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Audit Report Number
2008-KC-1007

TO: Dee Ann Ducote, Director, Community Planning and Development, 7ED

//**signed**//

FROM: Ronald J. Hosking, Regional Inspector General for Audit, 7AGA

SUBJECT: The City of St. Louis, Missouri, Used HOME Program Funds to Provide Excessive Development Subsidies

HIGHLIGHTS

What We Audited and Why

We audited the City of St. Louis (City) because it received more than $4 million in HOME Investment Partnerships Program (HOME) funding in 2007, making it the highest funded city in our region. Our audit objective was to determine whether the City used HOME funds for reasonable and necessary development costs.

What We Found

The City used HOME funds for costs that were not reasonable and necessary to produce housing for low-income families. It did not establish adequate controls to ensure that it determined the proper amount of subsidy for HOME-funded development activities. As a result, it was unable to assist additional low-income families.

What We Recommend

We recommend that the U.S. Department of Housing and Urban Development (HUD) require the City to design and implement a process to ensure that HOME-funded project costs are reasonable and necessary.

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

Auditee's Response

We provided the draft report to the City on September 12, 2008, and requested a response by September 26, 2008. It provided written comments on September 26, 2008.

The City generally disagreed with our audit conclusions. The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix A of this report.

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BACKGROUND AND OBJECTIVE

HOME Program
The HOME Investment Partnerships Program (HOME) is authorized under Title II of the Cranston-Gonzales National Affordable Housing Act, as amended, and is funded for the exclusive purpose of creating affordable housing for low-income households. HOME funds can be used to provide home purchase or rehabilitation financing assistance to eligible homeowners and new homebuyers, build or rehabilitate housing for rental or ownership, or for other reasonable and necessary expenses related to the development of nonluxury housing. Program funds are allocated to units of general local government on the basis of a formula that considers the relative inadequacy of each jurisdiction's housing supply, its incidence of poverty, its fiscal distress, and other factors.

City of St. Louis
The Community Development Administration (CDA) was created by the mayor of St. Louis in 1974 and is now responsible for administering federal funds for housing, community, and economic development programs that strengthen the City of St. Louis and its neighborhoods. The CDA manages the HOME program and also contracts with local government agencies, nonprofits, and private firms to carry out its housing development, home repair, homebuyer assistance, business and economic development, public facility improvement, historic preservation, and social service programs.

In 2006 and 2007, the City's HOME program provided funding for home repairs ($2.7 million) and housing production ($4.7 million). In its housing production program, the City used HOME funds for development subsidies ("construction gap"), which represents the difference between the cost to develop housing and the market price. Additionally, the City used HOME funds to provide downpayment assistance to eligible families.

We audited the City of St. Louis (City) because it received more than $4 million in HOME funding in 2007, making it the highest funded city in our region.

Our audit objective was to determine whether the City used HOME funds for reasonable and necessary development costs.

RESULTS OF AUDIT

Finding 1: The City Used HOME Funds for Excessive Development Subsidies

The City used HOME funds for costs that were not reasonable and necessary to produce housing for low-income families. It did not establish adequate controls to ensure that it determined the proper amount of subsidy for HOME-funded development activities. As a result, it was unable to assist additional low-income families.

Excessive Subsidies

The City used HOME funds for costs that were not reasonable and necessary to produce housing for low-income families. Regulations at 24 CFR [*Code of Federal Regulations*] 92.505 require the City to meet the requirements of Office of Management and Budget Circular No. A-87. The circular requires that costs be necessary and reasonable for proper and efficient performance and administration of federal awards. A cost is reasonable if, in its nature and amount, 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.

We reviewed the construction costs for the City's two HOME projects with the highest per unit subsidy. For each project, the City approved higher than necessary hard costs (site preparation, construction materials and labor). This resulted in higher than necessary HOME-funded development subsidies (the difference between the total costs and the market price of the finished units).

<u>2730-32 Miami</u>
The cost for these two single-family new construction houses on Miami was unreasonably high. While the City approved this project with hard costs budgeted at approximately $462,000, our cost analyst estimated that these houses could have been developed for approximately $343,000. In addition, during the city engineering technician's review of this project's cost, he indicated that it was 24 percent higher than other affordable housing, which cost about $100 per square foot. This assessment equates to total hard costs of $360,000. Because the approved hard costs were too high, the development subsidy was higher than necessary.

2730-32 Miami
Total development cost $751,637, including $309,437 in HOME funds
Two houses, each with 3 bedrooms, 2 ½ baths, and 1,800 square feet

<u>3522-24 California</u>

The cost of converting this four-family building to two town houses was also unreasonably high. While the City approved this project with hard costs budgeted at approximately $422,000, our cost analyst estimated that these units could have been converted for approximately $296,000. In addition, during the city engineering technician's review of this project's cost, he indicated that he was approving it under protest, duress, and against his better judgment. The approved costs were approximately $126,000 too high; therefore, the development subsidy was higher than necessary.

