Issue Date	November 23, 2009
Audit Report Number	2010-BO-1002

TO: Robert L. Paquin, Director, Office of Community Planning and Development, Boston Regional Office, 1AD

FROM: John A. Dvorak, Regional Inspector General for Audit, Boston Region, AGA

SUBJECT: The City of Holyoke, Massachusetts, Office of Community Development, Needs to Improve Its Administration of HOME- and CDBG-Funded Housing Programs

HIGHLIGHTS

What We Audited and Why

We audited the HOME Investment Partnerships Program (HOME) - and Community Development Block Grant (CDBG)-funded housing programs administered by the City of Holyoke's Office of Community Development (City) as part of our annual audit plan. The City was selected based upon our analysis of risk factors relating to HOME grantees in Region 1.

Our objective was to determine whether the City properly administered its HOME- and CDBG-funded housing programs in compliance with U.S. Department of Housing and Urban Development (HUD) requirements. Specifically, we wanted to determine whether the City awarded contracts for its HOME Development program in accordance with HOME and federal requirements. In addition, we wanted to determine whether the City adequately monitored its CDBG-funded Rental Neighborhood Improvement program and the subrecipient that administers this program.

What We Found

The City did not always award its HOME Development program contracts in accordance with federal requirements. Specifically, it did not obtain or prepare adequate cost estimates or conduct required cost analysis before it awarded $2.6 million in funds for three noncompetitive construction contracts. Construction cost estimates developed during the audit showed that expenditures claimed by the developer for the construction of the duplex units were an average of 14 percent higher than the construction cost estimates.[1] Additionally, all HUD assistance was not properly considered during the City's evaluations of project total development costs for duplexes developed as part of the HOME Development program. Lastly, the HOME investments subject to recapture were incorrectly calculated so that $344,178 would not be recaptured if the homeowners did not reside in the HUD-funded duplexes for the entire 15-year affordability period.

Additionally, 67 percent of the loans (26 of 39) processed under of the HUD-funded Rental Neighborhood Improvement program[2] went to properties that were owned by either the subrecipient (Olde Holyoke Development Corporation) or a second, related nonprofit, Contemporary Apartment Inc. (Contemporary Apartments). The subrecipient also did not treat related and nonrelated loans consistently regarding use of contracts, enforcement of timetables for completion, accrual of interest on advances, or project record keeping. In addition, (1) related party rehabilitation was not completed in a timely manner, (2) appropriate reviews and approvals of the projects were not made for all loans before committing the funds, (3) the subrecipient did not secure all program investments to related party loans, and (4) not all project records were maintained in accordance with record-keeping requirements.

Further, the City allowed the subrecipient to use program funds totaling $332,105 in the form of "grants." These grants were used for demolition activities which did not meet the Rental Neighborhood Improvement program's objectives[3] and were not carried out in compliance with the CDBG program.

What We Recommend

We recommend that the Director of the Office of Community Planning and Development require the City to establish appropriate internal controls over the

[1] Totaling $288,000 for seven duplexes.
[2] Since program inception in 1977.
[3] The objective of Rental Neighborhood Improvement program is "to make grants/or loans to owners of multi-unit rental properties to finance eligible improvements, repairs and rehabilitation of the rental properties."

HOME procurement process, including the segregation of duties so that the process is not entirely controlled by one person. We also recommend that the City repay $288,000 in unreasonable construction costs paid under the HOME Development program. Additionally, we recommend that HUD and the City conduct an independent cost analysis for the 2008 procurements to ensure that HOME and CDBG program expenditures of more than $1 million were reasonable and supported. For the unreasonable amounts, the City should reimburse the HOME/CDBG program from nonfederal funds.

Finally, we recommend that the Director of the Office of Community Planning and Development review the revised subrecipient contract for the Rental Neighborhood Improvement program to ensure that it contains appropriate controls, particularly when related parties are involved. These increased controls will ensure that HUD funds used for future related-party activities will be properly spent with appropriate performance measures in place, resulting in more than $1.7 million in funds put to better use for activities properly approved and overseen by independent parties.

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

Auditee's Response

We provided City officials with a draft audit report on October 23, 2009, and requested a response by November 3, 2009. We also provided and discussed preliminary results during the course of the audit, including on July 1 and July 9, August 5, and September 2, 2009. We held an exit conference with City officials on October 27, 2009, to discuss the draft report, and we received their written comments on November 2, 2009. The City agreed/disagreed with the facts, conclusions, and recommendations, as noted.

The complete text of the auditee's response, along with our evaluation of that response, can be found in Appendix B of this report.

TABLE OF CONTENTS

BACKGROUND AND OBJECTIVE

Congress created the HOME Investment Partnerships Program (HOME) in Title II of the Cranston-Gonzalez National Affordable Housing Act of 1990. Under the HOME program, the U.S. Department of Housing and Urban Development (HUD) allocates funds to eligible state and local governments for the purpose of (1) expanding the supply of decent, safe, and affordable housing for very low-income and low-income Americans and (2) strengthening public-private partnerships in the production and operation of such housing. The HOME program gives participating jurisdictions discretion over which housing activities to pursue. These activities may include acquisition, rehabilitation, new construction, and resident-based rental assistance. In addition, participating jurisdictions may provide assistance in a number of eligible forms, including loans, advances, equity investments, and interest subsidies. Up to 10 percent of the HOME funds received by a participating jurisdiction may be used to administer the program.

Congress created the Community Development Block Grant (CDBG) in Title I of the Housing and Community Development Act of 1974. This program is designed to develop viable urban communities by providing decent housing, a suitable living environment, and expanding economic opportunities, principally for persons of low and moderate income. Recipient communities, such as cities, may undertake a wide range of activities directed toward neighborhood revitalization; economic development; and community services, facilities, and improvements. Cities develop their programs and set their funding priorities in conformance with the statutory standards, program regulations, and other federal requirements. One of several activities that can be carried out with CDBG funds is the rehabilitation of residential and nonresidential structures. Community-based development organizations may carry out neighborhood revitalization, community economic development, or energy conservation activities. Each CDBG-eligible activity must meet one of three national objectives: benefit low- and moderate-income persons, aid in the prevention or elimination of slums or blight, or meet other community development needs having a particular urgency that the grantee is unable to finance on its own.

The City of Holyoke, Massachusetts (City), through its Office of Community Development, receives both HOME and CDBG funds. For the HOME program, the City is the lead city in a consortium of three cities called the Holyoke-Chicopee-Westfield consortium. For CDBG, the City receives its funds directly from HUD.

Year	CDBG	HOME[4]
2006	$1,130,743	$597,033
2007	$1,122,415	$593,635
2008	$1,085,209	$572,990

Each year, the City reports its planned activities and accomplishments to HUD through an annual plan and a consolidated annual performance and evaluation report. These documents identify the City's priorities, the methodology that the City intends to use to accomplish its priorities, and the

[4] The HOME funds in this table represent only the City's share of the consortium's funds.

City's accomplishments. Its first five priorities addressed homeownership, rehabilitation of owner-occupied housing, home-buyer assistance, creation of elderly housing, and rental housing rehabilitation.

Our audit focused on the City's housing programs, in particular, its homeownership program and rental housing rehabilitation.

Our audit objective was to determine whether the City properly administered its HOME- and CDBG-funded housing programs in compliance with HUD requirements. Specifically, we wanted to determine whether the City awarded contracts for its HOME Development program in accordance with federal procurement requirements (24 CFR (*Code of Federal Regulations*) 85.36). In addition, we wanted to determine whether the City adequately monitored its CDBG-funded Rental Neighborhood Improvement program and the subrecipient that administers this program

RESULTS OF AUDIT

Finding 1: The City Did Not Have Adequate Internal Controls over Its Procurement Process for the HOME Development Program

The City did not award its HOME Development program contracts in accordance with HOME program or federal procurement requirements.[5] Specifically, it

- Improperly awarded $2.6 million for three noncompetitive contracts
- Allowed the developer to spend unreasonable amounts to construct duplexes.
- Did not properly consider all CDBG assistance during its subsidy-layering evaluations.
- Did not ensure that recapture provisions were correctly calculated.

These deficiencies occurred because the City did not adequately establish and implement appropriate internal controls over its HOME procurement process. As a result, it awarded contracts totaling $2.6 million that were not processed in a manner that provided full and open competition consistent with federal procurement requirements. In addition, it expended $288,000 in unreasonable costs and could not ensure that more than $1 million in costs for an ongoing project were reasonable. It also provided more than $900,000 in subsidies that exceeded locally adopted cost guidelines used to evaluate governmental assistance. Lastly, it did not ensure that $413,086 would be returned to the HOME program if the assisted homeowners sold the duplexes before the expiration of the affordability period.

Improper Award of $2.6 Million for Three Noncompetitive Contracts

In each of the past three years, the City had attempted to award its HOME Development project through a competitive request for proposal. Each year, only one company, Contemporary Apartments, Inc. (Contemporary Apartments), responded with a proposal.[6] Each year, the City awarded the contract to Contemporary Apartments. However, the City did not obtain or prepare cost estimates or conduct required cost analyses before it awarded the contracts. The

[5] The HOME program is governed by 24 CFR Part 92. In 24 CFR 92.505, the program requires participating jurisdictions to follow 24 CFR 85.36 for procurements made under the HOME program.

[6] The City improperly qualified Contemporary Apartments as a community housing development organization (CHDO). The City has a longstanding partnership with Contemporary Apartments and its related companies. The City's actions in improperly qualifying a CHDO were the subject of Office of Inspector General (OIG) Audit Report 2009 BO 1003, dated May 14, 2009.

nonprofit developer used the $2.6 million to build eight duplexes. The 2008 project, Allyn-Dwight Homes, was in process[7] as of October 2009 at a cost of $1,043,893.

Federal procurement regulations at 24 CFR 85.36(c) require competition. When a city has attempted solicitation from a number of sources and competition is determined inadequate, regulations allow a city to accept a sole source contract. However, regulations at 24 CFR 85.36(d) and (f) also require a city to conduct cost estimates and additional cost analyses to ensure that it obtains the best value for its funds. Specifically, a city must perform a cost analysis that verifies the proposed cost data and projections of the data and evaluates specific elements of costs and profits. The City performed some limited analyses for the proposed projects, but these analyses were not sufficient to ensure that the City received the best possible prices.

