Audit Report

District Inspector General for Audit
Southeast-Caribbean District

Report: 98-AT-241-1003 Issued: March 26, 1998

TO: Angelo Castillo, Director, Community Planning and Development Division, Florida State Office, Coral Gables, Florida, 4DD

FROM: Nancy H. Cooper
District Inspector General for Audit-Southeast/Caribbean, 4AGA

SUBJECT: City of Miami
Community Planning and Development Programs
Miami, Florida

We completed a review of the City of Miami's Community Planning and Development (CPD) Programs for the years 1995 and 1996. Our objectives were to determine whether the City: (1) complied with Federal laws, Department of Housing and Urban Development (HUD) regulations, and other requirements; (2) had adequate controls to comply with the requirements; and (3) carried out its activities in an economical, efficient, and effective manner.

The City of Miami did not have adequate controls to ensure compliance with regulations or properly manage its CPD funds. As a result, the City spent $5,203,607 of Community Development Block Grant (CDBG) funds for grant administrative expenses without proper support. Also, the City spent $484,999 for ineligible grant administrative expenses. In addition, because the City did not efficiently and effectively manage its loan programs and did not safeguard its assets, approximately $9.9 million of its outstanding loan portfolio was in default. Further, the City allocated $4.75 million of HOME Investment Partnerships (HOME) funds for an affordable housing development that was not feasible.

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

If you have any questions, please contact Sonya D. Lucas, Assistant District Inspector General for Audit, at (404) 331-3369, or Gerald R. Kirkland, Senior Auditor, at (904) 232-1226. We are providing a copy of this report to the City of Miami.

Executive Summary

We have completed a review of the City of Miami's CPD Programs. The objectives of the review were to determine whether the City: (1) complied with Federal laws, HUD regulations, and other requirements; (2) had adequate controls to comply with the requirements; and (3) carried out its activities in an economical, efficient, and effective manner.

We determined the City did not have adequate controls to ensure compliance with regulations or properly manage its CPD funds. Also, the City did not efficiently and effectively manage its programs or adequately safeguard its assets.

Specifically, the review disclosed:

- The City spent $5,203,607 of CDBG funds for grant administrative expenses without proper support. Also, the City spent $484,999 for ineligible grant administrative expenses. As a result, the City deprived the intended program beneficiaries of $5,688,606.

- The City did not efficiently and effectively administer its loan programs or adequately safeguard its assets. As a result, approximately $9.9 million of the City's outstanding loan portfolio was in default.

- The City allocated $4.75 million of HOME funds to develop an affordable housing project that was not feasible. The homes were not affordable for prospective buyers and funding was insufficient to complete the project. Also, the developer owed the City $144,538 of program income.

We recommend that HUD require the City to reimburse the CDBG Program and the U.S. Treasury for all ineligible costs and resolve unsupported costs; submit certified Cost Allocation Plans; develop and implement controls and procedures to ensure proper administration of its loan programs and proper safeguarding of its assets; collect all loan payments over 90 days past due; repay the CDBG Program $686,270 for loan amounts written off as uncollectible; and demonstrate how the housing project can be made affordable to low and very low income families by obtaining sufficient subsidies, reconfiguring the project, or reducing the costs. Also, because of the significance of the findings, we recommend that HUD require the City to develop a corrective action plan for approval that corrects the systemic weaknesses identified in the findings.

We presented our findings to the City and HUD officials during the audit. We held an exit conference on January 21, 1998. The City provided written comments to our findings and has commendably taken initial steps to correct some deficiencies. The HUD Field Office in Coral Gables, Florida, also provided written comments to our findings. We considered the responses in preparing our final report. We included excerpts from the City's responses in each finding and the complete comments as Appendix D.

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Abbreviations:

CDBG	Community Development Block Grant
CFR	Code of Federal Regulations
CPD	Community Planning and Development
HOME	HOME Investment Partnerships
HUD	Department of Housing and Urban Development
MFR	Multifamily Rehabilitation
OMB	Office of Management and Budget
PITI	Principal, Interest, Taxes, and Insurance
SFR	Single Family Rehabilitation

Introduction

BACKGROUND

The CDBG Program was established by Title I of the Housing and Community Development Act of 1974. The program provides grants to aid in the development of viable urban communities by providing decent housing and a suitable living environment and expanding economic opportunities, principally for persons of low and moderate income. HUD gives the City of Miami annual entitlement grants to help the City's efforts in carrying out a wide range of community development activities directed towards neighborhood revitalization, economic development, and improved community facilities and services.

To be eligible for funding, every CDBG-funded activity must meet one of the program's three national objectives. Each activity, except program administration and planning, must:

- Benefit low and moderate income persons; or
- Aid in preventing or eliminating slums or blight; or
- Address a need with a particular urgency because existing conditions pose a serious and immediate threat to the health or welfare of the community.

The HOME Investment Partnerships Program was created under Title II of the National Affordable Housing Act of 1990. HOME was designed to strengthen public-private partnerships to expand the supply of decent, safe, sanitary, and affordable housing, with primary attention to housing for low and very low-income families.

The City of Miami's CPD Programs are administered through its Department of Community Development. For the audit period, the City's CDBG and HOME entitlement funds were:

SOURCE OF CPD FUNDS	**AMOUNT**
Unexpended CDBG funds from prior years	$ 23,508,092
Unexpended HOME funds from prior years	8,669,711
CDBG Program year May 1996	13,709,000
CDBG Program year May 1997	13,320,000
HOME Program year May 1996	4,038,000
HOME Program year May 1997	4,315,000
Program income, June 1, 1995 through May 31, 1996	3,298,724
Program income, June 1, 1996 through May 31, 1997	3,497,625
Prior period adjustments	76,044
Total	$ 74,432,196

The City of Miami is a Municipal Corporation governed by the Mayor and City Commissioners. The City's fiscal year is October 1 through September 30. The City's CPD Programs are administered by its Assistant City Manager. The City's books and records are maintained at 444 SW 2nd Avenue, Miami, Florida.

AUDIT OBJECTIVES, SCOPE AND METHODOLOGY

The focus of our review was to determine if the City complied with Federal laws, HUD regulations, and other requirements in carrying out its CPD Programs. Specifically, objectives were to determine whether the City:

- Complied with the CPD Program requirements, laws, and regulations;
- Had adequate controls to ensure compliance with HUD regulations; and
- Carried out its activities in an economical, efficient, and effective manner.

To accomplish the objectives, we tested program activities for compliance with program requirements, interviewed appropriate HUD staff and City officials, and reviewed HUD and City records related to the CPD Programs. We also reviewed various disbursements for eligibility, support, and proper allocation; evaluated the City's system of internal controls and management practices; and performed limited reviews of the City's Grantee Performance Reports.

Our review methodology included a judgmental selection of five multifamily rehabilitation loans. The City wrote off two of the loans as uncollectible. Also, one loan was past due and the City restructured the loan terms of the last two loans.

Our audit covered the period June 1, 1995, through December 31, 1996; however, we extended the audit period as necessary. We performed the audit field work between January and August 1997. We conducted our audit in accordance with generally accepted government auditing standards.

