CDBG loan (see appendix C) was for acquisition. However, the Department made the loan on May 6, 2002, 2 months after the project loan was closed. Since there was no acquisition made at the time of the loan, the \$390,000 was not needed. The Department did not provide documentation to support how the developer used the funds as required by OMB A-87, which provides that costs must be fully documented.

A \$100,000 Third Acquisition Loan Was Not Used as Intended

The second amendment to a third acquisition loan agreement stated that a \$100,000 CDBG loan (see appendix C) was to reduce the principal of the project's debt. The funds were used to pay off the balance of the bridge loan that the developer owed the Department. There was no documentation showing that the Department amended the agreement to allow the developer to use the funds to pay off the bridge loan. As a result, the \$100,000 loan was unsupported.

Conclusion

Overall, more than \$2.2 million in CDBG, HOME, and CHDO loan funds did not meet OMB Circular A-87 requirements, which provide that for costs to be eligible, they must be fully documented, reasonable, and necessary. The Department inappropriately loaned nearly \$1.2 million in HOME and CHDO funds to the developer to refinance the balance owed on the Mirabeau Apartments' mortgage. Also, more than \$1 million in CDBG loans was unsupported because the Department could not provide documentation to support the developer's use of the CDBG funds.

Recommendations

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

- 1A. Reimburse \$1,183,642 in HOME and CHDO funds to the HOME Investment Trust Fund treasury account from non-Federal funds.
- 1B. Provide documentation to support the \$1,031,000 in CDBG loans or reimburse the CDBG program from non-Federal funds.
- 1C. Establish and implement policies to strengthen oversight of its Community Development Department to ensure that an individual cannot approve transactions without approval from the City to ensure that activities are eligible and properly supported.

Finding 2: HOME and CDBG Funds Were Not Used as Intended and Recovered When Required

The Department loaned the developer \$772,000 in HOME funds that was not used as intended to increase the scope of the project rehabilitation work. Also, the Department did not recover \$323,720 in CDBG funds it had deposited into a local bank to secure a project loan after that loan was redeemed and \$100,000 provided to a CHDO for a terminated project. These conditions occurred because the former City officials did not provide adequate review and oversight of the Department and its former director. As a result, \$772,000 in ineligible expenditures reduced the Department's ability to provide additional services to the community, and \$423,720 in development funds was owed to the program.

HOME and CDBG Funds Were Used Improperly

The Department loaned the developer \$772,000 in HOME funds that the developer used improperly (see appendix C). It loaned the developer \$348,500 in HOME funds for rehabilitation work on the Mirabeau Apartments on November 26, 2003. Then on May 18, 2004, the developer requested an increase in the original \$348,500 loan amount to \$772,000 to increase the scope of the rehabilitation work. The rehabilitation work associated with the loans totaled \$144,664, of which \$123,501 was spent before the increase in scope request. The developer spent only \$21,163 for rehabilitation after he received the loans to increase the scope of work.

Of the \$772,000 loan, the developer used \$627,336 in HOME funds to pay himself a \$200,775 developer's fee, \$68,537 to pay the principal and interest on the project mortgage, \$18,557 to pay operating expenses, \$4,467 for legal fees, \$60,000 to pay a portion of the fourth acquisition loan, and \$275,000 to pay a portion of a \$750,000 project loan. However, the entire \$772,000 in HOME funds expended on the project was unallowable, since the Mirabeau project did not constitute an eligible HOME activity because the housing did not meet HOME requirements.

Mirabeau's ongoing property condition did not meet the requirements of 24 CFR 92.251(c)(3), which require the owner of rental housing to maintain the property in compliance with all applicable State and local housing quality standards and codes, or if there are no such standards, with HUD's Housing Quality Standards (see discussion in Finding 3).

Also, the housing's property standards did not meet all applicable local codes, rehabilitation standards, ordinances, and zoning ordinances at the time of project completion as required by 24 CFR 92.251(a)(1). The City lacked documentation

to support that Mirabeau met these standards and the condition of the property did not support that adequate rehabilitation was performed to bring the property into compliance with the applicable codes and standards (see discussion in Finding 4). Mirabeau did not qualify as affordable housing because the City did not impose the HOME affordability restrictions (rents and income targeting) on the project by deed restrictions or covenants running with the land as required in 24 CFR 92.252(e)(1)(ii). The City did not determine the minimum number of HOME units that had to be designated as HOME units and meet affordability requirements (see discussion in Finding 5).

The Department, under its former director, did not monitor the project activities as required by 24 CFR 85.40, which states that grantees must monitor grant- and subgrant-supported activities to ensure compliance with applicable Federal requirements. The Department, under its former director, did not properly document that it reviewed the Mirabeau Apartments as rehabilitation work was completed or reviewed the developer's expenditures. The housing manager stated that he was told by the former director that there was no need for documentation since the improvements were only cosmetic and there were no substantial structural repairs. The housing manager stated that he checked the rehabilitation work before the developer was paid but could not provide supporting documentation.

CDBG Funds Used as Collateral Were Not Returned

The Department entered into an agreement on October 29, 1999, with a local bank to make monthly deposits. The deposits were to maintain the value of the mortgages that it pledged to secure a \$3.5 million loan for the developer to purchase the Westland Apartments, the predecessor to the Mirabeau Apartments. The monthly deposits were based on the amortization of the \$1.6 million value of the pledged mortgages. The deposits were initially \$12,884 per month and later increased to \$13,000 per month. The Department used CDBG funds totaling \$323,720 to make deposits from November 16, 1999, through December 5, 2001 (see appendix C).

The bank foreclosed on the loan on November 21, 2001. To protect its income-producing mortgages, the Department entered into a collateral substitution agreement on January 3, 2002. According to the agreement, the Department was required to make a \$1 million bank deposit as collateral to obtain the release of the pledged mortgages. It used CDBG funds to make the deposit on January 4, 2002. The apartments were redeemed on March 14, 2002, and the bank released the \$1 million deposit. The deposit was used at closing. However, there was no documentation to support that the bank released the \$323,720 in collateral.

We requested an explanation for the disposition of the funds; however, the Department did not provide an explanation. Regulations at 24 CFR 570.202(b)

provide that the use of CDBG funds to guarantee a loan is an eligible expenditure. Once the loan is settled, the collateral must be returned.