In addition, in 2006 and again in 2007, the City improperly gave the developer these funds to build duplexes on land that was not owned by the City or the developer. The City was attempting to seize a parcel of land for nonpayment of taxes. City rules require that parcels of land seized for nonpayment of taxes be offered to the general public for bidding.

Unreasonable Amounts Spent by Developer to Construct Duplexes.

The City did not receive the best possible construction prices for the seven duplexes built by the developer, Contemporary Apartments. Contemporary Apartments used an affiliate, Olde Holyoke Development Corporation (Olde Holyoke), to manage the construction of the duplexes. The duplexes, like the two duplexes shown below, are attractive buildings that provide one unit of homeownership and one unit of rental housing,[8] but the costs paid by the City exceeded independent estimates by an average of 14 percent.

[7] The project, Allyn-Dwight Homes, consists of three duplexes built on three separate parcels of land. As of June 2009, one of the three duplexes had been constructed.

[8] The same homeowners have occupied these homes since they moved in. The homeowners have maintained the buildings, which provide stability for the neighborhood.

The Office of Inspector General (OIG) brought in a specialist with expertise in estimating construction costs. This in-house specialist developed a construction cost estimate for each duplex using the plans and specification provided by the nonprofit developer. The expenditures to build the units exceeded our construction cost estimates by 7 to 19 percent. As a result, the City overpaid its developer $288,000 (14 percent).

Address	76-78 North East	80-82 North East	43-45 Ely	137-139 Center	108-110 Walnut	112-114 Walnut	109-111 Beech	Total/ average
Cost of duplex	$228,612	$224,315	$292,197	$314,840	$314,893	$314,893	$349,356	$2,039,106
OIG estimate	$212,593	$205,313	$254,894	$254,383	$264,024	$264,024	$294,942	$1,750,173
Difference	$16,019	$19,002	$37,302	$60,457	$50,869	$50,869	$54,414	$288,933
Percentage	7%	8%	13%	19%	16%	16%	16%	14%

The City could have used this $288,933 to build another duplex that would have provided another two units of needed, affordable housing. The City also has an ongoing project, Allyn-Dwight Homes, with this same developer to build three more duplexes at a cost of $1,043,893. Using the average overpayment of 14 percent, we project that $146,000 of the ongoing $1 million project may be unreasonable.

Subsidy-Layering Evaluations Did Not Include CDBG

HOME regulations at 24 CFR 92.250(b) require that the City conduct a subsidy-layering review of HOME projects using guidelines that it has adopted for this purpose. This review should ensure that the City will not invest more HOME funds, in combination with other governmental assistance, than necessary to provide affordable housing.

The City developed subsidy-layering guidelines, which were included in the annual request for proposal for its HOME Development program. These guidelines required the City to recognize all government funding in its calculations, but the City did not include all HUD funding in its calculations for subsidy layering. It did not recognize demolition expenditures as part of the total development cost of these projects.

Property	Original developer's cost	Demolition costs paid by federal funds	Revised developer's cost
76-78 North East Street	$228,612	$72,454	$301,066
80-82 North East Street	$224,315	$72,454	$296,769
45-47 Ely Street	$292,197	$163,685	$455,882
137-139 Center Street	$314,840	$0	$314,840
112-114 Walnut Street	$313,566	$0	$313,566
108-110 Walnut Street	$314,893	$0	$314,893
109-111 Beech Street	$349,356	$0	$349,356

The developer used funds from the Rental Neighborhood Improvement program to pay for these demolition expenses. Finding 2 discusses the Rental Neighborhood Improvement program and explains how these expenses were not appropriate under the program.

The City's established local cost guidelines provide that HUD funds, in combination with all other government assistance, shall not exceed the lesser of (1) the difference between the amounts borrowed by the buyer as a first mortgage and the lesser of the actual total development cost, (2) the total development cost cap, or (3) 210 percent of the amount borrowed by the buyer as a first mortgage.

The City allowed the developer to exceed the local guidelines by $974,453 as shown in the table below.

Property	Sales price to home-owner	Revised developer's cost	Cap	Revised developer's cost less 1st mortgage	Cap less 1st mortgage	210% of 1st mortgage	Over-subsidy per local guidelines
76-78 North East St.	$79,900	$301,066	$270,000	$221,166	$190,100	$167,790	$133,276
80-82 North East St.	$79,900	$296,769	$270,000	$216,869	$190,100	$167,790	$128,979
45-47 Ely St.	$99,900	$455,882	$318,000	$355,982	$218,100	$209,790	$246,092
137-139 Center St.	$99,900	$314,840	$318,000	$214,940	$218,100	$209,790	$105,050
112-114 Walnut St.	$109,900	$313,566	$318,000	$203,666	$208,100	$230,790	$109,900
108-110 Walnut St.	$109,900	$314,893	$318,000	$204,993	$208,100	$230,790	$109,900
109-111 Beech St.	$109,900	$349,356	$318,000	$239,456	$208,100	$230,790	$141,256
Total							$974,453

The City included the local guidelines in its request for proposals for new projects funded by the homeownership program. Because the City allowed one developer to exceed the local guidelines, this developer knew that the guidelines could be exceeded. This knowledge gave that developer a competitive advantage.

Recapture Amounts Incorrectly Calculated

To ensure that HUD-funded homes remain affordable, HOME regulations at 24 CFR 92.254 requires the City to add a contract provision to impose a resale or recapture requirement on each HUD-funded home. The City chose to recapture the HOME funds if the homeowner did not live in the HUD-funded duplex for the affordability period.

HUD regulations also allow cities to submit different recapture methodologies to HUD for approval.[9] If HUD approves that recapture methodology, HUD allows that city to use the approved methodology. The City submitted a modification to the recapture methodology. This modification allowed the City to use a deferred payment loan to recognize the recapture amount. HUD approved this modification.

The City used the deferred payment loan to recognize the amount of the HOME funds to be recaptured if the homeowner did not live in the HUD-funded duplex for the entire affordability period. The amount of recapture should be the

[9] 24 CFR 92.254(5)(ii)(A)

difference between the fair market value of the duplex and the sales price to the homeowner.[10]

However, the City allowed its developer to use a different recapture methodology. The developer created a second mortgage using a fixed amount that was only a portion of the difference between fair market value and the purchase price. This second mortgage was held by the developer.

Property address	Correct recapture provision	Deferred payment loan	Unrecognized recapture amount
112-114 Walnut Street	102,693	25,000	77,693
108-110 Walnut Street	102,693	25,000	77,693
109-111 Beech Street	73,700	25,000	48,700
45-47 Ely Street	61,100	21,000	41,100
137-139 Center Street	72,000	21,000	51,000
76-78 North East Street	62,700	21,000	41,700
80-82 North East Street	96,200	21,000	75,200
Totals	$571,086	$159,000	$413,086

The homeowners would receive the benefit of the City's error in incorrectly allowing the use of the developer's deferred loan amount of $159,000 as the recapture amount. The City recognized recapture amounts of $159,000 when the recapture amount should have been $571,086. The difference of $413,086 represents HOME funds that would have been lost initially had homeowners failed to reside in the HUD-funded homes for the entire affordability period. The City mistakenly believed that the reduced amount of the deferred payment loans had also been approved by HUD.

For these duplexes, the affordability period is 15 years. Federal regulations at 24 CFR 92.254 also allow the recapture amount to be proportionally reduced over the life of the affordability period. The City also uses this feature of the regulations. As a result, the unrecognized recapture amount of $413,086 should be reduced as the homeowners reside in their HUD-funded house over time.

Property	Unrecognized recapture amount or Difference	Date of sale to homeowner	Years of expiration Years between June 30, 2009, and date of sale	Expired amount (Difference/ 15 years * years of expiration)	Outstanding liability as of June 30, 2009 (Difference - expired amount)
112-114 Walnut St.	$77,693	July 9, 2008	0.97	$5,048	$72,645
108-110 Walnut St.	$77,693	Nov. 25, 2008	0.59	$3,077	$74,616

[10] 24 CFR 92.254(5)(ii)(A)(5)

109-111 Beech St.	$48,700	July 9, 2008	0.97	$3,164	$45,536
45-47 Ely St.	$41,100	Aug. 29, 2007	1.84	$5,034	$36,066
137-139 Center St.	$51,000	Dec. 28, 2006	2.51	$8,517	$42,483
76-78 North East St.	$41,700	Nov. 14, 2003	5.63	$15,641	$26,059
80-82 North East St.	$75,200	Oct. 29, 2003	5.67	$28,426	$46,774
Totals	**413,086**	**n/a**	**n/a**	$68,908	$344,178

If the homeowners discontinue their residency in their HUD-funded homes before the affordability period expires, the City should repay the HOME program. As of June 30, 2009, the contingent liability to the HOME program was $344,178. This liability should be further reduced for each additional year that the homeowners reside in their HUD-funded home. As of June 2009, the homeowners all continued to reside in their HUD-funded homes. Annually, the City must report to HUD about its recapture methodology. In the annual plans, the City described the deferred payment loans. The annual plans did not identify that the amount of the deferred payment loans was less than the difference between fair market value of the duplexes and the sales price to the homeowners.

Allowing one developer to use a nonstandard recapture provision may be considered an arbitrary action in the procurement process. Arbitrary actions in the procurement process are considered to be restrictive of competition. Had the modified approach been included in the request for proposal, other potential bidders would have been aware of this "recapture option." This action may have affected the proposal process by discouraging additional proposals.

The City Had Begun Outreach to Other Entities

City officials stated that they had begun to reach out to other nonprofit entities and for-profit developers in the local area. As part of this outreach, the City was making these entities aware of the City's community development programs including the homeownership program. Increasing the competition for homeownership funds can help the City to address the issues identified.

Conclusion

The City needs to improve its award process and administration and oversight of its HOME- and CDBG-funded housing programs. Therefore, it needs to revise its procurement process for its HOME Development program to

- Encourage open competition,

- Ensure that it has proper analysis of costs,
- Recognize and address unreasonable expenditures,
- Include demolition costs in its subsidy-layering calculations,
- Correctly calculate the subsidy-layering amounts, and
- Properly recapture funds if families do not reside in the housing for the entire affordability period.