Findings

Finding 1

The City Inappropriately Spent $5,688,606

The City spent $5,203,607 of CDBG funds for grant administrative expenses without proper support. Also, the City spent $484,999 for ineligible grant administrative expenses. This occurred because the City shifted grant administrative costs between grants; exceeded the 20 percent grant administration limit; and paid indirect costs without supporting cost allocation plans, prior to receiving services, and prior to the central service departments incurring costs. As a result, the City deprived the intended program beneficiaries of $5,688,606.

HUD REQUIREMENTS

Title 24 of the Code of Federal Regulations (CFR), Part 570.200 (a)(5) requires that costs incurred, whether direct or indirect costs, must conform to Office of Management and Budget (OMB) Circular A-87 (A-87). Costs allocable to a particular grant cannot be charged to other grants. Indirect costs must be supported by a certified Cost Allocation Plan. For fiscal years beginning after September 1, 1995, A-87 requires Grantees to submit a certified plan to the cognizant agency. HUD is the City's cognizant agency. If the City has not submitted a certified plan, HUD may disallow all indirect costs.

THE CITY SHIFTED COSTS BETWEEN GRANTS TO AVOID EXCEEDING EXPENDITURE LIMITS

The City shifted costs between grants to avoid exceeding the 20 percent grant administrative expense limit. Because the City elected not to comply with requirements, the City deprived the intended program beneficiaries of $2,133,797.

A-87 stipulates that any excess costs over the Federal contribution under one award agreement are unallowable under other award agreements. Similarly, A-87 states any cost allocable to a particular grant or cost objective may not be shifted to other Federal grant programs to overcome fund deficiencies, avoid restrictions imposed by law or grant agreements, or for other reasons. Also, A-87 stipulates that amounts not recoverable as indirect costs or administrative costs under one Federal award may not be shifted to another Federal award unless specifically authorized by Federal legislation or regulation. Further, Title 24 CFR 570.200(g) limits expenditures for planning and administrative costs to 20 percent of the sum of any grant plus program income.

Based on a July 1991 inter-office memorandum, the City's Finance Department withdrew $1,850,997 from the May 1992 program year CDBG grant. The funds included cumulative indirect costs that Finance claimed it undercharged for fiscal years 1987 through 1991.

In July 1992, Finance charged another $215,382 of indirect costs to the program year. Thus, the City charged $2,066,379 of indirect costs to the May 1992 program year. The estimated indirect costs for the program year were $552,689.

Indirect costs are part of the grant administrative costs which are subject to a 20 percent limit. Because the City charged the cumulative indirect costs, the City exceeded the 20 percent limit for program year May 1992.

The HUD Jacksonville Area Office reviewed the Grantee Performance Report for the program year. In a June 14, 1993, letter the HUD Office disclosed the City apparently exceeded the 20 percent limit.

In an October 25, 1993, inter-office memorandum a former City Community Development Director requested Finance to transfer the over charges to the May 1992 program year indirect costs account. On October 26, 1993, Finance transferred indirect costs of $1,266,066 to other program years to avoid exceeding the 20 percent limit. The transfers included $1,166,329 to program year 1994; $99,589 to program year 1991; and $148 to program year 1987. In addition, the City transferred $36,482 to other expenses in the May 1992 program year.

Also, for program years May 1994 through May 1997 the City continued the practice of transferring costs to other grants to avoid exceeding the 20 percent limit. Generally, the City transferred grant administrative expenses that exceeded the total amount budgeted. The costs transferred included indirect costs and other grant administrative costs that caused the City to exceed the total grant administration budget. Because the City transferred the excessive costs before the end of the program year, the costs were not reported to HUD on the City's Grantee Performance Report.

As shown in the following chart the City transferred excess administrative expenses totaling $2,133,797.

DESCRIPTION		
Program Year May 1987		
Excess costs transferred from program year May 1992		$148
Program Year May 1991		
Excess costs transferred from program year May 1992		99, 589
Program Year May 1992		
Retroactive adjustment	$1,850,997	
Additional charge	215,382	
Less:		
Estimated indirect cost	(552,689)	
Transfer to program year May 87	(148)	
Transfer to program year May 91	(99,589)	
Transfer to program year May 94	(1,166,329)	
Excess costs charged to program year May 1992		247,624
Program Year May 1994		
Transfer from program year May 1992	1,166,329	
Less: Transfer to program year May 1995	(1,786,436)	
Excess costs charged to program year May 1994		0[1]
Program Year May 1995		
Transfer from program year May 1994	1,786,436	
Less: Transfer to program year May 1996	(1,459,464)	
Excess costs charged to program year May 1995		326,972
Program Year May 1996		
Transfer from program year May 1995	1,459,464	
Less: Transfer to program year May 1997	(869,336)	
Excess costs charged to program year May 1996		590,128
Program Year May 1997		
Excess costs transferred from program year May 1996 charged to program year May 1997		869,336
TOTAL EXCESS COSTS		**$2,133,797**

[1] In order to avoid the 20 percent limit, the City transferred out more than was transferred in. Thus, no excess costs resulting from the transfers remained in program year May 94.

The City believed it was acceptable to shift administrative costs between grant years. Although the City acknowledged the provisions of A-87, the City claimed it, as well as HUD, had administered the CDBG Program rules and regulations as a single Federal award. Any shifting of indirect costs that may have taken place always occurred within the Grant, rather than between two grant programs. The City also believed it was acceptable to charge indirect costs for previous years as long as the charges did not contribute to the City exceeding the 20 percent grant administration limit.

In the past HUD has allowed recovery of indirect costs from previous years. Based on a June 24, 1986, memorandum from Alfred C. Moran, former Assistant Secretary, Community Planning and Development, if a Grantee exceeded the 20 percent requirement in a program year, the Grantee would be considered to be in compliance with the requirement if it could allocate its planning and administrative expenditures to each source year of the CDBG funds and thereby demonstrate that it had not exceeded the 20 percent limit. In order to recover such excess costs, the Grantee would have to account for its expenditures on a grant by grant basis.

We discussed the matter with the HUD CPD Entitlement Division. The Assistant Director agreed that in order to recover such costs the City would have to account for its administrative costs on a grant by grant basis, support the undercharged amounts, and remain under the 20 percent limit for each applicable program year. Also, the City would have to show for each program year which administrative costs were applicable to each activity administered. However, in no case could any undercharged amounts from prior years be charged to the current year or future years.

We agreed that if the City could demonstrate that it would not have exceeded the 20 percent limit for 1987 through 1991 in which the City claimed it had undercharged the indirect costs, we would consider allowing the costs. The City provided documentation to support the 20 percent limit would not have been exceeded. However, the documentation is not sufficient to fully resolve the issues. Therefore the City did not adequately support $2,133,797 of grant administrative expenses that were transferred between program years.

THE CITY EXCEEDED THE 20 PERCENT GRANT ADMINISTRATION LIMIT

The City exceeded the 20 percent grant administration limit for program years May 1992 and 1994. Because the City failed to comply with requirements and report all expenses, the City expended $484,999 in excess of the grant administration limit. Thus, the City deprived the intended program beneficiaries $484,999.

The total administrative costs for program year May 1992 exceeded the 20 percent limit. The program year grant was $12,502,000 and program income was $1,937,187. The City also received an additional $697,016 for the program year. Thus, the maximum grant administrative expense allowed was $3,027,241. According to the Grantee Performance Report, the City charged $3,177,555 for grant administrative expenses. Therefore, the City exceeded the 20 percent limit by $150,314.

