



U.S. Department of Housing and Urban Development
Office of Inspector General for Audit, Midwest
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AUDIT MEMORANDUM
00-CH-249-1811

September 13, 2000

MEMORANDUM FOR: Robert Poffenberger, Director of Community Planning and
Development, Indiana State Office

FROM: Dale L. Chouteau, District Inspector General for Audit, Midwest

SUBJECT: City of South Bend
Broadway Street Mortgage Loan Subsidy Program
South Bend, Indiana

We completed a review of the Broadway Street Mortgage Loan Subsidy Program which is funded by the City of South Bend's Community Development Block Grant Program. The review resulted from a citizen complaint to our Office. The complainant alleged that Block Grant funds were misappropriated and that houses purchased under the Mortgage Loan Subsidy Program were substandard. The objectives of our review were to determine whether the complainant's allegations were substantiated and whether HUD's rules and regulations were violated.

The City was organized under the laws of the State of Indiana. The City is governed by a Mayor and a nine member City Council. The Mayor of the City is Stephen J. Luecke. The Community and Economic Development Department administers the City's Community Development Block Grant Program. Jon R. Hunt is the Department's Executive Director. The City's official records for the Broadway Street Mortgage Loan Subsidy Program are at 227 West Jefferson Boulevard, South Bend, Indiana.

To determine whether the complainant's allegations were substantiated and whether HUD's rules and regulations were violated, we reviewed the City's: Community Development Block Grant Agreements with HUD for the periods between October 1, 1997 and September 30, 2000; Mortgage Loan Subsidy Program Guidelines; Program administration contracts for the period between April 15, 1997 and December 31, 1999; and Program participants' files. We also reviewed HUD's files for the City, the Housing and Community Development Act of 1974, and Title 24 of the Code of Federal

Regulations Part 5. We interviewed: HUD's staff; City employees; the former Program administrator's employees; the complainant; and Program participants. In addition, our inspector inspected seven of the 20 houses that received assistance through the Broadway Street Mortgage Loan Subsidy Program to determine whether the houses met the City's Building Code. The seven houses were selected based either on the homeowners' responses to our questionnaire that problems existed with their house or their availability for an inspection.

The City's Broadway Street Mortgage Loan Subsidy Program was generally administered correctly. However, we found that the City did not follow the Housing and Community Development Act of 1974 to ensure houses assisted through the Mortgage Loan Subsidy Program met the City's Building Code. The Housing Inspector for the Housing Assistance Office, which the City contracted with to administer its Program, incorrectly certified that six of the seven houses met the City's Building Code when they did not. As a result, Block Grant funds were misappropriated. HUD also lacks assurance that houses were in decent condition when the Program participants purchased the houses.

We presented our draft finding to the Director of Financial and Program Management for the City's Community and Economic Development Department. We held an exit conference with the Director on August 15, 2000. The City disagreed that some of the housing construction work that was improperly performed or not provided was a violation of the City's Building Code. The City agreed to ensure the construction work was corrected.

We included an excerpt of the City's comments with the finding. The complete text of the comments are in Appendix B with the exception of one attachment that was not necessary for understanding the City's comments. A complete copy of the City's comments with the attachment was provided to HUD's Indiana State Office Director of Community Planning and Development. A copy of this memorandum was provided to the City's Mayor and the Executive Director of the City's Community and Economic Development Department.

Within 60 days, please provide us, for each recommendation made in this memorandum, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Also, please furnish us copies of any correspondence or directives issued because of the review.

Should you or your staff have any questions, please contact me at (312) 353-7832.