3522-24 California
Total development cost $640,602, including $258,350 in HOME funds
Two town houses, each with 2 bedrooms, 2 ½ baths, and 1,473 square feet

Inadequate Controls

The City did not establish adequate controls to ensure that it determined the proper amount of subsidy for HOME-funded development activities. It did not make a meaningful effort to control development costs or adequately verify that costs were reasonable and necessary. Instead, its development process discouraged competition by not

- Placing requests for proposal in widely circulated daily newspapers,
- Identifying the general design of the structure in the requests for proposal, and
- Obtaining, before the request for proposal, alderman approval of the development or blighting of the parcel for tax purposes.

Effect on Low-Income Families

As a result of its inadequate controls, the City was unable to assist additional low-income families. For the two projects reviewed, the City would have had approximately $245,000 available for other developments.

Recommendation

We recommend that the Director of the St. Louis Office of Community Planning and Development require the City to

1A. Design and implement a process to ensure that HOME-funded project costs are reasonable and necessary. (This procedure should include selecting projects through a competitive process and evaluating proposed project costs for reasonableness).

SCOPE AND METHODOLOGY

To accomplish our objectives, we reviewed the *Code of Federal Regulations* pertaining to the HOME program; the City's policies and agreements; and the results of prior certified public accountant, U.S. Department of Housing and Urban Development (HUD), and Office of Inspector General (OIG) reviews. We interviewed City and HUD staff.

We obtained the City's list of 35 projects, which were either open or completed between January 1, 2006, and December 31, 2007. The City allocated $12 million in HOME funding for 148 units at these projects. We determined that five projects met the following parameters:

- HOME investment greater than $100,000 per unit and
- Total development cost greater than $300,000 per unit.

We then selected for review the two projects with the highest per unit HOME funding. We performed site inspections, reviewed disbursing agent files for expense eligibility and drawdown support, and contracted with a cost analyst, who estimated the hard costs associated with these projects. We also reviewed the City's project development files for a history of project administration, eligibility of project and individuals assisted, and method of advertisement and selection.

We performed audit work from February through September 2008. The on-site audit work was performed at the City's Community Development Administration's office located at 1015 Locust Street, St. Louis, Missouri.

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. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

INTERNAL CONTROLS

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

- Controls over total development costs of HOME-assisted projects.

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 item is a significant weakness:

- The City did not have adequate controls to ensure that HOME funds were used for costs that were reasonable and necessary to produce housing for low-income families.

APPENDIXES

Appendix A

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

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September 26, 2008

Mr. Ronald J. Hosking
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Office of Inspector General
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RE: Audit Report—City of St. Louis
HOME PROGRAM

Dear Mr. Hosking:

Thank you for this opportunity to provide comment on the Inspector General's recent Audit Report for the City's HOME Investment Partnership program. We also wish to express our thanks to Carrie Gray and William Krueger of your staff for taking the time to review the draft report with my staff.

It is our understanding that the audit addressed the following aspects of the City's HOME program: whether the City used HOME funds for reasonable and necessary development costs.

The following are our responses to the finding and recommendations listed in the draft report, as well as our comments on other aspects of the report.

- **Finding 1:** The City used HOME funds for costs that were not reasonable and necessary to produce housing for low-income families. It did not establish adequate controls to ensure that it determined the proper amount of subsidy for HOME-funded development activities. As a result, it was unable to assist additional low-income families.

Our response to this finding is as follows:

Response to Finding 1:

The City respectfully disagrees with Finding 1 for the following reasons.

First, on the issue of cost, this finding is based on a review of the hard construction costs associated with the two (2) City HOME development projects with the highest cost/unit subsidy, 2730-32 Miami, a new construction project, and 3522-24 California, a rehabilitation project, and a comparison of those costs with costs estimated by a HUD-certified cost analyst.

Comment 1

We believe that rather than comparing these costs with a theoretical cost estimate, it is more appropriate to compare these costs with the costs of other developments constructed in the City of St. Louis. We believe that the following cost comparison demonstrates that the costs of both the newly constructed and the rehabilitated homes examined by the auditors is reasonable when compared with the costs of other homes built or rehabilitated in the City of St. Louis.

We have prepared the attached chart that compares the costs of non-HOME assisted rehabilitation and new construction developments with the costs of the HOME-assisted developments examined in the audit. The developments listed in the chart include a range of developments, including ones with and without City development subsidy assistance. Some are low-income housing tax credit projects that are built as new single-family rental homes; others are new construction market rate or income-restricted for-sale homes; others are market rate or income restricted rehabilitated homes.

Comment 2

As is demonstrated in the chart, the per square foot costs for the newly constructed homes on Miami examined in the audit fall towards the low end of the range of the seven (7) developments in the chart, and the per sq. ft. cost of the Miami homes at approximately $128/sq. ft. is approximately 94% of the average per sq. ft. cost for the 85 newly constructed homes in the chart.