HOME Funds Were Not Returned When the Project Was Terminated

The Department provided \$100,000 in HOME funds (see appendix C) to its CHDO to invest in a proposed condominium development involving units in the Mirabeau Apartments project. The Department's CHDO entered into a purchase and sale agreement on January 8, 2007, to purchase one tenth of one percent partnership interest in the Mirabeau Apartments for a \$100,000 investment. The Department provided \$100,000 in HOME funds to its CHDO on January 10, 2007. The CHDO wired the funds to the developer's bank account on January 16, 2007.

The agreement stated that the CHDO would own two units to initially rent to HOME-eligible tenants. The units would eventually be converted to condominiums and sold. The CHDO would receive a profit equal to 10 percent of its investment. Then the investment would roll over to another condominium unit for sale, and that process would continue.

The Department later determined that the conversion of project units to condominiums for sale was not viable and terminated the project. Regulations at 24 CFR 92.205(e) state that a HOME-assisted project that is terminated before completion, either voluntarily or otherwise, constitutes an ineligible activity and any HOME funds invested in the project must be repaid to the participating jurisdiction's HOME Investment Trust Fund, a set-aside account established by HUD at the U.S. Treasury for allocated HOME funds. However, the \$100,000 in HOME funds was not returned by the CHDO.

The original CHDO merged with another CHDO in May 2009. Staff of the current CHDO stated that it was not aware of the agreement or the \$100,000 investment and did not receive rent from the units. Staff also stated that the records received from the original CHDO were not complete and contained little information about transactions with the Mirabeau Apartments. As a result, the Department's failure to monitor the use of the \$100,000 allowed the developer unrestricted use of the HOME funds for several years.

Conclusion

Overall, nearly \$ 1.2 million in HOME and CDBG funds was owed to the program because former City officials failed to review and monitor the activities of the Department and its former director. The Department used \$772,000 in HOME funds for unintended purposes. It also failed to recover more than

\$323,000 in CDBG funds it had deposited into a local bank to secure a project loan after that loan was redeemed. In addition, \$100,000 in HOME funds was not recovered when the project was terminated.

Recommendations

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

- 2A. Reimburse \$772,000 in HOME funds used to pay ineligible expenses to the HOME Investment Trust Fund treasury account from non-Federal funds.
- 2B. Seek recovery of the \$323,720 in CDBG funds from the bank with interest from March 14, 2002, to the present. Reimburse \$323,720 in CDBG funds to the CDBG program from non-federal funds and reimburse the interest to the U.S. Treasury.
- 2C. Reimburse \$100,000 in HOME funds to the HOME Investment Trust Fund Treasury account from non-Federal funds.
- 2D. Ensure that its Community Development Department establishes and implements procedures to monitor and review project activities and developer expenditures to ensure that costs are eligible.
- 2E. Establish and implement procedures to review and oversee the agreements of its Community Development Department and recover CDBG and HOME funds when required.

Finding 3: The Mirabeau Apartments Were Not Properly Maintained

The Mirabeau Apartments were deteriorating, and no work was being performed to correct the deterioration. Of the 229 project units, 60 were offline and needed major rehabilitation to make the units livable. Although the interior of the occupied units appeared acceptable, the exterior of the buildings needed significant repair and correction of safety issues. These conditions existed because the Department's inspections during and after rehabilitation were not properly documented and did not report all deficiencies for the necessary corrective action. As a result, income was lost for 60 offline units.

Offline Units' Interiors Needed Repair

We performed two inspections of the project in February and May 2011. During a cursory inspection of the overall project and two occupied units, we noted that the interior of the two occupied units was in good condition and did not display safety or health issues. However, the offline units were in significant disrepair. Most of the units had been gutted. The appliances were missing; sheetrock on the walls and ceiling was stripped, exposing the rafters and wall studs; electrical wiring was stripped; bathroom fixtures were missing; carpets were ruined; and the walls with sheetrock had many holes. One unit was burned out, and no action had been taken to repair the unit. Regulations at 24 CFR 92.251(c) state that an owner of rental housing assisted with HOME funds must maintain the housing in compliance with all State and local housing quality standards and code requirements and if there are no such standards or code requirements, the housing must meet the housing quality standards in 24 CFR 982.401. In August 2013, the project manager confirmed that 60 of Mirabeau's 229 units remained offline and needed major repairs to make the units livable. Therefore, Mirabeau lost the opportunity to earn income on those units.

The Exterior of Buildings Was Deteriorating

Our inspections of the exteriors in February and May 2011 showed that the buildings' exteriors needed significant repair. There were indications of rotten wood on all of the buildings. It appeared that the rotten wood was not replaced during rehabilitation but, rather, painted over to cover up the rot. The soffits and fascia boards were rotten and falling down. The trim work on all of the buildings needed painting, and the gutters were falling off the buildings. We noted several exterior steps that did not have hand rails for safety. We performed cursory inspections of the exteriors in August 2013 and observed that similar conditions remained.

Annual Inspections Were Not Properly Documented

The Department is required by 24 CFR 92.504(d)(1) to inspect the project annually to determine compliance with property standards. It did not properly document the annual inspections performed during rehabilitation. It inspected the project after our inspections. In its report, the Department identified the problem with the rotten wood and stated that it planned to conduct a follow-up inspection for rotten wood by August 19, 2011. The report did not mention the other deficiencies identified. As of August 28, 2013, the project was still in disrepair, and the owner had not made necessary repairs to the project.

Recommendations

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

- 3A. Ensure that its annual inspections are properly performed and thoroughly documented so the inspection reports provide a clear trail of necessary repairs to ensure that the deficiencies are corrected and those corrections can be verified against the identified deficiencies.
- 3B. Inspect the project, identify the deficiencies, and require the owner to correct all deficiencies identified.

Finding 4: The Department’s Participation Agreement Did Not Include Required Elements

The Department’s participation agreement with the developer of the Mirabeau Apartments did not include all of the elements required by HUD regulations. Although its agreement did not comply with HUD requirements, the Department disbursed HOME funds. This condition occurred because the City allowed the Department to administer the program without its review or approval. As a result, the Department could not effectively monitor the completion of the Mirabeau project and account for the use of HOME funds.