The City Did Not Ensure That Houses Met Its Building Code Before Receiving Assistance

The City of South Bend did not follow the Housing and Community Development Act of 1974 to ensure houses assisted through the Broadway Street Mortgage Loan Subsidy Program met the City's Building Code. The City assisted 20 participants in purchasing houses under the Program. We inspected seven of the 20 houses and concluded each of the seven houses had construction work not provided or improperly performed. The Housing Inspector for the Housing Assistance Office, which the City contracted with to administer its Mortgage Loan Subsidy Program, incorrectly certified that six of the seven houses met the City's Building Code when they did not. A requirement of the Housing and Community Development Act of 1974 is that when Community Development Block Grant funds are used to assist individuals in purchasing a house, the house should be in decent condition. HUD defines decent housing as a dwelling unit that meets the applicable State and local building codes. The City established the Mortgage Loan Subsidy Program to meet the national objective of providing decent housing for low and moderate income individuals. The problems with the Mortgage Loan Subsidy Program occurred because the Housing Assistance Office did not have proper procedures and controls over the Program to ensure houses met the City's Building Code before the participants received the assistance. The City also did not monitor the Housing Assistance Office to ensure it administered the Program as required. As a result, Block Grant funds were not efficiently and effectively used. HUD also lacks assurance that houses were in decent condition when the Program participants purchased the houses.

Housing And Community Development Act

Title I, Section 101(c), of the Housing and Community Development Act of 1974 requires that when Community Development Block Grant funds are used to provide housing to low and moderate income residents of urban communities, the housing unit should be in decent condition. 24 CFR Part 5.703(g) defines decent housing as a dwelling unit that meets the applicable State and local building codes.

Sample Selection And Inspection Results

We selected a sample of seven of the 20 houses that received housing assistance through the City's Broadway Street Mortgage Loan Subsidy Program. We selected the seven houses to determine whether they met the City's Building Code when the Program participants purchased the houses. The City or the Housing Assistance Office, which the City contracted with to administer its Mortgage Loan

Subsidy Program, executed seven housing assistance contracts with the Program participants between April 1998 and April 2000.

Six of the 20 homeowners indicated in their responses to our questionnaire that problems existed with their housing construction work. One homeowner was selected based upon his availability for an inspection. The seven houses were inspected by our inspector during the week of June 5, 2000.

We provided the inspection results to HUD's Indiana State Office Director of Community Planning and Development and the Director of Finance and Program Management for the City's Community and Economic Development Department.

Block Grant Funds Were Used To Assist Participants With Purchasing Houses That Did Not Meet The City's Building Code

The City provided \$115,000 of Community Development Block Grant funds to assist seven participants in purchasing houses that did not meet the City's Building Code. The houses contained housing construction work that was improperly performed (\$3,900) and was not provided (\$4,450). The improper work and work that was not provided occurred at all seven houses inspected by our inspector. The seven houses were assisted under the City's Broadway Street Mortgage Loan Subsidy Program. The City recorded forgivable loan repayment agreements against the seven houses for the assistance provided.

The following table shows the amount of work that was improperly performed or not provided for the seven houses.

<i>Address of House</i>	<i>Work Improperly Performed</i>	<i>Work Not Provided</i>
125 Broadway Street	\$ 600	\$500
301 Broadway Street	1,175	950
309 Broadway Street	750	350
617 Pennsylvania Avenue	300	400
629 Pennsylvania Avenue	400	750
634 Pennsylvania Avenue	425	850
610 Wenger Avenue	250	650
Totals	<u>\$3,900</u>	<u>\$4,450</u>

The City established its Broadway Street Mortgage Loan Subsidy Program to provide housing assistance to low and moderate income households interested in purchasing a new house. The housing assistance was intended to promote homeownership in the City's Southeast Neighborhood. The Housing Inspector for the Housing Assistance Office, which the City contracted with to administer its Mortgage Loan Subsidy Program, was responsible for assuring that the houses met the City's Building Code.

Our inspector determined that the Housing Inspector for the Housing Assistance Office did not assure that the houses met the City's Building Code when they were purchased. The houses included construction work that was not performed correctly and not provided. The work incorrectly performed and not provided related to such items as no drywall fire break under basement stairwells, a sagging floor, stairwells with inconsistent stair heights and no trim boards installed, no attaching screws for basement support posts, no privacy locks for bathrooms, and an uncovered hole penetrating the exterior wall near the entrance of the gas line to a house. None of the houses were caulked where such items as electrical and gas lines penetrated the exterior of the houses. The following pictures show examples of construction work that was improperly performed or not provided.