Comment 3

The chart also compares rehabilitated homes. As is demonstrated in the chart, the cost for the rehabilitated homes on California is towards the high end of the range of rehabilitation costs for the 33 homes in the 21 rehabilitation developments included in the chart and appears to be approximately 24% higher than the average for the rehabilitation developments listed; however, the California hard cost at approximately $124/sq. ft. is considerably less than the hard cost of the one historic rehabilitation multifamily development we can cite in the short time available to respond to the audit.

Further, if the costs of all of the one-to-four family developments are averaged, the cost of the Miami development is approximately 3% more than the average per sq. ft. cost and the cost of the California development is approximately 1.5% less than the average per sq. ft. cost for the 28 developments and 116 homes listed. These calculations exclude the one multifamily development listed. These deviations, we believe, are well within the range of acceptability.

Given that this comparison indicates the hard costs per sq. ft. for the two developments examined by the auditors compare very favorably with the averages shown in the chart for a wide range of developments, we do not believe it is reasonable to conclude either that the City funded costs that were not reasonable or that the City could have assisted additional families if less costly developments were funded.

We would also like to comment on several reasons why costs in the City's urban environment for developments that use federal funding may be perceived as high when compared to costs that can be achieved in development that is 100% privately funded, particularly when such development is located in suburban "greenfields".

Comment 4

First, when new construction is undertaken on land where a previous structure has been previously demolished, it is impossible to predict subsurface conditions. In many instances, the debris from demolition is used to fill the former basement. Such conditions are obviously not suitable for new foundations, and the old debris must be dug out and in many cases the soil compacted before the property is ready for new construction. These factors add to the hard costs.

Comment 5

Second, most new construction in the City takes place, as did the new construction on Miami, in the context of existing neighborhoods. Section 106 of the federal Historic Preservation Act requires that new development in historic neighborhoods be designed to be compatible with the existing historic architecture. Most of the City's neighborhoods are either on or eligible for the National Register of Historic Places, both of which require compliance with Section 106. Even in those cases where such compliance is not mandatory, we strive to ensure that our developments complement the existing fabric of their neighborhoods. This, we believe, is not only good current urban planning policy but this policy is supported by evidence left by the mistakes of the past. Our City is dotted with vacant "Section 235" houses built in a cookie-cutter approach in the 1960s, where the same home design was used everywhere regardless of the neighborhood's character. Many more such homes have since been demolished. These home designs were clearly subsidized housing that stuck out like sore thumbs in a neighborhood's fabric, and the fact that so many of these homes were abandoned is evidence that a design approach that does not take into account and blend harmoniously with the fabric of a neighborhood has little likelihood of success. We believe that encouraging new construction design that is compatible with a neighborhood's architecture is key to the sustainability of the development and the neighborhood. Unfortunately, such design also adds to the hard cost.

Another related element is the need to rebuild the fabric of a neighborhood. The majority of our City was platted on lots that ranged in frontage from 25' to 35'. These are very narrow lots, and when a new home is built on one of these lots it is essential that care be taken to avoid damage to adjoining foundations, many of which are less than 5' and most of which are less than 10' from the new foundation.

Comment 6

With rehabilitation, while the existing home being rehabilitated is obviously compatible with the its neighbors, homes in need of rehabilitation include a very wide range of conditions. Some homes are in sound structural condition and need little structural modification except to add features (closets, bathrooms, larger kitchens) that are considered essential in today's modern housing market; others require extensive reconstruction of roofs, foundations, and exterior brick walls. Obviously, homes in good condition cost less to rehabilitate that do homes in very dilapidated condition; the varying conditions of the homes in the attached chart account in large part for the wide variation in hard costs. The rehabilitated California property was in very poor condition.

As noted above, most of the City's neighborhoods are either listed on the National Register of Historic Places or are eligible for such listing. In either case, HUD regulations require compliance with Section 106 in the rehabilitation of the properties. Even if this were not the case, for the reasons outlined above we would want to preserve these features—that is why we encourage all of our developers to apply for historic tax credits and rehabilitate the property in accordance with the Secretary of the Interior's standards. Windows, exterior millwork and tuckpointing are some of the more costly items that are covered by the Secretary's Standards. Compliance with these standards also adds to the cost of an urban rehabilitation development. Although historic tax credits are a source of funding that in part offsets the increased cost, the additional source of funding is not reflected in a comparison of the costs.

Comment 7

Next, rehabilitation of older homes carries with it a wide variety of environmental concerns. Most of the existing homes in the City were built more than 60 years ago. Lead paint was used extensively in most of these homes; asbestos was used extensively in many of them. In today's environmentally conscious climate, these environmental hazards must be remediated in any responsible rehabilitation development, and in most cases HUD regulations require such remediation. Remediating these hazards (and performing interior demolition and other work in accordance with lead-safe and other environmentally safe practices) also adds to the hard costs of construction.