Also, on May 9, 1994, Finance transferred $551,600 from its May 1994 program year indirect cost line item to its Disaster Grant. However on September 15, 1994, Finance reversed the May 9, 1994, journal entry and transferred the $551,600 back to the May 1994 program year grant. Since the City transferred the costs on May 9, 1994, and the City's CDBG Program year ended May 31, 1994, the City did not report the $551,600 of administrative costs on its Grantee Performance Report.

The May 1994 program year grant was $12,571,000 and program income was $3,274,913. Thus, the maximum allowable grant administrative expense was $3,169,183. According to the Grantee Performance Report, the grant administrative costs were $2,952,268 for the program year. However, the City did not report the $551,600 that was transferred. Since the City expended the $551,600, it should have been reported on the Grantee Performance Report. If the City reported the $551,600, the total grant administrative costs would have been $3,503,868. Thus, the City exceeded the 20 percent limit by $334,685.

THE CITY DID NOT HAVE COST ALLOCATION PLANS TO SUPPORT INDIRECT COSTS

The City did not have plans to support $3,069,810 of indirect costs charged to its CDBG grants. A-87 requires the Grantee to prepare and maintain a plan to support indirect cost charges. For fiscal years beginning after September 1, 1995, A-87 requires the Grantee to prepare an indirect cost rate proposal and related documentation to support indirect costs. The indirect cost rate proposal must be developed and submitted to HUD within 6 months after the close of the fiscal year.

A. Indirect Costs of $2,518,210 Were Charged to CDBG Without Support

The City did not prepare plans for approval to support indirect costs charged to its CDBG grants for program years May 1995 through May 1997. Also, indirect costs for program years May 1996 and May 1997 were based on costs for fiscal years beginning after September 1, 1995. Thus, the City was required to submit its indirect cost rate to HUD for approval.

The City did not have approved plans; however, it charged $2,518,210 of indirect costs to program years May 1995 through May 1997. Typically, the City withdrew funds from its line of credit early in the program year to pay its indirect costs. Since the City did not prepare the plans, the City based the amount withdrawn on plans from previous fiscal years. For example, the City initially charged $758,551 as indirect costs for program year May 1995, which also represented fiscal year 1995. The City based the $758,551 on its fiscal year 1992 plan. Once the fiscal year 1993 plan was prepared, the City adjusted the May 1995 program year indirect costs charged to closely reflect the 1993 plan. The City performed the same projections for the May 1996 and May 1997 program years. The City recently received the fiscal year 1994 plan. Thus, we anticipate the City will adjust the indirect cost for program years May 1995 through May 1997 to closely reflect the 1994 plan.

The City's staff explained the plans cannot be prepared and submitted within 6 months of the end of the fiscal year. The plans are not developed until the City's audited financial statements are prepared. Thus, the City typically does not receive the plans until 2 years after the respective program years have ended. This is further complicated by the fact the City's program year is June 1 through May 31, whereas its fiscal year is October 1 through September 30. Because the plans are not prepared timely, the City justified withdrawing the estimated indirect costs from the line of credit based on plans from previous fiscal years. The City did not have an approved provisional rate.

A-87 permits Grantees to use a provisional rate as a temporary indirect cost rate applicable to a specified period pending the establishment of a final rate for that period. The provisional rate must be approved. Also, A-87 permits Grantees to use a predetermined rate based on an estimate of the costs to be incurred during the period. However, predetermined rates may not be used by Grantees that have not submitted and negotiated the rate with the cognizant agency. HUD did not approve either a provisional rate or a predetermined rate.

B. Indirect Costs of $551,600 Were Charged to a Disaster Grant Without a Plan

On September 21, 1994, Finance charged $551,600 of indirect costs to the Disaster Grant. The City did not have a plan to support the charges. Coincidentally, the $551,600 represented the maximum grant administrative expense that could be charged to the Disaster Grant to meet the 20 percent limit. Thus, it appeared the City charged the $551,600 in order to maximize the administrative expense.

THE CITY PAID INDIRECT COSTS PRIOR TO RECEIVING SERVICES

The City paid indirect costs for program years May 1996 and May 1997 prior to receiving services. A-87 provides that a cost is allocable to a cost objective if the goods or services involved are chargeable or assignable in accordance with relative benefits received. Costs must be necessary and reasonable for proper and efficient grant administration. In determining reasonableness, consideration must be given to sound business practices.

The City's CDBG Program year is June 1 through May 31. The City's fiscal year is October 1 through September 30. The City's plans are based on the actual costs for the fiscal year. Because of the differing time periods, the indirect costs charged to the CDBG Program did not match the periods in which the services were received.

Although we do not take exception to the differing periods, we do not believe the City should pay indirect costs prior to receiving services and prior to the central service departments incurring related costs. For example, on June 9, 1995, the City withdrew $987,746 from its line of credit for indirect costs for program year May 1996. The City paid the $987,746 to the general fund. The payment was for indirect costs for services to be provided from June 1, 1995, through May 31, 1996. Thus, the City paid the full program year's indirect costs in June 1995 for services that had not been rendered and for which the central service departments had not incurred costs. We do not believe this represents sound business practice.

In September 1996, the City paid $987,746 for indirect costs for program year May 1997. Again, the City paid the indirect costs even though no services had been received and no costs had been incurred by the central service departments.

The City believed it was acceptable to pay indirect costs in advance. The City was informed by the consulting firm that prepares its plans that the practice was common in the industry. According to an OMB Policy Analyst, indirect costs cannot be paid until costs for services are incurred. If a provisional rate were approved, the City could pay its applicable portion of the indirect costs incurred based on the provisional rate.

AUDITEE COMMENTS

The City generally agreed with the finding. The City provided documentation to support that the 20 percent limit would not have been exceeded for years 1987 through 1991.

OIG EVALUATION

Based on the City's comments, we made revisions to the finding. We commend the City's positive efforts to resolve the weaknesses. Although the City provided documentation to try to show the 20 percent limit would not have been exceeded, the documentation was not sufficient to fully resolve the issues.

RECOMMENDATIONS

We recommend you require the City to:

1A. Provide adequate support for $2,133,797 of grant administrative expenses that were transferred between program years or repay any unsupported costs to the CDBG Program.

1B. Reimburse the CDBG Program for ineligible costs of $484,999.

1C. Submit certified Cost Allocation Plans as required to support indirect costs charges of $2,518,210 for program years May 1995 through May 1997 or repay any unsupported costs to the CDBG Program.

1D. Provide support for the $551,600 of administrative costs charged to the Supplemental Disaster Relief Grant or repay any unsupported costs to the U.S. Treasury.

1E. Submit for approval a corrective action plan to correct the systemic weaknesses identified in the finding.

Finding 2

Loan Procedures Needed Improvement

The City's loan procedures needed improvement. The City's underwriting and collection procedures were inadequate. In addition, the City failed to pursue legal remedies to cure defaults and recover losses, as well as protect its interests upon foreclosure. Also, loan decisions made by the City Commissioners were not in the City's best interest. As a result, about $9.9 million, or 36 percent, of the City's outstanding loan portfolio was in default. The City's failure to collect the loans reduced the amount of program income available to carry out its CDBG activities.

