audit report

Issue Date April 30, 2008
Audit Report Number 2008-PH-1008

TO: Charles E. Halm, Director, Office of Community Planning and Development, Baltimore Field Office, 3BD

FROM: John P. Buck, Regional Inspector General for Audit, Philadelphia Regional Office, 3AGA

SUBJECT: The State of Maryland Did Not Always Administer Its HOME-Assisted Single-Family Owner-Occupied Rehabilitation Program in Accordance with Federal Regulations

HIGHLIGHTS

What We Audited and Why

We audited the State of Maryland's (State) HOME Investment Partnerships program (HOME) as part of our annual audit plan. We chose to audit the State's single-family owner-occupied rehabilitation assistance program based on deficiencies identified in a sample of work write-ups reviewed during a previous review of the State's HOME program. This audit is the second phase of our review of the State's HOME program. Our overall audit objective was to determine whether the State administered its HOME-assisted single-family owner-occupied rehabilitation program (program) in accordance with U.S. Department of Housing and Urban Development (HUD) regulations and its own requirements.

What We Found

The State did not ensure that its single-family owner-occupied rehabilitation projects (projects) met HUD regulations and/or the State's property standards. As a result, it used $42,290 in program funds for a project that did not meet federal regulations and was unable to support its use of $2.3 million in program funds for projects.

What We Recommend

We recommend that the Director of HUD's Baltimore Office of Community Planning and Development require the State to reimburse its program $42,290 from nonfederal funds for the ineligible project, provide documentation to support its use of $2,071,462 or reimburse its program from nonfederal funds, ensure that housing rehabilitation work and required repairs are completed in accordance with HUD's or the State's standards or reimburse its program $205,372 from nonfederal funds, and implement adequate procedures and controls to address the findings cited in this audit report. These procedures and controls should help ensure that $74,648 in program funds is appropriately used over the next year for projects that comply with HUD's regulations and the State's standards.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.6, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We discussed the findings with the State during the audit. We provided the draft report to the State on March 21, 2008. We discussed the report with the State at the exit conference on April 3, 2008. The State provided its written comments to the draft report on April 7, 2008. The State generally agreed with the audit and stated that it was actively addressing the audit recommendations that it had not already implemented. The State also stated that it anticipates being able to provide documentation to support the unsupported costs identified in the audit report. The complete text of the State's response, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

The HOME Investment Partnerships program (HOME) is authorized under Title II of the Cranston-Gonzalez National Affordable Housing Act, as amended, and is regulated by 24 CFR [*Code of Federal Regulations*] Part 92. HOME is the largest federal block grant provided to state and local governments and is designed to create affordable housing for low-income households. HOME funds are awarded annually as formula grants to participating jurisdictions. States are automatically eligible for HOME funds and receive either their formula allocation or $3 million, whichever is greater. Participating jurisdictions may choose among a broad range of eligible activities using HOME funds. These activities may include providing home purchases or rehabilitation financing assistance to eligible homebuyers, building or rehabilitating housing for rent or ownership, or obtaining property to make way for HOME-assisted developments.

As a participating jurisdiction, the State of Maryland (State) administers its HOME program through its Department of Housing and Community Development. The State received more than $23 million in HOME grants from the U.S. Department of Housing and Urban Development (HUD) over a three-year period.

Grant year	Grant amount
2004	$8,177,261
2005	$7,814,492
2006	$7,357,097
Total	**$23,348,850**

The State primarily administers its HOME-funded single-family owner-occupied rehabilitation assistance program through the use of subrecipients. During our audit period, the State executed written agreements for the administration of HOME funds to at least 19 subrecipients to facilitate its rehabilitation assistance program. The written agreements specify that the subrecipients are to comply with federal and state regulations and with the State's own policies and procedures.

Our audit objective was to determine whether the State administered its HOME-assisted single-family owner-occupied rehabilitation program (program) in accordance with HUD regulations and its own requirements. To answer this audit objective, we determined whether the State (1) determined the cost reasonableness of rehabilitation projects, (2) ensured that the assisted properties were appropriately safeguarded against loss, (3) accurately and appropriately determined the after-rehabilitation values of assisted properties, (4) accurately determined the rehabilitation necessary to bring assisted properties up to applicable codes, (5) accurately determined the income eligibility of recipients, and (6) accurately determined the ownership of assisted properties.

RESULTS OF AUDIT

Finding 1: Controls over the State's Program Projects Were Inadequate

The State did not comply with federal regulations and with its own policies in providing housing rehabilitation assistance. It provided assistance for an ineligible project and did not have documentation to support that projects were eligible because it lacked procedures and controls to ensure that HUD regulations and its own policies were appropriately followed. As a result, it inappropriately provided more than $42,000 in program funds to assist one project that did not qualify as affordable housing. Also, the State was unable to support its use of more than $2 million in program funds. Therefore, HUD has no assurance that program funds were expended on eligible projects.

The State Provided $42,290 in Program Funds for an Ineligible Project

We selected for review 67 projects that the State completed between July 2004 and July 2007. The State provided $42,290 in program funds to assist one project in which the unit was not affordable. An affordability requirement of the program specifies that assisted units' after-rehabilitation values are not to exceed 95 percent of the median purchase price for the area, and program guidance allows the use of appraisals and tax assessments of comparable properties to determine compliance with this requirement. The following table shows the project number, appraisal date, pre-rehabilitation appraised value, affordability limit, the percentage by which the after-rehabilitation value of the unit exceeded the affordability limit, and the housing assistance amount.

Project number	*Appraisal date*	*Appraised value*	*Affordability limit*	*Percentage over limit*	*Assistance amount*
3800	Dec. 29, 2004	$275,000	$172,632[1]	59.3	$42,290

[1] To be conservative, we selected the limit effective January 1, 2005. Had we used the $160,176 affordability limit effective January 1, 2004, the percentage by which the after-rehabilitation value of the unit would have exceeded the limit would have been 71.7 percent.