Written Agreements Did Not Comply With HUD Regulations

The Department executed a “participation agreement” with the developer dated March 7, 2002. The funds were for acquisition and rehabilitation. However, the City allowed the Department to execute the agreement and administer the program without proper oversight. The agreement lacked key elements stipulated by 24 CFR 92.504(c). The agreement did not describe the use of HOME funds, the tasks to be performed, a schedule for completing the tasks, and a budget. These items must be in sufficient detail to provide a sound basis for the Department to effectively monitor performance under the agreement. Also, the agreement did not include the period of affordability, the project requirements, the property standards, records, enforceability requirements, a request for disbursement of funds, and the duration of the agreement.

By not having an agreement with its developer that contained all of the information required by the regulations, the Department could not effectively monitor the project and take appropriate actions when necessary to ensure compliance with program requirements.

Recommendation

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

- 4A. Review all of the Department’s participation agreements to ensure compliance with HUD and HOME requirements.

Finding 5: A Cost Allocation Plan Was Not Developed for the Mirabeau Apartments

The Department did not prepare a cost allocation plan to allocate the unit costs or identify the number of HOME-assisted units in the project. This condition occurred because the Department did not have the financial data to make the necessary calculations. Without an allocation plan, the Department could not support the number of HOME units, the eligible unit costs, and the period of affordability.

The Eligible Costs Per Unit or Period of Affordability Was Not Established

The project consisted of 229 units, which included efficiency and one-, two-, and three-bedroom units of varying square footage and style. Some of the units also included a study. The HOME Program Final Rule, 92.205 d, Multi-unit projects, provides that only the actual HOME-eligible development costs of the assisted units may be charged to the HOME program. If the assisted and nonassisted units are not comparable, the actual costs may be determined based on a method of cost allocation. Because the Mirabeau units were not comparable, the Department was required to prorate the actual costs on a unit-by-unit basis for the HOME-assisted units in the project. However, the Department did not have the records it needed to support the actual costs on a per-unit basis. Also, the Department did not have the total actual costs of the project because it did not obtain the records from the developer.

By not establishing the eligible costs per unit, the Department could not establish the period of affordability as required by 24 CFR 92.252(e), Qualification as Affordable Housing. The period of affordability is based on the eligible costs per unit. The period of affordability is the period during which the units are subjected to HOME program rules and regulations. As a result of this deficiency, the Department could not support the number of HOME units, the eligible unit costs, and the period of affordability.

Recommendations

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

- 5A. Ensure that the Department obtains all of the project costs from the developer to determine the applicable costs and properly prepare a cost allocation plan.

5B. Provide the cost allocation plan for review.

SCOPE AND METHODOLOGY

We conducted our audit from February through May 2011 at the Birmingham, AL, HUD office and the Department's central office located at 120 East Holmes Avenue, Huntsville, AL. We returned to these offices in August 2013 and conducted additional audit work. Our audit period was November 1, 2001, through December 31, 2010, and was expanded back to November 1999 to accomplish our objectives and to cover all HUD funds used in the Mirabeau project. It became necessary to expand our scope to include the earlier loans because the recent loans were used to repay older loans. Therefore, it was necessary to determine whether those older loans had been used as intended for eligible and supported activities.

To accomplish our audit objectives, we

- Reviewed applicable laws, regulations, and other HUD program requirements relating to the use of HOME and CDBG funds;
- Interviewed HUD and Department staff;
- Reviewed HUD's program files for the Department;
- Obtained and reviewed HUD's Integrated Disbursement and Information System reports; and
- Reviewed the Department's accounting records, policies, and procedures.

We reviewed 100 percent of the Department's expenditures for the Mirabeau project. Our review covered the period November 1999 through December 2010. We reviewed contracts and expenditures totaling more than \$8.3 million.

We relied in part on data maintained by the Department and the developer for the Mirabeau project and 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. Testing for reliability included the comparison of computer-processed data to payment requests and other supporting documentation.

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

INTERNAL CONTROLS

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the 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:

- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Effectiveness and efficiency of operations – Policies and procedures that the audited entity has implemented to provide reasonable assurance that a program meets its objectives, while considering cost effectiveness and efficiency.

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 or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiency

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

- The Department did not have proper controls and procedures to administer its CDBG and HOME programs to prevent and detect unsupported and ineligible costs for the Mirabeau Apartments project (see findings 1, 2, 3, 4, and 5).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

<u>Recommendation number</u>	<u>Ineligible 1/</u>	<u>Unsupported 2/</u>
1A	\$1,183,642	
1B		\$1,031,000
2A	772,000	
2B	323,720	
2C	<u>100,000</u>	
Total	<u>\$2,379,362</u>	<u>\$1,031,000</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

<p>Kenneth Benion Director</p>	 <p>HUNTSVILLE April 18, 2014 Community Development</p>
<p>Nikita K. Irons Regional Inspector General for Audit U. S. Department of Housing and Urban Development Office of Inspection General for Audit, Region 4 Richard S. Russell Federal Building 75 Spring Street SW, Room 330 Atlanta, GA 30303-3388</p>	
<p>Re: Response to Draft Audit Report on the City of Huntsville Alabama's Community Development Department's Community Development Block Grant and HOME Investment Partnerships Program</p>	
<p>Dear Ms. Irons:</p>	
<p>The City of Huntsville Alabama's Community Development Department ("CDD") offers the following response to the findings and recommendations contained in the draft report issued by the Department of Housing and Urban Development's ("HUD") Office of Inspector General ("OIG") for Audit, Region 4 Office (hereinafter "the OIG Report") and received by CDD on Monday, April 14, 2014. The OIG Report concerns the Mirabeau ("Mirabeau") apartment complex located within the City of Huntsville, Alabama (the "City"), and covers a time period from 1992 through 2014, more than twenty years, including a time period when Mirabeau was known as Westland and owned by a completely separate entity.</p>	
<p>CDD has worked diligently to obtain information responsive to the investigation and the OIG Report. Unfortunately, a number of factors have combined to make a complete response to the OIG Report difficult. Specifically, most of the activity concerning Mirabeau referenced in the OIG Report occurred under the prior Director of CDD. The former Director and most of the former CDD employees with direct knowledge and involvement with Mirabeau are no longer with CDD. Indeed, in 2009, shortly after the present Mayor of the City took office, the individual who served as director of CDD at the time Mirabeau first commenced, retired and was replaced by [REDACTED]. Other officers and staff with CDD also had resigned prior to the commencement of the OIG audit. The former Director, as well as some former officers and staff, were apparently the subject of an OIG investigation separate from (but perhaps related to) that which is present in the OIG Report. The ongoing nature of that separate investigation which lasted for a three to four year period, made it next to impossible to obtain full and complete information regarding Mirabeau and to get complete cooperation from past CDD Director and his officers and staff.</p>	
<p>The current Mayor, the current Director of CDD and their officers and staff are committed to working with HUD to provide affordable housing in Huntsville and to identify any issues that may exist respecting the use or application of HUD-based funding. Moreover, CDD</p>	
<p>The Star of Alabama</p>	
<p>1/2211137.4 P. O. Box 308 · Huntsville, AL 35804-0308 · Phone 256-427-5400 · FAX 256-427-5431 www.huntsvilleal.gov</p>	