HUD REQUIREMENTS

A-87, Paragraph A, 2.a, requires efficient and effective administration of Federal awards through the application of sound management practices. Title 24 CFR, Part 85.20(a)(3) requires Grantees to maintain effective control and accountability for all grant and subgrant cash and other assets. Grantees must adequately safeguard all such property.

LOAN PORTFOLIO ACTIVITY

The City administered several loan programs including multifamily rehabilitation (MFR), single family rehabilitation (SFR), rental rehabilitation, new construction, and various smaller programs. As of May 30, 1997, the City's portfolio contained 634 loans with an outstanding principal balance of $27,658,117. Approximately 187 or 30 percent of the loans were in default[2]. The outstanding balance of the defaulted loans was $9,904,456 or 36 percent of the outstanding loan portfolio balance. Further, $5,987,960 of the defaulted balance was over 90 days past due. The past due payments on all loans, including late fees, totaled $1,509,138.

The following table shows the City's complete loan portfolio.

[2] Loan payments were at least 30 days past due.

CITY'S LOAN PORTFOLIO AS OF MAY 30,1997

LOAN PROGRAM	PRINCIPAL BALANCE OUTSTANDING	PRINCIPAL BALANCE IN DEFAULT	PERCENT IN DEFAULT	DEFAULT > 90 DAYS	PERCENT DEFAULT > 90 DAYS
CDBG - MFR	$15,031,188	$6,738,463	44.8 percent	$4,772,984	31.8 percent
CDBG - SFR	5,274,361	1,781,682	33.8 percent	799,417	15.2 percent
Rental Rehab	5,489,370	979,732	17.8 percent	227,500	4.1 percent
HOME	748,986	110,790	14.8 percent	57,051	7.6 percent
UDAG	585,597	88,189	15.1 percent	50,338	8.6 percent
Scattered Site	368,919	102,281	27.7 percent	20,000	5.4 percent
Section 8	59,696	53,319	89.3 percent	50,670	84.9 percent
Other	100,000	50,000	50.0 percent	10,000	10.0 percent
TOTAL	**$27,658,117**	**$9,904,456**	**35.8 percent**	**$5,987,960**	**21.7 percent**

We limited our review to the MFR loan program due to the large outstanding loan portfolio; high defaults; and high susceptibility to fraud, waste, and abuse. As of May 30, 1997, the MFR loan portfolio outstanding principal balance was $15,031,188, which represented 54 percent of the City's outstanding loan portfolio.

Approximately 45 percent of the MFR loan outstanding balances were in default, which was 23 of the 40 MFR loans. The 23 defaulted loans represented 57.5 percent of the City's outstanding MFR loans. Twenty of the 23 defaulted loans were over 90 days past due. Also, 10 of the 20 loans were over 2 years past due. Approximately $1.1 million of the MFR loan payments, including late fees, were past due. A schedule of the defaulted MFR loans is included as Appendix B. In addition to the defaulted loans, the City wrote off five MFR loans totaling $2,373,865 as uncollectible during the May 31, 1996, program year.

We judgmentally selected five MFR loans for review. The loans reviewed included two loans the City wrote off as uncollectible, one in default, and two the City restructured. See Appendices C-1 through C-3 for detailed results of the deficient loans reviewed. In addition, we also performed a limited reviews of foreclosure requests for defaulted SFR loans.

THE CITY'S UNDERWRITING PROCEDURES WERE DEFICIENT

The City's underwriting procedures were deficient. For example, the City did not adequately analyze borrowers' credit worthiness or require equity investments from borrowers. As a result, the City made loans to borrowers who were not credit worthy. Therefore, the City increased the risk that borrowers would not repay loans and the risk of financial losses upon foreclosure. The deficiencies contributed to the defaulted and uncollectible loans.

A. The City Did Not Adequately Analyze Borrowers' Credit Worthiness

The City's Housing Division did not adequately analyze credit worthiness when underwriting MFR loans. For the five loans reviewed, the City did not obtain credit reports. Analysis of credit worthiness is an essential element of the underwriting process. Failure to consider credit worthiness demonstrates the City's lack of sound management practices.

Because the City did not adequately analyze credit worthiness, Housing inappropriately made a loan to Liberty City Improvement Corporation. Liberty's principal was also a principal of two other entities, Ideal Rehabilitation Inc., and DC Two Exponent, Inc., that previously defaulted on MFR loans. Despite the previous defaults, Housing made a $367,300 MFR loan to Liberty on August 15, 1990. Liberty defaulted on the loan in February 1991. The details regarding these loans are discussed in Appendices C-1 and C-2. It is not sound management practice for the City to make loans to borrowers with a poor credit history or who have previously defaulted on a Federal loan. At a minimum, the City should analyze credit worthiness by reviewing credit reports for the borrowing entities and its principals.

B. The City Did Not Require Equity Investment From Borrower

Housing did not require equity investments by borrowers. Private sector lenders generally require borrowers to make at least a 10 to 20 percent investment to receive a rehabilitation loan, but the investment cannot include debt equity (secondary loan proceeds). However, Housing allowed debt equity for the full equity investment.

Requiring borrowers to make an equity investment would reduce the likelihood of default because the borrowers risk losing their investments. Because the City did not require borrower investments, borrowers had less incentive to repay the loans. Thus, the City increased the risk of loss to the program.

THE CITY'S COLLECTION PROCEDURES WERE INADEQUATE

The City did not have written collection procedures detailing the collection process and assigning responsibilities for specific tasks. The lack of written procedures caused poor communication and misunderstanding of duties between the responsible divisions. Therefore, the procedures used by the City were inadequate to properly safeguard its assets. The City's failure to implement adequate collection procedures contributed to the $9.9 million in defaulted loans and the $2.3 million written off as uncollectible.

A. Weaknesses in the Finance Division's Procedures

A City Finance Department Accounts Receivable Clerk was responsible for collecting loan payments, contacting delinquent borrowers, notifying the other responsible departments when borrowers defaulted on their loans, and determining when a loan was uncollectible. When loans became past due, the Clerk sent various types of 30 and 60 day delinquency letters to borrowers and made personal contact with borrowers to discuss repayment. If a loan was not current after 120 days, the Clerk sent a letter threatening legal action. Although the 120 day letters threatened legal action, Finance did not begin sending the letters for MFR loans to Legal until February 1997 after our review started. Thus, Legal did not take any legal action pursuant to the letters. The Clerk continued to send the 120 day delinquency letters to the delinquent borrowers every month until the past due amounts were paid or the City took other action.

If the Clerk determined a loan to be uncollectible, the Clerk sent a foreclosure request form to Housing recommending foreclosure. However, loans were often delinquent more than a year before the Clerk sent a foreclosure request form to Housing. The Clerk did not recall sending Housing any foreclosure request forms for MFR loans even though some MFR loans had been delinquent for over 3 years. We were unable to determine the reason the Clerk seldom sent MFR loan foreclosure request forms to Housing.

B. Weaknesses in the Housing Division's Procedures

Housing was responsible for determining whether to restructure delinquent MFR loans or recommend foreclosure. However, Housing did not have access to the City's accounts receivable system. Therefore, Housing could not readily identify delinquent loans. Instead, Housing relied on Finance for notification of delinquent loans.

