



Issue Date	September 7, 2006
Audit Report Number	2006-LA-1019

TO: Steven B. Sachs, Director, San Francisco Office of Community Planning and Development, 9AD

Joan S. Hobbs

FROM: Joan S. Hobbs, Regional Inspector General for Audit, Region IX, 9DGA

SUBJECT: The City of Modesto (City) Modesto, California, Did Not Always Administer Its Community Development Block Grant in Compliance with Government Regulations

HIGHLIGHTS

What We Audited and Why

We audited the City of Modesto's (City) Park Recreation and Neighborhood Services Division (Neighborhood Division) in response to a request from the City's internal auditor, whose independence was challenged by the Neighborhood Division because his wife transferred into the Division in April 2002. The City Clerk and Auditor's Office withdrew from the audit, even though he was the only internal auditor to do the work. The City's Audit Committee (which consisted of the Mayor and two council members) agreed that the internal auditor could seek an outside source for the audit. We responded to the request and our audit results are contained herein.

Our overall audit objective was to determine whether the City administered its Community Development Block Grant (block grant) in accordance with the U.S. Department of Housing and Urban Development (HUD) requirements. More specifically, our objectives were to determine (1) whether the Neighborhood Division's procurement and bidding processes are in compliance with HUD and City requirements and (2) the eligibility of applicants in the City's rehabilitation program.

What We Found

The City did not adequately administer its block grant programs for its Housing Maintenance and Emergency Home Repair/Disabled Access Assistance Rehabilitation programs. It failed to comply with both federal, and its own, contracting requirements for the block grant-funded programs.

As a result, loan recipients were charged \$64,938 in unnecessary and unreasonable rehabilitation costs. Additionally, the City did not follow its underwriting requirements for determining applicant income and eligibility and paid \$3,441 in ineligible relocation costs for one applicant. (We brought the ineligible relocation costs to HUD's attention during the audit, HUD required the monies be repaid, and \$3,441 was wired to the U.S. Treasury in May 2006).

What We Recommend

We recommend that HUD require the City to reduce the loan balances for loan recipients who were charged \$64,938 for unreasonable and unnecessary rehabilitation costs identified during our audit, review all additional loan related rehabilitation work carried out after June 2005 to determine the reasonableness of costs charged for the work, and reduce the recipient loan balances for any identified overcharges. We also recommend that HUD require the City to implement a procurement system that meets federal requirements and develop an adequate quality control system to ensure that City staff properly monitor contractor charges, rehabilitation progress, and work quality. In addition, we recommend the City provide evidence that it now complies with its own underwriting requirements regarding verification of income and assistance eligibility for loan applicants.

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

Auditee's Response

We provided the City a draft report on July 19, 2006. The City provided written comments on August 4, 2006. It generally disagreed with our report.

The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report. Due to the volume of the exhibits to the auditee's response, the exhibits will be made available upon request.

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BACKGROUND AND OBJECTIVES

The Community Development Block Grant (block grant) program was established by Title I of the Housing and Community Development Act of 1974 (1974 Act), Public Law 93-383. The act grants states and units of general local government aid in the development of viable urban communities. This is done by providing decent housing and a suitable living environment and expanding economic opportunities, principally for persons of low and moderate income. Block grants are allocated to designated jurisdictions, including metropolitan cities or urban counties.

Annually, the City of Modesto, California (City) receives approximately \$4.3 million in block grant funds. These funds are available to support a variety of activities directed at improving the physical condition of neighborhoods through the provision of housing, public improvements and facilities, creating employment, or improving services for low and/or moderate-income households. Generally, the City has a fund balance with the U.S. Treasury, awaiting draw requests from the City to pay invoices submitted by organizations carrying out block grant activities.

The City initiated its Housing Maintenance Program (also known as the Housing Rehabilitation Program) in 1976. Under this program, the City revitalizes blighted neighborhoods and preserves existing homes in selected low-income areas known as target areas. In January 1994, the City Council designated Highway Village as one of the three target areas. The program uses block grant funds to provide low-interest loans to qualifying property owners to rehabilitate homes declared substandard. The program serves to eliminate health and safety hazards within the home and to promote the beautification of the neighborhood environment. The Community Development Program office administered the program until 1999 reorganization moved management of the program to the Neighborhood Division.

The City's Neighborhood Division offers a variety of housing rehabilitation programs. Housing rehabilitation includes programs for emergency housing repairs, housing maintenance programs, disabled access assistance, and property enhancement.

The Neighborhood Division has the following types of loan interest rates and terms available for participants in its housing rehabilitation programs:

- **Deferred Payment Loan** - These loans are deferred for up to 20 year terms and have a 3 percent, fixed interest rate. This type of loan is due and payable immediately upon sale or transfer of legal title to the property to another titleholder or if the beneficiary no longer resides in the house. To qualify for this loan the applicant's total gross annual household income shall be at or below 50 percent of the Median Area Income. The City places a mortgage lien on each property for the amount of the loan provided.
- **Payment Required Loan** – These loans are amortized for up to 15 years with a fixed interest rate at 3 percent. This type of loan is due and payable immediately upon sale or transfer of the legal title to the property to another titleholder or if the beneficiary no

longer resides in the house. To qualify for this level of financial assistance, the applicant's total gross annual household income must be 50 to 80 percent of the Median Area Income or, the loan must be a Disabled Access Assistance Program loan for rehabilitation of a non-owner occupied residence. The City places a mortgage lien on each property for the amount of the loan provided.

In addition to the block grant program, the Neighborhood Division is responsible for administering, monitoring, and supporting other public and affordable housing service programs funded by the U.S. Department of Housing and Urban Development (HUD) through the following grant programs:

- Emergency Shelter Grant
- HOME Investment Partnerships Program
- Economic Development Initiative Grants

The Neighborhood Division also administers the Affordable Housing Program, which is used for the development of affordable housing. Altogether, these grants (including the block grant program) provide approximately \$6 million annually in HUD funds to benefit the homeless and low- and moderate-income people in the community.

Our audit objective was to determine whether the City administered the block grant in accordance with HUD requirements. We wanted to determine (1) whether the Neighborhood Division's procurement and bidding processes were in compliance with HUD and City regulations and (2) the eligibility of applicants participating in the City's rehabilitation program.

RESULTS OF AUDIT

Finding 1: The City Did Not Properly Administer and Procure Rehabilitation Work, Resulting in Loan Recipients Being Overcharged at Least \$64,938

The City's procurement and bidding processes for rehabilitation contracts did not comply with HUD requirements or its own policies and did not foster full and open competition. Contrary to HUD's requirements and the City's procedures, rehabilitation work write-ups were not properly prepared; cost estimates were inadequate to ensure that rehabilitation costs were reasonable; important nonwinner bid documents were not retained; and required contract bidding procedures were not followed. We attribute many of the problems to poor contracting procedures and practices, inadequate contractor monitoring by the City rehabilitation specialists, inadequate supervision of the rehabilitation specialists, and disregard for HUD's and the City's own procurement requirements. As a result, at least \$64,938 in block grant funds used for the Housing Maintenance Program and Emergency Home Repair Program/Disabled Access Assistance Program Rehabilitation Programs were improperly spent for contractor overcharges on rehabilitation work for low- and moderate-income loan recipients.

Procurement Practices Did Not Comply with Requirements And Foster Open Competition

The City did not comply with HUD's and its own requirements for the procurement and bidding processes. It did not prepare detailed independent cost estimates before requesting bids for each property to be rehabilitated as is required. The work write-up forms were sometimes insufficient for contractors to properly bid on certain line items, such as heating and cooling units. Cost estimates used to ensure that rehabilitation costs were reasonable were not supported thereby limiting their usefulness in ensuring that rehabilitation costs were reasonable. Further, we believe more contractors would have participated in the program if the Neighborhood Division's bidding process was not limited to a noncurrent approved bidders list that hindered full and open competition, and had the rehabilitation work been advertised in the newspaper as called for by the City's policy.

During our audit period, July 1, 2000, through December 31, 2005, the City made 71 rehabilitation loans totaling \$1.9 million. Excluding loans made to housing authorities and nonprofits, there were a total of 58 loans to individual homeowners totaling \$1.1 million. We reviewed 28 of these loans totaling \$826,686 and found the following:

- 42 percent (12 of 28) of the contracts went to only two contractors,
- 70 percent (20 of 28) were let with only one, City defined, valid bidder,

Based upon the above, it is apparent that the City's policies and procedures rather than maximizing competition, actually limited competition.

Additionally, the City's policy was to destroy the bids of the nonwinning bidders for each rehabilitation contract solicitation. This occurred for all of the solicitations related to the 28 rehabilitation loans we reviewed. This policy was a major component in compromising the bidding process, generally administered by inadequately supervised rehabilitation specialists. As a result, there was no assurance that successful bidders' costs were reasonable or that nonwinning bids were properly and comparatively reviewed. We brought this weakness to the attention of management while on site, and the policy was immediately changed.

Monitoring and Supervision Were Inadequate

For the loans reviewed, rehabilitation specialists were responsible for

- Preparing work write-up forms and cost estimates,
- Conducting many of the bid openings, and
- Monitoring the rehabilitation work progress.

However, we did not find sufficient evidence of regular on-site monitoring of the work of the City-selected contractors, nor was there evidence that the rehabilitation specialists routinely prepared on-site monitoring reports (site-visits) documenting the reviews they did make. Based on the performance of the rehabilitation specialists, including insufficient monitoring of contractors and poor work write-ups, we concluded that the City's management staff did not provide adequate supervision of its rehabilitation specialists to ensure that they were effectively carrying out their job responsibilities. As a result, contracting processes were vulnerable to abuse and cost overcharges to loan recipients.

The City Required Loan Recipients to Select Contractors from Its Preapproved List as a Condition for Loan Approval

The City required loan applicants to use contractors from its approved bidders list. If a loan applicant wanted to select a licensed contractor of his or her own choosing rather than using the successful City's bidder, City staff stated the applicant would be denied a loan. During the audit, City staff initially told us that the borrowers selected their own contractors for the rehabilitation work; however, based on interviews with the City's management staff and our review of the procurement process, we concluded that the City, not the loan applicants, selected the contractors. The only choice the loan applicants had was to choose a City selected single bidder or from a City selected short list of bidders it determined to be the successful bidders. It should be noted that this was a loan not a grant program and although the loan applicants could not select their own contractors, mortgage liens were placed on the borrowers' homes for the cost of work done by the City-selected contractors.