Because it lacked sufficient controls in these areas, the City paid $288,933 in unreasonable construction costs and could not ensure the reasonableness of an ongoing $1 million project. With sufficiently detailed cost analyses, the City could avoid this situation. It also provided $974,453 in excess subsidies and could lose up to $344,178 if assisted homeowners leave the duplex units before the expiration of the affordability period. Finally, its procurement practices restricted free and open competition

Recommendations

We recommend that the Director of the Office of Community Planning and Development in Boston

1A. Evaluate the City's local cost guidelines to determine the reasonableness and propriety of the guidelines for each of the subject years, and direct the City to make any needed changes to its guidelines for future HOME activity.

1B. Require the City to use sole source procurement procedures when only one company responds in accordance with HOME requirements.

1C. Evaluate the improperly awarded $2.6 million in awards and work with the City to determine what actions are needed to ensure future awards are in accordance with HOME requirements.

1D. Work with the City to develop a repayment plan for the $288,933 in unreasonable costs and have the City repay these funds. To the extent allowed under law, funds should be repaid to the HOME program for use in additional HOME projects.

1E. Work with the City to develop detailed cost analyses for the ongoing 2008 Allyn-Dwight Homes project and have the City reduce costs to reasonable amounts based on these analyses. Using the 14 percent average, we estimate the future cost savings to be $146,145.[11]

[11] The Allyn-Dwight project is budgeted at $1,043,893. $1,043,893 x 14% = $146,145

1F. Direct the City to develop detailed cost analyses, if needed, for the 2009 City projects and evaluate the procurement for 2009 City projects to ensure that the City procures projects at a reasonable price.

1G. Direct the City to establish a new protocol for routinely preparing detailed cost analyses, if needed, for all future homeownership projects.

1H. Direct the City to repay to the HOME program the excess subsidy of $974,453 based on the City's guidelines. For the closed grants, the funds should be repaid to HUD. For the open grants, the funds should be repaid to the program.

1I. Evaluate the City's 2008 and 2009 contracts and ensure that the City used appropriate maximum subsidy guidelines, as provided in the local guidelines and request for proposals, in its 2008 and 2009 contracts; and require changes as needed.

1J. Direct the City to set up a contingency account representing the unfunded balances of $344,178; and to adjust the contingency account at least annually, as the affordability period expires.[12] These unfunded balances are due to the program if the eligible families dispose of or lose the property before the affordability period expires.

1K. Direct the City to appropriately change its recapture methodology for the three duplexes funded as the Allyn-Dwight project and any homeownership properties developed in the future.

1L. Direct the City to change the annual plans to reflect the revised recapture methodology to be used.

[12] The affordability period is 15 years.

RESULTS OF AUDIT

Finding 2: The Subrecipient That Administers the City's Rental Neighborhood Improvement Program Was Not Adequately Monitored

The subrecipient's[13] administration of the HUD-funded Rental Neighborhood Improvement Program was not adequately monitored by the City. Specifically, the City's monitoring failed to identify that the subrecipient

- Did not administer loans to related parties in the same manner as to nonrelated parties,
- Did not ensure that rehabilitation work funded by related-party loans was completed in a timely manner,
- Did not ensure that appropriate reviews and approvals of the projects were obtained for all loans before the commitment of funds,
- Did not secure all program investments for related-party loans,
- Did not ensure that all project records were maintained in accordance with HUD record-keeping requirements, and
- Used $332,105 for demolition costs that were not eligible expenses of the program.

These deficiencies occurred, in part, because several provisions of the contract between the City and the subrecipient were amended and revised over the years. These amendments and revisions gradually diminished the City's control of the program, and the responsibility for these controls was assumed by the subrecipient. At the same time that the controls shifted from the City to the subrecipient, participation in the program by nonrelated owners decreased, and participation by entities/companies related to the subrecipient increased. A majority of the loans were made to related parties, however, the program, as designed, did not include additional controls for related-party loans. While we found deficiencies in both types of loans, there was a greater frequency and dollar value to the deficiencies with the related party loans than with non related loans. Ultimately, performance deficiencies for related-party loans went undetected for years and were not appropriately addressed or corrected by the City. We estimate that program funds (current and projected) of $1.8 million as of June 30, 2009, are at risk for noncompliance unless the City increases its oversight of the subrecipient's management of program loans. Additionally, the City spent $332,105 on ineligible activities that did not meet the program objectives and were not carried out in compliance with CDBG program requirements.

A Majority of the Loans Were Made to Related Parties

Developed in 1977, the objective of the Rental Neighborhood Improvement program was to make grants or loans to owners of multiunit rental properties to

[13] The subrecipient is Olde Holyoke.

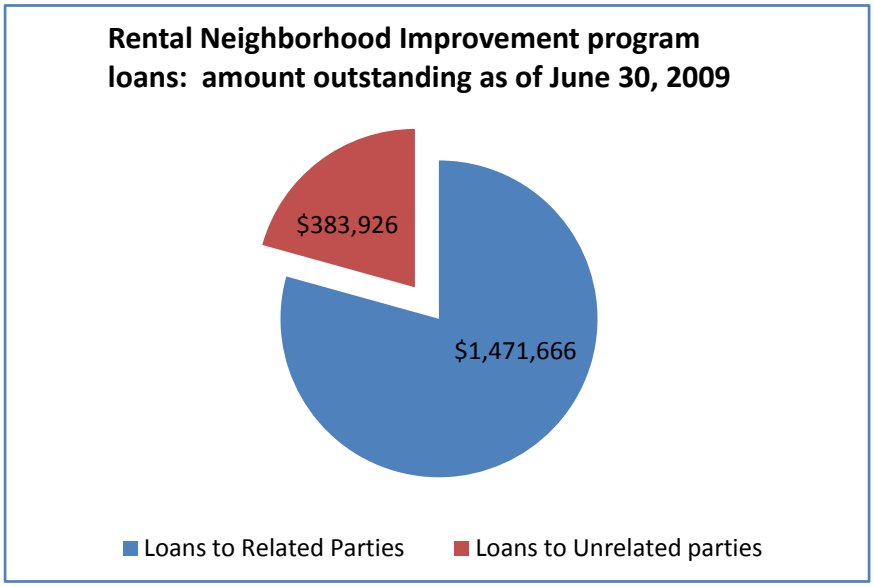
finance eligible improvements, repairs, and rehabilitation of the rental properties. Since the program's inception, the City has used a nonprofit subrecipient, Olde Holyoke, to administer the program.

Olde Holyoke

- Obtains applications,
- Inspects the properties to identify necessary work required to meet state code requirements,
- Reviews the loans,
- Evaluates the feasibility of the work,
- Reviews the credit history the applicant,
- Authorizes the loans,
- Examines completed work,
- Makes payments, and
- Administers the loan repayments.

Since the program began, the subrecipient has made 39 loans totaling more than $4.7 million. Of the 39 loans, 26 (or 67 percent) have been made for properties that were owned by either the subrecipient or its related nonprofit entity, Contemporary Apartments.

A majority of the loans outstanding as of June 30, 2009, were for properties that were owned by either the subrecipient or a second, related nonprofit. The total loan amount of program loans outstanding as of June 30, 2009, was more than $1.8 million. Outstanding loans to related parties represented 79 percent of the amount due as of June 30, 2009.



Although a majority of the program participants were related parties, the program, as of June 30, 2009, did not include additional controls for these related-party loans. Related-party activities were not carried out in compliance with CDBG regulations and contained several deficiencies.

The Subrecipient Did Not Treat All Loans in the Same Manner

Loans made to related and nonrelated parties were not treated consistently by the subrecipient regarding

- Enforcement of contracts,
- Timetables for completion,
- Accrual of interest on advances,
- Board review and approvals, and
- Project record keeping.

Specifically, loans made to nonrelated parties had to follow contracts, meet timetables for completion, and accrue interest on advances. Related-party loans were not required to meet these same standards. For loans to related parties, interest did not begin until project completion, which for some situations, was up to eight years. This treatment provided a disincentive for the related parties to complete the projects. If the related-party loans had been treated in the same manner as loans to nonrelated parties, the program would have earned an additional $22,522[14] in interest. This interest could have been used to further the Rental Neighborhood Improvement program.

Additionally, the files for loans to nonrelated parties contained rental regulatory agreements and work write-ups, and the loans were presented for approval by the board of directors. The files for related-party loans' records did not contain rental regulatory agreements, work write-ups, and permits for all work. At the time of our review, there were 10 outstanding loans for related parties and five outstanding loans for nonrelated parties. Of the 10 related-party loans, approvals for four of the loans were not recorded in the board minutes of the subreceipient. Additionally, the 10 loans to related parties were not recorded in the property records of the Hampden County Registry of Deed.

Related-Party Rehabilitation Work Was Not Completed in a Timely Manner

In general, the renovations funded by the loans to related parties took at least 30 months from the first advance to completion, with some renovations taking as long as three to eight years. Since loans for open projects (ongoing renovations) do not accrue interest, there was a disincentive to complete the renovations. Renovations funded by loans to nonrelated parties were generally completed within 18 months. For these loans, the loan agreements between the subrecipient and the nonrelated parties contained specific time completion requirements for renovations and contract provisions that prohibited work from lapsing for more than 15 days. The subrecipient strictly enforced these time completion requirements for loans to nonrelated parties.

Appropriate Reviews and Approvals of the Projects Were Not Made for All Loans

As noted, we determined that four of the ten outstanding loans made to related parties did not contain evidence of review and approval by the board of directors. Project summaries and board approvals were generally evidenced in the board minutes. The subrecipient could not provide evidence showing that these loans were reviewed by the board. Review and approval by the board is a requirement under the subrecipient agreement.

For one of the four loans, project activity R154, the subrecipient increased the funding four times, from an initial award of $35,000 in August 2006 to a total award of $150,000 as of August 2008. The gradual increase in the total amount of the loan over a two-year period rendered this loan agreement as essentially an open line of interest-free credit. This activity was still not finished as of June 30, 2009 (see appendix E).

The Subrecipient Failed to Secure All Related-Party Loans

When we began our review on December 1, 2008, none of the 10 related-party loans had been properly secured. To secure the loans, the lender (in this case the subrecipient acting for the City) records the loans in the property records of the local Registry of Deeds (Hampden County). This action safeguards the City if the loan recipient fails to repay the loan. After we notified the City of this discrepancy, the subrecipient took action to record these 10 related-party loans

between December 31, 2008, and June 9, 2009, thereby securing more than $1.5 million in related-party loans, however, two related-party mortgages had not been recorded as of May 20, 2009.