Comment 8

Finally, it is an unfortunate fact that using federal funds in a development project adds to the hard costs of the development. As noted above, compliance with the Section 106 historic regulations that apply to the HOME program adds to the hard costs in a variety of ways; HUD's lead remediation regulations and "lead-safe work practices" regulations also add to the cost. In addition, Section 3 regulations require the developer to prepare and implement a plan to hire low and moderate income residents and contract with Section 3 businesses wherever possible. For a variety of reasons, this often adds to the hard costs. It can also be argued that compliance with HUD's documentation requirements also adds to a construction contractor's cost of doing business and therefore to the hard costs, which include the contractor's overhead and general requirements costs.

Comment 9

The audit mentioned a note in the file made by a CDA engineering technician stating that he was approving the costs of the rehabilitation development under protest and duress and that the costs were too high. We would like to point out that (a) no one forced the engineering technician to approve the costs; (b) the engineering technician's analysis of the costs was based on an erroneous square footage assumption of 1,410 sq. ft.; the auditors agree that the actual area of the property in question was in fact 1,710 – 1,750 sq. ft. We believe that had this area error been corrected before or during the engineering technician's review of the project, his analysis would not have resulted in this comment, and we note that the file also contains a final approval by the engineering technician with no such notations.

In summary, the points we make with respect to the costs are the following:

- For the reasons discussed above, hard construction in a development in a City where the majority of the neighborhoods are historic and environmental issues exist in a majority of the existing buildings costs more.
- For the reasons listed above, hard construction in a development in a City where new development must occur where other development once existed costs more.
- For the reasons listed above, reasonable rehabilitation hard costs vary widely depending on the condition and location of the particular property.
- For the reasons discussed above, the use of direct HOME funding adds to the hard costs of development.
- We believe that a comparison of the hard costs of the Miami and California developments examined by the auditors with other urban developments is a more appropriate approach to determining whether the costs of these two particular developments were reasonable and necessary. Based on the comparison provided in the attached chart and discussed above, we believe the hard costs of these two developments were appropriate and reasonable.

We hope that the above discussion and the attached chart adequately address the issue of cost. We would be happy to discuss these issues in person with the auditors. We are pleased that the auditors were happy with the quality of the work on both projects and found the quality acceptable but not excessive.

Next, the draft audit stated that the City did not establish adequate controls to ensure that it determined the proper amount of subsidy for HOME-funded development activities, that the City did not make a meaningful effort to control development costs or adequately verify that costs were reasonable and necessary. The City also respectfully disagrees with this statement for the following reasons.

Comment 10

The City does have a process to ensure, to the extent possible, that an appropriate amount of subsidy is approved. Project budgets are reviewed by CDA's housing analysts for soft costs and by CDA's construction manager for hard costs. Construction costs are typically evaluated by comparison to costs on previous projects, confirmation of sub-contractor proposals, verification using Means data, site visits and discussions with the developer and/or general contractor. Project construction costs (hard costs) have been anticipated to fit within a usual cost range of $100 to $125, unless there are special project conditions to be considered. The wide range in anticipated costs is due to the varying design requirements for varying neighborhoods, varying subsurface conditions, varying conditions of existing buildings for rehabilitation, and varying designs, methods, materials and operations of different developments and contractors. This process is admittedly not perfect but we believe that perfection is not possible given the vagaries of urban development discussed above, and we believe that CDA does make a diligent and the best possible effort to review the costs of all HOME-funded projects and to ensure that the subsidy is the least amount necessary.

For the reasons discussed in the preceding section, construction/hard cost review and analysis for both new construction and rehabilitation development is a less than exact science, and judgment calls are necessary with respect to individual development projects with specific circumstances that affect hard costs, including the design of the project. In the case of new construction that must comply with Section 106 historic requirements, plans must be submitted to the State Historic Preservation Office for review before any construction commences. This review process often results in requirements for changes in the design of the project that add to the hard construction costs.

Further, given the uncertainties inherent in both rehabilitation and in unseen underground conditions in new construction projects, budgets of necessity sometimes contain allowances for these items. CDA requires that all funds, private and HOME, for HOME-funded projects be disbursed through a title company which tracks the vast majority of disbursements, and performs a reconciliation of all costs and disbursements at the completion of the project before the final payment is released. In some cases, if the entirety of an allowance is not used, funds are returned to CDA—this is not, however, a common occurrence because more often than not the amounts budgeted for contingency and allowances are insufficient to cover the actual costs.

Next, page 7 of the draft audit states that the City's development process discourages competition by (a) not placing requests for proposals in widely circulated daily newspapers; (b) not identifying the general design of the structure in the requests for proposals; and (c) not obtaining, before the request for proposals, aldermanic approval of the development for tax abatement. The City does not believe that it discourages competition and respectfully disagrees with portions of the implied recommendations, for the following reasons.

Comment 11

With respect to the issue of placing requests for proposals in widely circulated daily newspapers, the cost of such advertisements would be considerable, and we do not believe that such a practice would be effective in attracting additional respondents.