Loan Recipients Were Overcharged at Least \$64,938 for Contracted Rehabilitation Costs

With the assistance of an Office of Inspector General (OIG) appraiser/analyst, we reviewed 12 of the 28 rehabilitation loan files included in our review and determined that borrowers were often overcharged by the City-selected contractors for items such as heating and cooling, roofing, and bathroom remodels. For the 12 files reviewed, loan recipients were charged at least \$64,938 in excessive/unreasonable costs for rehabilitation work (see appendix D).

Two examples of these overcharges are as follows:

- Borrowers for the property on Sparks were overcharged at least \$8,705 for various work items and materials according to our appraiser. The majority of the \$20,240 in contract costs was for roofing removal and replacement and exterior painting at a cost of \$10,800 for the 1,044-square-foot home. Our

appraiser determined that a reasonable cost estimate for this portion of the work should have been no more than \$4,900, and that the homeowners were charged more than double that amount.¹

- Borrowers for the property on Rose Avenue were overcharged at least \$11,570 for various work items and materials according to our appraiser. One item included in the \$34,341 contract was \$8,000 for a new two and one-half ton heating and cooling unit for the 1,269-square-foot home. Our appraiser determined that a more reasonable charge would have been between \$5,860 and \$6,500 for labor and material, depending on the seasonal energy efficiency ratio rating.

For heating and cooling units, the higher the seasonal energy efficiency ratio rating (12 versus 13, etc.), the higher the cost for the unit. For this contract, the City's staff did not specify a seasonal energy efficiency ratio rating for the bidders which led us to question their claimed estimate of cost and how a proper bid could have been submitted.

The issue of overcharging for heating and cooling surfaced in a number of the loan files we reviewed, as well as the issue of no seasonal energy efficiency ratio rating being specified by City staff.

Conclusion

The failure of the City to implement adequate procurement and bidding processes for its rehabilitation programs limited competition and resulted in significant overcharges for the work completed under the programs. In this regard, for the 12 rehabilitation jobs we reviewed, the loan recipients were overcharged almost \$65,000 – 30 percent more than the amount determined reasonable by OIG's appraiser/analyst. The extent of the overcharges identified brings into question the other rehabilitation work done under these programs. Accordingly, the City should conduct independent cost reviews of all work done under the programs since July 1, 2005 to ensure that loan recipients were not charged excessive amounts for the work done to their properties.

¹ Our appraiser's estimates were based on information gathered from RS Means cost estimation data, home improvement store information, and contractors who perform like services.

Recommendations

We recommend that the director of the Office of Community Planning and Development require the City to

- 1A. Comply with HUD procurement requirements in 24 CFR [*Code of Federal Regulations*] 85.36 and its own policy and procedures manual by ensuring that work write-up forms are clearly written, procurement records are maintained, awards are made to the lowest priced responsible bidder, two or more responsible bids are received to avoid sole-source contracts, and procurements are publicly advertised and bids solicited from an adequate number of contractors.
- 1B. Design and implement appropriate quality control systems to ensure that City staff properly monitors contractor charges and document rehabilitation progress and work quality, including conducting and documenting site visits to evaluate the progress and quality of the rehabilitation work performed by the contractors.
- 1C. Immediately reduce loan amounts by at least \$64,938, plus interest, for the loan recipients listed in Appendix D who were charged unreasonable and unnecessary amounts for rehabilitation work. If loan amounts are not reduced for the individual loan recipients, the City must provide documentation supporting the original contract charges. Additionally, all overcharges agreed to must be refunded back to the City's block grant account from nonfederal funds.
- 1D. Change its policy of requiring loan recipients to select only contractors from the City's approved bidders list and allow them the option to seek out their own licensed and bonded contractors to perform the work.
- 1E. Conduct independent cost reviews of all work done under the programs since July 1, 2005, to ensure that loan recipients were not charged excessive amounts for the work done to their properties, and if overcharges are identified, reduce the lien amounts and refund the overcharges back to its block grant account from non-federal funds.

Finding 2: The City Approved \$3,441 in Ineligible Relocation Expenses

The City did not follow its established policies and procedures in determining eligibility of loan applicants. As a result, the City approved a \$104,606 rehabilitation loan and spent \$3,441 in relocation expenses for an ineligible applicant. The City later rescinded the loan approval based on a Housing Rehabilitation Loan Committee meeting report. However, the City still owed HUD \$3,441, which it repaid to the U.S. Treasury during our audit.

The City Did Not Follow Established Policies and Procedures

The City is required to review loan applications in accordance with the underwriting criteria set out in its policies and procedures manual. The manual states that a review should include verification of information regarding personal income, credit, employment, assets, assistance benefits, and other facts required to verify income and assistance eligibility. In one case we reviewed, the applicant was not able to provide the required documents for verification of income and declared zero income on his loan application. The City failed to follow its policies and procedures for income and credit verification and as a result, did not uncover the applicant's double identity and dual Social Security numbers before loan approval.

With the approved rehabilitation loan, the ineligible applicant became eligible for temporary relocation. In a March 29, 2001, memorandum, City staff recommended that the loan be rescinded and stated that the applicant could reapply if the applicant could provide proof that tax liens, which exceeded \$100,000, had been released. The City was concerned that the tax liens would subordinate the applicant's rehabilitation loan. The City incurred relocation expenses for the applicant before the rescission of the rehabilitation loan that should not have been approved. Although funds were not expended for the \$104,606 rehabilitation loan, the City's block grant program incurred relocation expenses in the amount of \$3,441, which included payments on behalf of the applicant for a deposit, first and last month's rent in the amount, and rental payments for March, April, May, and June 2001.

Generally, we found that the City's procedures for determining an applicant's eligibility were compliant with its own and federal regulations. However, in this instance the City did not follow its own policies and procedures manual and did not fully research the application and resolve the applicant's questionable claim of zero income. In fact the City did not become aware of the problems until it

received an anonymous complaint that the applicant had tax liens under another name. As a result, \$3,441 in block grant funds was expended for ineligible activities.

HUD's Office of Community Planning and Development staff worked jointly with us in an effort to recover the ineligible funds, and after completion of our fieldwork, we received a letter from HUD's community planning and development director, evidencing that the City had wired the \$3,441 to the U.S. Treasury.

Recommendations

We recommend that the director of the Office of Community Planning and Development require the City to

- 2A. Comply with the underwriting requirements in its policies and procedures manual relating to verification of income and credit when determining the eligibility of all loan applicants before relocation expenses are incurred, such as the \$3,441 identified in this report.

SCOPE AND METHODOLOGY

The audit generally covered the period from July 1, 2000, through December 31, 2005. We expanded the scope as necessary. We reviewed applicable guidance and discussed operations with management and staff personnel at the City and key officials from HUD's San Francisco Office of Community Planning and Development. Our primary methodologies included

- Reviewing applicable HUD regulations at 24 CFR [*Code of Federal Regulations*] 85.36 and 24 CFR 570.202, as well as Office of Management and Budget Circular A-87.
- Interviewing appropriate HUD personnel and relevant grant files to obtain an understanding of block grant program requirements and identify HUD's concerns with the grantee's operations.
- Reviewing the grantee's policies, procedures, and practices and interviewing key Park Recreation and Neighborhood Services personnel.
- Analyzing loan documentation for compliance with HUD and City requirements.
- Reviewing select rehabilitation files/projects to determine whether they were adequately documented and contained any costs that were not compliant with applicable cost principles.

We performed our audit fieldwork from November 2005 through April 2006. We conducted our audit in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

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

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

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

Relevant Internal Controls

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

- Policies and procedures to ensure that grant expenditures were eligible and adequately supported.
- Policies and procedures to ensure adequate procurement processes, which conform to HUD's and the City's requirements.

We assessed the relevant controls identified above.

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

Significant Weaknesses

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

- The City's Neighborhood Division's written policies and procedures did not conform to federal regulations in 24 CFR [*Code of Federal Regulations*] 85.36 and Office of Management and Budget Circular A-87. The City did not maintain documentation to support the bidding process (finding 1).

- The City does not have written program policies and procedures, which define the roles and responsibilities of housing rehabilitation specialists in monitoring the rehabilitation projects (finding 1).
- The City's policies and procedures do not ensure field supervision and spot check inspections of rehabilitation specialists (finding 1).
- The City's policies and procedures do not ensure that only eligible expenditures were charged to the block grant (finding 2).

APPENDIXES

Appendix A

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

Recommendation number	Ineligible 1/	Unreasonable or unnecessary 2/
1C		\$64,938
2A	\$3,441	

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 polices or regulations.

2/ Unreasonable/unnecessary costs are those costs 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.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments



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Recreation and
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August 3, 2006

Ms. Joan S. Hobbs, Regional Inspector General for Audit, Region IX, 9DGA
U.S. Department of Housing and Urban Development
Office of the Inspector General, Region IX
611 West Sixth Street, Suite 1160
Los Angeles, CA 90017-3101

Dear Ms. Hobbs:

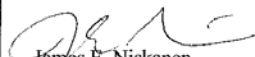
SUBJECT: Response to Use Restricted Draft Audit Report
City of Modesto, California

The City of Modesto would like to thank the Office of the Inspector General for responding to the City's request for audit. In addition to auditing services, OIG Auditors offered valuable technical assistance to City staff for improving administrative procedures and practices in the operation of HUD-funded programs.

Attached is the City's response to the draft audit report received by the City on July 21, 2006.

Should additional information be needed, please call Barbara Kauss, HUD Superintendent, at (209) 577-5275.

Sincerely,


James E. Niskanen
Director

JEN:bk
Attachment

cc: Steven B. Sachs, Director, San Francisco Office of Community Planning and Development, 9AD
George Britton, City Manager
Julie Hannon, Deputy Director
Barbara Kauss, HUD Superintendent



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2. Rehabilitation Cost Documentation	
3. New Estimating Format Sample	
4. Blank Work Write-Up	
5. City of Modesto Building Inspection Department Tidemark Systems Report	
6. "Housing Rehabilitation & Neighborhood Revitalization Program, Guidebook for Property Owners."	
7. City of Modesto Resolution No. 90-904	
8. Monitoring Logs	
9. Bid Certification Documents	
10. HUD and Staff Monitoring Reports	
11. Independent Cost Analysis Sampling	
12. Science Daily Article and Fair Housing & Equal Opportunity Questions and Answers Brief	
13. CPD Notices	

14. Outreach Report Documentation
15. Fraud Documentation Related to Relocation Expenses
16. Copy of OIG Use Restricted Draft Audit Report, as Received by the City of Modesto, July 27, 2006

**CITY OF MODESTO
MEMORANDUM OF RESPONSE**

DATE: August 3, 2006
TO: Joan S. Hobbs, Regional Inspector General for Audit, Region IX, 9DGA
FROM: James E. Niskanen, Director of Parks, Recreation and Neighborhoods
CC: Steven B. Sachs, Director, San Francisco Office of Community Planning and Development, 9AD
RE: **City of Modesto Response to Use Restricted Draft Audit Report Received July 21, 2006**

The City of Modesto appreciates the Office of the Inspector General's (OIG) response to a request for audit. The detailed review of CDBG Programs as well as HOME and ESG funded programs will provide information to the City to improve and enhance services to the Modesto community.