Project Records Were Not Maintained as Required

Project files for the related-party loans did not contain evidence of compliance with HUD record-keeping requirements at 24 CFR 570.506. The files did not include application submissions, evidence of federal procurement compliance, work write-ups, Davis Bacon compliance documentation, or permits for all work (see appendix E).

The Subrecipient Used $332,105 for Demolition

The subrecipient used $332,105 in Rental Neighborhood Improvement program funds to demolish existing buildings at three different parcels of land, which are not eligible activities under the program. The program objective is to finance for eligible improvements, repairs, and rehabilitation of rental properties. Demolition is neither repair nor rehabilitation of a rental property. In addition, the demolition activities were not carried out in compliance with the CDBG program rules governing

- Public participation[15] - The demolition activities were not specified in the annual action plans to HUD;
- Accurate and transparent reporting[16]- The demolition activities were not reported in the consolidated annual performance and evaluation reports to HUD;
- Environmental reviews[16]- One demolition activity did not have an environmental review, while another demolition activity's environmental review was based on misinformation regarding the source of funding;
- Displacement and relocation of tenants[17] - City records indicated that demolition activity R145 displaced 24 people, but the City/subrecipient relocated only one person; and

[15] 24 CFR 91.220
[16] 24 CFR 570.200(4)
[17] 24 CFR 570.606

- Conflicts of interest[18] - Contemporary Apartments, a related party of the subrecipient, financially benefited from demolition activity R151. A fire damaged a building owned by Contemporary Apartments. This related party received $303,000 in insurance proceeds. After the fire, the City allowed Olde Holyoke to use program funds totaling $163,685 to demolish the building. The City also allowed Olde Holyoke (as administrator for the program) to purchase the property for $16,300 from its related party, Contemporary Apartments. Our review of the records indicated that Contemporary Apartments was allowed to retain $199,000 in net insurance proceeds. Since Contemporary Apartments is a related party of Olde Holyoke, this transaction may have constituted a conflict of interest.

Two of these demolition activities were related to homeownership activities as discussed in finding 1. The associated costs were also not reported under the homeownership program or considered when ensuring that the City did not oversubsidize the properties (subsidy layering).

Program Controls Shifted from the City to the Subrecipient

The inadequate oversight in administering the Rental Neighborhood Improvement program occurred, in part, because of a shift in program controls from the City to the subrecipient. The subrecipient had administered the program since 1977. During that period, several contract provisions were amended and revised. These amendments and revisions had the effect of diminishing the City's control of the program.[19] These controls were assumed by the subrecipient.

During the initial years of the program, the City's building commissioner was responsible for making the initial determination of code deficiencies and noncompliance for project activities (buildings) that would enable the projects to be included in the program. As of June 30, 2009, the program agreement between the subrecipient and the City provided that the building must be in need of rehabilitation to comply with applicable codes of the Commonwealth of Massachusetts. Also, as part of the agreement, the subrecipient was required to review the list of code violations and determine whether there was sufficient justification for the project activity (building) to be included in the program.

[18] 24 CFR 570.611

[19] 24 CFR §570.501 - Responsibility for grant administration. (b) The recipient is responsible for ensuring that CDBG funds are used in accordance with all program requirements. The use of designated public agencies, subrecipient, or contractors does not relieve the recipient of this responsibility. The recipient is also responsible for determining the adequacy of performance under subrecipient agreements and procurement contracts, and for taking appropriate action when performance problems arise, such as the actions described in §570.910.

Since a majority of the loans by the subrecipient were made to related properties, the program did not have adequate controls to ensure that all items of noncompliance were appropriately addressed. Buildings, funded by project activities R147 and R154, underwent rehabilitation without the subrecipient obtaining the necessary permits. The funds were used for items such as roofs, moderate unit rehabilitation, and plumbing. Permits are required by local and state building codes to ensure that work is done properly and in compliance with state code requirements. Use of building permits provides independent inspection of rehabilitation work to ensure the safety of residents.

During the initial period of the program, the City solicitor required a certification that project investors had a marketable interest in the subject property. As of June 30, 2009, the agreement between the subrecipient and the City provided for the subrecipient's attorney to make such a certification. Since a majority of the loans were made for properties that were owned by either the subrecipient or its related nonprofit entity, the program did not have sufficient independent controls to ensure that an appropriate marketable interest was held.

During the initial period of the program, certain loan origination functions were assigned to local cooperating banks. As of June 30, 2009, these loan origination functions had become the responsibility of the subrecipient. Since a majority of the loans were made for properties that were owned by either the subrecipient or its related nonprofit entity, the program did not have sufficient independent controls to ensure the veracity and accuracy of the loan origination information.

During the initial period of the program, the City monitored Davis-Bacon compliance activity. The Davis-Bacon Act of 1931 is a federal law which established the requirement for paying prevailing wages on public works projects. All federal government construction contracts and most contracts for federally assisted construction over $2,000 must include provisions for paying workers the locally prevailing wages and benefits paid on similar projects. As of June 2009, the subrecipient was responsible for monitoring Davis-Bacon compliance activity. We determined that the subrecipient did not maintain complete supporting documentation to demonstrate compliance with Davis-Bacon requirements. This documentation would include evidence that wages and certified payrolls were reviewed and interviews were held to ensure that proper wages were paid.

During the initial period of the program, a five-member financial review board consisting of local bank officers independently reviewed the projects. As of June 30, 2009, the subrecipient's board of directors acted as the financial review board for the projects included in the program. As noted, four of the ten related-party loans were not reviewed by this board.

There Was a Risk of Noncompliance Due to Deficiencies and Lack of Controls

As of June 30, 2009, the total of the loans outstanding and the cash balance available was more than $2.6 million.[20] Based on the deficiencies noted in this finding, we estimate that at least 67 percent of the total program funds of $2.6 million (current and projected use) totaling more than $1.7 million, are at risk for noncompliance. The estimate of 67 percent represents the percentage of the total program loans made to related parties since program inception. As of June 30, 2009, this percentage had remained consistent throughout the program for 32 years. The deficiencies noted in this finding were concentrated, almost exclusively, on the related-party loans issued by the subrecipient under the program. Until the City takes corrective action to address the deficiencies cited in this finding, the deficiencies will continue to exist, and the program funds will be at risk.

New Loan Protocols Were Being Developed

In response to initial results communicated to the City during the audit, the City began to develop new protocols for loans to related parties. These protocols involve additional layers of review by City employees who are independent of the subrecipient's organization. The City intended to add these protocols to the next agreement for the program. The agreement in place as of June 2009 will expire December 31, 2009. Properly implemented, the independent layers of review can help the City to address the issues identified and help to ensure that future program-funded activities are conducted in compliance with HUD regulations and completed in a timely manner without performance deficiencies.

Conclusion

The City allowed controls over the Rental Neighborhood Improvement program to shift from the City to the subrecipient. These changes in the control environment of the program led directly to the performance deficiencies noted for loans to related parties. These deficiencies went undetected for years and, therefore, were not appropriately addressed or corrected by the City. As a result

[20] The total amount of Rental Neighborhood Improvement program loans outstanding was more than $1.8 million, and the total cash balance available for the program, as shown in the subrecipient's (Olde Holyoke) bank accounts, was $778, 049 totaling more than $2.6 million.

of the deficiencies that occurred and the lack of proper internal controls that caused them, we estimate that as of June 30, 2009, program funds (current and projected) of more than $1.7 million are at risk for noncompliance. In addition, the program lost more than $22,000 in forfeited interest and incurred $332,105 for demolition activities that were not eligible program expenses.

Recommendations

We recommend that the Director of the Office of Community Planning and Development in Boston

2A. Review the proposed changes to the Rental Neighborhood Improvement program (RNIP) agreement to ensure that the agreement contains appropriate independent controls for oversight and monitoring of program activities by the City, and require the City to make any changes needed. This action will ensure funds are spent appropriately and result in $1,764,540[21] in initial RNIP funds being put to better use.

2B. Direct the City to repay $22,522 in forgone interest to the RNIP fund.

2C. Determine necessary action to ensure that the City's program objective accurately reflects CDBG authorized activities, and to ensure demolition is not funded using RNIP funding.

2D. Require the City to repay to the program the $332,105 improperly used for demolition activities that are not eligible under RNIP from other funds.

[21] $1,764,540 represents the outstanding balance of $2,633,642 multiplied by 67%, the percentage of loans to related parties. We used the percentage of loans to related parties because our review found a greater frequency of occurrence and a larger dollar impact for the problems with loans to related parties.

SCOPE AND METHODOLOGY

We performed an audit of the housing activities funded under the CDBG and HOME programs as administered by the City. Specifically, we examined the City's HOME Development and Rental Neighborhood Improvement programs. Our fieldwork was completed at the City's Office of Community Development located at City Hall Annex, 20 Korean Veterans Plaza, Holyoke, Massachusetts, and the offices of Olde Holyoke, 70 Lyman Street, Holyoke, Massachusetts, from March to August 2009. Olde Holyoke is colocated with its related nonprofit, Contemporary Apartments. Our audit generally covered the period July 2006 to June 2009 and was extended when necessary to meet our objective. This extension included a review of the Rental Neighborhood Improvement program for the 10-year period from 1999 to 2009 and a HOME Development project, J. Albert Homes II, completed in 2003.

To accomplish our audit objective, we

- Reviewed applicable CFR sources, Office of Management and Budget circulars, HUD handbooks/guidebooks, and HUD notices pertaining to the HOME and CDBG programs.
- Reviewed the City's draft policies and procedures and held discussions with City officials to gain an understanding of the City's accounting controls, procurement practices, and monitoring policies.
- Reviewed independent public audit reports as well as HUD monitoring reviews.
- Evaluated the internal controls and conducted sufficient tests to determine whether controls were functioning as intended.
- Reviewed the annual action plans and consolidated annual performance and evaluation reports submitted to HUD to identify activities, programs, and procedures that were inaccurately described in the plans and reports.
- Evaluated the City's HOME procurement practices through a review of procurements under the HOME Development program. The population is one new project per year, totaling three projects in our three-year audit period. These three projects funded eight duplexes. As of June 2009, five duplexes were complete, and three duplexes were being built. We opted to use a 100 percent selection because the universe is small and the impact of each unit is large. We also decided to add J. Albert Homes II, a 2002 project, because of its inherent relationship with the demolition activities funded under the Rental Neighborhood Improvement program. J. Albert Homes II consisted of two completed duplexes.
- Evaluated loans and grants funded by the Rental Neighborhood Improvement program. Based on our initial testing, we decided to review 100 percent of the activities. This change meant that we reviewed three additional loans not previously selected. These three loans were made to nonrelated projects.
- Obtained and reviewed project files maintained by Olde Holyoke, including applications, cost support files, invoices and contracts, general ledgers for July 1999 to June 2009, funding activity notification letters, Olde Holyoke board minutes for the period January

2000 to February 2009, and Contemporary Apartments board minutes for the period January 2000 to February 2009.