The City has two daily newspapers—the St. Louis Post-Dispatch and the Daily Record. The Post-Dispatch is the only true daily newspaper—the Daily Record is a legal publication with page upon page of legal notices of various sorts and its circulation is not by any means wide. Most of CDA's requests for proposals involve single buildings and small sites. We do not believe that, as a rule, most small developers and contractors who would be interested in responding subscribe to the Daily Record or have the time to peruse the notices on a regular basis. This leaves the Post-Dispatch. Due in large part, we think, to an increasing dependence on the internet for news and information, the circulation of the Post-Dispatch is continuing to drop. Nevertheless, advertising in the Post in a manner that would be noticed by those who do read the paper is costly. A 30-line standard classified ad in very small print costs approximately $350. These ads appear every Sunday, Monday, Wednesday, Saturday and Friday for a total of 30 days, as best we can determine from the Post Dispatch website at the time we write this response, so the ad would run for 6 weeks. However, there is no guarantee that an ad of this type would attract any better response that we already get, and the cost to run an ad of the size that would attract any attention at all would be closer to $1,400. Further, as is the case with the Daily Record, we do not believe that most small developers and contractors who would be interested in responding would have the time to peruse the classifieds on a regular basis. Placing an ad in a location in the newspaper that would attract attention would cost considerably more, although we could not determine the exact cost as we write this response. However, we will check further into the cost of running meaningful advertisements in the Post-Dispatch, and if after reviewing the costs the local HUD office agrees that this approach could be productive and that we should consider it, we will.

The City's current approaches to attracting responses to its Requests for Proposals are the following.

All "Requests for Proposal" are posted online through CDA's website, which can be and is frequently accessed by the public. CDA also mails RFPs to developers and contractors CDA thinks may be interested in certain types of projects. In addition, CDA staff participate in regular meetings with the Homebuilders Association and building trades associations. They frequently attend and appear as guest speakers at the St. Louis Rehabbers Club and similar functions. Housing analysts often attend Tuesday Realtor's open houses. CDA funds two organizations, MoKan and the Contractors Assistance Program, in an effort to increase small and minority contractor participation. All of these networking and funding activities and many more, both formal and informal, are intended to attract interest in HOME-assisted projects and stimulate investment in City neighborhoods, with or without CDA financial support. CDA is always open, however, to any and all practical suggestions for increasing interest in development opportunities and requests for proposals. One of the most common topics in discussions with the above organizations is how to the City might improve its processes to make it easier for developers to participate in the City's programs—as a result of these discussions over the past seven years, a number of process improvements have been made at a number of levels.

Even with this outreach, however, many RFPs receive only one response or no responses. We believe there are several reasons for this. First, there are not a large number of developers/ contractors interested in addressing the problem properties that are the subjects of these RFPs. Second, many of those that are interested are only capable of financing and developing one or a few buildings at a time. CDA's process requires that the developer/contractor finance as much of the development cost as the market will support, thereby requiring that the developer take risk, minimizing the amount of HOME funding that is put at risk, and leveraging the amount of HOME funding we receive. Particularly in these days of tight credit, developers are not beating down our doors to do these projects. Completing these developments is critical to addressing our goals of improving the quality of homes available and affordable to our low and moderate income residents and improving the neighborhoods in which these residents live and these projects are located. Therefore, CDA seeks to interest developers in the properties through a variety of means and to work with only one developer if only one developer is interested, monitoring and reviewing the costs in the manner discussed above. The need for compliance with the regulations discussed above and what we believe is a rigorous but necessary CDA review process, discussed above and below, also tends to discourage competition.

Comment 11

However, we will check further into the cost of running meaningful advertisements in the Post-Dispatch. We will obtain applicable advertising cost data within the next 45 days and will then review this data with the local HUD office. If the local office agrees that this approach could be productive and that we should consider it, we will.

With respect to "identifying the general design of the structure in the RFP", CDA does describe the general design of the structure intended in the RFP by stating, by way of examples, that the design must be compatible with the character of the neighborhood, that the design must comply with the Secretary of the Interior's Standards, etc. Since the developer is risking his or her money in financing the development, most developers wish to control the design the development project. CDA's role is to review the developer's proposed design to ensure that it meets the general standards stated in the RFP, that the design is not excessive, and that the design is consistent with our goal—and HUD's goal—of creating sustainable mixed income neighborhoods and making sure that affordable housing is not stigmatized. Our policy, which we believe to be firmly grounded in the spirit of the National Affordable Housing Act of 1992

(HOME Investment Partnership Program), overall guidance from the U.S. Department of Housing and Urban Development and sensible community development policy, is that HOME units should be largely indistinguishable from market-rate houses.