City staff has reviewed the Use Restricted Draft Audit Report presented to the San Francisco Office of Community Planning and Development listing two audit findings. The City of Modesto respectfully **disagrees** with the findings presented and offers the following comments:

General Comments

The City of Modesto **strongly contends** that the Community Development Block Grant is administered **in compliance** with Government Regulations. While specific files may not have been organized using processes and practices preferred by representatives of the HUD OIG, program processes are **in compliance** with HUD regulations. The City of Modesto presents this response based on regulatory sources and requests that the rejoinder offered to this response state regulatory citations as well.

The City requests that OIG's report clarify that the audit was requested by the City of Modesto Internal Audit, as the Internal Auditor has a Conflict of Interest. The City of Modesto Internal Auditor is married to the staff person responsible for financial analysis, IDIS reporting and budgeting of HUD CDBG, ESG, HOME and ADDI funded programs, therefore considered it inappropriate and a conflict of interest for the Internal Auditor to audit HUD programs administer in-part, by his wife. The City Internal Auditor attended an auditing training at the same time as an OIG auditor and presented the conflict of interest issue. The OIG auditor suggested that the OIG could conduct the audit to avoid conflict of interest. It is important to clarify this to avoid the misconception that the City Internal Auditor requested the assistance of the OIG for any other reason.

Comment 1

In exit interview discussion with the OIG, auditors questioned if a conflict of interest existed as the Internal Auditor did not have a financial interest in the HUD programs and had no potential for financial gain. In 24 CFR 570.900 Subpart O (b) (3) it states, "In conducting performance reviews, HUD will primarily rely on information obtained from the recipient's performance report, records maintained, findings from monitoring grantee and subrecipients audits, audits and surveys conducted by the HUD Inspector General, and financial data regarding the amount of funds remaining in the line of credit plus program income." Per regulation, HUD relies on, among other things, records of the City's internal and independent audits. In the City's Neighborhoods' Divisions personnel structure, the wife the Internal Auditor is a Financial Analyst who is involved in budgeting, record maintenance, procurement, sub-recipient contract review and financial reporting. In 24 CFR 570.611 "Conflict of Interest" Section (2) (b) Conflicts prohibited, it states: "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. **For the UDAG program, the above restrictions shall apply to all activities that are a part of the UDAG project, and shall cover any such financial interest or benefit during, or at any time after such person's tenure.**"

The City contends that the Internal Auditor had at the very least a perceived conflict of interest in auditing the Community Planning Development Urban Development Action Grant (UDAG) performance reviews, due to immediate family ties. The Government Auditing Standards: 2003 Revision released on June 01, 2003 Chapter 1 Section 1.24 states: "Auditors should be objective and free of conflicts of interest in discharging their professional responsibilities. Auditors are also responsible for being independent in fact and appearance when providing audit and attestation services. Objectivity is a state of mind that requires auditors to be impartial, intellectually honest, and free of conflicts of interest. **Independence precludes relationships that may in fact or appearance impair auditors' objectivity in performing the audit or attestation engagement.** The maintenance of objectivity and independence requires continuing assessment of relationships with the audited entities in the context of the auditors' responsibility to the public."

Additionally, the City requests that the OIG audit report note the following corrections or clarifications:

1. Page 4 of the OIG draft report mentions a "Lease to Own" program. The City **does not** administer a "Lease to Own" program.
2. Page 9 of the OIG draft report lists the cost of an air-conditioning unit as "\$8,0000." Please clarify if the amount shown should read as \$80,000 or \$8,000.

Comment 2

Comment 3

The City would also request that the OIG's audit report note the high level of cooperation provided by staff, including the list of all immediate and documented list of changes made to procedures during the course of the audit. Staff has presented this list to the Citizens Housing and Community Development Committee and the Modesto City Council. A chart accompanied by documentation of changes was presented to representatives of the OIG before the conclusion of the Audit. (Copy of Summary of Updates, CH&CDC Report and City Council Report attached in Response Appendix 1.)

Comments Specific to Finding 1 (The City of Modesto did not properly administer and procure rehabilitation work, resulting in loan recipients being overcharged at least \$64,938.)

The City of Modesto **disagrees** with Finding One. The City's Recreation and Neighborhood Services Division has procurement policies and procedures that **are** in compliance with 24 CFR 85.36, which is allowed by the Department of Housing and Urban Development. The 2005 Title 24 – Housing and Urban Chapter V, Part 570 – Community Development Block Grants, states in Section 24 CFR 570 (f)(1)(i)(A) and (B), "*Activities eligible under this subpart, other than those authorized under 570.204, may be undertaken subject to the local law: (i) By the recipient through: (A) Its employees, or (B) Procurement contracts governed by the requirements of 24 CFR 85.36.*"

The draft OIG audit report asserts many preferences and recommendations, but does not indicate statutorily backed violations of program regulations. The City of Modesto is genuinely appreciative of the technical assistance presented by the OIG and has already implemented or will be implementing many of the OIG auditors' recommendations. The City would request, however, that a distinction be made between OIG programmatic recommendations and violation of program regulations.

1. Page 6 of that the OIG report states that the City did not prepare independent cost estimates before requesting bids for each property to be rehabilitated.

The City **disagrees** with this statement. The City did prepare cost estimates before requesting bids in accordance with 24 CFR 85.36 (f) (1), which states: "*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.*"

The regulation does not require that cost estimates be prepared or substantiated by a third party. Additionally, the regulation does not specify a form, format or method of the price analysis or estimate. Attached are work write-ups with cost-estimates from the twelve (12) files reviewed and referenced in OIG Draft Report Appendix "D." (Please see Response Appendix 2 for attachments.)

While HUD does not require the use of an independent estimating tool, we accept OIG's recommendation and have implemented an administrative process of documenting

Comment 4

independent estimating tools by RS Means, a company that auditors stated would be appropriate. The City presented this information to the OIG representatives in a summary file of information. (Please see new estimating format sample in Response Appendix 3.)

2. Page 6 of the OIG's audit report states that the work write-ups forms were sometimes insufficient for contractors to properly bid on certain line items, such at heating and cooling units.

The City disagrees with this statement. Neither the Code of Federal Regulations nor HUD specifies a work write-up form or format for residential construction cost estimates. The OIG audit report does not cite specific examples nor justify this claim with survey information from contractors or other viable sources. The work write-up forms used by the City are consistent with industry standard. (Blank work-write form attached in Response Appendix 4.)

In discussion with OIG auditors, regarding format and content of work write up, auditors suggested using practices similar to those used in HUD's HOME Investment Partnerships 203 (k) Rehabilitation Program and suggested that the City use procurement practices. Please note that:

- (A) The 203k program guidelines state that ANY format may be used for work write-up and cost estimates;
- (B) The 203k program makes reference to CPD 203(k) form 4240.4 REV-2 Appendix-1 Rehabilitation Checklist Section 203(k). The City has reviewed this form and found that it is similar to the current work-write up form and format used in the rehabilitation programs.

The City appreciates the technical assistance offered by the OIG auditors but would **strongly contend** that the City's rehabilitation programs are subject to and in compliance with CDBG regulations.

The City would further contend that Contractors can viably bid using information provided in the current work write-up format.

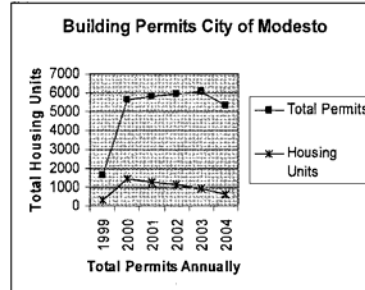
3. Page 6 of the OIG audit's report states that the OIG believes more contractors would have participated in the program if the Neighborhood Services Division's bidding process was not limited to a non-current approved bidders' list that hindered free and open competition and had the rehabilitation work been advertised in the newspaper as called for by the City's policy.

The City **disagrees** with this statement. The City of Modesto is concerned that the OIG audit report's stating that more contractors would have participated in the program if the Neighborhood Services Division was not limited to a non-current approved bidders' list; that hindered "free and open" competition. The statement and assertions of the OIG report do not take into account the market conditions at the time of the rehabilitation project work.

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According to the City of Modesto Building Inspection Department Tidemark System, the number of building permits and housing permits increased significantly from 1999 to 2000. This is significant, as building permits are often pulled 3 to 12 months prior to the beginning of actual construction. From 1999 to 2000 Total Permits increased by 351% and Housing Units Permits increased by 484%. This increase peaked in 2003 after four years of increase. Because of the sudden spike in construction, the availability of general contractors in the area was severely limited.



	1999	2000	2001	2002	2003	2004
Total Permits	1599	5611	5805	5962	6092	5298
Housing Units Permits	303	1468	1264	1127	946	649

The City's loan rehabilitation programs provide housing preservation opportunity to underserved clients in the City of Modesto, including persons who would not be able to obtain financing for rehabilitation work elsewhere. Many rehabilitation program rehabilitation jobs have been challenging for contractors due to clients with mental health issues, sub-standard original construction of homes and a greater amount of paperwork for less profit. Unfortunately, many contractors are reluctant to bid on rehabilitation jobs, when other work is readily available. The impact of the significant increase in construction starts was that fewer contractors were willing to bid on the small-scale rehabilitation jobs.

The City contends that market conditions were a predominant factor in the number of contractors choosing to bid on rehabilitation program jobs. It is essential to factor in local market conditions to any estimation of contractor availability and construction costs during this time period. (Please see attached Building Inspection Department Tidemark System Report in Response Appendix 5)

a. Approved Bidder List

The City does maintain a list of approved bidders as is allowed in 24 CFR 85.36(c)(4), which states, "Grantees and subgrantees will ensure that all pre-qualified lists of persons, firms, or products which are used in acquiring goods and services are current and included enough qualified sources to ensure maximum open and free competition. Also, grantees and subgrantees will not preclude potential bidders from qualifying during the solicitation period."

The City does maintain a list of approved or pre-qualified contractors for the rehabilitation programs but would not consider the list to be "pre-approved" contractors as listed in the report. Neither the OIG audit report nor procurement regulations referenced by the report define the term "current." The City does maintain a "current" list of contractors who are qualified to complete rehabilitation projects.