- Reviewed applicable land records from Hampden County Registry of Deeds.
- Tested disbursements for each activity by (1) reviewing lists of disbursements that made up the loan amount; (2) reviewing land records; (3) reviewing Olde Holyoke Rental Neighborhood Renewal program project files to determine work performed; (4) reviewing Olde Holyoke Rental Neighborhood Improvement program files to determine whether files met federal requirement for record keeping, Davis-Bacon compliance, procurement, and permits; (5) reviewing City building department records to gain information for comparison purposes; (6) reviewing borrower funding notification letters from Olde Holyoke to the City for accuracy; (7) reviewing whether disbursements were supported by invoices, contracts, and proposals; and (8) identifying the existence of rental rehabilitation loan agreements and whether the agreements contained time completion provisions. We also reviewed the three grants.
- Examined the various initial Rental Neighborhood Improvement program agreements, amendments, and scopes of services as executed between the City and Olde Holyoke from the initial contract in 1977 to the present contract in 2009.

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 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 objective:

- Internal controls with regard to the HOME Development program procurement process
- City oversight and management of the Rental Neighborhood Improvement program

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 items are significant weaknesses:

- Internal controls with regard to the HOME Development program procurement process
- City monitoring and management of the Rental Neighborhood Improvement program.

APPENDIXES

Appendix A

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

The audit identified questioned costs totaling $3,872,876 as follows:

Recommendation number	Ineligible 1/	Unreasonable or unnecessary 2/	Funds to be put to better use 3/
1C			
1D		$288,933	
1E			146,145
1H	$974,453		
1J			$344,178
2A			$1,764,540
2B			$22,522
2D	$332,105		
Totals	**$1,306,558**	**$288,933**	**$2,277,385**

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

2/ Unnecessary/unreasonable costs are those that are not generally recognized as ordinary, prudent, relevant, and/or necessary within established practices. Unreasonable costs exceed the costs that would be incurred by a prudent person in conducting a competitive business. A legal opinion or administrative determination may be needed on these costs.

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. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures, and any other savings that are specifically identified. In this case, (1) the potentially unreasonable costs of $146,145 for the ongoing duplex homeownership activity will be better spent for reasonable costs, (2) the $344,178 in unsecured/unrecognized HOME investments subject to recapture contingency will be appropriately funded, (3) $1,764,540 will be expended in accordance with CDBG regulations, and appropriate project performance will be achieved. Lastly, interest of $22,522 due to the program will be used to further the program objectives.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

Comment 1

COPY

Mayor Michael J. Sullivan
City of Holyoke

William H. Murphy, Administrator
Office for Community Development

October 30, 2009

John A. Dvorak
Regional Inspector General for Audit
U.S. Dept. of HUD – Office of the Inspector General for Audit
10 Causeway Street
Room 370
Boston, MA 02222-1092

Dear Mr. Dvorak,

Please accept this correspondence as the City of Holyoke's formal written response to your Agency's draft report 2010-BO-100X as received on October 23, 2009 and discussed at the exit conference October 27, 2009.

Finding 1: The City Did Not Have Adequate Internal Controls Over Its Procurement Process for the HOME Development Program

The City disagrees with the finding generally and disagrees specifically with each of the four subparts thereof.

Recommendation 1A: We agree to a CPD review of the local cost guidelines.

Recommendation 1B: We disagree with the conclusion that cost analyses and related determinations required at 85.36 (d)(4)(i-iii) were not properly done. The competitive proposal RFP contains the City's estimate of the cost of providing decent, affordable, non-luxury housing based on 2.5 bedrooms/unit. The housing proposed in response to the RFP is compared with the City's estimate, as well as to the proposed and actual costs incurred by the same and other developers of similar housing produced in the market area. The cost elements are reviewed to verify accuracy and reasonableness. The City sees no requirement that the independent cost estimate, or the cost analysis, be done by a third party. We can provide HUD with a detailed description of the steps taken in our analysis.

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Birthplace of Volleyball

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

Comment 2

Recommendation 1C: We disagree that $2.6M was improperly awarded. See 1B above.

Comment 3

Recommendation 1D: We disagree that the city should pay back what the auditors term unreasonable costs because we disagree with the "book" cost estimates provided by the OIG appraiser. It is unclear whether the OIG book appraisals include Energy Star upgrades. We can demonstrate to HUD the real cost of home construction in the area, using HUD dollars, and which HUD can verify. The unit cost of constructing these Energy Star compliant duplex homes in Holyoke is below average for the Springfield-Holyoke-Chicopee metropolitan area.

Comment 4

Recommendation 1E: We disagree. Cost analyses were done. The costs are reasonable. See 1B and 1D above.

Comment 5

Recommendation 1F: We disagree. Cost analyses will be done, if needed. We note that detailed cost analyses are not required where adequate competition exists (i.e. where there is more than one RFP respondent).

Comment 6

Recommendation 1G: We disagree. Cost analyses are done, as needed. The City is willing to consider a "new protocol" for these analyses, but would be hesitant to adopt complex requirements that it would be expected to apply even when procurement facts and circumstances would not warrant it.

Comment 7

Recommendation 1H: We disagree that that the city should pay back what the auditors term excess subsidy. No statutory or regulatory maximum subsidy limits were breached. Cost of homes is below average for the area. (See 1D above and 1I below). The City's guidelines are not, and were never, intended to be requirements, absolutes or eligibility thresholds. They contain the estimated costs of providing decent, affordable, non-luxury housing based on average 2.5 bedrooms/unit. They express program preferences for structuring financing and soft cost line items limits, and they apply equally to new construction and rehabilitation, single and multi-family. They are subject to adjustment for legitimate project specifics, including but not limited to, site and utility issues, unit square footage, etc.

We believe the auditors misinterpreted Section 3 of the local guidelines and used it as the governing cost limit. Section 3 is intended to express the local preference that the sales price of the housing be about one third of the development cost. The goal is to encourage buyer investment and to discourage the "no money down" or "distressed sale price" used by some developers. We can provide further explanation on the purpose of Section 3 of the Local Guidelines.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

Comment 8

Recommendation 1I: We agree to an evaluation. Subsidy maximums are contained in the RFP and subsidy maximum are allowed to be breached. The local guidelines are the starting point as required in 85.36. The purpose is to inform developers of the city's preferences and objectives, subject to specific site conditions or varying construction details. See 1B-H.

Comment 9

Recommendation 1J: We disagree to a contingency fund for affordability. We believe the City's recapture provisions conform to the regulations. HOME regulations at 92.254(a)(5)(ii) state that recapture provisions must ensure that the participating jurisdiction recoups all *or a portion* (our italics) of the HOME assistance to the homebuyers, if the housing does not continue to be the principal residence of the family for the duration of the period of affordability. We presented to HUD, in 1997, a fixed amount second mortgage format, for OHDC homes, which did, and continues to, represent a *portion* of the HOME assistance. HUD approved that format in March 1997.

The City's recapture provisions reflect market conditions. The areas in which these homes are built have very low median family incomes and very low housing costs as demonstrated by US Census reports dating back at least 50 years.

We can demonstrate that the fixed amount second mortgage format has worked for CDBG and HOME since the first homes were constructed in the 1970s to ensure continued affordability or the recapture of funds. In fact, of the 158 homes and condominiums constructed and sold from 1973 through the present (beginning with Model Cities, then CDBG and since 1997 with HOME), there have been NO FORECLOSURES and only THREE paybacks (recaptures) during the required affordability periods of the particular funding sources. Of the three paybacks, two of the original owners still live there, they just paid off the second mortgage for personal or financial reasons. Only one family moved during the mandated affordability period.

Comment 10

Recommendation 1K: We disagree (See 1J above).

Comment 11

Recommendation 1L: We agree. The Consolidated Plan unintentionally, but erroneously, gave the impression that the amount to be recaptured was the exact mathematical difference between the fair market value and the sales price. Those words have since been corrected and clarified. (See www.holyoke.org, Community Development, 2009 Annual Plan Update).

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

Finding 2: The Subrecipient That Administers the City's Rental Neighborhood Improvement Program Was Not Adequately Monitored.

Comment 12

The City agrees that RNIP monitoring has been imperfect and is working to increase timely project completion, make related party loans more transparent and to insure file completeness. The City disagrees that demolition expenses are not eligible RNIP program costs.

Recommendation 2A: We agree that oversight has been imperfect and that, should the program continue, the City will amend the RNIP agreement in order to make related party loans more transparent. It will detail the steps necessary for permission to do work on related party property that would be otherwise eligible. We will provide HUD with a draft of the proposed change to the RNIP scope of services for comment.

OCD has already developed a file checklist for RNIP files, to be used by OHDC, that will standardize all file contents for all RNIP loans.

Comment 13

We point out, however, that related party RNIP loans have been allowed since October 1979 when the contract was amended to allow Olde Holyoke to make an RNIP loan for its own property. In other instances, letters from OCD and various Mayors, have allowed RNIP loans on OHDC or CAI property. We can produce these letters for HUD. We admit this "in writing" permission has been inconsistent of late, but this will be remedied by the RNIP agreement amendment proposed above.

We also note that while the auditors point out how RNIP operated in 1977, the City does not have the staff in its Building, Law, or Community Development Departments that it did in 1977, the CDBG funding is not at levels of 1977, nor are there the multitude of local banks that existed in 1977. The City is fortunate that the Contractor was willing to assume duties that the auditors refer to from the 1970s, for little to no cost, so that this program could continue.