and the City are committed to identifying any improvements we can make to better enable CDD to comply with all HUD requirements.

According to the OIG Report, the OIG audit was initiated in 2011 at the request of the Office of Community Planning and Development, Alabama State Office. The stated objectives of the audit were to determine (1) whether CDD's commitment to use HOME and CDBG funds for the acquisition and rehabilitation of Mirabeau was an eligible activity; and (2) whether CDD had adequate controls and procedures to ensure appropriate accountability for and administration of the project.

The OIG Report generally found CDD lacking in adequate controls and procedures to ensure appropriate accountability for, and administration of, the Mirabeau project in accordance with HUD's policies and guidelines. As an initial matter, the City of Huntsville elected [REDACTED] as Mayor in 2008. He replaced the then Director of Community Development with [REDACTED] in February 2009. In 2011, [REDACTED] took another position within the City and [REDACTED] became Interim Director of CDD. In 2012, the "Interim" designation was removed, and [REDACTED] is still Director of CDD today. [REDACTED] and his staff have formulated written policies and procedures to codify what CDD had been doing in the past, and have created policies and procedures where none may have previously existed. Finally, CDD, under the guidance and direction of Mayor [REDACTED] and his staff, has broadened its system of checks and balances in order to bring CDD more in line with the rest of the City. As a part of the efforts of [REDACTED], and [REDACTED] and their staffs, specific policies and procedures, including a procedure manual were put in place. Attached hereto as Exhibit A is the City's Procedure Manual as it relates to CDD.

Before addressing the specific findings in the OIG Report, CDD and the City think it is important to provide some background information regarding the property that is currently "Mirabeau." During the exit interview with OIG, CDD and the City made it clear that while the OIG Report talks about "Mirabeau," the investigators and the findings in the OIG Report go well beyond Mirabeau. This investigation has gone back as far as 1992 -- more than twenty years ago. This property has had two separate development life cycles as it relates to CDBG and other HUD programs during those twenty plus years. Initially, in 1992, the developer consisted of a partnership named Westland, which became the name of the project during that phase. The Westland developer and CDD invested in what was then a neighborhood marked by high crime rates and the absence of safe, affordable housing. After about ten years, the persons and entities involved in Westland had left that project, the Westland entity itself was in bankruptcy, and some of the units, while not reverting to their pre-1992 condition, had some wear and tear on them.

In the early part of this century, a new developer brought the project back to life as "Mirabeau." Today, Mirabeau is home to a number of low and moderate income residents who desire a safe and conveniently located neighborhood in which to live. The complex has been transformed into a safe and quiet community that is gated and secure. Before CDD's involvement in this property, the former Fantasia Apartments (the name of the privately owned apartments that occupied this property prior to it becoming Westland) had over 500 police calls annually, and had an overall negative impact on the surrounding neighborhood. Last year, there were very few calls to the police from this area, and the adjacent neighborhood is now thriving.

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Comment 1

The Lowe Mill, an historic structure adjacent to Mirabeau, is now home to over 200 local artists who work under one roof where creativity abounds. This huge, private investment could not have happened until the crime rates and other social ills that existed in that neighborhood improved.

Westland/Mirabeau has been a big part, if not the key component, of this improvement. The residents at Mirabeau and the people in the adjacent neighborhoods have benefited from each other. With Mirabeau, the community was able to stabilize. As a result, private dollars are starting to be invested in newly renovated housing for low and moderate income citizens. The State of Alabama invested tax credits in a recently constructed multi-family project adjacent to Mirabeau. Adjacent businesses have opened and appear to be doing well. This neighborhood is no longer looked upon as an undesirable part of the City.

A lot has happened in this community since that initial investment by CDD some twenty years ago. Some of the articles and photographs that are included herewith capture the condition of this property before and after CDD's involvement, and are attached hereto as Exhibit B. CDD and the City believe that the primary goal of stabilizing this property and providing safe, decent, and affordable housing options for Huntsville's low and moderate income residents has been achieved at Mirabeau. We are grateful that we have had HUD's support in the past in implementing this goal. CDD hopes that it can work with HUD to address any existing issues or concerns so as to once again have HUD's confidence and support, as well as its guidance, as we move forward; however, some of the findings in the OIG Report seem at odds with these goals, and certainly will make "affordability" a problem issue for Mirabeau.

CDD certainly intends to cooperate and work with HUD to identify and remedy any issues or concerns respecting HUD-financed programs. In light of the events over the past several years, CDD has worked with an outside consultant that specializes in matters of HUD compliance. The consultant assisted CDD in taking a fresh look at its policies and procedures. The consultant also recommended areas for improvement. CDD initiated many of the consultant's recommendations and has over the last five years implemented new and improved policies and procedures.

CDD respectfully and reasonably believes that any review of issues or concerns raised in the current audit must be considered in conjunction with prior HUD audits and monitoring reviews. As noted, the OIG Report and investigation go all the way back to 1992. This property has had two life cycles and two different owners during that time period. During this twenty plus year time frame, HUD has conducted monitoring reviews regarding various aspects and programs of CDD, and specifically it has reviewed and monitored the Mirabeau project itself. At no time during these reviews were any questions raised regarding the eligibility of the funding for the Mirabeau apartments or CDD's controls and procedures for that project.