The City's practice is to keep the Approved Contractor's list current in the following manner:

- Expiring contractor licenses are reviewed monthly for active contractors;
- Expiring insurance policies are reviewed monthly for any contractor currently working on a housing rehabilitation project;
- Current business license payments are reviewed quarterly for contractors currently working on a housing rehabilitation project;
- New contractors are added to the list as approved; and
- Annually, letters are sent to contractors asking if they wish to continue receiving bid notifications via e-mail.

While the list is routinely updated for purposes of insurance and licensing requirements, contractor qualifications are specifically verified and documented upon award of individual bids. The City's Contractor list is available to all qualified contractors at no cost; and the City takes exception at the OIG's assertion that the list is not "free and open." The City's approved list is consistent with HUD regulations in that it is "**full and open**" (24 CFR 85.36 (c) (2)).

Additionally, the City's bidding policy allows contractors not on the list to bid on rehabilitation jobs, including "owner- builders." To date, there have been three "owner-builder" clients utilizing funding through the rehabilitation program, including [REDACTED] (2006), [REDACTED] (1993) and [REDACTED] (1991.)

Clients are encouraged to refer contractors to bid on jobs, whether or not the contractor is on the list. A contractor does not have to be on the City's Approved Contractor list to be awarded a bid; however, a contractor not on the list would have to provide required proof of insurance, licensing and other documentation before an agreement could be signed.

Part of the City's rehabilitation program orientation is to provide homeowners with a brochure providing information entitled, "Housing Rehabilitation & Neighborhood Revitalization Program, Guidebook for Property Owners." The brochure states, "**H&R staff will assist you with the bidding process. The City is always looking for qualified, licensed contractors for housing rehabilitation projects, so if you know of anyone interested, please have them call our office at (209) 577-5245. Minority and female contractors are especially encouraged to participate.**" (Brochure attached in Response Appendix 6.)

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During the course of the Audit, the City did discover that Rehabilitation support staff, for a limited period (approximate six months of time) had sent bid notices to contractors who had routinely been bidding on rehabilitation jobs. This was done to create efficiency and encourage bidding by soliciting contractors active in the program. Upon discovery of this practice from an internal management review on October 26 through 28, 2005, this practice was immediately stopped. Furthermore, the Recreation and Neighborhood Services Division also took steps to further bid outreach by enrolling in the City's on-line bidding process, establishing an out-reach committee and contacting all contractors on the pre-qualified list to determine if they continued to be interested in remaining on the list. The on-line bidding process was implemented and operational on April 3, 2006, during the course of the audit. The information was presented to the OIG in a summary chart of updates with accompanying documentation that bids are now listed on-line. (Please see Summary of Updates Charts in Response Appendix 1)

Comment 8

b. Procurement Policy

The Neighborhood Services Division does follow the City's Policies and Procedures Purchasing Manual. However, bidding for rehabilitation programs fall under a separate set of City regulations—The Policy and Procedure Manual for the City's Community Development Block Grant. The Modesto City Council Adopted Resolution No. 90-904 on November 13, 1990, stating,

"Now, therefore, be it resolved that the City council of the City of Modesto does hereby adopt the Policy and Procedures manual for the City's Community Development Block Grant (CDBG) Program, as recommended by the Citizens Housing and Community Development Committee, a copy of which is filed in the office of the City Clerk, City of Modesto." (A copy of Resolution No. 90-904 is attached to this report in Response Appendix 7.)

Chapter 6.4 of the Policy and Procedure Manual, "Administrative Procedures for Bidding on Housing Rehabilitation Projects," states in Section 6.4: "*Bid packets can be picked up by contractors or their representatives at the Recreation and Neighborhoods Services Division, 1010 10th Street, Suite #4300, from 7:30 .m. to 5:00 p.m., Mondays through Fridays. Bids are posted on Wednesdays. The due date for returning bid proposals will be listed on the Bid Return and Proposal form.*

The Recreation and Neighborhood Services Division may periodically announce requests for bids for housing rehabilitation projects through local newspapers, trade journals, industry associations, and/or public service announcements.

Bidders will be responsible for contacting property owner and/or tenants when scheduling inspection appointments for review of the posted work."

The purpose of separate bidding procedure is to provide prompt service to clients, especially, when rehabilitation work is to provide emergency or medical relief to homeowners. The City did comply with the approved bidding procedures, as adopted by the Modesto City Council; also, consistent with procurement regulations found in 24 CFR 85.36

4. Pages 6-7 of the OIG report states that, excluding loans made to housing authorities and nonprofits, there were a total of 58 loans to individual homeowners totaling \$1.1 million, that 28 loans were reviewed, and of those, 42% of the contracts went to only two contractors and 70% were let with only one valid responsive bidder.

Procurement regulations found in 24 CFR 85.36(d)(2)(i)(B) state:

"(i) In order for sealed bidding to be feasible, the following conditions should be present:"

and then in part (B) continues:

"(B) Two or more responsible bidders are willing and able to compete effectively and for the business."

The City maintains a list of Approved Bidders, as allowed by 24 CFR 85.36(c)(4) in order to document that responsible bidders are willing and able to compete effectively and for the business. HUD regulations do not state that two "responsive" bidders are required to make a bid process valid. Attached is a summary chart of bids from each of the 12 reviewed files referenced in the OIG audit report Appendix "D." Of the 12 bid processes, eight of the bid processes documented two or more bids. There were four bid processes with only one bid. All of the bid processes were sent to more than two responsible bidders.

Please note that HUD and City regulations allow for non-competitive bid processes as well. Procurement by noncompetitive proposal is allowed in situations where the awarding agency authorizes noncompetitive bids and after solicitation of a number of sources, competition is determined inadequate. (24 CFR 85.36(d)(4)(C) and (D).

5. Page 7 of the OIG audit report states that representatives of the OIG did not find sufficient evidence of regular on-site monitoring of the work of City-selected contractors, nor was there evidence that the rehabilitation specialist routinely prepared on-site monitoring reports documenting the reviews.

The City of Modesto disagrees with this statement.

a. Monitoring

The City of Modesto does monitor on-site rehabilitation activities and has documented monitoring in each client file. Attached are summary charts documenting monitoring actions taken by City staff on the 12 files referenced in Appendix "D." Logs kept in the client files documented the monitoring actions. Information on the charts was taken from project logs kept from City staff. (Please see written monitoring logs in Response Appendix 8. Attached to logs are typed summaries of logs prepared for this response.)

The representatives of the OIG recommended that the City better label and organize file information. During the course of the audit, the Recreation and Neighborhood Services Division staff implemented a file protocol for newly established files that will be more

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user friendly to audit staff. This information was presented to representatives of the OIG in a summary chart of program updates.

b. Homeowner Selection

The City **disagrees** with this statement and **did not select** the contractors for individual rehabilitation projects.

Attached are copies of "BID CERTIFICATION DOCUMENTS" of the 12 files referenced in Appendix "D." Please note that the bottom of each document includes a "CONTRACTOR SELECTION CERTIFICATION" signed by each homeowner certifying that the homeowner selected the contractor. The certification also states the reason given by the homeowner for selecting the contractor. This form illustrates that the homeowner selects the contractor. (Please see attached Bid Certification Documents in Response Appendix 8.)

- 6. Page 7 of the OIG draft audit report states: "Based on the performance of the rehabilitation specialists, including insufficient monitoring of contractors and poor work write-ups, we concluded that the City's management staff did not provide adequate supervision of its rehabilitation specialists to ensure that they were effectively carrying out their job responsibilities. As a result, contracting processes were vulnerable to abuse and cost overcharges to loan recipients."**

The City **strongly disagrees** with this statement. Please note that the OIG draft audit report neither defines nor cites "abuse" vulnerabilities resulting in cost overcharges to clients. The City **strongly disagrees** with any implication that processes were vulnerable to abuse that may have had negative impact on clients. Additionally, the City **disagrees** with OIG audit report assertions of overcharging in the absences of a local market survey of construction costs and market conditions.

Supervisory monitoring of Housing Rehabilitation Specialists occurred consistently during the time period files reviewed by the OIG representatives. Following are examples of supervisory monitoring:

- a. The Deputy Director of the Parks, Recreation and Neighborhoods Department's Neighborhood Services Division met with HUD Program staff weekly and included discussion of rehabilitation projects. (Please see attached agendas of weekly staff meetings.)
- b. The Senior Housing Rehabilitation Specialist or Housing Program Supervisor met weekly with subordinate staff assigned to rehabilitation programs. Detailed project updates were provided to this supervisor and were charted with updates. The Senior Housing Rehabilitation Specialist conducted on-site spot checks of rehabilitation projects coordinated by Housing Rehabilitation Specialists.
- c. The Senior Housing Rehabilitation Specialist is a working supervisor position. The Supervisor maintained first-hand knowledge of contractors, contracting issues and client issues by directly overseeing all jobs.

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- d. The Senior Housing Rehabilitation Specialist conducted all initial inspections and signed off on all final check releases, creating an inherent gate keeping system of monitoring projects and project completion.
- e. The Senior Housing Rehabilitation Specialist reviewed customer and contractor evaluations to monitor job and project satisfaction.

The City has in place an appropriate management organizational structure. The City is administered through a Council-Manager form of government as established by the Modesto City Charter. The Modesto City Charter, Title 2, Chapter 5, of the Charter establishes a personnel system, with the administration of the Parks, Recreation and Neighborhoods Department established in Title 12. With authority established in the Charter, the City has implemented a system of management oversight and responsibility. City staff assigned to administer HUD programs fall into this personnel system that includes personnel rules.

The Department of Parks Recreation and Neighborhoods administers programs and provides supervision within the City's personnel rules, including annual performance evaluations, quarterly coaching sessions, required staff technical and career development training, risk management and accountability. The City strongly believes proper and progressive management and oversight was provided to the staff involved in the Housing Rehabilitation Program and has gone to great lengths to involve the Housing Rehabilitation staff in professional development and team-building exercises conducted by a nationally known trainer, [REDACTED]. To further enhance the team, the City created the position of HUD Programs Manager (Superintendent).

The City's administration and management of HUD programs has been reviewed annually by HUD and has been monitored three times since 2000 by HUD Field Office Staff. Monitoring reports have not indicated any lack of management oversight in the City's AUD-funded programs administered by the Neighborhood Services Division. (Please see attached HUD Monitoring Reports and Documentation of Staff Monitoring in Response Appendix 10.)