The house at 629 Pennsylvania Avenue did not have the required drywall fire break installed under the basement stairwell.



The house at 309 Broadway Street had an undersized floor joist in the laundry room causing the floor to sag in the middle of the room. The floor tiles are cracking as a result of the floor sag.



An unused open hole was made through the exterior wall of the home located at 634 Pennsylvania Avenue. This could allow rodent and vermin infestation to the house.



The Housing Assistance Office's Housing Inspector was responsible for performing the inspections of the homes to determine whether they met the City's Building Code. He certified that six of the seven houses met the City's Building Code. The house at 617 Pennsylvania Avenue was certified as meeting the Building Code by a former City Code Inspector. The City's Building Commissioner said the former Code Inspector over looked the items that did not meet the Building Code. The Housing Assistance Office's Inspector said it was an oversight that he failed to identify that the houses did not meet the City's Building Code. The Executive Director for the Housing Assistance Office said no one from her Office monitored the Housing Inspector's inspections of the houses to ensure the quality of the Inspector's work.

The City did not monitor the Housing Assistance Office to ensure it administered the City's Broadway Street Mortgage Loan Subsidy Program as required. As a result, Community Development Block Grant funds were not efficiently and effectively used. HUD also lacks assurance that houses met the City's Building Code when the Program participants purchased the houses.

Auditee Comments

Excerpts paraphrased from the City's comments on our draft finding follow. Appendix B, pages 12 to 14, contains the complete text of the comments.

While we agree that the Building Code violations on the houses must be completed correctly, we do not agree that every item cited in your report is actually required by the City's Code. We do agree with the spirit of this finding and fully intend to take steps to ensure that the necessary repairs are completed.

We intend to work with the administering entity to minimize any future problems.

**OIG Evaluation Of
Auditee Comments**

We agree that not every item cited as housing construction that was improperly performed or not provided was a violation of the City's Building Code. However, the seven houses cited in the finding contained between five and eight Code violations. In addition, the houses had construction work that was not a violation of the City's Building Code, but the work did not meet the terms of the sale agreements. The actions proposed by the City to ensure the housing construction work is corrected should ensure that the houses meet the City's Building Code and the sale agreements.

The City should establish procedures and controls to monitor the applicable contractor, who administers the City's Broadway Street Mortgage Loan Subsidy Program, to ensure the contractor follows the Program's requirements.

Auditee Comments

We disagree that Title I, Section 101(c), of the Housing and Community Development Act of 1974 requires Community Development Block Grant funds to provide decent housing to low and moderate income residents of urban communities. While providing decent housing is certainly one of the objectives, it is not required that all or any Block Grant funds be used to provide housing.

While 24 CFR Part 5.703(g) says a decent, safe, and sanitary dwelling unit means a unit that meets the applicable State and local building codes, the implementing regulations for the Block Grant Program are contained at 24 CFR Part 570. Nothing requires home purchases assisted with Block Grant funds to meet the requirements of 24 CFR Part 5.703(g).

**OIG Evaluation Of
Auditee Comments**

The City used Community Development Block Grant funds to provide financial assistance to low and moderate income individuals interested in purchasing a new home. The City met the objective of serving income eligible individuals. However, the City was also required to ensure that when Block Grant funds were used to provide housing, the housing unit should be in decent condition as required by Title I, Section 101(c), of the Housing and Community Development Act of 1974. HUD defines decent housing as a dwelling unit that meets the applicable State and local building codes.

24 CFR Part 5.703(g) is HUD's definition of decent housing.

Auditee Comments

The Housing Assistance Office was not required under contract to inspect the homes prior to purchase. We believe the City's Building Department inspection should be satisfactory to ensure the quality of the homes. The Housing Assistance Office did inspect these houses.