Comment 12

"Identifying the general design of the structure in question" implies that CDA staff would either go a considerable distance in the direction of design and specifications for assisted projects, or, at a minimum, create a number of relatively standardized building types, with standardized components, in order to simplify the budget review process. CDA's goal is to attract developers who will assume the financing, marketing and overall development responsibility and risk for the project, rather than to fully design a development that is then bid among general contractors with the City taking all of the financing risk. As for working from a limited number of standardized building types, we believe that restricting CDA's support to a relatively narrow range of housing types would discourage truly competitive responses by limiting the creativity of potential developers. Furthermore, the creation of certain building types to be used for all CDA-assisted projects would detract from the unique and often historic character of many of the City's 79 neighborhoods and might well provide a visual cue that certain houses are occupied by low and moderate income households. We strive to make sure that we give careful consideration to the impact each CDA-assisted project will have on its existing streetscape and that it fits as seamlessly as possible into the neighborhood fabric.

CDA will review the content of its Requests for Proposals to determine if improvements can be made to provide further guidance without adversely impact competition, incurring significant additional cost before a developer is selected, or standardizing design requirements to the extent that neighborhood character is negatively affected.

Comment 13

With respect to obtaining aldermanic approval for real estate tax abatement prior to soliciting proposals, we will explore this possibility by consulting with aldermen in the wards where our RFP buildings are located. We believe that in most cases it will be possible to obtain the alderman's agreement to introduce an ordinance that makes tax abatement available for the property concurrently with the placement of the RFP, so that we can assure developers that tax abatement will be available if CDA and the abatement-granting agency determine that tax abatement is needed. While tax abatement may, in some but not all cases, make it possible for the developer to sell the property at a higher price or reduce operating costs for rental developments, thereby lowering the HOME subsidy, this will have no impact on the hard costs. Further, due to concerns expressed by both City government and the Board of Education about the impact of tax abatement on the budgets of the various property taxing jurisdictions, the City strives to grant as little tax abatement as necessary and only if necessary, and each request for tax abatement is examined against these goals. We note also that in virtually all income-restricted rental and for-sale developments, tax abatement is approved by the Alderman, both for the purpose of lowering the subsidy amount (which is also a concern to the Alderman, as funds available for development in each ward are limited) and for the purpose of lowering the cost of homeownership for low and moderate income buyers.

Many developments with HOME assistance also receive subsidies from other sources, including federal low-income housing tax credits, state low-income housing programs, state and federal historic tax credits, and the City's Affordable Housing Trust Fund. The City encourages the use of these other financing sources to minimize the amount of HOME funds used on each development. In the particular cases examined by the auditor, due to the small two-unit scales of the developments, the only additional non-city subsidy available was the state historic tax credit program for the rehabilitation development, and the rehabilitation development did in fact utilize state historic tax credits.

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The HOME program is a very valuable tool for the City and addresses very important goals. As indicated above, we continually seek additional participation in our programs, and we are committed to improving continually improving our processes and policies. We very much appreciate the auditors' help in reviewing this program and, as discussed above, we will strive to improve our processes to take their comments into account while continuing to meet our goals for the program, our neighborhoods, and our low and moderate income residents. We believe that these are important goals for the City of St. Louis as well as important goals for HUD.

Please feel free to contact me if you have any questions. We thank you again for the opportunity to provide this response, and for the courtesy demonstrated by your staff.

Sincerely,

Barbara A. Geisman
Executive Director for Development

BAG/bg
ATTACHMENT: Cost Comparison Chart
copies: Mayor Francis Slay
Carrie Gray, CPA, Assistant Regional Inspector General for Audit, HUD Office of Inspector General—St. Louis
William Krueger, Senior Auditor, HUD Office of Inspector General—St. Louis
Dee Ann Ducote, CPD Director, St. Louis Local HUD Office
James Geraghty, HOME Monitor, St. Louis Local HUD Office
Jill Claybour, Acting Director, Community Development Administration