7. **Page 8 of the OIG draft audit report states, "The City required loan applicants to use contractors from its approved bidder list. If a loan applicant wanted to select a licensed contractor of his or her own choosing rather than using the successful City's bidder, City staff stated the applicant would be denied a loan." The OIG draft audit report states also that, "The only choice the loan applicants had was to choose a City-selected single bidder or from a City-selected short list of bidders it determined to be the successful bidder."**

The City **disagrees** with these statements and contends that both of the statements above are **inaccurate**. The City of Modesto Parks, Recreation and Neighborhoods Department, Recreation and Neighborhoods Services Division Housing Rehabilitation Program's Administrative Procedures for Bidding on housing Rehabilitation Projects, Chapter 6, item 6.3, states that any person, partnership, or corporation with a current California general contractor's license is eligible to participate as a housing rehabilitation contractor, as long as the contractor meets a list of conditions. Contractors do not have to be on the City's Approved Contractor List to be awarded a bid. In fact, the City promotes clients encouraging

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contractors to bid on rehabilitation jobs.

Attached are copies of "BID CERTIFICATION DOCUMENTS" of the 12 files referenced in Appendix "D." Please note that the bottom of each document includes a "CONTRACTOR SELECTION CERTIFICATION" signed by each homeowner certifying that the homeowner selected the contractor. The certification also states the reason given by the homeowner for selecting the contractor. (Please see Bid Certification documents in Response Appendix 9.)

Homeowners have the opportunity to act as "owner-builder" requesting reimbursement only for materials. Homeowners may also request technical assistance only from City staff.

8. Page 8 states that, "With the assistance of an Office of the Inspector General (OIG) appraiser/analyst, we reviewed 12 of the 28 rehabilitation loan files included in our review and determined that borrowers were often overcharged by the City-selected contractors for items such as heating and cooling, roofing, and bathroom remodels. For the 12 files reviewed, loan recipients were charged at least \$64,938 in excessive/unreasonable costs for rehabilitation work."

The City **disagrees** that clients were charged at least \$64,938 in excessive/ unreasonable costs for rehabilitation work. The OIG appraiser's estimates, according to the report footnote 1 on page 9 of the OIG draft audit report, were based on information gathered from RS Means cost estimation data, home improvement store information, and contractors who perform like services. The City contends that market conditions play a large factor in the cost of supplies and services.

The OIG has not presented a current local market construction supply and service cost—neither analysis nor similar analysis for time periods concurrent with past rehabilitation jobs completed.

In the instructions for use prologue to Means Residential Repair & Remodeling Costs, Contractor's Pricing Guide 2006, it states, "General business conditions influence 'in-place' costs of all items. Substitute materials and construction methods may have to be employed. These may affect the installed cost and/or life cycle costs. Such factors may be difficult to evaluate and cannot necessarily be predicted on the basis of the job's location in a particular section of the country. Thus, where these factors apply, you may find significant but unavoidable cost variations for which you will have to apply a measure of judgment to your estimate."

The City contends that the two examples cited on page 9 of the OIG draft audit report did not take into consideration specific conditions that may have cost and other job-related variations. The City requested that [REDACTED] A.I.A. Architect, provide an independent review of cost determinations reference in the OIG's draft audit report Appendix D. [REDACTED] reviewed the following properties:

- a. 423 Pine
- b. 2517 Striven

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- c. 2720 Sparks Way
- d. 613 Rose Way

██████████ reviewed the City's estimates, work write-up specifications and bids in each file. Using knowledge from his Architectural credentials and experience, knowledge of local market and contractor availability conditions, RS Means estimating tools and information from client files ██████████ prepared independent estimates to use in a comparison cost analysis of each file. ██████████ concluded that cost estimates were reasonable and necessary to complete rehabilitation work at respective properties. (Please see attached Independent Cost Analysis in Response Appendix 11)

9. Page 9 of the OIG draft audit report states, "Our appraiser also determined that the requirements in the Uniform Federal Accessibility Standards should have been followed for the alternations since the borrowers have a disability. However, the grab bars in the bathroom were not secured and located in accordance with Uniform Federal Accessibility Standards requirements and in his opinion, the removal of the tub and installation of a new tub should not have occurred. Instead, a walk-in shower should have been installed for easy access and to help eliminate a possible slip and fall."

The City **strongly disagrees** with the statement above and the opinion of the OIG appraisal and has concerns about the statement on several levels. Please consider the following:

a. Uniform Federal Accessibility Standards

The City of Modesto is aware that Section 504 of the Rehabilitation Act of 1973 (24 CFR Part 8) requires full accessibility in accordance with the Uniform Federal Accessibility Standards, or "UFAS." Section 504 applies to all federally assisted newly constructed housing of five or more units and substantially rehabilitated housing of fifteen or more units.

Furthermore, 24 CFR Part 8.29 requires that single family housing units receiving federal assistance for construction and rehabilitation activities must be made accessible upon the request of the prospective buyer if the nature of that buyer's handicap requires such modifications. However, the Department of Housing and Urban Development does not require that homeowners and recipients of the CDBG-funded housing rehabilitation programs to be subject to the requirements in the Uniform Federal Accessibility Standards.

HUD's Department of Fair Housing and Equal Opportunity has published a "People with Disabilities, Section 504, Frequently Asked Questions," web site to address questions regarding the requirements of one specific law, Section 504 of the Rehabilitation Act of 1973, as amended."

<<http://www.hud.gov/offices/fheo/disabilities/sect504faq.cfm>>

At this web site the Department of Fair Housing and Equal Opportunity addresses which

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recipient of Federal Funding is subject to the Uniform Federal Accessibility Standards:

Question: Who are "recipients of federal financial assistance"?

Answer: The Section 504 regulations define "recipient" as any State or its political subdivision, any instrumentality of a state or its political subdivision, any public or private agency, institution organization, or other entity or any person to which federal financial assistance is extended for any program or activity directly or through another recipient, including any successor, assignee, or transferee of a recipient, but excluding the ultimate beneficiary of the assistance, 24 CFR 8.3. Thus, a HUD-funded public housing authority or a HUD-funded non-profit developer of low-income housing is a recipient of federal financial assistance and is subject to Section 504's requirements. However, a private landlord who accepts Section 8 tenant-based vouchers in payment for rent from a low-income individual is not a recipient of federal financial assistance. Similarly, a family that receives Community Development Block Grant (CDBG) or HOME funds for the rehabilitation of an owner-occupied unit is also not a recipient because it is the ultimate beneficiary of the funds. (Please see attached FHEO Questions and Answers in Response Appendix 12.)

December 26, 2000, the U.S. Department of Housing and Urban Development Community Planning and Development Division issued Notice CPD-00-9 addressing Section 504 of the Rehabilitation Act of 1973. In this notice, HUD clarifies that recipients of funding in owner-occupied rehabilitation programs are not subject to Section 504, thus UFAS standards. The notice stated, "A family that will receive CDBG or HOME funds for the rehabilitation of an owner-occupied unit is not subject to the requirements of Part 8 since it is the ultimate beneficiary of the funds, and not a recipient of Federal financial assistance." The OIG auditors referenced rehabilitation recipients from years 2000 to present in their report. During the time period referenced, HUD policy has been that recipients of rehabilitation programs, such as those operated by the City, are not subject to Section 504 standards.

HUD recently updated this in November of 2005 entitled, "Accessibility Notice: Section 504 of the Rehabilitation Act of 1973 and the Fair Housing Act and their applicability to housing programs funded by the HOME Investment Partnerships Program and the Community Development Block Grant Program." Notice CPD-05-09, issued November 3, 2005 (during the course of the audit) and expiring November 3, 2006, maintains the policy that the City's rehabilitation program is not subject to Section 504 of the Rehabilitation Act of 1973. The current notice states,

"The Section 504 regulations define "recipient" as any State or its political subdivision, any instrumentality of a state or its political subdivision, any public or private agency, institution, organization, or other entity, or any person to which Federal financial assistance is extended for any program or activity directly or through another recipient, including any successor, assignee, or transferee of a recipient, but excluding the ultimate beneficiary of the assistance (24 CFR 8.3.) A family that will receive CDBG or HOME

funds for the rehabilitation of an owner-occupied unit is not subject to the requirements of Part 8, since it is the ultimate beneficiary of the funds." (Notices from CPD Notice Year 2000 and CPD Notice Year 2005 are attached in Response Appendix 13.)

b. Grab Bars

The Grab Bars referred to by the OIG Appraiser **were not a part of the City's project and were installed either prior to or after the City's CDBG-funded rehabilitation work**. The City would contend that it is the homeowner's right to install grab bars not funded by public money in any manner that he or she deems fitting. In this situation, the resident offered information explaining the non-traditional placement of the grab bar in the bathroom as a means of avoiding injury during seizures. The City does not question such items unless they are in direct violation of City Building Codes or a hazard.

c. Reasonable Accommodation

The homeowner living at the property on Sparks Avenue has a disability that includes a seizure disorder. The homeowner implied a request for reasonable accommodation, due to the seizure disorder. The homeowner specifically requested that a new tub be installed to accommodate his disability. The Fair Housing and Equal Opportunity web page referenced earlier, (<http://www.hud.gov/offices/fheo/disabilities/sect504faq.cfm>;) also addresses the issue of clients who request reasonable accommodation that a housing provider believes is not in the best interest of the client:

Question: When can a federally assisted housing provider insist on an alternative to the accommodation requested by a tenant?

Answer: If the housing provider believes the requested accommodation is unreasonable, the housing provider may, but is not required to, propose a substitute accommodation. In doing so, the housing provider should give primary consideration to the accommodation requested by the tenant or applicant because the individual with a disability is most familiar with his or her disability and is in the best position to determine what type of aid or service will be effective. If the housing provider suggests an alternative accommodation, the tenant may reject it if s/he feels it does not meet his or her needs.

The City contends that it is ultimately a homeowner's decision as to the installation of a tub and would also make the case that the OIG Appraiser may not have considered the client's other family members or visitors who may want or need to utilize a bath tub. (Please see attached FHEO Questions and Answers in Response Appendix 12.)

- 10. Page 9 of the OIG draft audit report states that, "Borrowers for the property on Rose Avenue were overcharged at least \$11,750 for various work items and materials according to our appraiser. One item included in the \$31,341 contract was \$8,000 for a new two and on-half ton heating and cooling unit for the 1,269 square-foot home. Our appraiser determined that a more reasonable charge would have been between \$5,860**

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and \$6,500 for labor and material depending on the seasonal energy efficiency ratio.”

The City of Modesto specified the heavy duty heating and cooling unit as a reasonable accommodation to the clients living on Rose Avenue. HUD regulations state in 24 CFR 8.11 (a) the following:

“ A recipient shall make reasonable accommodation to the known physical or mental limitations of an otherwise qualified applicant with handicaps or employee with handicaps, unless the recipient can demonstrate that the accommodation would impose an undue hardship on the operation of its program.”