According to the Housing Division Chief, Finance was responsible for initiating the foreclosure process by sending a foreclosure request form to Housing. Housing was responsible for recommending foreclosure and sending the form to Legal. Even though Housing knew many loans were seriously delinquent, Housing relied on Finance to send a foreclosure request form to initiate the process.

C. Weaknesses in the Legal Division's Procedures

Legal was responsible for foreclosing on loans. However, Legal did not have adequate staff assigned or an effective system established to perform timely foreclosures. As a result, the City never foreclosed on a MFR mortgage. As of March 31, 1997, 10 SFR loans that were sent to Legal for foreclosure from November 1991 through September 1996 were not foreclosed. Legal had only completed foreclosure on one SFR loan in the last 2.5 years.

An Assistant City Attorney and a part time legal assistant were assigned to perform foreclosures for the community development loans. However, the Assistant City Attorney was also responsible for foreclosures of code enforcement liens as well as other foreclosures. At the time of our review, in addition to the community development loans, the Assistant City Attorney had about 900 code enforcement foreclosures in inventory. The Assistant City Attorney also receives about 200 additional foreclosure cases annually. According to the Assistant City Attorney, each foreclosure case requires about 20 staff hours. Therefore, it would take about 18,000 (900 cases x 20 staff hours) staff hours to complete the 900 cases currently in inventory. This does not consider the additional 200 cases received annually or any community development foreclosure cases.

Generally, when the City received a Notice of Foreclosure Action from other lien holders, the City had 30 days or less to respond to the foreclosure action. Otherwise, the other lien holders could obtain a summary judgment and the debt to the City would be extinguished. However, Legal did not have a system in place to track correspondence with Housing or the status of foreclosure cases. The lack of a tracking system seriously interfered with the City's ability to respond timely to the Notices. Upon receiving a Notice, Legal sent a letter to Housing requesting advice as to what action to take. Because there was no system to track correspondence, Legal could not ensure a timely response was received from Housing. Also, Legal could not ensure timely action would be taken if a response was received. Legal recognized the weaknesses caused by the lack of a tracking system, and has commendably begun the development of a tracking system.

OTHER WEAKNESSES EXISTED IN THE CITY'S PROCEDURES

The City did not pursue all legal remedies to cure defaults and recover losses. In addition to foreclosures, the City had other available remedies to safeguard its assets. The remedies included collecting rents through assignment of rent agreements and pursuing personal guarantees to recover losses. Also, the City did not take appropriate action to protect its interests upon foreclosure by superior lien holders.

A. The City Did Not Pursue Collection Through Assignment of Rent Agreements

The City required each MFR borrower to execute an assignment of rent agreement. The agreements authorized the City to require all property rents be assigned to the City to cure defaults. However, despite the high defaults, the City never exercised its rights pursuant to the agreements. As a result, the City increased the risk of loss to the program.

B. The City Did Not Pursue Personal Guarantees To Recover Losses

Since 1986, the City required all MFR borrowers to personally guarantee the loans in order to decrease the risk of loss. Even though the City wrote off over $2.3 million in program year ending May 31, 1996, the City did not take action pursuant to the guarantees to recover the losses. The City has never exercised its rights to recover any losses pursuant to the guarantees.

Legal explained they had never received a request to pursue collection against personal guarantees. Thus, Legal took no action. Housing assumed Legal pursued collection against personal guarantees based on its foreclosure recommendations. This further illustrates the poor communication and misunderstanding of duties caused by the lack of written procedures.

C. <u>The City Did Not Protect Its Interest Upon Foreclosure By Superior Lien Holders</u>

The City did not protect its interest upon foreclosure by superior lien holders. The City claimed this occurred because it did not have funding authorized to pay off superior mortgages and because it did not have adequate resources to manage properties acquired through foreclosure. As a result, the City lost at least $1,571,480 following foreclosure by superior lien holders.

Generally, the City had 30 days or less to respond to notices of foreclosures from other lien holders. Otherwise, the other lien holders could obtain a summary judgment and the debt to the City would be extinguished. In order to avoid the summary judgment, the City could have satisfied the note to the foreclosing lien holder. However, the City did not have a funding source established to satisfy the liens. The City recognized the need to establish a funding source; however, funding was not provided.

Also, the City did not have staff assigned to manage multifamily properties. We believe the City should have anticipated that foreclosures would occur; thus the City should have planned accordingly.

COMMISSIONERS' INVOLVEMENT HAMPERED LOAN PROGRAM OPERATIONS

The City established a loan committee responsible for recommending approval or disapproval of loan applications, loan agreement restructuring, and lien subordinations. In spite of the committee's recommendations, the City made certain decisions regarding MFR loans because of political pressure by City Commissioners.

We identified three cases where the City Commissioners became involved in decisions regarding loans. In each of the three cases, the borrowers requested the City to subordinate its liens to increased superior mortgages. The loan committee disapproved the requests. Against the loan committee's recommendations, the Commissioners subsequently approved the subordinations. As a result of the Commissioners' actions, the City increased its risk of loss by over $1 million.

The following illustrates an example of the Commissioners' involvement in a MFR loan. The City made a $1,685,283 deferred payment loan to Downtown Investments, Inc., in April 1994 from its HOME Program funds. Pursuant to the loan terms, the City would forgive a portion of the loan annually for 10 years. Downtown Investments, Inc., was not required to make any payments on the loan unless they defaulted on a superior mortgage or failed to comply with the HOME Program requirements. The City held a third mortgage position.

In a February 16, 1995, memo the City was informed that the second mortgage holder was foreclosing on the mortgage. On August 18, 1995, Miami Capital Development, Inc., a sub-recipient that administers the City's economic development loan program, obtained the second mortgage.

In January 1997, after the first mortgage holder began foreclosure, Downtown Investments requested the City to subordinate its mortgage to a new first mortgage. Downtown Investments planned to obtain a new first mortgage loan of $950,000. Downtown Investments would use $539,000 of the loan proceeds to pay off the existing first and second mortgages. Downtown Investments would receive the remaining $411,000 as a return of equity. If the City agreed to the subordination, the City's risk would be increased as a result of the $411,000 larger mortgage. Although the defaulted borrower would receive $411,000 from the refinance, the City would not receive compensation for its increased risk. The loan committee disapproved the request.

The City's staff determined the appropriate action was for the City to pay off the first mortgage balance of $209,000 and then foreclose. This would prevent the City's $1,685,283 mortgage from being extinguished upon foreclosure by the superior lien holder. The second mortgage holder, Miami Capital Development, agreed to subordinate its lien position to the City.

However, the City Commissioners did not agree. At a July 10, 1997, meeting the Commissioners approved Downtown Investments request for the City to subordinate its mortgage to the larger refinanced mortgage. The Commissioners, however, did require Downtown Investments to use the remaining $411,000 to rehabilitate another property owned by them. However, the City did not have an interest in the other property. Thus, the City would not receive a benefit for its increased risk.

We do not believe the Commissioners acted in the City's best interest by approving the subordination. The property was valued at about $2 million. Thus, the City could have sold the property for a price sufficient to recover the HOME funds. Thus, we believe foreclosure was a more appropriate option than subordination of the lien. Also, by December 22, 1996, Downtown Investments had defaulted on both the first mortgage and the second mortgage assumed by Miami Capital Development. The balances were $209,000 and $330,000, respectively. Since Downtown Investments defaulted on the previous mortgages, we are concerned Downtown Investments will be unable to make payments on a $411,000 greater mortgage. In addition, we are concerned that the Commissioners elected to increase the City's risk of loss to a borrower who had previously defaulted twice on its mortgage loans.