The State Lacked Documentation to Support Its Use of More Than $2 Million in Program Funds

The State lacked sufficient documentation for 41 (61 percent) of the 67 projects selected for review to support that it used more than $2 million in program funds for appropriate projects. The following shows where the State was missing and/or lacked sufficient documentation to demonstrate that the projects were qualified to receive assistance. The State did not

- Demonstrate that costs for 33 projects were reasonable,
- Safeguard program funds in accordance with its own requirements by ensuring that hazard insurance polices and/or deeds of trusts were in place for 11 projects,
- Appropriately determine that after-rehabilitation values did not exceed affordability limits in 10 projects,
- Ensure that work write-ups detailing the scopes of rehabilitation were maintained in five projects to demonstrate that they were conducted appropriately,
- Include income from additional household members and/or have sufficient documentation to support the income eligibility in four projects, and
- Ensure that an applicant owned the assisted unit in one project.

The State Did Not Adequately Manage Its Program

The deficiencies identified regarding the State's providing assistance for an ineligible project and lacking documentation to support that projects were appropriate occurred because the State did not adequately manage its program to ensure compliance with and full implementation of HUD regulations and its own requirements.

The State did not adequately manage its program, which was primarily facilitated by subrecipients through executed written agreements. Depending on their designation level, the subrecipients either had authority to approve program funds up to a certain amount without prior approval from the State or were primarily responsible for gathering documentation for the State to qualify applicants for program funds. The State did not fully enforce the executed written agreements with its subrecipients to ensure compliance with HUD regulations or with its own policies. Discussions with the subrecipients disclosed that they were not fully knowledgeable of federal program requirements. Interviews with 14 subrecipients regarding how they determined after-rehabilitation values revealed that at least eight subrecipients inappropriately used tax assessments of the projects to establish after-rehabilitation values and to determine the maximum amount of program funds the homeowners were qualified to receive. However, at least four subrecipients stated that the State now requires the use of appraisals, which is an approved method.

Further, the State's level of monitoring of its subrecipients was inadequate to ensure compliance with either HUD requirements or its own policies. The State performed on-site monitoring reviews of some of its subrecipients and required others to complete a procedural monitoring questionnaire. The monitoring reports supported the State reviews for certain documents but did not support its verification of eligibility determinations and income calculations. Further, the State could not document that it followed up on procedural corrective actions noted on the monitoring reports.

Conclusion

The State did not properly use its program funds when it failed to comply with federal regulations and its own polices in providing housing rehabilitation assistance. As previously mentioned, the State provided $42,290 in HOME funds to assist an ineligible project. Further, the State was unable to support its use of more than $2 million in HOME funds for 41 additional projects.

Recommendations

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

1A. Reimburse its program from nonfederal funds $42,290 expended on an ineligible project in which the unit was not affordable since the after-rehabilitation value of the assisted unit exceeded applicable affordability limits.

1B. Provide adequate supporting documentation or reimburse its program from nonfederal funds, as appropriate, for the $2,071,462 in HOME funds used for the 41 projects cited in this finding for which the State lacked sufficient documentation to support that program funds were expended on reasonable costs, units were adequately safeguarded, assisted units' after-rehabilitation values complied with affordability limits, records were maintained to demonstrate the rehabilitation required, recipients and households were income eligible, and ownership was properly verified.

1C. Establish and implement adequate procedures to ensure that adequate source documents are used to determine income eligibility so that only income-eligible applicants are approved for program assistance.

1D. Establish and implement procedures to ensure that appropriate methods are used to determine the after-rehabilitation values before approving program funds.

1E. Establish and implement adequate procedures to ensure that independent cost estimates are performed and provided for each project to ensure that program funds are expended on reasonable rehabilitation costs.

1F. Establish and implement adequate procedures to ensure that hazard insurance policies are retained in the project files for approved applicants.

1G. Establish and implement adequate procedures to ensure that scopes of work detailing the rehabilitation to be completed are required and documented for all assisted projects.

1H. Establish and implement adequate procedures to ensure that adequate and appropriate homeownership evidence is acquired and maintained in the project files.

Finding 2: The State's Rehabilitated Projects Did Not Meet HUD's and/or the State's Standards

The State did not ensure that its projects met HUD's and the State's standards. Of 24 State projects inspected, 17 did not meet HUD's and the State's standards and had material deficiencies that existed at the completion of the housing rehabilitation work. The State used program funds to pay for rehabilitation work that was improperly performed or not provided. It also did not include all necessary housing rehabilitation work in the scopes of work for the 17 projects. The deficiencies occurred because the State did not adequately manage its program to ensure and require compliance with federal regulations and written agreements. Further, its inadequate management allowed for the use of insufficiently detailed work write-ups to guide the scope of the rehabilitation. As a result, the State used more than $780,000[2] in program funds for projects that did not meet HUD's and/or the State's standards. Based on our project sample, we estimate that over the next year, the State will use program funds for projects that, after the completion of the housing rehabilitation work, will need more than $74,000 in required repairs to meet HUD's and the State's standards.

The State Used Program Funds That Did Not Meet HUD's and the State's Standards

We selected 24 assistance projects that the State indicated were completed between September 2006 and July 2007. Our appraiser inspected the 24 projects from September 25 through October 19, 2007, to determine whether the State ensured that the projects met HUD's and the State's standards at the completion of the housing rehabilitation work.

Of the 24 projects inspected, 17 (71 percent) had 180 deficiencies, indicating that the projects did not meet HUD's and the State's standards at the completion of the housing rehabilitation work. Seventeen projects were considered to be in material noncompliance since they had multiple preexisting deficiencies and/or the deficiencies were noted in the scopes of work but not corrected. The State provided $780,199[3] in housing rehabilitation assistance for the 17 projects. Our appraiser estimated that it would cost $42,674 to correct the deficiencies identified. The State also recorded property liens against the 17 projects for the amount of program funds it provided for housing rehabilitation assistance. The following table categorizes the 180 deficiencies in the 17 projects.