The homeowner presented documentation by a medical doctor attesting to disabilities caused by heart problems and a stroke. The client requested a heavy duty cooling system as physical disabilities caused overheating and could lead to potential physical problems. The City suggested an accommodation that was acceptable to and supported by the client in the larger volume heating and cooling unit. The City is not in the position to question an accommodation that is reasonable, not an undue hardship to the City and that is the choice of the homeowner.

The City of Modesto is located in a geographic area known for its heat. The UT Southwestern Medical Center in Dallas, Texas, completed a study of heart patients in a hot weather environment. (Summary of the study as reported in “Science Daily, October 2005,” is attached in Response Appendix 12.) The study not only shows the correlation to persons with heart problems and heat-related death but also concluded the following:

“Since so many variables could impact the level of heat stress, such as wind and humidity, we don't have a set an environmental temperature threshold to give to patients with heart failure,” Dr. Crandall said. “What we can say is that they should be more aware of the heat and, if they begin to feel overheated, they should get into an air-conditioned environment.”

The City of Modesto contends that the OIG Appraiser is not qualified to determine the environmental temperature threshold needed for the client living on Rose Avenue and that the heavy-duty heating and cooling unit was reasonable in light of the client's heart problems.

The Fair Housing and Equal Opportunity web site **specifically states** that accommodations must be responded to **case by case and an individual's need for accommodation may vary from person to person**. Additionally, HUD does not accommodate clients according to size or configuration of a housing unit. The Fair Housing web site states the following:

Question: What is a reasonable accommodation under Section 504?

Answer: A "reasonable accommodation" is a change, adaptation or modification to a policy, program, service, or workplace which will allow a qualified person with a disability to participate fully in a program, take advantage of a service, or perform a job. Reasonable accommodations may include, for example, those which are necessary in order for the

person with a disability to use and enjoy a dwelling, including public and common use spaces. Since persons with disabilities may have special needs due to their disabilities, in some cases, simply treating them exactly the same as others may not ensure that they have an equal opportunity to use and enjoy a dwelling.

"In order to show that a requested accommodation may be necessary, there must be an identifiable relationship, or nexus, between the requested accommodation and the individual's disability. As discussed in the next question and answer, **what is reasonable must be determined on a case-by-case basis.**" (Please see attached FHEO Questions and Answers in Response Appendix 12.)

11. Page 9 of the OIG draft audit report states, "For heating and cooling units, the higher the seasonal energy efficiency ratio rating (12 verses 13, etc.), the higher the cost for the unit. For this contract, the City's staff did not specify a seasonal energy efficiency ration rating for the bidders, which led us to question their claimed estimate of cost and how a proper bid could have been submitted.

The City would contend that specifying a Seasonal Energy Efficiency Ratio (SEER) rating would be redundant as California State law specifies SEER rates, and it is already stated that rehabilitation program jobs must be in compliance with state laws. Please note that as of June 1, 2001, Title 24 Energy Efficiency standards in California prohibits any air conditioning unit to be sold in the state of California that is not at least 10 SEER and that is not in compliance with the California Energy, Energy Efficiency Standards. The rehabilitation project on Sparks Street referenced is compliant with 2001 Standards, as appropriate for the time period of the job; specifically 2001 Energy Efficiency Standard Title 24 Part 6, Section 112 Tables 1-C through 1-C7, which is established by the Federal Appliance Standards. These standards may be accessed at the following Internet Web Site:

<<http://www.energy.ca.gov/title24/2001standards/index.html>>

Comments Specific to Finding Response 2: (The City Approved \$3,441 in Ineligible Relocation Expenses.)

The City of Modesto **disagrees** with Finding 2. Please consider the following:

Page 9 of the OIG draft report in Finding #2, the draft report states, "*the City of Modesto later rescinded the loan approval based on a grand jury report.*"

The City contends that this statement is **not factual**. The Housing Rehabilitation Loan Committee rescinded the loan to [REDACTED] on April 5, 2001; and the Grand Jury report was issued on April 10, 2001.

Page 9 of the OIG draft audit report states: "*The City failed to follow its policies and procedures for income and credit verification and as a result, did not uncover the applicant's double identity and dual social security number before loan approval.*"

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The City **disagrees** with this statement and contends that City staff did follow and confirm sources submitted from the client, including:

- May 13, 1998, June 22, 1999, August 16, 2000 - [REDACTED] was asked to complete the loan application. The loan application included his name and social security number as well as questions on whether he ever filed bankruptcy or used another name for credit purposes. The form contained the verbiage on fraudulent statements, US Code Title 18.
- May 13, 1998, June 22, 1999, August 16, 2000 - [REDACTED] was asked to complete the *Participant Profile*. The form included his name and social security number. The form also contained the verbiage on fraudulent statements, US Code Title 18.
- July 12, 1999 - Request from the Recreation and Neighborhood Services Division for [REDACTED] to complete a *Statement of Information* for Stewart Title Company. The form included his name and social security number as well as questions on whether he ever filed bankruptcy, used another name for credit purposes, or was in default on a federal debt. A *Statement of Information* was also requested from [REDACTED] the previous owner and that was also received.
- July 9, 1999 - Letter to [REDACTED] from the Recreation and Neighborhood Services Division requesting information on \$50,000 Deed of Trust on 2620 Crommelin recorded in 1983.
- July 15, 1999 - Phone conversation between City staff member [REDACTED] and [REDACTED] requesting a reconveyance instrument for \$50,000 Deed of Trust.
- July 31, 2000 - Phone conversation between City staff member [REDACTED] and [REDACTED] to request income information received from individuals.
- August 9, 2000 - [REDACTED] visited the office and a request was made for income information received from individuals.
- August 21, 2000 - As requested, [REDACTED] submitted a written statement, under penalty of perjury, to the Recreation and Neighborhood Services Division on the three individuals who were his sources of income.
- October 16, 2000 - Letter requested copy of Grant Deed, evidence of property insurance, and 99-00 property tax statement from [REDACTED]

The City's policies within the HUD program are clearly not designed to uncover fraudulent activities or misrepresentation.

The fact is that the client involved in this case misrepresented himself and did not declare other social security numbers or identities. It is the City's position that the client was fraudulent in his

representation of himself; and once this misrepresentation was discovered, the City took appropriate action in rescinding the previously approved housing rehabilitation loan.

The City of Modesto would contend that CDBG funds were not inappropriately used for temporary relocation activities; rather, this client did fraud the City and HUD. The distinction is important, as, according to our research and policies, funding temporary relocation expenses is an eligible expense in the CDBG program.

The City also would encourage the OIG to request that a current income eligibility training for local participating jurisdictions be offered by HUD CPD Offices. When such a training program becomes available, the City of Modesto would welcome the opportunity to attend.

Conclusion:

The City of Modesto would like to reiterate that it disagrees with both Finding #1 and Finding #2 listed in the OIG draft report. The City believes it has clearly listed the reasons for our disagreement with both findings in the response to the OIG draft report, including citations of statutory, regulatory and policy requirements. The City of Modesto is appreciative of the OIG audit, as the guidance and insight provided by the OIG auditors was helpful and many of the recommendations from the OIG have already been implemented.

Comments in Response to HUD Recommendations:

1A. Comply with HUD procurement requirements in 24 CFR 85.36 and its own policy and procedures manual by ensuring that work write-up forms are clearly written, procurement records are maintained, awards are made to the lowest priced responsible bidder, two or more responsible bids are received to avoid sole contracts, and procurements are publicly advertised and bids solicited from an adequate number of contractors.

The City of Modesto will **continue** to comply with requirements in 24 CFR 85.36 and the City's own policy and procedures manual by:

1. Ensuring that work write-up forms are clearly written: A Supervisor, as delegated by the Neighborhood Services Division Deputy Director, will be required to review and approve all work-write up forms before project is put out to bid.
2. Ensuring that procurement records are maintained: The OIG auditors indicated that the City's Bid Certification Form, which previously stated that bids not selected would be destroyed. During the course of the Audit, the City updated the form and the practice. The form was revised on January 19, 2006 and immediately presented to the OIG auditors. Additionally, the update was presented in a summary chart of resolutions to the auditors, along with a copy of the revised form. (Revised form attached in Response Appendix 1.)
3. Ensuring awards are made to the lowest priced responsible bidder and two or more responsible bids are received to avoid sole contracts:

The City of Modesto will continue to follow HUD regulations as stated in 24CFR85.36(c)(4)(d)(2)(ii)(A-D):

(A) The invitation for bids will be publicly advertised and bids shall be solicited from an adequate number of known suppliers, providing them sufficient time prior to the date set for opening the bids;

(B) The invitation for bids, which will include any specifications and pertinent attachments, shall define the items or services in order for the bidder to properly respond;

(C) All bids will be publicly opened at the time and place prescribed in the invitation for bids;

(D) A firm fixed-price contract award will be made in writing to the lowest responsive and responsible bidder. Where specified in bidding documents, factors such as discounts, transportation cost, and life cycle costs shall be considered in determining which bid is lowest. Payment discounts will only be used to determine the low bid when prior experience indicates that such discounts are usually taken advantage of; and

(E) Any or all bids may be rejected if there is a sound documented reason.

The City of Modesto will continue to promote competitive bidding ensuring that two or more responsible bidders are willing and able to bid. The City of Modesto will use non-competitive procurement only when the award of a contract is infeasible under small purchase procedures, sealed bids or competitive proposals as allowed according to 24CFR85.36(c)(4)(d)(4)(i)(A-D).

4. Ensuring that procurements are publicly advertised and bids solicited from an adequate number of contractors.

The City of Modesto will publicly advertise bids from an adequate number of contractors by continuing the following efforts:

- a. As presented to the OIG auditors during the course of the audit, the Neighborhood Services Division has posted bids on-line since April 03, 2006 via the City of Modesto Bid On-line service through Planet Bids. (Please see attached letter to Vendors explaining the Bid On-line process in Summary of Updates, Response Appendix 1.)
- b. The City of Modesto will continue efforts in Outreach as reported in the staff report provided to the Housing Rehabilitation Loan Committee on March 2, 2006. This

report was presented to OIG auditors in a summary of updates during the course of the audit. (Outreach report attached in Response Appendix 14.)

- c. The City of Modesto will continue to maintain a list of pre-qualified contractors in order to comply HUD regulations requiring the City to have 2 or more responsible bidders willing and able to bid (24CFR85.36(c)(4)(d)(2)(ii)(A-D).

1B. Design and implement appropriate quality control systems to ensure that City staff properly monitor contractor charges and document rehabilitation progress and work quality, including conducting and documenting site visits to evaluate the progress and quality of the rehabilitation work performed by the contractors:

The City has presented a summary of monitoring contacts as well as contact logs in client files that document a significant amount of contact monitoring over charges, rehabilitation progress, work quality and job progress. The City requests that the OIG specify, per regulation, a reporting format acceptable to meet this recommendation.