We identified two other cases in which the City Commissioners may not have acted in the City's best interest. In both cases, the Commissioners acted against the loan committee's recommendations. One case involves the refinancing and subordination of loans to Ideal Rehab, Incorporated and Liberty City Investments Corporation.[3] The other case involves the sale of a property owned by Indian River Investments Management Company. The details regarding these loans are discussed in Appendices C-1 and C-3, respectively.

[3] Separate loans were originally made to Ideal and Liberty. The loans were subsequently restructured into a single loan.

AUDITEE COMMENTS

The City generally agreed with the Finding. The City is seeking City Commission approval to impose a voluntary moratorium on the CDBG and HOME funded MFR loan programs. This would afford the City an opportunity to work with HUD in addressing the weaknesses and deficiencies cited in the audit. The City plans to aggressively pursue collection and legal actions against all delinquent loan accounts under the MFR Programs.

OIG EVALUATION

We commend the City for recognizing the weaknesses and its taking actions to resolve the deficiencies. We believe the City recognizes that substantial improvements in the loan programs must be made.

RECOMMENDATIONS

We recommend you require the City to:

2A. Repay the CDBG Program $686,270 for amounts written off as uncollectible for the DC Two Exponent, Inc. loan.

2B. Repay the CDBG Program $368,077 representing past due interest and late fees forgiven for the Ideal Rehab, Inc. and Liberty City Improvement Corporation loans.

2C. Collect all loan payments over 90 days past due, within 90 days, either through repayment from the borrowers, assignment of rents, foreclosure, or personal guarantees. As of May 30, 1997, about $1,500,000 of the loan payments were past due. The City should consider establishing a task force or other committees to aggressively pursue collections.

2D. Implement controls and procedures to ensure proper administration of its loan programs and proper safeguarding of its assets. At a minimum the controls and procedures should include:

- Obtaining and analyzing credit reports for the borrowing entity and its principals;
- Requiring disapproval of loans to entities and individuals who have demonstrated a lack of credit worthiness;
- Requiring a minimum equity investment of 10 percent from borrowers;
- Written procedures delineating the roles and responsibilities of the various departments in carrying out the loan collection process;

- Developing and implementing a mortgage tracking system which provides access to information as needed by the various departments. The system should provide for the development of delinquency reports and status reports on cases referred for legal action;

- Developing guidelines for analyzing the economic feasibility of pursuing foreclosures;

- Establishing a pool of funds for use in performing foreclosures and protecting the City's interest upon foreclosure by superior lien holders;

- Establishing procedures for managing properties upon foreclosure;

- Establishing a loan committee with proper expertise in evaluating loans. The committee should include at least one member from a private financial institution; and

- Establishing written procedures and guidelines for use by the loan committee in approving loans, subordinating loans, and restructuring loans.

2E. Assume the risk for any loan transactions approved by the City Commissioners against the recommendation of the loan committee.

2F. Submit for approval a corrective action plan to correct the systemic weaknesses identified in the finding.

Finding 3

The City Allocated $4.75 Million For A Project That Was Not Feasible

The City allocated $4.75 million of HOME funds to develop an affordable housing project that was not feasible. The homes were not affordable for prospective buyers and funding was insufficient to complete the project. Also, the developer owed the City $144,538 of program income. The City did not require the developer to demonstrate the homes were affordable to very low income families or require the developer to obtain adequate financing to complete project construction. As a result, the City spent over $1.9 million of the HOME funds as of August 12, 1997, and the developer did not construct or pre-sell any units.

CITY ALLOCATED $4.75 MILLION OF HOME FUNDS

On September 14, 1995, City Commissioners adopted a resolution allocating $2.375 million of HOME funds to develop an affordable housing project. The resolution also allocated an additional $50,000 for predevelopment costs. Subsequently, on December 7, 1995, the Commissioners rescinded the original resolution and adopted a new resolution. The new resolution allocated $4.75 million for the project and an additional $50,000 for environmental studies and predevelopment costs. The funding was conditioned on the owner securing equal funding from Dade County and/or the State of Florida.

CITY AUTHORIZED PROPERTY PURCHASE DESPITE AN INACCURATE APPRAISAL

The City authorized the purchase of the development site although the appraisal was inaccurate. A January 2, 1996, appraisal report valued the property at $900,000. The appraiser allotted a contract price of $700,000 and a demolition cost of $200,000. The valuation presumed the property was vacant and available for development and that the City abandoned and vacated two interior public streets. However, 96 of the property’s 235 units remained occupied and the City did not abandon or vacate the interior streets. As of August 12, 1997, the streets were not released for the project.

An appraisal review performed on January 11, 1996, concluded the appraiser’s value may have been overstated by $200,000. The review appraiser also concluded the value estimated did not reflect the current market value of the property, but a future market value. The estimated value was subject to demolition of existing improvements, vacating of public streets, and replatting the site. The review appraiser further concluded that the sites used as comparisons were not physically and economically similar to the project site; adjustments applied to comparable sites were unreasonable and not accurately supported; and the final value estimated was not consistent with the data and analysis presented in the report.

Despite the review appraiser's comments, on January 30, 1996, the City authorized a disbursement of $725,000 to purchase the site. Liberty Housing Associates purchased the site on February 15, 1996.

INDEPENDENT CONSULTANT DETERMINED THE PROJECT WAS NOT VIABLE

The City hired an independent consultant to analyze the project development. In an October 31, 1996, report the consultant concluded that the development was not a viable project. The consultant stated the developer should provide sufficient funding to complete the overall development, as well as provide sufficient evidence of available subsidized end loan financing for individual buyers. The consultant further stated cost savings could be accomplished in the construction process by reducing the per square footage costs and reducing and/or redesigning the homes to make them affordable for prospective home buyers. Therefore, the cost savings would make the overall development a more viable and attractive project.

IMPLEMENTATION OF THE HOUSING DEVELOPMENT

The housing project, Northwestern Estates (formerly Knight Manor), was implemented to increase the supply of affordable housing for low and very low income families and individuals. The City allocated the funding for land acquisition and assisting in financing the development of 134 affordable homes. The project is located in the Model City Community Development target area of Miami, Florida.

The Urban League of Greater Miami, Inc., a State of Florida not-for-profit corporation, sponsors the project. The Urban League is also the Community Housing Development Organization approved by the City to conduct HOME activities within the Model City target area. Liberty Housing Associates is the project developer.

THE HOMES EXCEEDED AFFORDABILITY LIMITS

According to the Community Housing Development Organization Agreement, the project was intended to increase the supply of affordable housing for low and very low income families and individuals. However, the sale prices exceeded affordability and income limits were insufficient for eligible families to qualify.

Title 24 CFR 92.254, sets forth requirements for housing to qualify as affordable. It states if a participating jurisdiction intends to use HOME funds for homebuyer assistance, the participating jurisdiction may use the Single Family Mortgage Limits under Section 203(b) of the National Housing Act or it may determine 95 percent of the median area purchase price for single family housing in the jurisdiction.