**OIG Evaluation Of
Auditee Comments**

The City contracted with the Housing Assistance Office to administer the Broadway Street Mortgage

Loan Subsidy Program. The Office's Housing Inspector performed inspections of the houses to ensure they met the City's Building Code. The City paid the Housing Assistance Office for the housing inspection services. Therefore, the City should have ensured that the Housing Inspector's inspections were performed correctly and that the houses met the City's Building Code.

Auditee Comments

While the finding states \$8,350 in housing construction work needs attention and faults the City and the Housing Assistance Office for failing to ensure the construction work was corrected at the time of purchase, several of these items were noted as warranty or material defect. Thus, those items only appeared after the house was purchased. We agree the builder may have a responsibility to correct such items as cracked tiles, broken driveway apron, and cracks in the drywall, these are certainly not items anyone expected. Citing these items in the finding is unjustified. These items total \$1,875, leaving a balance of \$6,475 as potential Code violations.

OIG Evaluation Of Auditee Comments

As previously mentioned, we agreed that not every item cited as housing construction work improperly performed or not provided was a violation of the City's Building Code. The construction work cited as warranty or material defect are items not required by the City's Code; however, these are items that the builder or his subcontractors did not perform correctly. The City should ensure that these items are corrected to meet the intent of the Program to provide decent, safe, and sanitary housing.

Auditee Comments

The City's Building Commissioner indicates the Code numbers cited in the finding do not correspond to the current Building Code adopted by the City. The Commissioner provided a copy of the City's current Code to the auditors, but it appears a different version of Code may have been used in developing the finding.

OIG Evaluation Of Auditee Comments

The Building Commissioner did not provide a copy of the City's Building Code. While an older version of the City's Code was used in developing the finding, the Building Commissioner did verify that the Code citations mentioned in the inspection reports did exist in the City's current Building Code. We provided the City's Director of Finance and Program Management for the Community and Economic Development Department with a schedule that showed the housing construction work that was cited as Code violations were contained in the City's current Building Code.

Recommendations

We recommend that the Director of Community Planning and Development, Indiana State Office, assures that the City of South Bend:

- A. Ensures that the \$8,350 of construction work cited in this finding is correctly completed. If the City is unable to ensure the construction work is completed, then the City should reimburse its Community Development Block Grant Program from non-Federal funds the total amount of housing assistance that was provided to the applicable houses and release the applicable loan repayment agreements.
- B. Establishes procedures and controls to ensure assisted houses meet the City's Building Code before the participants receive the housing assistance as required by Title I, Section 101(c), of the Housing and Community Development Act of 1974.
- C. Establishes procedures and controls to monitor the applicable contractor, who administers the City's Broadway Street Mortgage Loan Subsidy Program, to ensure the contractor follows the Program's requirements.

Schedule Of Ineligible Costs

<u>Recommendation</u> <u>Number</u>	<u>Ineligible Costs</u> <u>1/</u>
B	<u>\$8,350</u>
Total	<u>\$8,350</u>

1/ Ineligible costs are costs charged to a HUD program or activity that the auditor believes are not allowable by law, contract, or Federal, State, or local policies or regulations.

Auditee Comments

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CITY OF SOUTH BEND STEPHEN J. LUECKE, MAYOR
COMMUNITY & ECONOMIC DEVELOPMENT

August 10, 2000

Heath Wolfe
Assistant District Inspector General for Audit
Department of Housing and Urban Development
Office of Inspector General
77 West Jackson Boulevard, Room 2646
Chicago, IL 60604

Dear Mr. Wolfe:

We have received your letter dated August 1, 2000 and the attached draft audit finding on our Broadway Street (Southeast) Mortgage Subsidy program. The purpose of the program is to assist low to moderate income clients purchase newly constructed homes within the Southeast neighborhood. While we agree all outstanding code items on these units must be completed correctly, we do not agree that every item cited in your report is actually a code required item. We further believe your stated rationale in determining this issue constitutes a finding, took literary license in interpreting the applicability of certain laws and regulations. We will clarify our positions on these points later in this letter. That said, as we told your auditors, we do agree with the spirit of parts of the finding and, as recommended, fully intend to take steps to work with all involved to have all necessary repairs completed for the benefit of our clients, the assisted home buyers. We further intend to work with the subgrantee administering this program to minimize any future problems.