As an example, in the April 2007 on-site monitoring review of the City conducted by HUD's Region IV Office out of Birmingham, which covered the City's CDBG and HOME Programs, and which is attached hereto as Exhibit C. HUD specifically reviewed the Mirabeau project, which at that time, was in the process of redevelopment. In its review of Mirabeau, HUD noted as follows:

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Comment 2

"[t]he files had all of the necessary written agreements, and [REDACTED] (the then Director of CDD) spent some time with CPD staff reviewing the project. The construction work is being monitored by the Community Development Department. Occupants of the units are low-moderate income persons."

The review also stressed that the units being rehabilitated were in compliance with local building codes, and that the project files showed that the City was inspecting the projects in accordance with 24 CFR 35.310. The review specifically noted the following:

"[t]he city has established and maintains sufficient records to enable HUD to determine that they are meeting the requirements in this area. [...] Records are maintained that apply to other Federal requirements of the programs in use."

With respect to the use of HOME funds for Mirabeau, HUD noted that:

"[r]ehabilitation of a rental property is an eligible activity under 24 CFR 92.205. HOME funds, as well as CDBG funds, are invested in the rehabilitation of the Mirabeau Apartments. [...] The files contained all of the required written agreements between the project owner and the city. [...] The review indicated the activity was eligible under the HOME Program regulations."

CDD is confident that any findings or issues identified relative to Mirabeau in the 2007 monitoring review could have been effectively addressed and remedied by the then-existing CDD officers. It is telling that, not only were there no findings or issues identified in 2007, but just the opposite is true. The reviewer made it clear that this was a HOME/CDBG eligible project, and that all necessary documents were present.¹

A more recent review was conducted in 2010. That monitoring review did not focus on Mirabeau specifically; nonetheless, it did reference the ongoing nature of that re-development. The HUD reviews from 2005, 2007 and 2010 make it clear that HUD was aware of Mirabeau and had investigated it on prior audits of The City of Huntsville, giving the City and CDD more than passing grades for their work on the project.

Comment 3

In light of these monitoring reviews, which (1) approved the overall eligibility of the activities at Mirabeau, and (2) indicated the presence of appropriate documentation and support at least as late as the date of the 2007 monitoring review, CDD would respectfully request that HUD limit the finding in the OIG report to the time period from 2008 to the present, or at the very least, consider limiting the findings to the time period from 2002 to the present during the time that this project has been known as Mirabeau and has operated under the current developer.

Limiting the review's time frame would also assist CDD with the requests for documents. CDD has been working diligently to locate any and all files and paperwork to respond to the OIG Report and to provide to HUD. However, going back to 1992 makes the search for documents even more difficult. As noted above, this project was known as the "Westland Apartments" from

¹ A similar monitoring review from May 2005 is attached hereto as Exhibit D and shows no concerns over CDD's Mirabeau project.

1992 through 2002. From 2011 through to the time period just prior to the exit interview, CDD believed that the focus of the OIG audit was on “Mirabeau,” not on “Westland.” With regard to Westland, CDD has now made available to OIG all of the documentation it has been able to locate, and, with the exception of one issue present in the OIG Report, all “Westland related issues” have been “cleared.” The one issue raised as part of the “Westland” phase of this development is from the 1992 to 2001 time frame. To seek to re-visit something that is almost fifteen to twenty years old, involving a different developer on a project – “Westland” - that went into bankruptcy, but was released by the United States Bankruptcy Court, is well beyond any reasonable statute of limitations or fundamental fairness.

Comment 2

With regard to most of the missing documents relating to the “Mirabeau” phase of this development, CDD believes that there are several factors that should be taken into consideration before blanketly stating that the loans in the “Mirabeau” project are “unsupported.” First, the “unsupported” transactions all come from the 2002 to 2004 time period when Mirabeau was being acquired and rehabilitated by a new owner. This was well prior to HUD’s 2007 monitoring review which clearly stated that all of the necessary documents were present. If they were present in 2007, under a prior City administration and prior CDD Director and staff, OIG should not re-visit this issue some five to seven years later and claim that those documents just don’t exist. This is even more unreasonable when considered in light of the investigation itself. The developer and former CDD Director and staff may have some or all of the “supporting” documents, but they have been reluctant to fully cooperate with the City and CDD while a separate investigation was pending through OIG.

Comment 4

Finally, CDD notes that the vast majority of “eligibility” issues raised in the OIG report relate to HOME funds. The use of HOME funds only came after this project became known as Mirabeau (post 2001). HOME funds create “affordability” for local residents, and CDD and the City of Huntsville would like to maintain “affordability” on this project – particularly as it explores possible new ownership for the Property. However, the OIG Report requires the City to re-pay all HOME funds, thereby removing any “affordability” existing on these units and eliminating one of the City’s (and presumably HUD’s) main objectives – affordable housing. Interestingly, the OIG’s primary basis for questioning the eligibility of the HOME funds is based on the lack of a cost allocation; however, CDD and the City of Huntsville had been requesting assistance on preparing cost allocations for several years without receiving any samples or other help. Now, OIG wants to (a) penalize the City of Huntsville for not having a cost allocation; and (b) penalize the current and future residents of Mirabeau by removing affordability.

Overall, this property has a long history, and many of the people that were involved in Westland or Mirabeau are no longer with CDD. Combining the lack of access to former employees with the passage of time, and the fact that there have been different project names and different owners makes a full and complete response difficult, if not impossible. In spite of these hurdles, CDD has worked diligently to cooperate as much as possible with OIG, and it looks forward to working with HUD to put any issues with Mirabeau behind it, and moving forward with an affordable housing success story in Huntsville.

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CDD offers the following response to the more specific findings contained in the Draft Report:

FINDING ONE:

The OIG Report finds that CDD made “inappropriate” and “unsupported” loans to the Developer. The OIG Report then goes on to specify six separate items that it believes supports its Findings. CDD disagrees with the initial premise of the finding for several reasons, and further disagrees with many of the specific items which it will address separately in points 1A through 1 F below.