The single family mortgage limit under Section 203(b) of the Act for Dade County was $112,350. Since the Model City neighborhood where the project is located is an economically depressed area of Dade County, the mortgage limits were not representative of the area market. Therefore, the prudent method to determine affordability for the project was to use 95 percent of the median purchase price for the immediate area of the project and similar adjacent areas. Per Title 24 CFR 92.254, to determine the median purchase price at least 3 months of sales data were required since sales were less than 250 per month.

We determined the median area purchase price was $60,000. Thus, to qualify as affordable the purchase prices cannot exceed $57,000 ($60,000 x 95 percent). As shown in the following table, the estimated prices of the homes ranged from $53,000 to $91,400. Therefore, only 14 of the 134 homes qualified as affordable.

PLANNED UNIT MIX AND SALES PRICES

UNIT TYPE	NUMBER OF UNITS	DESCRIPTION	SALES PRICE PER UNIT	TOTAL PROCEEDS
Model A	8	Single family	$91,400	$731,200
Model B	8	Single family	$91,400	$731,200
Model C	8	Single family	$91,400	$731,200
Model A(T)	14	Two story townhouses	$53,000 to $55,000	$756,000
Model B(T)	96	Two story townhouses	$74,500 to $76,000	$7,224,000
TOTAL	134			$10,173,600

In addition, low and very low income families will not qualify for the homes without subsidies. The following tables illustrate the required income and cash investment for home purchases, as well as the income limits and family size for Dade County.

INCOME AND CASH INVESTMENT REQUIREMENTS

(1) PURCHASE PRICE	$54,000	$75,250	$91,400
(2) DOWNPAYMENT	2,200	3,262	4,070
(3) MORTGAGE AMOUNT (1) - (2) = (3)	51,800	71,988	87,330
(4) PRINCIPAL & INTEREST @ 8 PERCENT	380	528	641
(5) TAXES & INSURANCE	128	169	200
(6) PITI (4) + (5) = (6)	508	697	841
(7) MINIMUM INCOME TO MEET 31 PERCENT REQUIREMENT	19,647	26,970	32,555
(8) MAXIMUM FIXED EXPENSES TO MEET 43 PERCENT REQUIREMENT	704	966	1,167
(9) MAXIMUM EXPENSES WITHOUT PITI	196	269	326
(10) MINIMUM CASH INVESTMENT (1) x 7 PERCENT = (10)	3,780	5,268	6,398

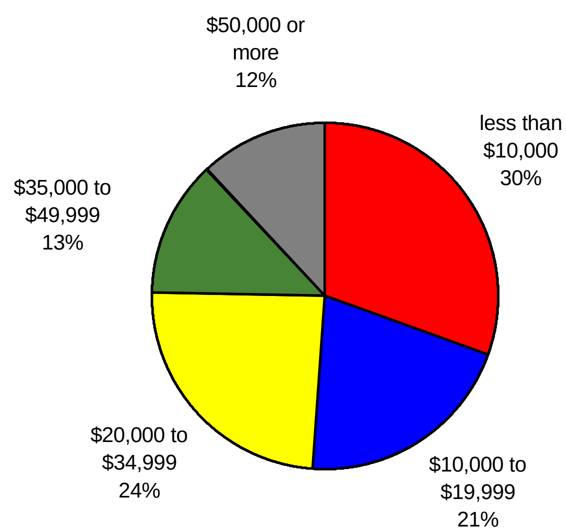
LOW AND VERY LOW INCOME LIMITS FOR DADE COUNTY

FAMILY SIZE	LOW	VERY LOW
1	24,900	15,600
2	28,500	17,800
3	32,050	20,000
4	35,600	22,250
5	38,450	24,050
6	41,300	25,800
7	44,150	27,600
8	47,000	29,350

As shown in the above tables, because of the minimum income needed to meet the 31 percent requirement, the income limits for very low one and two person families were inadequate to qualify for mortgages on any of the homes. Also, only very low income families with seven and eight members would qualify for the $75,250 averaged priced homes. No very low income families qualified for the $91,400 homes. The only families qualified for the $91,400 homes were low income families with four or more persons.

Since the project is located in an economically depressed area, the median income data for Dade County was not truly representative of the neighborhood incomes. Therefore, we obtained household income information in the immediate area of the project and similar adjacent areas.

HOUSEHOLD INCOMES WITHIN THE ZIP CODE AREA OF THE PROJECT



As shown in the above chart, incomes were less than $20,000 for 51 percent of the households in the immediate area. Therefore, it would be difficult to locate enough qualified buyers to purchase the homes.

To date, sufficient subsidies were not available to make the homes affordable. The City committed $66,000 to assist the homebuyers with end loan financing. Also, Dade County proposed providing $250,000 from its Surtax program to assist with the end loan financing. At our review, the $250,000 was not committed. If the average subsidy needed per household was conservatively estimated at $5,000, sufficient subsidies would only be available to assist about 63 families [($250,000 + 66,000)/$5,000]. The remaining 71 families would need adequate income to purchase the homes without subsidies.

FINANCING WAS INSUFFICIENT TO COMPLETE THE PROJECT

The developers did not obtain sufficient financing to complete the project. The estimated development cost was about $15 million for 134 homes. The developer obtained a commitment to finance construction of only 25 homes.

On June 27, 1997, Liberty Housing Associates executed a loan commitment agreement with Bank Atlantic. The loan agreement was scheduled to be closed before September 15, 1997, or the commitment expired on September 30, 1997, unless extended by Bank Atlantic. As of October 22, 1997, the loan was not closed and the commitment was extended. Bank Atlantic committed to loan Liberty Housing Associates $1,590,170 to construct 18 affordable townhouses and 7 single family residences.

The loan funds would be provided as units were sold. For each unit sold, the following conditions must be met: (1) Liberty Housing Associates must provide a purchase contract; (2) the buyers must make a nonrefundable cash down payment of at least 3 percent of the purchase price; (3) the buyers must have a written loan commitment for any end loan permanent financing needed; and (4) Liberty Housing Associates must put its required funds into the project prior to the advancement of any funds by the lender. Further, Bank Atlantic would not provide funding for the townhouse units unless all 9 homes in the building were sold to approved buyers. As of October 22, 1997, Liberty Housing Associates had not sold any of the homes.

Although Liberty Housing Associates obtained a commitment to finance construction of 25 homes, it is unlikely Liberty Housing Associates can pre-sell the units to qualified buyers prior to expiration of the commitment. Regardless, Liberty Housing Associates does not have a commitment to finance construction of the remaining 109 homes.

PROGRAM INCOME OF $144,538 WAS NOT RETURNED TO THE CITY

The City and the developer violated HUD's regulations regarding program income. The City provided $725,000 of HOME funds to acquire the project site. After the site was acquired, the Dade County School Board condemned approximately one acre of the site. As compensation for the condemnation, the School Board paid the developer $144,538. Since the site was acquired with HOME funds, the proceeds represented program income.

The Federal Register Final Rule Part 92.503 (a)(1), published September 16, 1996, requires program income be deposited in the City's HOME Investment Trust Fund unless the City permits the subrecipient to retain the program income for other HOME projects pursuant to a written agreement. The Community Housing Development Organization Agreement requires the project sponsor to obtain written approval if program income is used. No written approval was granted. The City's Housing Division notified the developers on several occasions that the funds must be returned to the City. However, the developer did not return the funds.