Comment 14

Recommendation 2B: We disagree that the City should pay back what the auditors term "foregone interest." The RNIP policy on charging interest on advances prior to project completion has no correlation to whether the loan was to a related or unrelated party, as the auditors inferred. The policy of OHDC in administering the RNIP was, and is, to apply interest ONLY when owners (borrowers), who did not have a construction supervisor's license, wanted to act as their own

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

Comment 14

general contractor, i.e. purchase materials, select subcontractors. If an owner engaged a licensed supervisor of construction or if the project was put out to bid to construction companies, there was no intermediate interest clause included in the Promissory note. Out of the 39 cases reviewed, only 4 contained an intermediate interest clause. All these were owners, without construction supervisor licenses, who wanted to act as their own general contractor. One was a restaurant owner, one a police officer, one a real estate investor and one an owner of two small grocery stores. These cases required greater review and more inspections by the RNIP program's licensed Supervisor of Construction.

Comment 15

Recommendation 2C: We disagree with the auditors finding that demolition is not part of the RNIP contract and the costs should therefore be disallowed. While we admit the 30+ year old project files viewed were in disarray, we have gone into the vault and assembled the available RNIP agreements. These records demonstrate that the 1977 RNIP agreement, as amended in 1979 to include and allow demolition, is still in force and is operating with revolved funds. We can additionally demonstrate that there were also several separate RNIP contracts in the 1990s, for small amounts of new CDBG money with separate scopes of services. The 1990s contracts did not include demolition and no demolition was undertaken with those funds. All demolition was funded within the original 1977 agreement, as amended, eligible and allowed.

Demolition is allowed under CDBG. RNIP was originally funded with CDBG and is now operating on CDBG program income. The City has chosen to include demolition, since 1979, in the RNIP agreement. To have OIG suggest removal of the demolition component from the RNIP scope of services sets a dangerous precedent of allowing OIG to design local programs to suit its own view and removes the local option inherent in CDBG.

Comment 16

Recommendation 2D: We disagree that the City should pay back RNIP demolition costs as demolition is an allowable CDBG activity and was in the RNIP Scope of Services since 1979. See 2C above.

Thank you for the opportunity to make formal written comments to this audit. We appreciate the opportunity to work with HUD to remediate any technical deficiencies to strengthen the CDBG and HOME program administration.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

Very truly yours,

William H. Murphy
Administrator

xc. Michael J. Sullivan, Mayor
Robert Paquin, HUD CPD Director
Kevin Smullen, Assistant Regional Inspector for Audit.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

OIG Evaluation of Auditee Comments

Comment 1 The completive proposal RFP referred by the City did not contain cost estimates. The City did not complete or have the required estimates. Regulations at 24 CFR 85.36(d) and (f) require grantees, such as the City, to complete cost estimates to ensure that it obtains the best value for its funds. What the City refers to as "estimates" are standard and the City's Local Cost Guidelines that are required under the HOME program (24 CFR 92.250(b)). These guidelines provide standards related to total development cost caps and maximum subsidies for all activities funded under the HOME Development program. Program activities include new construction and rehabilitation of single and multi-family units to be purchased and owned by low-income families. The total development cost caps are not the necessary cost estimates required for the activity of new construction of modular duplex housing units.

The analyses performed by the City for the proposed projects were limited, and they were not sufficient to ensure that the City received the best possible prices. Also, based on what was found a detailed description of the steps taken in the City's analysis would show that the cost analyses were insufficient. Specifically, the City must perform a cost analysis that verifies the proposed cost data and projections of the data and that evaluates specific elements of costs and profits. The analyses performed by the City did not include any of this type of information. Lastly the audit report did not cite a requirement that cost estimates and analyses be performed by a "third party" and we agree that these estimates may be done my completed by City officials as long as they are done sufficiently.

Comment 2 The $2.6 million in noncompetitive contracts was not awarded in accordance with federal requirements, and therefore was not properly awarded. Specifically, the City did not follow the Regulations at 24 CFR 85.36(d) and (f), and as such the award of these funds were improper. Further, we noted in Comment 1 why the award was improper, or specifically the required cost estimates and cost analyses were not properly prepared as required by the Regulations at 24 CFR 85.36(d) and (f) thus making this an improper award.

Comment 3 In the response to this recommendation, the City failed to provide any documentation for us to evaluate or in support of its statements that the cost of home construction in the area or the unit cost of constructing these duplex homes in Holyoke was below the average for the Springfield-Holyoke-Chicopee

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

metropolitan area. Based on what we found, the City needs to repay the unreasonable costs because it did not put forth sufficient effort to ensure that the costs were reasonable. With regard to the quality of the estimate, **t**he cost estimates developed by the independent appraiser were based on the Marshall and Swift universal standards and included the maximum allowed for energy adjustments. This adjustment addresses items such as extra insulation, thermal pane windows, and heavier doors, etc. According to the Marshall and Swift standards, this energy adjustment is calculated based on a determination of the local climate being mild, moderate, or extreme. The appraiser was very diligent and used the extreme designation, which is the highest adjustment factor allowed. Using this designation, the appraiser estimated the energy adjustment to range from $1.36 extra per sq. foot for the Albert II project to $1.83 extra per sq. foot for the Dwight Homes project.

The City failed to provide any documentation to support its statements that the cost of home construction in the area or the unit cost of constructing these duplex homes in Holyoke. The appraisal shows that the cost paid were not reasonable, and thus, if the City had made this effort to ensure that the cost were reasonable, the City would have produced more housing.

Comment 4 In the response to this recommendation, the City failed to provide any documentation for us to evaluate or in support of its statements that the cost of analyses were done. The City did not complete or have the required estimates. Based on what documentation we found during the audit, City needs to repay the unreasonable costs because it did not put forth sufficient effort to ensure that the costs were reasonable. Also see comments 1 and 3.

Comment 5 The procurement facts warranted the completion of a cost analyses because there was no competition. Also, a detailed cost analyses would not be not required where adequate competition exists (i.e. where there is more than one respondent). However, as noted in the finding there was only one respondent, and therefore, the detailed cost analyses were required. The City did not complete or have the required estimates.

Comment 6 To ensure compliance with HUD requirements in the City's administration of its HOME program, the City needs to establish new protocols for routinely preparing detailed cost analyses when needed for future homeownership projects. It is the City's responsibility to ensure the costs paid are reasonable, and thus, the City needs to have policies and procedures in place to ensure that the costs are reasonable.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Comment 7 Our review found that regulatory maximum subsidy limits were breached, in at least one instance. Using the HUD guidelines, we determined that one project, 45 Ely Street, was over-subsidized by $62,250. The City's established local cost guidelines provide that HUD funds, in combination with all other government assistance, shall not exceed the lesser of (1) the difference between the amounts borrowed by the buyer as a first mortgage and the lesser of the actual total development cost, (2) the total development cost cap, or (3) 210 percent of the amount borrowed by the buyer as a first mortgage. The City allowed the developer to exceed the local guidelines by $974,453, a significant amount that represents the amount of subsidies in excess of the local guidelines. This occurred because the City did not include all HUD funding in its calculations for subsidy layering, and it did not recognize demolition expenditures as part of the total development cost of the projects.

Comment 8 As noted in the finding, the City included the local guidelines in its RFPs for new projects funded by the homeownership program. Because the City allowed one developer to exceed the local guidelines by almost $1 million (see Comment 7), this developer understood that the guidelines could be exceeded, and this knowledge gave that developer an unfair competitive advantage. HUD needs to ensure that the City used appropriate maximum subsidy guidelines in its 2008 and 2009 contracts and require changes as needed

Comment 9 The City's practice of identifying an optional amount that was less then "the difference between fair market value and the affordable sales price" and offering this option to only one developer does not conform to the applicable regulations, nor was this practice approved by HUD. The regulations provide that the HOME investment that is subject to recapture is based on the amount of HOME assistance that enabled the homebuyer to buy the dwelling unit. This includes any HOME assistance that reduced the purchase price from fair market value to an affordable price. The City should submit to HUD for review and approval the optional recapture methodology it used. If approved, this optional (modified) recapture option should be offered to all participants of the HOME program and included in the RFPs to ensure competition is fair.

Allowing one developer to use an optional and nonstandard recapture provision may be considered an arbitrary action in the procurement process. Arbitrary actions in the procurement process are considered to be restrictive of competition. Had the optional (modified) provision been included in the request for proposal, other potential bidders would have been aware of this recapture option. The actions by the City may have affected the proposal process by discouraging additional proposals.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

HUD regulations allowed the City to recoup a portion of the HOME assistance. However, this may only be accomplished using recapture options that are acceptable to (approved by) HUD as provided in the HOME regulations at 24 CFR 92.254. In the instances cited in the finding, the recapture option used was not one of the four options accepted by HUD and included in the regulations.

Comment 10 The City is not using recapture options that are acceptable to (approved by) HUD as provided in the HOME regulations at 24 CFR 92.254. The City allowed its developer to use a different recapture methodology than the one approved by HUD. The City must use the correct recapture amount which should be proportionally reduced over the life of the affordability period. The incorrect unrecognized recapture amount subjects the HOME program to a potential loss of $344,178 as of June 30, 2009. (Also see Comment 9).

Comment 11 The wording in the Consolidated Plan has been changed, as noted. However, as noted in Comment 9 and 10, the City cannot use this modified recapture option without HUD approval, and it cannot use this option exclusively with OHDC. This practice of limiting this option to only one developer does not foster fair competition. The City must offer this modified recapture, once approved by HUD, to all potential respondents of the City's HOME development program RFPs.

Comment 12 The City has been working to increase timely project completion, make related party loans more transparent, and insure file completeness. However, we reiterate that demolition expenses do not represent eligible RNIP program costs as further explained in Comments 15 and 16.

Comment 13 The City is willing to implement this recommendation. However, since the 1970's the contractor (OHDC) has not assumed RNIP program duties for little or no cost. As part of its review of the revised RNIP agreement, HUD should ensure that the agreement contains appropriate compensation to the contractor(s) as explained further in Comment 14.

Comment 14 The City's description of the RNIP policy on charging interest is not contained in any records or other documents provided during the audit, and it was never provided in any discussion with the auditors during the assignment. The City's description is also not consistent with information provided by the OHDC staff during the audit regarding interest accruals prior to project completion. According to City officials and as recorded in the financial records provided by OHDC, upon project completion, OHDC receives a developer fee totaling 10% of the final loan amounts. The 10% developer fee "compensation provision" was

also not provided in writing or in any contracts, or records provided during the audit. This developer fee was applied to both unrelated and related party loans. We note that payment of 10% developer fees for related party loans was contrary to information provided by City officials about such developer fees.

