Issue Date March 20, 2009	
Audit Report Number 2009-PH-1007	

TO: Ronnie Legette, Director, Office of Community Planning and Development, Richmond Field Office, 3FDM

John P. Buck

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

SUBJECT: The City of Norfolk, Virginia, Did Not Ensure That Program Income Was Returned to Its HOME Program as Required

HIGHLIGHTS

What We Audited and Why

We audited the City of Norfolk's (City) HOME Investment Partnerships (HOME) program based on a request from the Community Planning and Development Division in the U.S. Department of Housing and Urban Development's (HUD) Richmond, Virginia, field office. Our audit objective was to determine whether the City properly administered its HOME program by following HUD requirements related to homebuyer assistance, modernization rehabilitation, and funds for community housing development organizations.

What We Found

The City generally followed HUD requirements related to homebuyer assistance, modernization rehabilitation, and funds for community housing development organizations. However, it did not properly monitor its subrecipient to ensure that about $288,700 in program income was returned to its HOME program as required. The City has since implemented adequate procedures for monitoring its subrecipients to ensure that this problem does not recur.

What We Recommend

We recommend that the Director of the Richmond Office of Community Planning and Development require the City to recover $288,728 in program income that was not properly returned to its HOME program or repay the amount to its program from nonfederal funds.

Auditee's Response

We discussed the audit results with the City and HUD officials throughout the audit and at an exit conference on February 27, 2009. The City provided written comments to our draft report on March 6, 2009. The City agreed with our finding and recommendation. The complete text of the City's response can be found in appendix B of this report.

TABLE OF CONTENTS

Background and Objective	4
Results of Audit	
Finding: The City Did Not Ensure That Program Income Was Returned to Its HOME Program as Required	5
Scope and Methodology	8
Internal Controls	9
Appendixes	
A. Schedule of Questioned Costs	11
B. Auditee Comments	12
C. Calculation of Program Income Due to the City’s HOME Program	13

BACKGROUND AND OBJECTIVE

The HOME Investment Partnerships Program (HOME) was created 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 to state and local governments designed exclusively 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, such as providing home purchase or rehabilitation financing assistance to eligible homeowners and new homebuyers and building or rehabilitating housing for rent and ownership. States may also use HOME funds for other reasonable and necessary expenses related to the development of non-luxury housing, including site acquisition or improvement, demolition of dilapidated housing to make way for HOME-assisted development, and payment of relocation expenses.

As a participating jurisdiction, the City of Norfolk (City) administers its HOME program through the Norfolk Redevelopment and Housing Authority (subrecipient). The City provided its subrecipient more than $11.1 million over a five-year period to administer its HOME program.

Program year	Grant amount
2003	$1,990,356
2004	$2,423,543
2005	$2,242,132
2006	$2,226,825
2007	$2,316,498
Total	**$11,199,354**

The City uses its HOME funds on the following activities:

- Homebuyer assistance
- HOME program Equity Secure (modernization/rehabilitation)
- American Dream Downpayment Initiative funds
- Community housing development organization operating assistance

In addition, the City uses 10 percent of its HOME funds for its administrative expenses.

Our audit objective was to determine whether the City properly administered its HOME program by following HUD requirements related to homebuyer assistance, modernization rehabilitation, and funds for community housing development organizations.

RESULTS OF AUDIT

Finding 1: The City Did Not Ensure That Program Income Was Returned to Its HOME Program as Required

The City did not adequately monitor its subrecipient to ensure that program income was returned to its HOME program as required. As a result about $288,700 in program income received from homes or properties that were refinanced or resold before the end of the required affordability periods was not available to provide other low-income families the opportunity to become homeowners. The City has since implemented adequate procedures for monitoring its subrecipients to ensure that this problem does not recur.

Program Income from Properties Refinanced or Sold Was Not Returned to the HOME Program as Required

Regulations identified in 24 CFR [*Code of Federal Regulations*] 92.254 require deed restrictions, land covenants, or other similar mechanisms to impose resale or recapture requirements and to ensure affordability periods related to HOME-assisted housing. Additionally, if a property is refinanced before the end of the affordability period, all or a portion of assistance must be returned to the participating jurisdiction, classified as program income. Affordability periods are identified as the minimum number of years, specified by HUD, that the home must be occupied by an income-eligible homeowner.

The City's subrecipient entered into an agreement with the Olde Huntersville Development Corporation (Olde Huntersville), a community housing development organization, to provide downpayment and closing cost assistance to qualified homebuyers. The agreement required Olde Huntersville to secure a deed of trust in the name of the subrecipient, as well as a promissory note payable to the subrecipient for each home purchase involving homebuyer assistance. The note payable would equal the greater of 25 percent of the sale price or the difference between the fair market value of the home and the amount affordable for the family, plus the closing cost and downpayment assistance.