[2] Ten of the projects cited in this finding were also cited in finding 1. Therefore, to avoid double-counting, we reduced the questioned costs reported in finding 2 by $574,827 for the 10 projects. The seven remaining projects (not included in finding 1) total $205,372 and are addressed in the recommendations for finding 2. To comply with the recommendations, the State needs to correct all of the deficiencies related to the 10 projects as reported in both finding 1 and finding 2.

[3] See footnote 2.

Types of deficiencies	Number of deficiencies
Electrical	43
Roofs, gutters, fascias, and soffits	32
Stairs, rails, porches	22
Windows	12
Doors	11
Plumbing, sewer, and water supply	9
Floors	8
Bathrooms	7
Exterior surfaces and foundations	6
Lead-based paint	6
Ceilings	5
Water heaters, heating, air conditioning	5
Walls	4
Security and ventilation	4
Insulation	4
Fire exit	1
Counter top	1
Total	**180**

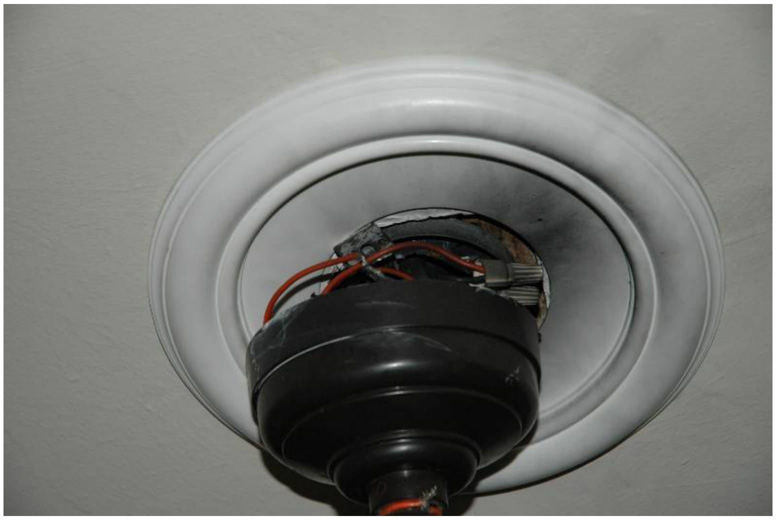
We provided our inspection results to the manager of the State's HOME program on December 20, 2007, and to the Director of HUD's Baltimore Office of Community Planning and Development on February 13, 2008.

Standards Deficiencies Were Present

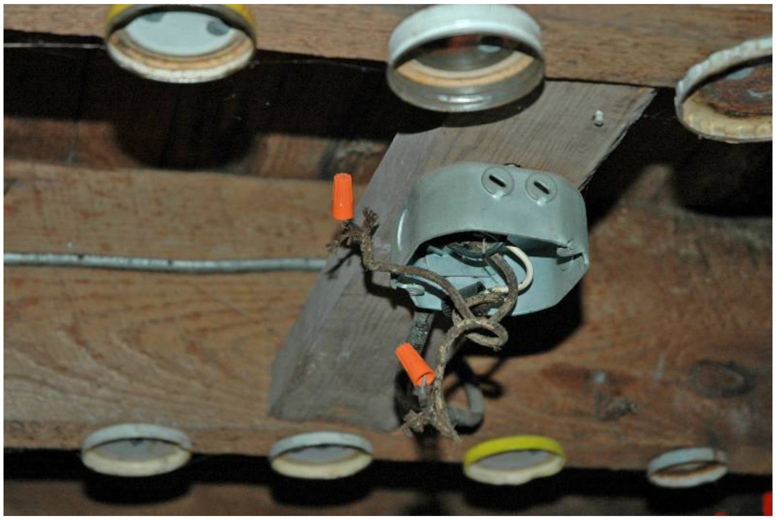
The following are pictures of some of the violations we noted from the 17 projects that were cited with material noncompliance while conducting inspections.

Project #4106: One of two junction boxes for a future lamp has exposed live wires.

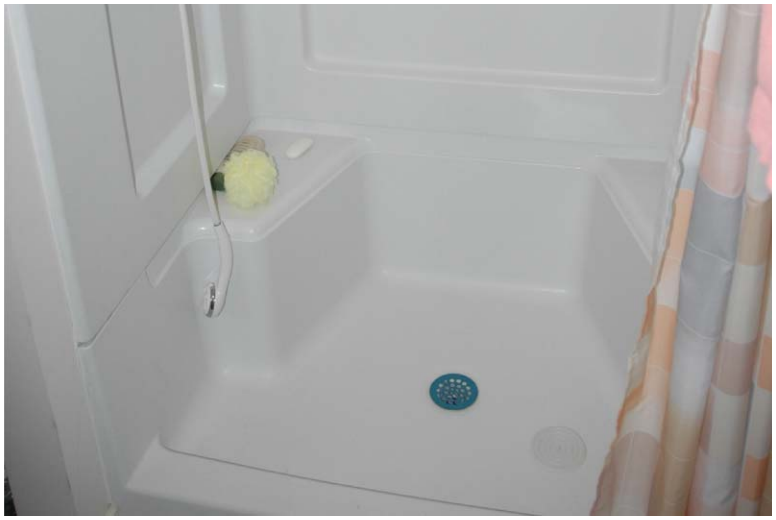
Project #3836: The 2nd floor left/rear bedroom ceiling fan was improperly connected and has a short in it.