Comment 5

As an initial matter, CDD rejects the premise that the loans made were “inappropriate.” CDD’s goals and that of the City of Huntsville were to provide safe, affordable housing for low-moderate income persons in the City of Huntsville. As noted throughout this letter, Mirabeau (and its predecessor, Westland) have been great success stories for our community, so to call any of the loans “inappropriate,” is wrong, and misses the true goals of CDD, the City of Huntsville and the Department of Housing and Urban Development. Likewise, in its preamble to the specific issues in this Finding, OIG is critical of the former Mayor and former Director of Community Development for failing to document the use of funds. Again, CDD and the City must take issue with this Finding. The loan transactions that are being criticized in the OIG Report are from 2002 to 2004. The HUD monitoring review from 2007, attached hereto as Exhibit C, makes clear that in 2007, HUD reviewed these loans and found that they were supported with the appropriate documentation. To penalize CDD and the City now, more than five years after the HUD review gave Mirabeau a clean bill of health, is contradictory at best and incorrect at worst.

Comment 2

1A

Inappropriate Refinance Loans Were Made From HOME and CHDO Funds - This specific finding makes the CDD loan of HOME Funds “ineligible” for two basic reasons: (1) Mirabeau’s ongoing property condition failed to meet local building and zoning codes; and (2) CDD’s failure to provide a cost allocation for affordability and otherwise ensure affordability on the project. CDD and the City do not agree that these HOME loans should be “ineligible” for these or any other reasons. First, the issue with regard to maintenance is misleading at best. The Mirabeau developer to whom the HOME loan was made in 2002, took what was then a ten year old project called Westland and rehabbed it with construction work taking place over a several year period. In fact, in the HUD monitoring review of 2007, attached hereto as Exhibit D, HUD noted that CDD was monitoring the then ongoing construction work and that the units were being rehabilitated in compliance with local building codes. Now, some ten years after much of the construction work was done to rehabilitate the units, OIG wants to criticize the construction process. Further, OIG began its investigation of Mirabeau in 2010 and completed it in 2014. During this four year investigation, in which there was some focus directly on the developer, it was nearly impossible to get the developer/owner to perform any ongoing maintenance until the investigation was complete. Neither CDD nor the City are the owner of this development, but both are trying to make sure that maintenance moves forward now that this lengthy investigation is coming to an end.

Comment 6

Comment 4

Comment 2

Comment 7

Finally, with regard to the cost allocation, CDD and the City have several issues of concern. The cost allocation on this development was initially to be “floating,” and not tied to a particular unit, as there were a number of different types and styles of units in the development and “affordability” needed to be a flexible concept so that it would move from unit to unit as need be. When CDD reached out to HUD for assistance on developing the appropriate cost allocation for this type of project, it was not given any direction or help. Now OIG wants the City to repay all of the money that went into this project to make it “affordable.” If that recommendation is accepted by HUD it raises two issues: (1) are we working together to further the goal of affordable housing? and (2) on what numbers are the cost allocations supposed to be based when there will truly no longer be any HOME funds in the project? CDD and the City ask HUD to reject this recommendation of ineligibility, and instead work together with CDD and the City to develop a correct cost allocation for the project and keep affordability on this project for the current owner and any future owner.

1B

Comment 3

\$300,000 in Bridge Loan Funds Was Paid to the Developer – The OIG Report states that CDD provided a \$950,000 bridge loan to the developer, of which it states that \$300,000 was paid directly to the developer. The OIG Report says that the bridge loan was not awarded to reflect the payment to the developer, and that there were no supporting documents showing how these funds were used. As such, the OIG Report recommends that these funds be repaid. As an initial matter, this bridge loan was made in March of 2002, well over ten years ago. As noted, CDD has been and continues to work to locate any and all documents that reflect or support this transaction and will provide those to OIG, or HUD if they are located. We have tried to find these records, not only by searching among CDD’s documents, but by reaching out to the developer. As noted, the developer has not been fully cooperative, in part, due to the pendency of this and a related investigation, but CDD still hopes that it can gain access to more records on this matter now that the investigations appear to be coming to an end. Likewise, CDD is willing to request that the developer amend the documentation for this loan to reflect the change in the use of funds. CDD would ask that HUD allow it to make such an amendment in lieu of demanding reimbursement of this money. Finally, CDD again directs HUD’s attention to its 2007 monitoring review which notes that adequate support for this 2002 loan existed at that date. Because all relevant officers and staff of CDD that were involved in the 2007 monitoring review are no longer employees of the City, CDD does not know what instruments HUD may have reviewed or inspected during the 2007 monitoring review; however, CDD continues to search for any and all such documents. If the appropriate documents for this 2002 loan were present in 2007, CDD and the City should not be punished because they seem to be missing now.

1C

Comment 2

Comment 3

\$200,000 Of A First Acquisition Loan Was Not Used As Intended - The OIG Report seeks repayment of \$200,000 out of \$1.2 million of a first acquisition loan. The OIG Report states that the use of the \$200,000 is not supported by existing documents. As an initial matter, the first acquisition loan was made in March of 2002, well over ten years ago. As noted, CDD continues to work to locate any and all documents that reflect or support this transaction and will provide those to OIG, or HUD if they are

located. We have tried to find these records not only by searching among CDD's documents, but by reaching out to the developer. As noted, the developer has not been fully cooperative due to the pendency of an ongoing investigation. CDD still hopes, however, that it can gain access to more records on this matter. Finally, CDD again directs HUD's attention to its 2007 monitoring review which notes that adequate support for this 2002 loan existed at that date. Because all relevant officers and staff of CDD that were involved in the 2007 monitoring review are no longer employees of the City, CDD does not know what instruments HUD may have reviewed or inspected during the 2007 monitoring review; however, CDD continues to search for any and all such documents. If the appropriate documents for this 2002 loan were present in 2007, CDD and the City should not be punished because they seem to be missing now.