Olde Huntersville did not secure deeds of trust in the name of the subrecipient as required. Instead, it improperly secured deeds of trust in its own name and improperly kept program income from homes refinanced. We identified 37 homebuyer assistance loans that the subrecipient discovered were inactive before the end of the affordability periods. Our review of files and foreclosure information for the 37 homebuyers that received about $635,300 in downpayment assistance through Olde Huntersville from 1994 through 2001 showed that it improperly secured deeds of trust in its own name for all 37 loans. It also failed to remit to the subrecipient proceeds from 23 of the homes that were refinanced for equity or sold before the end of the required affordability periods. Of the 37 cases reviewed, Olde Huntersville received note payoffs for 23 homes, and 14 were foreclosed on. There were no proceeds available after the sale of the 14 foreclosed homes to cover the amount owed to the HOME program for those loans that did not meet the affordability periods. However, we estimated that about $288,700 (see appendix C) should have been remitted to the subrecipient by Olde Huntersville for the 23 homes that were refinanced for equity or sold before the end of the required affordability periods. Olde Huntersville only received about $245,200 in proceeds for those homes because it underestimated the amount of the payoffs. Instead of remitting the proceeds it received to the subrecipient for return to the HOME program as required, it improperly retained the proceeds.

The City and Its Subrecipient Did Not Perform Adequate Monitoring

The City did not perform adequate monitoring to ensure the return of proceeds or program income from home sales to its HOME program. As a result, Olde Huntersville improperly put deeds of trust in its own name and did not remit home sales proceeds to the subrecipient as required. The subrecipient was first alerted to the issue in July 2005, when homeowners called to request guidance after receiving letters informing them of refinancing restrictions. In one case, the subrecipient learned that the homeowner had refinanced and that the payoff was made to Olde Huntersville.

Upon learning that Olde Huntersville did not remit program income as required, the subrecipient took action to limit its community housing development organizations' involvement in the HOME program to prevent the situation from recurring. These organizations are currently limited to developing affordable housing for sale to low-income families approved by the subrecipient to receive downpayment assistance. The subrecipient accepts and approves all applications from prospective homeowners, verifies income eligibility, determines downpayment assistance based on income, provides financial seminars for homeowners, helps homeowners obtain preapproval from lenders, and obtains deeds of trust in its name. Olde Huntersville ceased to participate in the City's HOME program in February 2002.

The City's annual action plan, incorporated into its most recent consolidated plan submitted to HUD, states that it has developed comprehensive guidelines for subrecipient monitoring using HUD monitoring forms as a guide. The City provided a copy of its monitoring template/checklist for its HOME program, as well as its most recent monitoring report on the subrecipient. The City also recently included a provision in its agreement with its subrecipient requiring the subrecipient to perform monitoring of HOME program subrecipients and provide copies of its monitoring reports to the City within 30 days of its monitoring activities.

Conclusion

The City failed to ensure that its HOME program was administered in accordance with applicable requirements because it did not adequately monitor its subrecipient. Also, its subrecipient did not monitor its community housing development organization to ensure its compliance with HOME program requirements. As a result, more than $288,700 in program income from properties that were refinanced or sold before the required affordability periods was not returned to the City's HOME program and, therefore, not available to provide other low-income families the opportunity to become homeowners. The City and its subrecipient have taken the necessary steps to help prevent further instances of noncompliance; however, the City must recover the program income that was not properly returned to its HOME program or repay the amount to its program from nonfederal funds.

Recommendation

We recommend that the Director of the Richmond Office of Community Planning and Development

1A. Require the City to recover $288,728 in program income that was not properly returned to its HOME program or repay the amount to its program from nonfederal funds.

SCOPE AND METHODOLOGY

We performed our audit at the City's subrecipient's offices from June to November 2008. The subrecipient is located at 201 Granby Street, Norfolk, Virginia. Our audit covered the period July 1, 2002, through June 30, 2008. However, we extended the period as necessary to achieve our audit objective.

We relied on data from HUD's Integrated Disbursement and Information System reports. We traced the information found in the reports to actual file documents and found the data to be sufficiently reliable to meet our audit objective.

To accomplish our objective, we reviewed

- Applicable laws, regulations, agreements between the City and its subrecipient, agreements between the subrecipient and its community housing development organizations, and HUD program requirements at 24 CFR Part 92.
- The subrecipient's accounting records, audited financial statements for 2006 and 2007, policies and procedures, and organizational chart.
- HUD's monitoring reports for the subrecipient.
- Homeowner files and foreclosure information for all loans (37) that the subrecipient discovered were inactive before the end of the affordability periods. The homeowners collectively received $635,322 in downpayment assistance loans from the City's HOME program from 1994 to 2001.
- Files for 25 of 452 low-income families that received downpayment assistance loans to determine compliance with HUD guidelines.
- Files for 10 of 68 homeowners that received modernization/rehabilitation assistance to determine compliance with HUD guidelines.
- Funding for community housing development organizations to determine whether funds were spent in a timely manner and for eligible activities.

We also interviewed employees of the City and its subrecipient as well as HUD staff.

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 finding and conclusion based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our finding and conclusion 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 controls are achieved:

- Program operations,
- Relevance and reliability of information,
- Compliance with applicable laws and regulations, and
- Safeguarding of assets and resources.