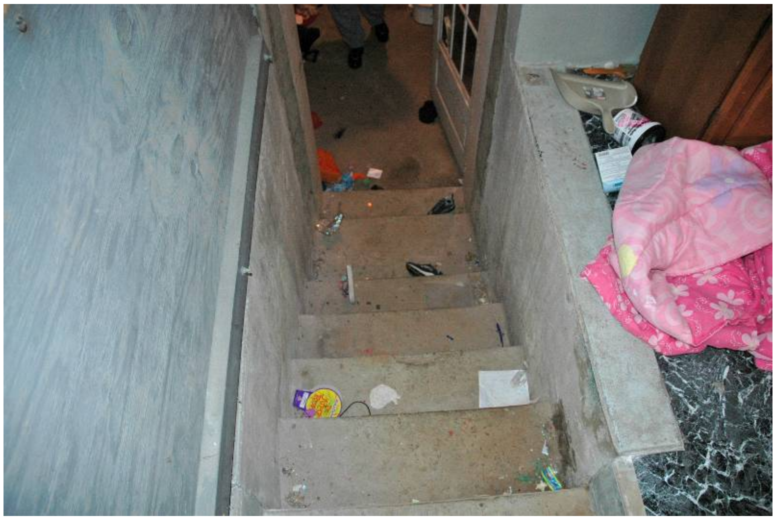
Project #3869: The junction box on the basement ceiling is open and has exposed wires and connections.



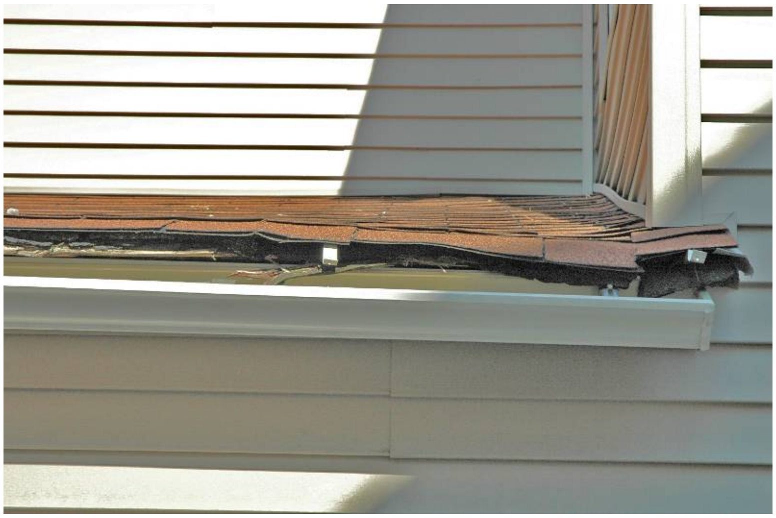
Project #3836: The new shower stall does not meet handicapped accessibility requirements as required by the scope of work.



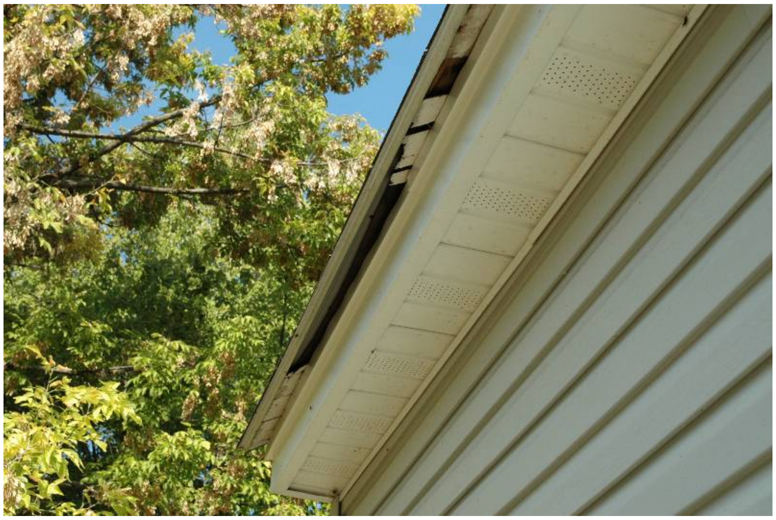
Project #3849: The stairway from the rear porch to the basement needs a handrail and a guardrail on the open side of the stairway pit.



Project #3869: There is rotten sheathing along the lower roof edge above the first floor bathroom.



Project #3874: The edge of the roof on the left side of the house shows wood deterioration.



The State Did Not Adequately Manage Its Program and the Work Write-Ups Were Not Sufficiently Detailed

The inspection deficiencies identified reflect the State's inadequate management of its program. The program requires participating jurisdictions to manage the day-to-day operations of the program to ensure compliance with federal requirements and written agreements. As mentioned in finding 1, the State's administration of its program was primarily facilitated by subrecipients. Of the inspections performed for the 24 sampled projects, the State's subrecipients facilitated 22 of the projects, which included determining the scope of rehabilitation needed and inspecting the work completed.

The State's executed written agreements with its subrecipients specified their obligation to comply with program requirements and those in Office of Management and Budget Circular A-87. Further, the written agreements specified that subrecipients were to enter into agreements, to be approved by the State, if they subcontracted responsibilities and duties of the written agreement. Two subrecipients subcontracted responsibilities relating to determining the scope of the rehabilitation and inspections to contractors without entering into agreements approved by the State, as specified in its policies. As a result, the State did not adequately manage its administration of its subrecipients and was unable to ensure that parties involved in the program complied with program requirements or with its own written agreements.

Lastly, the work write-ups detailing the scope of the rehabilitation were not sufficiently detailed to clearly define the scope of the rehabilitation, solicit quality bids, or ensure reasonable costs. The deficient work write-ups contributed to the inspection deficiencies identified.

Conclusion

The State did not ensure that its projects met HUD's and its own standards. In addition, the State used HUD funds to pay for housing rehabilitation work that was incomplete and/or improperly performed, and it did not include all of the necessary housing rehabilitation work in the scope of work. The State used $780,199[4] in HUD funds for the 17 projects that materially failed our inspections.

If the State implements adequate procedures and controls over program funds to ensure compliance with HUD's and/or its own standards, we estimate that over the next year, it will not use program funds for projects that, after the completion of the housing rehabilitation work, need at least $74,648 in required repairs to meet HUD's and the State's standards. Our methodology for this estimate is explained in the Scope and Methodology section of this audit report.