First, we disagree with the assertion that "Title I, Section 101(c), of the Housing and Community Development Act of 1974 *requires* Community Development Block Grant funds to provide decent housing to low and moderate income residents of urban communities". While providing decent housing is certainly one of the objectives it is not required that all, or any, CDBG funds must be used in that fashion. Further, while 24 CFR 5.703(g) may say "a decent, safe, and sanitary dwelling unit means a unit that meets the applicable State and local building codes", the implementing regulations of the CDBG program under 24 CFR 570, specifically 24 CFR 570.201(n) (Homeownership assistance) under which our Broadway Street Mortgage Subsidy program is eligible, neither references nor requires home purchases assisted with CDBG to meet the requirements of 24 CFR 5.703(g).

Second, our subgrantee, Housing Assistance Office (HAO) was not required under contract to inspect the homes prior to purchase. Indeed, because of our understanding outlined above, we believe the Building Department inspection should be satisfactory to ensure the quality of the homes. However, Housing Assistance Office does provide an inspection service on other, similar programs and, in an effort to provide better service for the home buying clients did inspect these units.

Third, we must note that while your finding states \$8,350 worth of items needing attention, and faults the City and its subgrantee for failing to have all these items corrected at the time the home was purchased, several of these items you noted as “warranty” or “material defect” items, meaning those conditions only appeared during the passage of time, as the house was occupied. We agree the builder may have the responsibility to correct such items (cracked tiles, broken driveway apron, cracks in drywall), but they certainly are not items anyone could have foreseen would develop in the future. Counting those as part of our “finding” is unjustified. According to our calculations, these items which are clearly in this category total \$1,875, leaving a balance of \$6,475 as potential code items.

Fourth, our Building Commissioner indicates the code numbers cited in your report do not correspond to the correct current code book adopted for South Bend, Indiana. The Building Commissioner gave a copy of the correct current code to your auditor during a personal meeting on the subject, but it appears some different version of code may have been used in developing your report. We have attached our line by line response to each cited area of concern listed in your report. In general, we assert \$3,275 of the items listed are definitely not code violations, leaving the cost of correcting potential code violations to be \$3,200. (Please note there are \$1,075 in items which we cannot tell from the picture/information provided whether an actual violation exists, if it is determined there is no violation, the amount will decrease.) For seven units, averaging about \$100,000 each in appraised value, that’s about ½ of 1%.

We feel it is important to note that the amount of work needing to be corrected is very minor and completely normal in new housing construction. We agree code violations must be corrected, but are not sure the magnitude of the need, nor the regulatory foundation are sufficient to warrant a “finding”.

Finally, we are disturbed that this draft does not speak at all to the overwhelming benefit to both our client home buyers and our community revitalization efforts this program provides to South Bend. Your auditors were visibly impressed with the overall quality of these homes. They are beautiful! A real asset to our community. While the program is not perfect, we are working hard to provide an exceptional opportunity for eligible home buyers-both the chance to live in a large, beautiful new home, and the potential to recognize a real increase in net worth-because they are willing to take a risk in a neighborhood during its rebuilding.

In closing, we would like to thank you and your staff for your diligence and professionalism in conducting this audit. We were also impressed with their genuine concern for our clients and their welfare. As we discussed with them many times, we are open to suggestions for improvement to our programs and sincerely wish to provide great

CDBG programming for the citizens of the City of South Bend. We know we are not experts in all areas and appreciate your assistance in further refining and improving our efforts.

Sincerely,

Elizabeth Leonard
Director
Financial & Program Management

Distribution

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