Comment 2

1D

Comment 3

\$41,000 of a Mezzanine Loan was not Used as Intended – The OIG Report seeks repayment of \$41,000 of CDBG funds that were part of a \$171,000 mezzanine loan. The OIG Report states that the \$41,000 was paid to the developer without supporting documentation showing how these funds were used. As an initial matter, the mezzanine loan was made in March 2002. As noted, CDD continues to work to locate any and all documents that reflect or support this transaction and will provide those to OIG, or HUD if they are located. We have tried to find these records not only by searching among CDD's documents, but also by reaching out to the developer. As noted, the developer has not been fully cooperative due to the pendency of an ongoing investigation. CDD still hopes, however, that it can gain access to more records on this matter. Finally, CDD again directs HUD's attention to its 2007 monitoring review which notes that adequate support for this 2002 loan existed at that date. Because all relevant officers and staff of CDD that were involved in the 2007 monitoring review are no longer employees of the City, CDD does not know what instruments HUD may have reviewed or inspected during the 2007 monitoring review; however, CDD continues to search for any and all such documents. If the appropriate documents for this 2002 loan were present in 2007, CDD and the City should not be punished because they seem to be missing now.

Comment 2

1E

Comment 3

\$390,000 Second Acquisition Loan Was Not Used as Intended – The OIG Report seeks repayment of the \$390,000 second acquisition loan from 2002. CDD is still working to locate any and all documents that reflect or support this transaction and will provide those to OIG, either as they are located, or when the effort to identify the same is exhausted. However, as noted above, the 2007 monitoring review notes that adequate support for this 2002 loan existed in 2007. CDD does not know what instruments HUD may have reviewed or inspected in 2007, but if the appropriate documents existed then, CDD and the City should not be punished because they seem to be missing now.

Comment 2

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Comment 8

1F

\$100,000 Third Acquisition Loan Was Not Used as Intended - The third acquisition loan was made in 2003. According to the OIG Report, the \$100,000 was used to pay down the bridge loan, and the OIG Report seeks repayment because the agreement was not amended to allow the developer to use the funds in this manner. CDD is certainly willing to amend the agreement as necessary and appropriate so as to reflect the actual use of these funds. CDD would ask that HUD allow it to seek such an amendment instead of requiring repayment of \$100,000.

FINDING TWO

The OIG Report finds that certain HOME funds were not used as intended, and that some CDBG funds were not "recovered." The OIG Report breaks the Finding down into three specific findings referred to below as 2A, 2B and 2C.

Comment 6

2A

HOME and CDBG Were Used Improperly - OIG Finds that loans of HOME funds totaling \$772,000 were "ineligible" because the housing did not meet HOME requirements. OIG bases this finding on the same two basic premises set forth in finding 1A above. CDD and the City adopt and incorporate fully herein the response set forth in 1A above and reiterates the request that HUD work with CDD and the City to maintain affordability at Mirabeau going forward, and so that the City does not have to repay the \$772,000.

Comment 9

2B

CDBG Funds Used as Collateral Were Not Returned - CDD takes exception to OIG's finding that \$336,720 is "collateral." CDD did make payments to Regions between November and December 2001. These payments constituted continuing interest payments to Regions. In October 1999, Regions Bank and CDD entered into a forbearance agreement. Under this forbearance agreement CDD/the City was to make payments monthly in the amount of \$12,883.63. These payments were in the context and form of interest payments rather than collateral. In fact, on December 5, 2000, the United States Bankruptcy Court, Central District of California, Los Angeles Division, confirmed this by ordering the then Debtor, Westland Apartments, Ltd. and the City/CDD to "make an interest payment to Regions." A copy of the Forbearance Agreement, with Regions and the United States Bankruptcy Court Order are attached hereto as Exhibits E and F, respectively. By making interest payments to Regions for existing loans, CDD was assisting the borrowers whose loans had been pledged as collateral, by "re-financing" those loans. The use of CDBG funds to re-finance these loans is a permissible use of CDBG funds. It is incorrect to call the interest payments "collateral," and HUD should reject this finding, and not require the repayment of this money from 1999 and 2001.

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2C

Comment 3

Home Funds Were Not Returned When the Project Was Terminated - With regard to the portion of Finding 2C relating to the CHDO, CDD does not dispute OIG's analysis of the regulations, however, due to the pendency of the ongoing separate OIG investigation; CDD has not been able to fully and completely determine what actions the CHDO took and what interest(s) it may have obtained in the Mirabeau project, if any. As such, at this point in time, CDD is not able to agree with or take exception to this portion of Finding 2C.

FINDING THREE

3A

Comment 6

The Mirabeau Apartments Were Not Properly Maintained - As noted above, this Finding is misleading, or because of the passage of time, is taken out of context and is incorrect. The current developer bought Mirabeau out of bankruptcy in the beginning of 2002. The loans made to the developer at that time and even afterward were to acquire and rehab what was then a ten year old Westland Apartment Complex development. The developer spent a number of years doing exactly that. In fact, the HUD monitoring review of 2007 notes that the rehabilitation of this project was being appropriately constructed and appropriately monitored by CDD even during that time period.² For the last four years, Mirabeau has been under the cloud of investigations, and, as such, getting the developer/owner to perform the maintenance has been next to impossible. However, now that it appears the OIG investigations are at an end, CDD has been and will continue to conduct a full inspection of the project to note any violations or issues and will communicate any deficiencies to the developer/owner. CDD notes that the units that are currently occupied are generally noted by the OIG Report to be in good repair. The unoccupied units appear to be the concern of the OIG Report. It is important to note that a number of the unoccupied units were being reviewed and considered for removal due to the fact that they are in a possible flood plain as indicated by recent studies conducted by the City in conjunction with FEMA.

Comment 2

Comment 7

FINDING FOUR

Comment 1

The Department's Participation Agreement Did Not Include Required Elements. - As noted above, the Director of CDD changed in 2009. ██████████ became the Director in 2009, and ██████████ in 2011/2012. One of CDD's primary goals and accomplishments over the past number of years has been working with HUD to make sure that CDD's policies and procedures, as well as any forms CDD uses are compliant and up to date. An example of the participation language CDD has been using for the past several years is attached hereto as Exhibit H.

² There are number of job inspection reports relating to inspections by CDD of the ongoing work. By way of example, a few are attached hereto as Exhibit G.