Recommendations

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

2A. Certify that the housing rehabilitation work cited in this finding is completed in accordance with HUD's and the State's standards and the projects meet HUD's and the State's standards or reimburse its program $205,372[5] from nonfederal funds for the housing rehabilitation assistance that was provided for the 17 projects that materially failed to meet HUD's and the State's standards and release the applicable liens against the properties.

2B. Implement adequate procedures and controls to ensure that projects meet HUD's and the State's standards at the completion of the housing rehabilitation work to prevent projects completed over the next 12 months from needing an additional $74,648 in required repairs to meet HUD's and the State's standards.

2C. Establish and implement adequate procedures to ensure that the work write-ups submitted by rehabilitation specialists are sufficient in detail to comply with both federal regulations and with the State's own policies to ensure that contractors are bidding on consistent work and techniques.

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[4] See footnote 2.
[5] See footnote 2.

2D. Establish and implement adequate procedures to ensure that completed rehabilitation properties are inspected to ensure that the work performed complies with the scope of the work write-ups.

2E. Establish and implement adequate procedures to ensure that contractors and subcontractors performing any functions of the HOME program for the State enter into executed written agreements to ensure their compliance with responsibilities and obligations required under the program.

SCOPE AND METHODOLOGY

To accomplish our audit objective, we

- Reviewed applicable federal regulations at 24 CFR [*Code of Federal Regulations*] Part 92, Office of Management and Budget Circular A-87, HUD's Building HOME: A Program Primer, HOMEfires, Technical Guide for Determining Income and Allowances for the HOME Program, FHA Mortgage Limits and HUD Income Limits, and the State's policies and written agreements relating to the administration of its HOME-assisted single-family owner-occupied rehabilitation program.

- Conducted interviews and discussions with officials and employees of HUD's Office of Community Planning and Development, the State, its subrecipients of the HOME rehabilitation assistance program, HOME recipients, and local code officials.

- Obtained a listing of the State's HOME awards for its rehabilitation assistance activities administered between July 2004 and July 2007, and selected a statistical sample of 67 out of a universe of 146 awards to determine whether HOME program requirements were met.

- Reviewed the executed written administration agreements established between the State and its subrecipients to determine the authority to administer HOME funds, requirements to support compliance with income eligibility, property standards, and hazard insurance regarding the administration of the program.

<u>Finding 1</u>

Using the U.S. Army Audit Agency's statistical software, we initially statistically selected 46 of the State's program units to review from a universe of 138 units assisted with HOME funds for rehabilitation during the period between July 2004 and June 2006. The sampling criteria used a 90 percent confidence level, 10 percent estimated error rate, and precision of plus or minus 10 percent. We selected an additional 21 units for review that were chosen for inspections in which the completion dates were between September 2006 and July 2007. From the 67 selected units, the State expended more than $3 million out of more than $6.3 million from the universe of 146 awards. The 67 units were selected to determine whether the State complied with federal regulations and its own policies in administering its single-family owner-occupied rehabilitation assistance program.

The 67 assistance activities that were selected were reviewed to determine whether the State ensured that (1) HOME funds were expended on reasonable rehabilitation costs by using independent cost estimates, (2) the assisted properties were appropriately safeguarded against loss, (3) the assisted units complied with after-rehabilitation values, (4) it maintained adequate records to support compliance with applicable property standards, (5) it accurately determined the income eligibility of recipients, and (6) recipients owned the assisted units.

Finding 2

We selected for inspection all 24 rehabilitation assistance projects for which the State indicated that the last HOME draw was made between September 2006 and July 2007. We selected this timeframe to ensure that we selected the most recently rehabilitated units for inspection. Our appraiser inspected the 24 properties to determine whether the projects met HUD's and the State's standards. The State provided $1,345,315 in program funds for the 24 projects.

The State did not ensure that the HOME-assisted units were rehabilitated according to the work write-ups and that conditions relating to the decency, safety, and sanitation of the units were addressed. Based upon the deficiencies and preexisting conditions identified, our appraiser provided cost estimates to correct the deficiencies. The appraiser developed the estimates based on sources such as RS Means Repair and Remodeling Cost Data for labor costs and some equipment and market prices for materials from stores such as Home Depot and Lowes.

Our results determined that 17 (71 percent) projects out of the 24 projects inspected materially failed to meet HUD's and the State's standards at the completion of the housing rehabilitation work. A project was considered in material noncompliance when it contained multiple preexisting deficiencies and/or the deficiencies were noted in the scope of work but not corrected. Our appraiser estimated that the projects needed $42,674 (5 percent of the program funds provided) in repairs to meet HUD's and the State's standards.

The State will receive more than $1.4 million in program funds on projects for program year 2008 according to its consolidated plan for federal fiscal year 2007 (July 1, 2007 – June 30, 2008). We estimate that the State will annually use program funds for projects that, after completion of housing rehabilitation work, need at least $74,648 ($1,492,950 times 5 percent) in required repairs to meet HUD's and the State's standards. This estimate is presented solely to demonstrate the annual amount of program funds that could be put to better use on eligible projects if the State implements our recommendations. While these benefits could recur, we were conservative in our approach and only included the initial year in our estimate.

We performed our audit work from July 2007 through February 2008 at the State's office located at 100 Community Place, Crownsville, Maryland. We performed our inspections at units located primarily in Western Maryland and the Eastern Shore between September and October 2007. The audit generally covered the period July 2004 through June 2006 but was expanded to July 2007 to include recently rehabilitated units. To achieve our audit objective, we relied in part on computer-processed data within the State's database. Although we did not perform a detailed assessment of the reliability of the data, we did perform a minimal level of testing and found the data to be adequate for our purposes.

We performed our review in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

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

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Management oversight processes - Policies and controls that management has in place to reasonably ensure that its subrecipients follow HOME program requirements and its written agreements.

- Monitoring of subrecipients' administration of the HOME program - Policies and procedures to ensure that adequate reviews are performed to detect noncompliance with both federal requirements and written agreements.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weaknesses

Based on our review, we believe the following items are significant weaknesses:

- Inadequate monitoring reviews of the State's subrecipients.