1C. Immediately reduce loan amounts by at least \$64,938, plus interest, for the loan recipients listed in Appendix D who were charged unreasonable and unnecessary amounts for rehabilitation work. If loan amounts are not reduced for the individual loan recipients, the City must provide documentation supporting the original contract charges. Additionally, all overcharges agreed to must be refunded back to the City's block grant account from nonfederal funds.

The City has obtained independent cost estimate for a sampling of four recipients listed in Appendix D, representing 58% of the amount the OIG is alleging as overcharged. The independent cost estimate was conducted by [REDACTED] A.I.A Architect, who is familiar with the local and on-going construction market in Modesto. [REDACTED] reviewed the following recipient files and has the following conclusions:

"I have reviewed the following projects with regard to their associated costs relevant to local construction practices. For my analysis of these projects, I used the "Means Residential Repair and Remodeling" cost estimating book, 2006 addition, as a reference guide-line for cost comparison for the Modesto area and vicinity, along with local area sub-contractor costs, and my 25 years of experience as an Architect doing private and government, (HUD and FEMA), residential remodeling and new construction projects. It is important to remember that every project is different from each other with respect to location, contractor, material costs, size and shape of each building (or space) to receive work, etc. In other words, each building, which has similar work does not necessarily have similar costs. It is my opinion, that each of the projects overall costs are consistent with the costs association with remodeling projects, at the time they were bid."

██████████ evaluated the following rehabilitation program projects:

- o 613 Rose Avenue (OIG appraiser stated \$11,570 overcharged)
- o 2720 Sparks Way (OIG appraiser stated \$8,705 overcharged)
- o 2517 Strivens Avenue (OIG appraiser stated \$8,705 overcharged)
- o 423 Pine Street (OIG appraiser stated \$9,404 overcharged)

The OIG's appraiser asserted that these properties resulted in overcharges to rehabilitation program recipients by \$38,019. This represents over 58% of the total amount the report states in overcharges in Appendix D, and therefore is a significant sampling. The independent cost analysis completed by a licensed architect found the City's estimates and bid results to be consistent with the local area. **Additionally, in ██████████ found deemed the cost of rehabilitation work at 423 Pine Street to be low, and states in his report that the cost could have reasonably been 20% higher. The report states the following:**

"The costs associated with this project are very reasonable considering the amount of work that needed to be completed on each building. The bids indicate that the cost probably should have been 20% higher. After reviewing the cost breakdown and the amount of difficult to get the project completed, it is my opinion that the costs were below what they should have been to complete this project. The owners should be very please with the final results." (Please see Independent Cost Analysis in Appendix 11)

Based on these conclusions, the City of Modesto **disagrees** that recipients were charged an unreasonable or unnecessary amount for rehabilitation work and requests that the OIG respectfully reconsider Recommendation 1C. *"Immediately reduce loan amounts by at least \$64,938, plus interest, for the loan recipients listed in Appendix D who were charged unreasonable and unnecessary amounts for rehabilitation work. If loan amounts are not reduced for the individual loan recipients, the City must provide documentation supporting the original contract charges. Additionally, all overcharges agreed to must be refunded back to the City's block grant account from nonfederal funds."* The Community Development Block Grant funded programs are specifically designed to be administered at a local level, including analysis of project needs and cost analysis using local market conditions. **The City has been responsible in obtaining cost analysis that is consistent with the local market and has not administer cost estimating practices that resulted in overcharging of clients.**

1D. Change its policy of requiring loan recipients to select only contractors from the City's approved bidders list and allow them to seek out their own licensed contractors to perform the work.

It is **not** the City's policy to require that loan recipients select only contractors from the City's approved bidders' list. Recipients are allowed and **encouraged** to seek out their own licensed contractors to perform the work. The City requests that the OIG reconsider this recommendation.

1E. Conduct independent cost reviews of all work done under the programs since July 1, 2005,

to ensure that loan recipients were not charged excessive amounts for the work done to their properties, and if overcharges are identified, reduce the lien amounts and refund overcharges back to its block grant account from non-federal funds.

Based on the independent cost estimates provided by [REDACTED] the City **does not agree** that there is cause warranting independent cost reviews of all rehabilitation files.

The City updates policies, procedures and practices to encourage and ensure fair cost estimates for rehabilitation project bids. During the course of the audit, the City notified auditors that estimating practices had been updated. While HUD does not require the use of an independent estimating tool, the City has accepted OIG auditors' recommendations and has implemented an administrative process of documenting independent estimating tools by RS Means, a company that auditors stated would be appropriate. The City presented this information to the OIG representatives in a summary file of update information.

2A. Comply with the underwriting requirements in its policies and procedures manual relating to verification of income and credit when determining the eligibility of all loan applicants before relocation expenses are incurred, such as the \$3,441 identified in this report.

The City will **continue** to comply with underwriting requirements and its own policies and procedures manual relating to verification and credit when determining the eligibility of all loan applicants before relocation expenses are incurred. The OIG identified one atypical and complicated case of a recipient who committed fraud against the City by reporting incorrect information and using false identities and social security numbers.

It should also be noted that while the City **disagrees** with Finding 2, we were cooperative and prompt in refunding money to HUD of \$3,441 when requested to do so during the course of the audit. The relocation funds were disbursed in the year 2000; and the case was subsequently reviewed by the San Francisco HUD Field Office, including the City's administration of the situation. HUD representatives had never before indicated that the City inappropriately disbursed relocation funds or that the funds should be returned to HUD. Attached is a report of information submitted to the San Francisco Department of Housing and Urban Development Field Office detailing the activities associated with case. Also attached is documentation that the City of Modesto has returned funds used for relocation, in the amount of \$3,441, to HUD. (Please see Fraud documentation in Response Appendix I5)

Response Appendix:

1. Summary Chart of Updates Completed During the Course of the Audit.
2. Rehabilitation Cost Documentation
3. New Estimating Format Sample
4. Blank Work Write-Up
5. City of Modesto Building Inspection Department Tidemark Systems Report
6. "Housing Rehabilitation & Neighborhood Revitalization Program, Guidebook for Property Owners."
7. City of Modesto Resolution No. 90-904
8. Monitoring Logs
9. Bid Certification Documents
10. HUD Monitoring Reports
11. Independent Cost Analysis Sampling
12. Fair Housing & Equal Opportunity Questions and Answers Brief
13. CPD Notices
14. Outreach Report Documentation
15. Fraud Documentation Related to Relocation Expenses
16. Copy of OIG Use Restricted Draft Audit, Received July 27, 2006

OIG Evaluation of Auditee Comments

- Comment 1** We revised the reason for the audit to include “whose independence was challenged by the Neighborhood Division because his wife transferred into the Division in April 2002. The City Clerk and Auditor’s Office withdrew from the audit, even though he was the only internal auditor available to do the work. The City’s Audit Committee (which consisted of the Mayor and two council members) agreed that the internal auditor could seek an outside source for the audit. We responded to the request and our audit results are contained herein.”
- Comment 2** This information was obtained from the City of Modesto’s webpage. However, we have removed the statement from the report.
- Comment 3** We corrected the number in the report to show \$8,000.
- Comment 4** 24 CFR 85.36 (f) (1), which states: *“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.*** The audit report does not suggest the City hire a third party to prepare or substantiate individual cost estimates. We were addressing the fact that during our review of the files we did not find an individual itemized cost estimates prepared by the Neighborhood Division's rehabilitation specialists in all of its project files. This response further illustrates that City staff may not understand the federal procurement requirements.
- We found instances where there were itemized in-house cost estimates in three of the 28 files we reviewed, however there was no information on how the rehabilitation specialist arrived at their costs. The only independent cost estimates which detailed the individual cost for each item of repair were the ones completed by the contractor the City selected. The documents provided by the City in its draft report response were copies of the contractor’s itemized cost estimates and grand total cost estimates which we had previously reviewed during the audit.
- Comment 5** In interviews with Neighborhood Division management and staff we showed them a specific item listed on their work write-up form (form) for installation of heating and cooling (HVAC). Each person who viewed this particular form stated that they could not bid on the item because the form did not provide sufficient information. Two of the rehabilitation specialists working for the City stated that they were also general contractors and they could not adequately bid on the particular item that was shown to them in the interviews. We do not

concur with City management staff's change of opinion and new contention that contractors can viably bid using information provided in its current work write-up format. The frequent overcharges for heating and cooling identified by the OIG appraiser/analyst attests to this being a problem the City needs to address.

Comment 6 In its response the City makes an assumption that additional contractors would not bid because of perceived market conditions; however, it did not address the fact that the City did not provide required opportunities for contractors and the public to become aware of available jobs. Instead it remained steadfast with its non current list of approved contractors and did not advertise the jobs in the official newspaper as was required by the City's procurement policies. We do not concur with its statements and it should comply with published procurement requirements.

Comment 7 No provisions exist for the owner-occupant type homeowners to obtain rehabilitation loans who do not go through the City's bid procedures. However, the City allows for owner-builders (who appear to be investor/landlords) to receive rehabilitation loan funds obtained through HUD.

We believe every loan recipient, not only owner-builders, should be afforded the option of selecting qualified licensed and bonded contractors to perform the rehabilitation work on his/her home. We also believe the City may open itself up to charges of unfair practices if it treats its low and moderate income borrowers in such manner.

Comment 8 In an interview on December 21, 2005, City staff told us that their department follows the City of Modesto's guidelines as outlined in the City's purchasing manual for bidding procedures. These bidding procedures state "purchases subject to sealed bidding are subject to public advertising. The notice inviting bids that are publicly advertised must be published in the official newspaper by one or more insertions, the first of which must be for at least seven days before the time of the bid opening." In addition, contrary to the claim in its response, the City's practices did not comply with 24 CFR 85.36(d)(2)(ii)(A) which states the invitation for bids will be publicly advertised.

Comment 9 24 CFR 85.36(d)(2)(i) states "Two or more responsible bidders are willing and able to compete effectively and for the business". The fact that the City sent the bid packages to bidders on their approved bidders list does not satisfy this requirement. As mentioned in our review 70% of the projects reviewed showed only one responsible bidder willing and able to compete effectively for the business. Since there was only one responsible bid the City should have re-posted the bid. It appears that the City either disregarded federal requirements or City Management does not understand the requirements (24 CFR (d) (2)).

Comment 10 The files that we researched did not show that the rehabilitation specialist conducted on-site monitoring of the contractors and prepared site-visit reports. The logs submitted by the City in Appendix 8 in support of their statement do not show that the rehabilitation specialists did ongoing on-site monitoring of the rehabilitation work for each project. These logs were primarily a chronology of ongoing contacts but they are not site-visit reports. Based upon the documents subsequently provided by the City in their response it appears that they may not be familiar with what a site-visit report should show.