HARD COST COMPARISONS--NEW AND REHABILITATED SINGLE-FAMILY HOMES IN CITY OF ST. LOUIS

Address	Units	Sq. Ft./ Unit	Total Gross Sq. Ft.	Total Develop-ment Cost	Hard Costs	Hard Cost/ Gross Sq. Ft.	Start Date	Type of Structure	Type of Occupancy	Type of Construction	Type of Area
MULTIFAMILY HOMES--REHABILITATION											
Crown Square	90	778	70,000	$34,942,000	$11,550,000	$ 165.00	2007	Multifamily	Rental	Rehabilitation	Historic District--106 Applies
SINGLE-FAMILY HOMES--NEW CONSTRUCTION											
Maple Acres III	10	1,450	14,500	$1,974,500	$1,511,715	$104.26	Jun-08	Single Family	For-Sale	New	Not Historic Eligible--No 106
3449-51 Indiana	2	1,440	2,880	$419,747	$319,864	$111.06	Jan-06	Single Family	For-Sale	New	National Register District--106
2730-32 Miami	**2**	**1,800**	**3,600**	**$751,637**	**$462,000**	**$128.33**	**2008**	Single Family	For-Sale	New	National Register District--106
North Market Place Homes	20	1,271	25,420	$4,720,000	$3,508,380	$138.02	2004	Single Family	For-Sale	New	Not Historic Eligible--No 106
Ville Phillips Estates	12	1,625	19,500	$3,684,764	$2,702,244	$138.58	Jun-07	Single Family	For-Sale	New	Certified Local District--106
Lillian Park II	21	1,380	28,980	$5,295,000	$4,115,160	$142.00	Sep-08	Single Family	Lease	New	Not Historic Eligible--No 106
St. Ferdinand Homes	18	1,357	24,418	$5,163,000	$3,662,700	$150.00	Sep-08	Single Family	Lease	New	Not Historic Eligible--No 106
AVG. HARD COST/GROSS SF:	**85**		**119,298**		**$16,282,063**	**$136.48**					
2730-32 Miami Cost/Sq. Ft. as % of Average New Home Cost:						**94.03%**					
ONE, TWO, AND FOUR-FAMILY HOMES--REHABILITATION											
2638 Armand	1	2,264	2,264	$210,000	$161,790	$71.46	Jan-08	Single Family	For-Sale	Rehabilitation	Certified Local District--106
2238 Shenandoah	2	2,261	4,522	$485,661	$327,240	$72.37	Jul-08	Single Family	For-Sale	Rehabilitation	National Register District--106
1903-05 Serbian	2	1,683	3,366	$342,671	$260,360	$77.35	May-07	Single Family	For-Sale	Rehabilitation	National Register District--106
3910 DeTonty	2	1,922	3,844	$613,715	$333,750	$86.82	May-08	Single Family	Rental	Rehabilitation	Certified Local District--106
3246 Michigan	1	2,420	2,420	$282,697	$215,521	$89.06	Jul-08	Single Family	For-Sale	Rehabilitation	National Register District--106
3004 Virginia	1	940	940	$96,900	$85,011	$90.44	May-07	Single Family	For-Sale	Rehabilitation	Eligible--106 Applies
4066 DeTonty	1	2,785	2,785	$346,066	$257,961	$92.63	Jul-08	Single Family	Rental	Rehabilitation	Certified Local District--106
2624 Nebraska	1	1,550	1,550	$185,000	$144,724	$93.37	Aug-06	Single Family	For-Sale	Rehabilitation	Eligible--106 Applies
2837 Texas	2	1,200	2,400	$475,658	$238,778	$99.49	May-07	Single Family	For-Sale	Rehabilitation	National Register District--106
4056 Minnesota	4	825	3,300	$528,775	$336,207	$101.88	Oct-07	Single Family	For-Sale	Rehabilitation	National Register District--106
3219 Iowa	1	2,907	2,907	$422,061	$296,534	$102.01	Dec-06	Single Family	For-Sale	Rehabilitation	National Register District--106
2240-42 Jules	1	1,700	1,700	$266,969	$174,295	$102.53	Apr-06	Single Family	For-Sale	Rehabilitation	National Register District--106
4060 DeTonty	2	1,645	3,290	$458,797	$342,019	$103.96	Jul-08	Single Family	Rental	Rehabilitation	Certified Local District--106
2743 Ann	1	2,857	2,857	$410,444	$302,373	$105.84	Mar-07	Single Family	For-Sale	Rehabilitation	Certified Local District--106
2732 Geyer	1	1,548	1,548	$208,871	$165,015	$106.60	Jun-06	Single Family	For-Sale	Rehabilitation	Certified Local District--106
3653 S. Compton	1	1,237	1,237	$206,684	$132,591	$107.19	Jan-08	Single Family	For-Sale	Rehabilitation	National Register District--106
2627 Nebraska	1	1,800	1,800	$259,354	$196,025	$108.90	Oct-07	Single Family	For-Sale	Rehabilitation	Eligible--106 Applies
2647 Shenandoah	1	1,985	1,985	$485,661	$221,886	$111.78	Dec-06	Single Family	For-Sale	Rehabilitation	Certified Local District--106
3222-24 California	**2**	**1,710**	**3,420**	**$640,602**	**$422,000**	**$123.39**	**2008**	Single Family	For-Sale	Rehabilitation	National Register District--106
2521-23 Minnesota	2	1,875	3,750	$607,582	$472,242	$125.93	Jul-07	Single Family	For-Sale	Rehabilitation	Eligible--106 Applies
2817 Wyoming	1	1,710	1,710	$327,793	$264,744	$154.82	May-07	Single Family	For-Sale	Rehabilitation	National Register District--106
AVG. HARD COST/GROSS SF:	**31**		**53,595**		**$5,351,086**	**$99.84**					
3224 California Cost/Sq. Ft. as % of Average Rehabilitation Cost:						**123.59%**					
ALL SINGLE-FAMILY HOMES--REHABILITATION											
AVERAGE HARD COST/GROSS SQ. FT.--ALL:			**172,893**		**$21,633,149**	**$125.12**					
2730-32 Miami Cost/Sq. Ft. as % of Average Single-Family Cost:						**102.56%**					
3224 California Cost/Sq. Ft. as % of Average Single-Family Cost:						**98.62%**					

OIG Evaluation of Auditee Comments

Comment 1 We consider our site-specific cost estimate to be more reliable and accurate than a comparison of average hard costs for other completed structures assisted by the City. Since the City has not been making a meaningful effort to control costs or competitively select developers we consider the average square foot hard costs discussed in the City's response to be inflated

Comment 2 The City has not been making a meaningful effort to control costs or competitively select developers. As a result, we consider the average square foot hard costs discussed in the City's response to be inflated. Further, the only other new construction development of the same size on the City's chart has a square foot hard cost of $111. Miami's hard costs exceed this amount by 16 percent.