- Lack of adequate controls over the State's administration of its HOME-assisted single-family owner-occupied rehabilitation program facilitated by subrecipients.

APPENDIXES

Appendix A

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

Recommendation number	Ineligible 1/	Unsupported 2/	Funds to be put to better use 3/
1A	$42,290		
1B		$2,071,462	
2A		$205,372	
2B			$74,648
Total	**$42,290**	**$2,276,834**	**$74,648**

1/ Ineligible costs are those 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 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.

3/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an OIG recommendation is implemented. This includes reductions in outlays, deobligation of funds, withdrawal of interest subsidy costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings which are specifically identified. In this instance, if the State implements our recommendation, it will cease to use program funds for projects that, after completion of the housing rehabilitation work, need required repairs to meet HUD's and the State's standards. Once the State successfully improves its procedures and controls, this will be a recurring benefit. Our estimate conservatively reflects only the initial year of this benefit.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Auditee Comments

Martin O'Malley
GOVERNOR

Anthony G. Brown
LT. GOVERNOR

Raymond A. Skinner
SECRETARY

Clarence J. Snuggs
DEPUTY SECRETARY

DHCD
Maryland Department of Housing and Community Development

April 7, 2008

Mr. John P. Buck
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Wanamaker Building
100 Penn Square East
Suite 1005
Philadelphia, PA 19107

Dear Mr. Buck:

Comment 1

Comment 2

The purpose of this letter is to provide the response of the Maryland Department of Housing and Community Development (DHCD) to the Audit Report of HOME-assisted single-family owner-occupied rehabilitation program (HOME STAR program) provided by your office on March 21, 2008. DHCD anticipates being able to supply documentation for the HOME funds identified as unsupported in the audit report. In addition, DHCD has already taken a number of steps to better manage the HOME program and monitor subrecipients to ensure that they are following federal and State regulations and procedures for managing the program. While many of these improvements were in process or planned prior to the HUD audit, DHCD is actively addressing those audit recommendations not already being implemented. Our response addresses each finding and recommendation.

<u>Finding 1: Controls Over The State's Program Projects Were Inadequate</u>

The State Provided $42,290 in Program Funds for an Improper Activity

Recommendation 1A: Reimburse its [HOME STAR] program from nonfederal funds $42,290 expended on an ineligible project in which the unit was not affordable since the after-rehabilitation value of the assisted unit exceeded applicable affordability limits.

COMMUNITY DEVELOPMENT ADMINISTRATION
Division of Development Finance

100 Community Place
Crownsville, MD 21032

PHONE 410-514-7400
TOLL FREE 1-800-756-0119
FAX 410-987-8763
TTY/RELAY 711 or 1-800-735-2258
WEB www.mdhousing.org

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Comment 2

DHCD Response: DHCD agrees the after-rehabilitation value of the assisted unit exceeded applicable affordability limits and will reimburse from nonfederal funds the $42,290 expended for HOME STAR Project Number 3800. Changes made in 2007 should ensure that this type of error is caught before HOME funds are committed or paid in future. Affordability limits are now included on the underwriting worksheet as a check item and projects are again verified to ensure that they do not exceed affordability limits when a project is input into the HUD IDIS system.

The State Lacked Documentation to Support Its Use of More Than $2 Million in Program Funds

Recommendation 1B: Provide adequate supporting documentation or reimburse its program from nonfederal funds, as appropriate for the $2,071,462 in HOME STAR funds used for the 41 projects cited in this finding for which the State lacked sufficient documentation to support that program funds were expended on reasonable costs, assisted units' after-rehabilitation values complied with affordability limits, units were adequately safeguarded, records were maintained to demonstrate the rehabilitation required, recipients and households were income eligible, and ownership was properly verified.

Comment 1

Comment 3

DHCD Response: The audit identified certain subrecipient project files with missing or insufficient documentation to support program costs. DHCD is actively working with the subrecipients on this issue, has already collected documentation to support some of the documentation identified as deficient, and anticipates being able to provide the necessary remaining documentation to demonstrate that the projects were qualified to receive HOME STAR program assistance. It is important to note that the overall documentation compliance level was greater than 85%, indicating that most of the subrecipients are doing a good job.

Comment 2

In order to improve the compliance rate, DHCD will provide training and technical assistance with all subrecipients to address the appropriate use of cost estimates, which was a common error across subrecipients and accounted for over half of the documentation deficiencies. Other issues were limited to specific subrecipients and will be addressed with technical assistance to the relevant agencies and enhanced monitoring.

The State Did Not Adequately Manage Its Program

Recommendation 1C: Establish and implement adequate procedures to ensure that adequate source documents are used to determine income eligibility so that only income-eligible applicants are approved for program assistance.

Recommendation 1D: Establish and implement procedures to ensure that appropriate methods are used to determine the after-rehabilitation values before approving program funds.

Comment 2

DHCD Response: DHCD operates its HOME STAR program through executed written agreements with local housing agencies. It provides technical guidance and training to staff of those agencies and monitors their performance to ensure that they are following federal and State regulations and procedures for managing the HOME program. DHCD had identified the need for additional HOME monitoring prior to the start of the HUD audit and had taken steps to remedy the problem by hiring a full-time HOME Program Manager tasked with improving the procedures and monitoring of DHCD's HOME Program. During 2007, a HOME Monitoring Plan was implemented including training, in-house reviews, on-site monitoring, and standardized monitoring checklists.

Comment 2

Training for the local housing agencies held in June 2007 covered a number of issues related to HOME program loans, specifically including income verification, hazard insurance and maximum property values. Agency staff were provided copies of HUD's 'purple book' entitled "Technical Guide for Determining Income and Allowances for the HOME Program" and trained in the use of the Part 5 income determination. Additional training and technical assistance will be scheduled to address the issues found in this audit.