Comment 11 No provisions and options exist for owner-occupant homeowners to select contractors who do not go through the City's bid procedures. On the forms submitted as support for this comment in eight of the twelve documents submitted there was only one bid presented to the homeowner and there was no choice to be made by the homeowner. The process is flawed since there is no selection process when there is only one contractor's bid presented. In these instances the City staff shows up with the bid certification document and the one bid and the homeowner is asked to sign.

Based on our review of the files and various interviews, we concluded that the City was the procurer of the contractors and not the owner-occupant borrowers. The Contractor Selection Certification statement the City had the homeowners sign is misleading and an inaccurate statement of what actually occurred.

Comment 12 The Senior Rehabilitation Specialist duties included supervising the rehabilitation specialists. During his interview with us he told us that "the rehabilitation specialists were self supervising and that he did not conduct any on-site spot checks of the rehabilitation specialist". The City provided us with a one year sampling of weekly staff meetings and spreadsheets which show ongoing project information.

We believe staff meetings are not valid substitutions for monitoring the actual work of the rehabilitation specialists including their work write-ups, cost estimating procedures and preparation of on-site monitoring reports.

Comment 13 We reviewed the requirement in Chapter 6 of the City's Administrative Procedures for Bidding on Housing Rehabilitation Projects and spoke with City staff and learned that the practice is that if the owner-occupant wants a licensed contractor of their choosing then that contractor must go through the City's bidding process.

Again, the City has missed the point made in our audit report. Each owner-occupant should be given the option to select a licensed and bonded contractor to do the work on their home. The City selected contractor should not be the only choice available. In addition, after reviewing numerous files and talking with homeowners, we concluded that the "Contractor Selection Certification" that the

owner-occupants were told to sign misrepresented what actually occurred in the procurement process. The owner-occupant had to sign the certification and go along with the City's procurement process or else the loan would be denied.

Comment 14 The opinion obtained by the City-paid architect indicates he used the RS Means cost estimating book 2006 addition, his experience, and known local area sub-contractor costs. The OIG appraiser/analyst used RS Means cost estimating books for 2003 and 2004 editions which more appropriately reflected the time period for the rehabilitation costs in our report. The appraiser/analyst was also fortunate to obtain copies of three actual local bids for heating and cooling systems for a similar size home (1058 sq ft) with a 2 ½ ton size unit. In addition, the OIG appraiser/analyst did site visits and inspections for each of the twelve properties in our report.

As a result, we believe substantive due diligence was performed by the OIG appraiser/analyst but do not believe the same can be attested to for the architect's opinion on the four files the City referenced in its response.

Comment 15 We concur with the City's response in which it provided documentation that the City's rehabilitation program is exempt from and not subject to Section 504 of the Rehabilitation Act of 1973 and this paragraph has been removed.

Comment 16 The City's response indicates the staff may have missed our point, which is the fact that homeowners were overcharged for the 2 ½ ton heating and cooling unit. The homeowner was charged \$8,000 instead of the \$5,860 to \$6,500 which should have included labor and materials. The City now contends that it specified a heavy duty heating and cooling unit with a larger volume but we found no such evidence in this file nor in any other files reviewed.

Comment 17 Our audit work revealed a wide price variation for the same types of heating and cooling units installed at several different properties. Our focus on the heating and cooling units was primarily on the substantial difference in the cost estimations for each unit when the type and capacity were similar. The City's response that the California state law in 2001 required a minimum 10 SEER unit, in no way responds to the fact that the higher the SEER rating the higher the cost. Nor did it address the fact that without a specified SEER rating there is more room to question their claimed estimate of cost and how a proper bid could have been submitted.

Comment 18 We concur and changed the report to read "the City of Modesto later rescinded the loan approval based on a Housing Rehabilitation Loan Committee meeting report."

Comment 19 Chapter 7.6 of the City's CDBG Policies and Procedures Manual, Credit Report and Title Search, states ... "within 2 days of signed authorization to verify information an in-file credit report will be obtained on the applicant." Our review

of the files on this applicant did not show evidence that the City obtained a credit report prior to loan approval. The chronology of events provided by the City with this response shows the City received loan applications on May 13, 1998, June 22, 1999, and August 16, 2000, but does not show a credit report was obtained. The loan was approved on January 4, 2001.

Appendix C

CRITERIA

A. Title I of the 1974 Act, as amended, authorizes the Community Development Block Grant entitlement program. Entitlement grants are allocated to designated metropolitan cities or urban counties (almost 900 nationwide). The entitlement amount is determined by applying either one of two formulas. One formula considers the grantee's population, extent of poverty, and housing overcrowding. The other formula considers the grantee's extent of growth lag, extent of poverty, and age of housing.

B. 24 CFR [*Code of Federal Regulations*] 85.36(b)(9): "Grantees and subgrantees will maintain records sufficient to detail the significant history of procurement. These records will include, but are not necessarily limited to the following: rationale for the method of procurement, selection of contract type, contractor selection or rejection, and the basis for the contract price."

C. 24 CFR [*Code of Federal Regulations*] 85.36(d)(2): "Procurement by sealed bids (formal advertising). Bids are publicly solicited and a firm-fixed-price contract (lump sum or unit price) is awarded to the responsible bidder whose bid, conforming with all the material terms and conditions of the invitation for bids, is the lowest in price. The sealed bid method is the preferred method for procuring construction, if the conditions in §85.36(d)(2)(i) apply.

In order for sealed bidding to be feasible, the following conditions should be present:

1. A complete, adequate, and realistic specification or purchase description is available;
2. Two or more responsible bidders are willing and able to compete effectively and for the business; and
3. The procurement lends itself to a firm fixed price contract and the selection of the successful bidder can be made principally on the basis of price."

D. 24 CFR [*Code of Federal Regulations*] 85.36(d)(2)(ii): "If sealed bids are used, the following requirements apply:

1. The invitation for bids will be publicly advertised and bids shall be solicited from an adequate number of known suppliers, providing them sufficient time prior to the date set for opening the bids;
2. The invitation for bids, which will include any specifications and pertinent attachments, shall define the items or services in order for the bidder to properly respond;

3. All bids will be publicly opened at the time and place prescribed in the invitation for bids;
4. A firm fixed-price contract award will be made in writing to the lowest responsive and responsible bidder. Where specified in bidding documents, factors such as discounts, transportation cost, and life cycle costs shall be considered in determining which bid is lowest. Payment discounts will only be used to determine the low bid when prior experience indicates that such discounts are usually taken advantage of; and
5. Any or all bids may be rejected if there is a sound documented reason.”

E. 24 CFR [*Code of Federal Regulations*] 570.202(a)(1): “Community Development Block Grant funds may be used to finance the rehabilitation of privately owned buildings and improvements for residential purposes; improvements to a single-family residential property which is also used as a place of business, which are required in order to operate the business, need not be considered to be rehabilitation of a commercial or industrial building, if the improvements also provide general benefit to the residential occupants of the building.”

F. 24 CFR [*Code of Federal Regulations*] 570.202(b)(2)(3): “Community Development Block Grant funds may be used to finance the following types of rehabilitation activities, and related costs, either singly, or in combination, through the use of grants, loans, loan guarantees, interest supplements, or other means for buildings and improvements described in paragraph (a) of this section, except that rehabilitation of commercial or industrial buildings is limited as described in paragraph (a)(3) of this section.

1. Labor, materials, and other costs of rehabilitation of properties, including repair directed toward an accumulation of deferred maintenance, replacement of principal fixtures and components of existing structures, installation of security devices, including smoke detectors and dead bolt locks, and renovation through alterations, additions to, or enhancement of existing structures, which may be undertaken singly, or in combination;
2. Loans for refinancing existing indebtedness secured by a property being rehabilitated with Community Development Block Grant funds if such financing is determined by the recipient to be necessary or appropriate to achieve the locality’s community development objectives.”

G. Office of Management and Budget Circular A-87, C 2, Reasonable costs. A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. The question of reasonableness is particularly important when governmental units or components are predominantly federally funded. In determining reasonableness of a given cost, consideration shall be given to

1. Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the government unit or the performance of the federal award.

2. The restraints or requirements imposed by such factors as sound business practices; arms length bargaining; federal, state, and other laws and regulations; and terms and conditions of the federal award

3. Market prices for comparable goods or services.

4. Whether the individuals concerned acted with prudence in the circumstances considering their responsibilities to the governmental unit, its employees, the public at large, and the federal government.

5. Significant deviations from the established practices of the governmental unit, which may unjustifiably increase the federal award's cost.

H. City of Modesto Purchasing Manual, Section I, Procurement Regulations Procedure Number 3, Bidding Procedures Item Number B, Formal Bids states:

“All purchases in excess of \$50,000 are subject to formal sealed bid procedures and must be publicly advertised.

All purchases between \$5,000 and \$50,000 may, in the discretion of the Purchasing Officer, be subject to sealed bid procedures and subject to public advertising.

The notice inviting bids that are publicly advertised, must be published in the official newspaper by one or more insertions, the first of which must be at least seven days before the time of the bid opening.”

Appendix D

OIG INSPECTOR'S PROPERTY ANALYSIS

The OIG appraiser/inspector reviewed the rehabilitation work on 12 properties. His review consisted of work completed by the contractors and cost estimates of work performed and material used to determine whether the costs were reasonable.

The OIG inspections disclosed work that did not meet or exceed industry standards in the majority of the projects reviewed.

The cost determination difference was \$64,938 as shown in the schedule below.

Property address	Loan type	(a) Approved bid amount ²	(b) High-end evaluation amount	Difference column (a) – (b)
2524 Garvey	HMP	14,784	11,103	3,681
423 Pine	HMP	41,959	32,355	9,604
2517 Striven	HMP	69,500	61,360	8,140
416 Maple	HMP	19,900	15,300	4,600
2720 Sparks Way	HMP	20,240	11,535	8,705
1613 Galvez	EHRP	10,335	4,775	5,560
1517 Victor Way	EHRP	14,780	12,030	2,750
613 Rose Ave.	EHRP	29,300	17,730	11,570
1412 Del Monte	EHRP	17,725	14,710	3,015
3229 Para Drive	EHRP	16,125	11,600	4,525
2220 Jeanine Drive	EHRP	16,029	15,391	638
305 Longfellow	EHRP	9,780.	7,630	2,150
Totals		280,457	215,519	64,938

HMP = Housing Maintenance Program
 EHRP = Emergency Home Repair Program

² Actual loan amounts may differ from approved bid amounts because of other non-contract events involved in the transaction.