Comment 4

FINDING FIVE

A Cost Allocation Plan Was Not Developed For the Mirabeau Apartments – CDD notes that the intention in working with HUD on this project was to have a floating designation based on a ratio and procedure set forth at 24 CFR § 92.252(j). CDD has communicated to HUD that it was willing to perform such an allocation but that it needed assistance or a sample cost allocation to work from in order to make sure that it was done correctly. In spite of these requests to HUD, CDD has not been provided with any forms or samples from similar projects. Moreover, by now making the HOME funding on this project “ineligibility,” there is no funding on which to base the allocation of affordability. CDD and the City of Huntsville do not want to lose affordability on this project, and again renew their request that HUD reject the recommendation regarding the eligibility of the HOME funding and instead assist CDD and the City with the development of a floating cost allocation plan and a method to allow CDD and the City to maintain affordability on this project for years to come.

In sum, CDD and the City want to work with HUD to maintain affordability at Mirabeau by keeping all HOME payments as “eligible.” Likewise, for all of the reasons set forth herein, CDD and the City would respectfully request that HUD reject the findings relating to support documents and not require the City to repay those funds.

This concludes the response of the City of Huntsville and its Community Development Departments to the OIG Report. We appreciate the opportunity to submit this response and we hope to be able to meet with HUD to discuss the OIG Report and this response in more detail at a date to be determined.

Sincerely,



Kenneth Benion

Director, City of Huntsville
Community Development Department

cc: The Honorable Tommy Battle
Mayor of the City of Huntsville

1/22/1137.4

OIG Evaluation of Auditee Comments

- Comment 1** The audit report is based upon the City's policies and procedures in place at the time the activities we audited. The policies and procedures provided in the City's comments were not presented during the audit; therefore, we did not review them. HUD needs to review these policies and procedures and ensure the City implements them.
- Comment 2** While HUD did perform monitoring reviews that included the City's HOME and CDBG programs, the HUD reviews included limited testing of selected items. The City comments state that it did not know what instruments HUD may have reviewed or inspected during the monitoring review. HUD's monitoring review reports disclosed that limited testing was used to make its determinations. HUD's 2005 monitoring report specifically stated that HUD performed a 4 day monitoring review with results based on a sample of CHDO agreements, three files from the City's Homebuyer Program files, two CDBG activities, and three CDBG housing rehabilitation files, all unrelated to the Mirabeau activity. HUD's 2007 monitoring report also evaluated the eligibility of selected CDBG activities and HUD's review of rental rehabilitation at Mirabeau was based on inspections of 3 units. Conversely, the OIG audit was a much more complete and detailed review of the City's specific activities for the Mirabeau project and its predecessor Westland.
- Comment 3** The City was responsible for maintaining all documents to support it used the HUD funds for eligible and supported activities at the time funds were provided and expended. The City should have obtained, protected, and archived the documents during the personnel changes. The City should not have to rely on obtaining the necessary documents from its developers and former employees after the transactions were completed. The difficulties the current City administration encountered during the audit to locate and obtain necessary documents from external parties to support its use of HUD funds does not alter its responsibility.
- Comment 4** The cost allocation plan is the planning document that the City was required to prepare and use from the beginning of the project for any of the HOME funds to be eligible. Without an allocation plan, the Department could not support the number of HOME units, the eligible unit costs, and the period of affordability. The HOME Program Final Rule, 92.205 d, Multi-unit projects, provides that only the actual HOME-eligible development costs of the assisted units may be charged to the HOME program. If the assisted and nonassisted units are not comparable, the actual costs may be determined based on a method of cost allocation. Because the Mirabeau units were not comparable the cost allocation plan must designate the specific units funded by HOME for the Mirabeau project. By not establishing the eligible costs per unit, the Department could not establish the period of affordability as required by 24 CFR 92.252(e).

- Comment 5** As discussed in finding 1, the loans were used for activities that were not eligible.
- Comment 6** The Mirabeau project must be properly maintained at all times for the funding to be eligible, notwithstanding difficulties the City encountered to get the developer to perform ongoing maintenance. OIG is not criticizing the construction process, but the lack of documentation to support that Mirabeau met the standards and that adequate rehabilitation was performed to bring the property into compliance.
- Comment 7** The HOME Program Final Rule, 92.205 d, Multi-unit projects, provides that only the actual HOME eligible development costs of the assisted units may be charged to the HOME program. If the assisted and nonassisted units are comparable in terms of size, features and number of bedrooms, the actual costs of the HOME-assisted units can be determined by prorating the total eligible development costs of the project. However, the Mirabeau units were not comparable. The project consisted of 229 units that included efficiency and one-, two-, and three-bedroom units of varying square footage and style. Some of the units also included a study. Because the units were not comparable, the Department was required to prorate the actual costs on a unit-by-unit basis. The Department did not have the records it needed to support the actual costs on a per-unit basis. Also, it did not have the total actual costs of the project because it did not have the records from the developer. The instructions for preparing a cost allocation plan and identifying the number of HOME-assisted units are included in HUD's Notice CPD 8-2. The City needs to work with HUD regarding the cost allocation plan because the Mirabeau units are not comparable; therefore, they cannot be floating units.
- Comment 8** While the City may seek to amend its agreement with its developer, the stated purpose of the executed \$100,000 CDBG loan agreement was to reduce the principal of the project's debt. However, the CDBG loan funds were used for other purposes by the developer. Consequently, these funds remain unsupported. The City needs to work with HUD regarding if it can seek to amend the developer's former agreement.
- Comment 9** The collateral amount is \$323,720 not \$336,720, as stated in the City's comments. The deposits were required by the bank to maintain the pledge value for the \$1.6 million mortgage pool that the City pledged as collateral to secure a \$3.4 million loan, as discussed finding 2. Therefore, the City's monthly deposits were not interest payments.

Appendix C

THE MIRABEAU APARTMENTS LOANS

Loan title – Program Funds	Loan amount	Loan amount ineligible	Loan amount unsupported
Loan refinance - HOME	932,831	932,831	
Loan refinance - CHDO	250,811	250,811	
Bridge loan - CDBG	950,000		300,000
First acquisition loan - CDBG	1,200,000		200,000
Mezzanine loan - CDBG	171,000		41,000
Second acquisition loan - CDBG	390,000		390,000
Third acquisition loan - CDBG	100,000		100,000
Rehabilitation loan - HOME	772,000	772,000	
Collateral deposit loan - CDBG	323,720	323,720	
Condominium investment loan - HOME	100,000	100,000	
Totals	<u>\$5,190,362</u>	<u>\$2,379,362</u>	<u>\$1,031,000</u>