Comment 2

A memorandum dated August 6, 2007 regarding file documentation was mailed to all local agencies receiving HOME funds notifying them that DHCD requires an appraisal to determine that property values comply with affordability limits; outlining the use of Part 5 to determine income eligibility; requiring verification of hazard insurance with DHCD as loss payee, and determining applicable codes. Recordkeeping checklists were provided as a tool to ensure that files were complete. Each agency director was asked to sign and return a statement verifying that they received the information and their files were adequately documented. In 2007, DHCD added verification of insurance coverage documentation to its HOME payment approval process to ensure that insurance is in place. DHCD will add a certification to the documentation checklist submitted with payment requests and require the subrecipient to certify that the loan is in compliance with federal and State regulations and procedures and that the file contains the required documentation in order to further strengthen controls.

Comment 2

In addition, the monitoring schedule of the local housing agencies who administer Special Loans Programs, including the HOME programs, has recently been updated and a number of visits are scheduled prior to the end of June 2008. The scope of monitoring has been broadened to include a review of projects in progress as well as projects that have been completed and closed, in order to identify any issues at an earlier stage when they are more easily rectified. Technical assistance will be provided to address any issues found and bring the agency staff up to date on any policy or procedural changes. A written summary report will be prepared for each monitoring visit. Additionally, the monitoring schedule has been expanded to better track the status of monitoring visits, reports and follow-up actions.

Recommendation 1E: Establish and implement adequate procedures to ensure that independent cost estimates are performed and provided for each project to ensure that program funds are expended on reasonable rehabilitation costs.

Comment 2

DHCD Response: As indicated previously, DHCD will provide training and technical assistance with all subrecipients to address the appropriate use of cost estimates, which was a common error across subrecipients. DHCD is also investigating cost estimation software that could be used to facilitate and standardize the cost estimation process.

Recommendation 1F: Establish and maintain adequate procedures to ensure that hazard insurance policies are retained in the project files for approved applicants.

Comment 2

DHCD Response: As indicated in the response to Recommendations 1C and 1D, DHCD addressed the verification of hazard insurance with DHCD as loss payee in its August 6, 2007 letter. In addition, DHCD added verification of insurance coverage documentation to its HOME payment approval process in 2007, to ensure that insurance is in place.

Recommendation 1G: Establish and implement adequate procedures to ensure that scopes of work detailing the rehabilitation to be completed are required and documented for all assisted projects.

Comment 2

DHCD Response: DHCD will provide mandatory training to the local agency rehabilitation specialists on the preparation and filing of appropriate work write ups.

Recommendation 1H: Establish and implement adequate procedures to ensure that adequate and appropriate homeownership evidence is acquired and maintained in the project files.

Comment 2

Comment 1

DHCD Response: The local agency administrators verify ownership of properties through a deed or title work and should maintain a copy of this verification in their files. In August 2007, recordkeeping checklists were provided to local agencies as a tool to ensure that files are complete in future. DHCD underwriters verify ownership through online tax records of the Maryland Department of Assessments and Taxation (referred to as SDAT). DHCD has a copy of the SDAT record for the one property questioned, which verifies the recipient as the owner of record.

Finding 2: The State's Rehabilitation Projects Did Not Meet HUD's and/or the State's Standards

The State Used Program Funds That Did Not Meet HUD's or the State's Standards

Recommendation 2A: Certify that the housing rehabilitation work cited in this finding is completed in accordance with HUD's and the State's standards and the projects meet HUD's and the State's standards or reimburse the program $205,372 from nonfederal funds for the housing rehabilitation assistance that was provided for the 17 projects that materially failed to meet HUD's and the State's standards and release the applicable liens against the properties.

Comment 2

DHCD Response: DHCD is actively addressing the issues identified in the HUD appraiser's inspection reports. We have contacted the local agencies for additional information and are in the process of reviewing the responses that have been received thus far. DHCD anticipates being able to supply documentation to certify that the housing rehabilitation work cited in this finding is completed in accordance with HUD's and the State's standards and that the projects meet HUD's and the State's standards. As issues are clarified and resolved at the local level, DHCD will provide the necessary training and technical assistance to ensure that future housing rehabilitation projects and work meet HUD's and the State's standards.

Standards Deficiencies Were Present

Recommendation 2B: Implement adequate procedures and controls to ensure that projects meet HUD's and the State's standards at the completion of the housing rehabilitation work to prevent projects completed over the next 12 months from needing and additional $74,648 in required repairs to meet HUD's and the State's standards.

Comment 2

DHCD Response: DHCD will provide mandatory training to the local agency rehabilitation specialists on the preparation of acceptable work write ups in accordance with the DHCD Special Loans Handbook covering the HOME programs. The scope of DHCD monitoring and inspections has been broadened to include a review of cases in progress as well as projects that have been completed and closed, in order to identify issues at an earlier stage when they are more easily rectified. DHCD will implement controls to ensure that local rehabilitation specialists are ensuring that completed work complies with the write up, as well as expanding its own inspection program. DHCD's Rehabilitation Inspector currently inspects a sampling of completed properties when monitoring local agencies, which will be expanded to include checks of projects in process. We will particularly focus on those agencies with clearly demonstrated weaknesses.

The State Did Not Adequately Manage Its Program and the Work Write-Ups Were Not Sufficiently Detailed

Recommendation 2C: Establish and implement adequate procedures to ensure that the work write-ups submitted by the rehabilitation specialists are sufficient in detail to comply with both federal regulations and with the State's own policies to ensure that contractors are bidding on consistent work and techniques.

Comment 2

DHCD Response: DHCD will provide mandatory training on work write ups as described in Response 2B. DHCD will also work the local agencies to develop rehabilitation standards.

Recommendation 2D: Establish and implement adequate procedures to ensure that completed rehabilitation properties are inspected to ensure that the work performed complies with the scope of the work write-ups.

Comment 2

DHCD Response: DHCD will implement controls to ensure that completed work complies with the write up, as described in Response 2B.

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Recommendation 2E: Establish and implement adequate procedures to ensure that contractors and subcontractors performing any functions of the HOME program for the State enter into executed written agreements to ensure their compliance with responsibilities and obligations required under the program.