Also, as noted in the OHDC board minutes dated August 11, 2000, an RNIP loan provided to an OHDC related entity (Contemporary Apartments) totaling $145,000 was forgiven for reasons that were sufficiently documented. However, in retaining the proceeds of the loan, OHDC (through Contemporary Apartments) effectively received additional compensation that could be used for administrative matters, such as monitoring existing loans, in addition to the developer fees that were paid.

During the period 1999 to 2009, there were 10 loans for related parties and five loans for nonrelated parties; our audit reviewed all 15 loans. The loans made to nonrelated parties were required to adhere to contracts, meet timetables for completion, and accrue interest on advances. For loans to related parties, interest did not begin until project completion, which for some situations, was up to eight years. If the related-party loans had been treated in the same manner as loans to nonrelated parties, the program would have earned an additional $22,522 in interest.

We calculated the interest forgone using the same methodology that the subrecipient (OHDC) used for its nonrelated loans. Each time funds are drawn down from the loan, interest is accrued on the expenditures to date, multiplied by 3% annual interest for the days elapsed since the last advance. For these nonrelated loans, the calculation occurred over the life of the loan from first advance to the first payment. For those related loans that had not made a first payment, we used a default date of June 30, 2009. We then subtotaled all of the interest foregone. The amount calculated as foregone interest should be returned to the RNIP program.

Comment 15 Demolition expenses are allowable costs but only when carried out in compliance with specific CDBG program rules regardless of whether or not the City's RNIP agreement contained provisions for demolition that were included in the governing contracts.

In addition, the finding notes that the City spent $332,105 on ineligible activities that did not meet the RNIP program objectives, and were not carried out in compliance with CDBG program requirements. "The RNIP program objective was to finance eligible improvements, repairs, and rehabilitation of rental

properties. Demolition is neither repair nor rehabilitation of a rental property. In addition, the demolition activities were not carried out in compliance with the CDBG program rules governing: 1) public participation, 2) accurate and transparent reporting, 3) environmental reviews, 4) displacement and relocation of tenants, and 5) conflicts of interest.

Comment 16 Demolition expenses are allowable costs under the CDBG program, but only when carried out in compliance with specific CDBG program rules. In the instances cited in the finding, the demolition activities were not carried out in compliance with the CDBG program rules governing: 1) public participation, 2) accurate and transparent reporting, 3) environmental reviews, 4) displacement and relocation of tenants, and 5) conflicts of interest as explained in Comment 15.

Appendix C

RENTAL NEIGHBORHOOD IMPROVEMENT LOANS WERE MODIFIED AND FUNDS WERE OUTSTANDING (FOR SAMPLE) AS OF JUNE 30, 2009

RNIP* no.	Setup date	Initial funding amount	Date of last modification	Funds committed	Amount outstanding as of June 30, 2009
R128	Mar. 3, 1993	$50,000	May 18, 2005	$ 144,000	$21,958
R138	May 1, 1999	$70,000	Aug. 1, 2000	$ 70,000	$36,752
R139	Oct. 8, 1999	$90,000	Oct. 1, 2001	$ 103,800	$-
R140	Dec. 12, 1999	$ 105,000	n/a	$ 105,000	$73,163
R141	July 1, 2000	$52,000	Nov. 13, 2007	$ 86,000	$80,507
R142	Jan. 10, 2001	$40,000	n/a	$ 40,000	$26,962
R143	Feb. 28, 2001	$ 115,000	Dec. 11, 2001	$ 115,000	$-
R144	Aug. 21, 2002	$ 260,000	Jan. 31, 2002	$ 341,000	$262,903
R147	Apr. 1, 2003	$ 165,000	Nov. 14, 2008	$ 300,000	$272,800
R150	May 10, 2006	$40,000	Apr. 30. 2007	$ 40,000	$22,420
R152	Aug. 28, 2006	$45,000	n/a	$ 45,000	$34,765
R153	Aug. 28, 2006	$80,000	n/a	$ 80,000	$54,334
R154	Aug. 28, 2006	$35,000	Aug. 24, 2008	$ 150,000	$144,150
R155	Oct. 1, 2008	$50,000	n/a	$ 50,000	$37,883
R156	Jan. 1, 2009	$60,000	n/a	$ 60,000	$47,860
	Totals	**$1,257,000**		**$ 1,729,800**	**$1,116,457**

* RNIP = Rental Neighborhood Improvement program

Appendix D

FOR RENTAL NEIGHBORHOOD IMPROVEMENT LOANS, UNFINISHED WORK LED TO INTEREST FORGONE

RNIP No.	Is work complete?	Last advance	Number of amendments	First advance	Date of first payment or default date of June 30, 2009	Elapsed days	Interest forgone
R128	No	Mar. 31, 2009	3	n/a	n/a	n/a	n/a
R138	Yes	Aug. 15, 2000	0	June 30, 1999	Oct. 31, 2000	489	n/a
R139	Yes	n/a	1	Dec. 17, 1999	Jan. 31, 2002	776	n/a
R140	Yes	Feb. 12, 2002	0	Mar. 31, 2002	Dec. 2, 2002	246	n/a
R141	Yes	Jan. 29, 2008	2	July 1, 2000	June 30, 2008	2921	$9,682
R142	Yes	June 26, 2001	0	Jan. 19, 2001	Aug. 31, 2001	224	n/a
R143	Yes	Apr. 18, 2002	1	Apr. 30, 2001	Apr. 30, 2002	365	n/a
R144	Yes	Sept. 1, 2003	1	Mar. 18, 2002	Oct. 31, 2003	592	n/a
R147	Yes	Feb. 12, 2009	3	Apr. 30, 2003	Oct. 31, 2006	1280	Not determined
R150	No	June 29, 2006	1	Apr. 27, 2006	June 30, 2009	1160	$763
R152	No	May 21, 2009	0	Sept. 14, 2006	June 30, 2009	1020	$1,796
R153	No	Sept. 6, 2007	0	Sept. 28, 2006	June 30, 2009	1006	$3,937
R154	No	Sept. 17, 2008	5	Feb. 8, 2007	June 30, 2009	873	$5,399
R155	No	June 30, 2009	0	Oct. 31, 2008	June 30, 2009	242	$945
R156	No	Apr. 30, 2009	0	Jan. 29, 2009	June 30, 2009	152	n/a
Total	7						$22,522

Appendix E

FOR RENTAL NEIGHBORHOOD IMPROVEMENT LOANS, RELATED AND UNRELATED LOANS RECEIVED INCONSISTENT TREATMENT

RNIP No	Amount Outstanding at 6/30/09	Is Work Complete?	Is it a Related party Loan?	Is there a Mortgage	Is there Board Approval	Are all Cost Supported?	Are all costs Eligible?	Are there Rental Rehabilitation Regulatory Agreements?	Are there Work Write Ups?	Is there Compliance with Procurement Regulations	Documentation of Federal Regulations	Are there building permits?
R128	$21,958	No	Yes	No	Yes	No	**No**	No	Yes	No		n/a
R138	$36,752	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	No		Yes
R139	$-	Yes	Yes	No	Yes	Yes	No	No	Yes	No		Yes
R140	$73,163	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	No		Yes
R141	$80,507	Yes	Yes	Yes	Yes	Yes	Yes	No	No	No		Yes
R142	$26,962	Yes	Yes	Yes	No	Yes	Yes	No	No	No		No
R143	$-	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	No		Yes
R144	$262,903	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	No		Yes
R147	$272,800	Yes	Yes	Yes	Yes	Yes	Yes	No	No	No		No
R150	$22,420	No	Yes	Yes	No	Yes	Yes	No	No	No		Yes
R152	$34,765	No	Yes	No	Yes	Yes	Yes	No	No	No		Yes
R153	$54,334	No	Yes	No	Yes	Yes	Yes	No	No	No		Yes
R154	$144,150	No	Yes	Yes	No	Yes	Yes	No	No	No		No
R155	$37,883	No	Yes	Yes	No	Yes	Yes	No	No	No		Yes
R156	$47,860	No	No	Yes	No	Yes	Yes	Yes	Yes	No		Yes
	$1,116,457	7										

Appendix F

CRITERIA

Finding 1

24 CFR 85.36 - Procurement (d) Methods of procurement to be followed.

> (4) Procurement by noncompetitive proposals is procurement through solicitation of a proposal from only one source, or after solicitation of a number of sources, competition is determined inadequate.
>
> > (i) Procurement by noncompetitive proposals may be used only when the award of a contract is infeasible under small purchase procedures, sealed bids or competitive proposals and one of the following circumstances applies:
> >
> > (A) The item is available only from a single source;
> >
> > (B) The public exigency or emergency for the requirement will not permit a delay resulting from competitive solicitation.
> >
> > (C) The awarding agency authorizes noncompetitive proposals; or
> >
> > (D) After solicitation of a number of sources, competition is determined inadequate.
>
> (ii) Cost analysis, i.e., verifying the proposed cost data, the projections of the data, and the evaluation of the specific elements of costs and profit, is required.

24 CFR 85.36 - Procurement (f) Contract cost and price.

> (1) Grantees and subgrantees must perform a cost or price analysis in connection with every procurement action including contract modifications. The method and degree of analysis is dependent on the facts surrounding the particular procurement situation, but as a starting point, grantees must make independent estimates before receiving bids or proposals. A cost analysis must be performed when the offerer is required to submit the elements of his estimated cost, e.g., under professional, consulting, and architectural engineering services contracts. A cost analysis will be necessary when adequate price competition is lacking, and for sole source procurements, including contract modifications or change orders, unless price reasonableness can be established on the basis of a catalog or market price of a commercial product sold in substantial quantities to the general public or based on prices set by law or regulation. A price analysis will be used in all other instances to determine the reasonableness of the proposed contract price.

§ 92.250 Maximum per-unit subsidy amount and subsidy layering.

(b) Subsidy layering. Before committing funds to a project, the participating jurisdiction must evaluate the project in accordance with guidelines that it has adopted for this purpose and will not invest any more HOME funds, in combination with other governmental assistance, than is necessary to provide affordable housing.

HUD Notice: CPD 98-1 - Layering Guidance for HOME Participating Jurisdictions When Combining HOME Funds with Other Governmental Subsidies.

III. DEFINITIONS

Governmental Assistance - Governmental assistance includes any loan, grant, (including Community Development Block Grant), guarantee, insurance, payment, rebate, subsidy, credit, tax benefit, or any other form of direct or indirect assistance from the Federal, State or local government for use in, or in connection with, a specific housing project.