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

Relevant Internal Controls

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

- Program operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.

- Validity and reliability of data – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.

- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

  We assessed the relevant controls identified above.

A 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 that the following item was a significant weakness:

- Lack of monitoring on the part of the City and its subrecipient to ensure that program income from homes refinanced or sold was returned to the HOME program as required.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/
1A	$288,728

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local policies or regulations.

Appendix B

AUDITEE COMMENTS

City of Norfolk
Office of the City Manager

March 6, 2009

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

Via Email: jbuck@hudoig.gov

Dear Mr. Buck:

Thank you for the opportunity to respond to the draft report presented to the City and staff from the Norfolk Redevelopment and Housing Authority (NRHA) our subrecipient on February 28, 2009. Norfolk's efficient Administration of the HOME program continues to be at the forefront of our priorities as we provide a response to your office on this Draft OIG Report. In order to protect the HOME program from further instances of programmatic losses the City of Norfolk has implemented mechanisms to avoid future occurrences, and we appreciate the recognition of this implementation in your draft document.

Norfolk agrees with the finding as stated, that program income from properties refinanced or sold were not returned to the HOME program as required. Loan payoffs in the amount of $288,727.77 were not obtained by our subrecipient, NRHA as required by contract terms. Further, the City acknowledges that it did not adequately monitor the activities of NRHA and its administration of the HOME Program during the time when this issue occurred from 2002 to 2005.

As such the resulting program income was not used in a manner consistent with grant requirements. The Olde Huntersville Development Corporation collected $245,249.49 in loan proceeds of which 43,478.28, was not received. Consequently, the City agrees that the total amount of unforgiven payoff balances related to these loans that should be returned to the HOME program is $288,727.77.

We further concur with the recommendation of repayment to which we offer the following proposal for to meet the requirements of Recommendation 1A:

> The City acknowledges that a repayment of these funds much be obtained from non-federal sources. In the coming weeks, the City will work with staff from HUD's Richmond Field Office to determine an appropriate repayment strategy. The City is ready to execute the appropriate measures to resolve this issue in a timely manner to ensure confidence can be restored to the HOME program and its staff.

Again, we appreciate the time your office has given the City to complete this review. We remain, committed to the highest level of standards in all of our HUD program activities. Should you have further questions please do not hesitate to contact my office directly at (757)664-4242.

Sincerely,

Regina V.K. Williams
City Manager

C: Norfolk City Council
Norfolk Redevelopment & Housing Authority

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Appendix C

CALCULATION OF PROGRAM INCOME DUE TO THE CITY'S HOME PROGRAM

Loan Number	Settlement date	HOME loan amount	Date sold or refinanced*	Years until 20th anniversary	Program income due**
1188	12/07/1999	$18,720.00	07/14/2004	16	$14,976.00
995	12/15/1998	$14,986.93	10/12/2004	15	$11,240.20
636	05/01/1998	$19,900.00	11/25/2003	15	$14,925.00
225	05/25/1995	$16,660.00	12/31/2002	13	$10,829.00
214	05/03/1994	$9,400.00	03/29/2002	13	$6,110.00
1155	09/30/1999	$18,600.00	10/21/2002	17	$15,810.00
215	03/29/1994	$16,700.00	04/21/2004	10	$8,350.00
1063/1064	04/28/1999	$14,683.87	08/13/2003	16	$11,747.10
1228	01/03/2000	$15,090.70	09/05/2003	17	$12,827.10
1340	05/26/2000	$14,180.88	07/09/2004	16	$11,344.70
238	10/01/1996	$18,361.60	04/28/2004	13	$11,935.04
241	10/31/1996	$22,118.26	06/14/2004	13	$14,376.87
234	04/12/1996	$20,750.00	06/07/2005	11	$11,412.50
220	12/16/1994	$19,676.93	06/30/2004	11	$10,822.31
228	10/23/1995	$18,475.00	01/09/2004	12	$11,085.00
501	05/23/1997	$27,750.00	04/19/2005	13	$18,037.50
222	01/30/1995	$14,332.50	01/19/2005	11	$7,882.88
254	06/06/1997	$25,111.22	11/08/2004	13	$16,322.29
571	12/19/1997	$19,794.36	11/26/2003	15	$14,845.77
230	02/16/1996	$14,500.00	11/18/2002	14	$10,150.00
218	10/12/1994	$23,093.71	12/03/2002	12	$13,856.23
239	8/20/1996	$22,372.94	02/23/2004	13	$14,542.41
1581	04/19/2001	$17,000.00	01/23/2004	18	$15,300.00
TOTAL					**$288,727.89**

***** The schedule above does not include 14 loans which were foreclosed on because there were no proceeds after the sale of those homes to cover the funds due for the loans that did not meet the affordability period. The affordability period for each loan was 20 years and the loan amounts provided were forgiven at a rate of five percent per year.

****** The program income due was calculated by dividing the HOME loan amount by 20 years (affordability period for each loan), and multiplying the result by the number of years remaining from the date the loan was sold, refinanced, or closed to the twentieth anniversary.