Comment 2

DHCD Response: Executed agreements between DHCD and its subrecipients specified an obligation for the subrecipient to receive State approval if they subcontracted responsibilities and duties of the written agreement. DHCD will review this requirement and the language in the agreement and clarify the requirement with local agencies. DHCD will also obtain the contracts for services for review and approval from the two subrecipients noted in the report.

Thank you for your cooperation and that of your staff throughout the audit and your recommendations to improve DHCD's administration of the HOME program. If you have questions or need additional information, please contact Tonna Phelps, Director, Single Family Housing at (410) 514-7509 or phelps@mdhousing.org.

Sincerely,

Frank B. Coakley
Assistant Secretary

OIG Evaluation of Auditee Comments

Comment 1 We have performed a thorough audit of all of the files the State and/or its local agency administrators have provided related to our audit sample and have evaluated and factored into our audit conclusions all of the documentation they have provided to date. Based on our audit we identified $2.3 million in unsupported costs. Unsupported costs require a future decision by HUD officials which will take into consideration any additional supporting documentation that the State provides.

Comment 2 We are encouraged that the State has expressed that it is initiating corrective action or has recently taken some of the steps needed to correct the problems discussed in this report.

Comment 3 The audit showed that the State lacked sufficient documentation for 41 (61 percent) of the 67 projects that we reviewed. As such, we disagree with the State's assertion that its overall documentation compliance level was greater than 85 percent.

Appendix C

FEDERAL REGULATIONS, GUIDANCE, AND THE STATE'S WRITTEN POLICIES

A. Regulations at 24 CFR [*Code of Federal Regulations*] Part 92, Definitions, state: "Low-income families means families whose annual incomes do not exceed 80 percent of the median income for the area, as determined by HUD with adjustment for smaller and larger families…"

B. Regulations at 24 CFR [*Code of Federal Regulations*] 92.203(a)(2) state that a participating jurisdiction must determine households' annual income by examining source documentation evidencing households' annual income. Section 92.203(d)(1) states that the participating jurisdiction must calculate the annual income of the family by projecting the prevailing rate of income of the family at the time the participating jurisdiction determines that the family is income eligible. Annual income shall include income from all family members.

C. Regulations at 24 CFR [*Code of Federal Regulations*] 92.251(a)(1) require housing that is constructed or rehabilitated with HOME funds to meet all applicable local codes, rehabilitation standards, ordinances, and zoning ordinances at the time of project completion. The participating jurisdiction must have written rehabilitation standards to ensure that HOME-assisted housing is decent, safe, and sanitary.

D. Regulations at 24 CFR [*Code of Federal Regulations*] 92.254(a)(2)(iii) state that if a participating jurisdiction intends to use HOME funds for projects, the participating jurisdiction may use the single-family mortgage limits under Section 203(b) of the National Housing Act, or it may determine 95 percent of the median purchase price for single-family housing in the jurisdiction. Section 92.254(b) and (c) state that in cases of rehabilitation not involving acquisition, housing is affordable if the estimated value, after rehabilitation, does not exceed 95 percent of the median purchase price and is the principal residence of an owner who qualifies as low-income and if the ownership interest meets the definition of homeownership.

E. Regulations at 24 CFR [*Code of Federal Regulations*] 92.504(a) state that participating jurisdictions are responsible for managing the day-to-day operations of their HOME program, ensuring that HOME funds are used in accordance with all program requirements and written agreements, and taking appropriate action when performance problems arise. The use of State recipients, subrecipients, or contractors does not relieve the participating jurisdiction of this responsibility.

F. Regulations at 24 CFR [*Code of Federal Regulations*] 92.505(a) state that requirements of Office of Management and Budget Circular A-87 apply to government entities.

G. Regulations at 24 CFR [*Code of Federal Regulations*] 92.508(a) state that a participating jurisdiction must establish and maintain sufficient records to enable HUD to determine whether the participating jurisdiction has met the requirements of 24 CFR [*Code of Federal Regulations*] Part 92. The participating jurisdiction must maintain records demonstrating the following:
   - Each household is income eligible in accordance with 24 CFR [*Code of Federal Regulations*] 92.203.
   - Each project's estimated value after rehabilitation does not exceed 95 percent of the median purchase price for the area in accordance with 24 CFR [*Code of Federal Regulations*] 92.254(a)(2).

H. Regulations at Office of Management and Budget Circular A-87, Attachment A, section (C)(2)(a-c) state that a cost is reasonable if it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. In determining the reasonableness of a given cost, consideration shall be given to: whether the cost is recognized as ordinary and necessary, factors such as sound business practices, and market prices for comparable goods and services.

I. The State's written agreement for administration of HOME funds, section 9B, states that if the local administrator desires to subcontract any duties and responsibilities during the term of this agreement, the local administrator will submit a proposed agreement and information about the subcontractor to the Department of Housing and Community Development (DHCD) for DHCD to determine whether the subcontractor and subcontracting agreement are acceptable.

J. Building HOME: A HOME Program Primer, chapter 4, states that acceptable methods to determine after-rehabilitation values include appraisals, tax assessments of comparable properties, and estimates of value.

K. The Technical Guide for Determining Income and Allowances for the HOME Program states that the earned income of minors under the age of 18 is not included.

L. Policies in chapter 3 of the State's Special Loans Program Handbook state that work write-ups must clearly define the scope of work, be subdivided in a manner that adds clarity or simplifies the itemization of prices, materials and equipment shall be specified whenever possible, should indicate how repaired areas are to be finished, trade work shall follow a detailed format, should indicate the location of where lead hazards are located, and how remediation will take place. Drawings are required when additions, major alterations, or façade work are proposed. Upon receipt of a contractor's proposal, the Housing Rehabilitation Officer must evaluate the reasonableness of the cost. The contractor's proposal should be compared to the cost estimate of the job prepared by the Housing Rehabilitation Officer. Generally, the lowest responsible bidder should be selected for the job.