Comment 3 As stated above, the City has not been making a meaningful effort to control costs or competitively select developers. As a result, we consider the average square foot hard costs discussed in the City's response to be inflated. Further, the City's chart contains six other rehabilitation developments of the same size, including one by the same developer. These developments reflect a square foot hard cost of $72 to $104, plus the developer's other project at $126. These costs average $93 per square foot. Using the City's figures, California is 32 percent higher than the average. Using our square footage amount of 1,473 per unit, California is 54 percent above the average. [See Comment 9]

Comment 4 The City believes that unusual site conditions add to a development's hard costs. We believe that this condition does not explain or justify the hard costs on the Miami development. This condition was taken into account by our contract cost analyst in arriving at his competitive cost estimate. This estimate was based on an inspection of the completed structures, a review of the plans and specifications and discussions with local contractors.

Comment 5 The City believes that encouraging new construction design which is compatible with the neighborhood's architecture adds to a development's hard costs. We believe that this condition does not explain or justify the hard costs on the Miami development. This condition was taken into account by our contract cost analyst in arriving at his competitive cost estimate. This estimate was based on an inspection of the completed structures, a review of the plans and specifications and discussions with local contractors.

Comment 6 The City believes that the very poor condition of an existing structure adds to a development's hard costs. We believe that this condition does not explain or justify the hard costs on the California development. This condition was taken into account by our contract cost analyst in arriving at his competitive cost estimate. This estimate was based on an inspection of the completed structures, a review of the plans and specifications and discussions with local contractors.

Comment 7 The City believes that environmental concerns add to a rehabilitation development's hard costs. We believe that this condition does not explain or justify the hard costs on the California development. This condition was taken into account by our contract cost analyst in arriving at his competitive cost estimate. This estimate was based on an inspection of the completed structures, a review of the plans and specifications and discussions with local contractors.

Comment 8 The City believes that use of federal funds in a development adds to a development's hard costs by adding requirements to follow Section 106, lead abatement and section 3 regulations. We believe that this issue does not explain or justify the hard costs on either the Miami or California development

For example, the City prepared a chart showing hard cost comparisons which were used to justify high costs found on the Miami and California developments. We reviewed this chart and found that for other developer's Section 106 two unit developments the square foot hard costs ranged from $72 to $104. We conclude that Section 106 requirements did not contribute to high hard costs to the extent claimed by the City.

Comment 9 The City noted a discrepancy in the square foot total used on the California development. They believe that the square footage is 1,710 per unit, not the 1,410 shown on the construction budget. We checked with our cost analyst who indicated that he determined the actual interior living space using a standard industry method. The cost analyst measured the floor joists and found that each unit contained 1,473 square feet. We have changed the photo caption to reflect this higher number.

The City did not address this discrepancy until our audit. We found nothing in the files to indicate that the engineering technician's concerns were addressed. The technician's words "under protest and duress" were unusual words to use when signing the California construction budget. As to the final budget approval which was not annotated with these words, the technician signed both budgets on the same day and each shows the same square footage cost.

Comment 10 The City's construction manager evaluates the development's hard costs by comparing them to costs on previous projects. As previously stated, the City's chart shows that prior developments' costs are lower than the developments addressed in our finding. This situation evidences the City's evaluation process is not effective. [See Comments 2, 3, 9 and 13]

Comment 11 The City indicates that it has a process to ensure, to the extent possible, that effort to advertise is made, but that advertising in the daily newspaper is not cost effective. Instead, they inform developers through listings on their website. We believe changes can be made which will make the process more competitive and, as such, more cost effective. For example the City could use a small ad in the daily newspaper directing the reader to the website. They do indicate a willingness to review the process and make improvements that address our concerns.

Comment 12 The City indicates that it has a process to ensure that the request for proposal states that the structure must be compatible with the neighborhood. They have not considered stipulating any further design requirements. They believe the developer should be allowed to use his design. We believe changes can be made which will make the process more competitive and, as such, more cost effective. For example, the City could indicate the square foot size, the number of stories and the number of bedrooms. The City has indicated a willingness to review the process and make improvements that address our concerns.

Comment 13 The City does not indicate that aldermanic approval or tax abatement will be provided in their request for proposals. Instead, it states that these may be obtainable. We believe changes can be made which will make the process more competitive and, as such, more cost effective. By obtaining the aldermanic approval and the tax abatement prior to the request for proposals, any potential developers would be able to submit proposals based on this additional information. The City has indicated a willingness to review the process and make improvements that address our concerns.