IV. USE OF THE GUIDELINES

Based on the certification contained in the annual submission of the consolidated plan and the subsidy layering provisions of §92.250(b) of the HOME final rule, a PJ [participating jurisdiction] must use the guidelines it has adopted to document that when HOME funds are used in combination with other governmental assistance, no more subsidy is invested than is necessary. The project file should contain the required evaluation. For example, if a project is using HOME funds in combination with local tax increment financing, the PJ would use the guidelines, evaluate the project, and document the evaluation.

V. PROJECT EVALUATION

Before a PJ invests HOME funds in a project, it must assess if other governmental assistance has been, or is expected to be, made available to that project.

City's Local Guidelines:

1. Total Development Cost Limits Definition: Total Development Cost is defined as the sum of all allowable project costs necessary for the development of the housing.

3. Maximum Public Subsidy - Homeowner units Local CDBG/HOME funds, in combination with all other government assistance, shall not exceed the lesser of: a. The difference between the amount borrowed by the buyer as a first mortgage and the lesser of the actual Total Development Cost or the Total Development Cost cap, or b. 210% of the amount borrowed by the buyer as a first mortgage.

24 CFR 92.254, Qualification as Affordable Housing: Homeownership, 5. Resale and recapture. To ensure affordability, the participating jurisdiction must impose either resale or recapture requirements, at its option. The participating jurisdiction must establish the resale or recapture requirements that comply with the standards of this section and set forth the requirements in its consolidated plan. HUD must determine that they are appropriate.

ii. Recapture. Recapture provisions must ensure that the participating jurisdiction recoups all or a portion of the HOME assistance to the homebuyers, if the housing does not continue to be the principal residence of the family for the duration of the period of affordability. The participating jurisdiction may structure its recapture provisions based on its program design and market conditions. The period of affordability is based upon the total amount of HOME funds subject to recapture described in paragraph (a)(5)(ii)(A)(5) of this section.

A. The following options for recapture requirements are acceptable to HUD. The participating jurisdiction may adopt, modify or develop its own recapture requirements for HUD approval. In establishing its recapture requirements, the participating jurisdiction is subject to the limitation that when the recapture requirement is triggered by a sale (voluntary or involuntary) of the housing unit, and there are no net proceeds or the net proceeds are insufficient to repay the HOME investment due, the participating jurisdiction can only recapture the net proceeds, if any. The net proceeds are the sales price minus superior loan repayment (other than HOME funds) and any closing costs.

1. Recapture entire amount. The participating jurisdiction may recapture the entire amount of the HOME investment from the homeowner.

2. Reduction during affordability period. The participating jurisdiction may reduce the HOME investment amount to be recaptured on a prorata basis for the time the homeowner has owned and occupied the housing measured against the required affordability period.

3. Shared net proceeds. If the net proceeds are not sufficient to recapture the full HOME investment (or a reduced amount as provided for in paragraph (a)(5)(ii)(A)(2) of this section) plus enable the homeowner to recover the amount of the homeowner's downpayment and any capital improvement investment made by the owner since purchase, the participating jurisdiction may share the net proceeds. The net proceeds are the sales price minus loan repayment (other than HOME funds) and closing costs.

4. Owner investment returned first. The participating jurisdiction may permit the homebuyer to recover the homebuyer's entire investment (downpayment and capital improvements made by the owner since purchase) before recapturing the HOME investment.

5. Amount subject to recapture. The HOME investment that is subject to recapture is based on the amount of HOME assistance that enabled the homebuyer to buy the dwelling unit. This includes any HOME assistance that reduced the purchase price from fair market value to an affordable price, but excludes the amount between the cost of producing the unit and the market value of the property (i.e., the development subsidy). The recaptured funds must be used to carry out HOME-eligible activities in accordance with the requirements of this part. If the HOME assistance is only used for the development subsidy and therefore not subject to recapture, the resale option must be used.

6. Special considerations for single-family properties with more than one unit. If the HOME funds are only used to assist a low-income homebuyer to acquire one unit in single-family housing containing more than one unit and the assisted unit will be the principal residence of the homebuyer, the affordability requirements of this section apply only to the assisted unit. If HOME funds are also used to assist the low-income homebuyer to acquire one or more of the rental units in the single-family housing, the affordability requirements of § 92.252 apply to assisted rental units, except that the participating jurisdiction may impose resale or recapture restrictions on all assisted units (owner-occupied and rental units) in the single family housing. If resale restrictions are used, the affordability requirements on all assisted units continue for the period of affordability. If recapture restrictions are used, the affordability requirements on the assisted rental units may be terminated, at the discretion of the participating jurisdiction, upon recapture of the HOME investment. (If HOME funds are used to assist only the rental units in such a property then the requirements of § 92.252 would apply and the owner-occupied unit would not be subject to the income targeting or affordability provisions of § 92.254.)

24 CFR 85.36 - Procurement (c) Competition.

> (1) All procurement transactions will be conducted in a manner providing full and open competition consistent with the standards of §85.36. Some of the situations considered to be restrictive of competition include but are not limited to:
>
> (i) Placing unreasonable requirements on firms in order for them to qualify to do business,
> (ii) Requiring unnecessary experience and excessive bonding,
> (iii) Noncompetitive pricing practices between firms or between affiliated companies,
> (iv) Noncompetitive awards to consultants that are on retainer contracts,
> (v) Organizational conflicts of interest,
> (vi) Specifying only a brand name product instead of allowing an equal product to be offered and describing the performance of other relevant requirements of the procurement, and
> (vii) Any arbitrary action in the procurement process.

Finding 2

24 CFR 570.501 - Responsibility for grant administration. (b) The recipient is responsible for ensuring that CDBG funds are used in accordance with all program requirements. The use of designated public agencies, subrecipient, or contractors does not relieve the recipient of this responsibility. The recipient is also responsible for determining the adequacy of performance under subrecipient agreements and procurement contracts, and for taking appropriate action when performance problems arise, such as the actions described in §570.910.

24 CFR 570.611 - Conflict of interest.

(a) Applicability. (1) In the procurement of supplies, equipment, construction, and services by recipients and by subrecipients, the conflict of interest provisions in 24 CFR 85.36 and 24 CFR 84.42, respectively, shall apply.

> (2) In all cases not governed by 24 CFR 85.36 and 84.42, the provisions of this section shall apply. Such cases include the acquisition and disposition of real property and the provision of assistance by the recipient or by its subrecipient to individuals, businesses, and other private entities under eligible activities that authorize such assistance (e.g., rehabilitation, preservation, and other improvements of private properties or facilities pursuant to §570.202.

(b) Conflicts prohibited. The general rule is that no persons described in paragraph (c) of this section who exercise or have exercised any functions or responsibilities with respect to CDBG activities assisted under this part, or who are in a position to participate in a decision-making process or gain inside information with regard to such activities, may obtain a financial interest or benefit from a CDBG-assisted activity, or have a financial interest in any contract, subcontract, or agreement with respect to a CDBG-assisted activity, or with respect to the

proceeds of the CDBG-assisted activity, either for themselves or those with whom they have business or immediate family ties, during their tenure or for one year thereafter.

(c) Persons covered. The conflict of interest provisions of paragraph (b) of this section apply to any person who is an employee, agent, consultant, officer, or elected official or appointed official of the recipient, or of any designated public agencies, or of subrecipient that are receiving funds under this part.

24 CFR 570.606 - Displacement, relocation, acquisition, and replacement of housing.

(a) General policy for minimizing displacement. Consistent with the other goals and objectives of this part, grantees (or States or state recipients, as applicable) shall assure that they have taken all reasonable steps to minimize the displacement of persons (families, individuals, businesses, nonprofit organizations, and farms) as a result of activities assisted under this part. (b) Relocation assistance for displaced persons at URA [Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970] levels. (1) A displaced person shall be provided with relocation assistance at the levels described in, and in accordance with the requirements of 49 CFR part 24, which contains the government-wide regulations implementing the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 (URA) (42 U.S.C. [*United States Code*] 4601–4655).

24 CFR 570.200 - General policies.

(a) Determination of eligibility. An activity may be assisted in whole or in part with CDBG funds only if all of the following requirements are met: (4) Compliance with environmental review procedures. The environmental review procedures set forth at 24 CFR part 58 must be completed for each activity (or project as defined in 24 CFR part 58), as applicable.

24 CFR 570.302 - Submission requirements.

In order to receive its annual CDBG entitlement grant, a grantee must submit a consolidated plan in accordance with 24 CFR part 91. That part includes requirements for the content of the consolidated plan, for the process of developing the consolidated plan, including citizen participation provisions, for the submission date, for HUD approval, and for the amendment process.

24 CFR 91.220 - Action plan.

The action plan must include the following: (c) Activities to be undertaken. A description of the activities the jurisdiction will undertake during the next year to address priority needs in terms of local objectives that were identified in § 91.215. This description of activities shall estimate the number and type of families that will benefit from the proposed activities, the specific local objectives and priority needs (identified in accordance with § 91.215) that will be addressed by the activities using formula grant funds and program income the jurisdiction expects to receive during the program year, proposed accomplishments, and a target date for completion of the activity.

Performance reporting meets three basic purposes: 1) it provides HUD with necessary information for the Department to meet its statutory requirement to assess each grantee's ability to carry out relevant CPD programs in compliance with all applicable rules and regulations; 2) it provides information necessary for HUD's Annual Report to Congress, also statutory mandated; and 3) it provides grantees an opportunity to describe to citizens their successes in revitalizing deteriorated neighborhoods and meeting objectives stipulated in their Consolidated Plan.

24 CFR 92.250 - Maximum per-unit subsidy amount and subsidy layering.

(b) Subsidy layering. Before committing funds to a project, the participating jurisdiction must evaluate the project in accordance with guidelines that it has adopted for this purpose and will not invest any more HOME funds, in combination with other governmental assistance, than is necessary to provide affordable housing.

City's Local Guidelines:

3. Maximum Public Subsidy - Homeowner units Local CDBG/HOME funds, in combination with all other government assistance, shall not exceed the lesser of: a. The difference between the amount borrowed by the buyer as a first mortgage and the lesser of the actual Total Development Cost or the Total Development Cost cap, or b. 210% of the amount borrowed by the buyer as a first mortgage.