CITY DID NOT RECORD PROPERTY DEED

The City did not record the property deed as agreed. The City and Liberty Housing Associates executed a Covenant on February 15, 1996. According to the Covenant, the City agreed to make disbursements of HOME funds for construction on the condition that construction improvements commenced on or within 12 months from the date of the Covenant. In the event construction did not start by the commencement date, the property would be conveyed to the City by warranty deed. Liberty Housing Associates executed the deed in favor of the City and authorized the City to record the deed in the Public Records if construction did not commence by the commencement date. Commencement of construction would be evidenced by recordation in the Public Records of Dade County of a Notice of Commencement. As of August 12, 1997, (18 months from the covenant date) construction had not commenced and the City held the deed but did not execute its right to record the deed.

CITY SPENT OVER $1.9 MILLION ON THE PROJECT

The City agreed to fund $4.75 million of the estimated $15 million total development costs. The funding would be disbursed in two phases of $2,375,000. Phase I funding would be used primarily for land acquisition, tenant relocation, and demolition/clearing. Phase II included funding for site work, construction of a model center, and construction of pre-sold units. The City was not obligated to disburse funds for phase II until the project sponsor had pre-sold two-thirds of the units. Also, the City was not obligated to disburse any funds for construction unless the City had received evidence of sufficient financing to complete construction and ensured the project was affordable for low and very low income families. Although the City spent $1,925,814 of HOME funds for phase I activities, the developer did not pre-sell or construct any units, provide evidence of sufficient financing, or ensure the project was affordable.

AUDITEE COMMENTS

The City generally agreed with the finding. The City is taking steps to ensure compliance with requirements. The City informed the developer to repay the $144,538.

OIG EVALUATION

We commend the City for its efforts to ensure compliance with requirements. However, the City must ensure that no additional funding, except necessary funding for relocation and security, be provided until the developer is in compliance with requirements.

RECOMMENDATIONS

We recommend you require the City to:

3A. Demonstrate how the Northwestern Estates housing project can be made affordable to low and very low income families by obtaining sufficient subsidies, reconfiguring the project, or otherwise reducing the costs.

3B. Provide evidence the developer has obtained sufficient financing to complete project development.

3C. Reimburse $144,538 of program income to its HOME Investment Trust Fund.

3D. Discontinue funding the project, except for necessary costs such as relocation and security until the City complies with recommendations 3A, 3B, and 3C.

3E. Take other appropriate action, as needed, to protect the Secretary's interest and the integrity of the HOME Program, including terminating the project.

Internal Controls

In planning and performing our audit, we considered the internal controls of the management of the City of Miami to determine our auditing procedures and not to provide assurance on internal controls. Internal control is the process by which an entity obtains reasonable assurance as to achievement of specified objectives. Internal control consists of interrelated components, including integrity, ethical values, competence, and the control environment which includes establishing objectives, risk assessment, information systems, control procedures, communication, managing change, and monitoring.

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

- Management philosophy and operating style.
- Accounting for and maintaining control over program receipts and disbursements.
- Assuring expenditures for administering the programs were eligible.
- Management monitoring methods.
- Reporting program results.
- Assuring proper underwriting, servicing, and collection of loans.
- Assuring housing activities will provide affordable housing to eligible recipients.

We assessed these controls. To the extent possible, we obtained an understanding of the City's procedures and HUD requirements, assessed control risk, and performed various substantive tests of the controls.

A significant weakness exists if internal control does not give reasonable assurance that goals and objectives are met; that resource use is consistent with laws, regulations and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data are obtained, maintained, and fairly disclosed in reports. Based on our review, significant weaknesses existed in the internal controls we tested as discussed in the findings.

Follow-Up on Prior Audits

An Office of Inspector General audit (report number 94-AT-251-1002, dated October 18, 1993) of the City's Emergency Shelter Grant Program contained one finding. The finding disclosed the City did not properly manage its Emergency Shelter Grant Program. Specifically, the City did not execute a written agreement for services, did not monitor expenditures, and did not timely submit required reports to HUD. The finding was resolved.

The last financial audit report completed by Deloitte & Touche for the fiscal year ended September 30, 1995, contained one finding pertaining to the CDBG Program. The finding did not relate to an issue in our report. The finding was not resolved.

Issues Needing Further Study and Consideration

During our review, other matters regarding the City's special economic development loan program came to our attention that require correction or improvement. Miami Capital Development, Inc. administers the City's special economic development loan program.

LOAN DEFAULT RATE WAS EXCESSIVE

Based on Miami Capital Development's April 30, 1997, Loan Portfolio Status Report, approximately 33 percent of the outstanding principal balance of loans was in default. The defaulted loans represented about 32 percent of the outstanding loans. At November 30, 1996, about 21 percent of the outstanding balance was in default which represented 23 percent of the loans. Thus, the default percentages have increased rather significantly over a 5 month period. We believe the increased defaults indicate a weakness in Miami Capital Development's procedures.

PROGRAM INCOME MAY NOT HAVE BEEN PROPERLY DISBURSED

Miami Capital Development, Inc. administered a revolving loan fund used to provide economic development loans. In addition to receiving funding from the City to provide the loans, Miami Capital Development also received program income in the form of loan repayments. The loan repayments were required to be deposited into the revolving loan fund for use in making new loans.

According to Title 24 CFR 570.504 (c) and (b)(2)(i), any program income should be disbursed from the revolving loan fund before additional cash withdrawals are made from the U.S. Treasury for the same activity. We believe the City did not require Miami Capital Development to substantially disburse program income prior to making additional withdrawals.

At April 30, 1997, Miami Capital Development reported a balance of $723,657 in the revolving loan fund. This included about $389,000 of program income received from November 30, 1996, to April 30, 1997, from loan principal payments. During the same period, Miami Capital Development made only four new loans which totaled $86,000. Even though Miami Capital Development had a large balance in the revolving loan fund and made only $86,000 of loans in 5 months, the City allocated Miami Capital Development an additional $560,000 for the revolving loan fund for the period July 1, 1996, to June 30, 1997. The City also provided Miami Capital Development $250,000 for administrative expenses for the period.

Although Miami Capital Development needs to maintain funds in the revolving loan fund to provide loans, given the low loan activity, we do not believe a substantial balance is needed in the revolving loan fund. Miami Capital Development should substantially use the revolving funds to pay administrative expenses prior to the City withdrawing funds to pay those expenses. Alternatively, unless the new loan activity increases, the City should reduce the amount of funding to the revolving loan fund.

Further, the City did not require Miami Capital Development to remit interest earned on the revolving loan fund. Title 24 CFR 570.500(b), requires the revolving loan fund cash balance to be held in an interest bearing account. Any interest paid on the funds is considered interest earned on grant advances and must be remitted to HUD at least annually.

According to the City, interest earned on the revolving loan fund was used to pay Miami Capital Development's administrative expenses and to make new loans. The City was not aware the interest should be remitted to HUD. Thus, the City did not require Miami Capital Development to remit the funds. Given the large cash balance in the revolving loan fund, the interest income may be significant.

INSUFFICIENT PUBLIC BENEFIT RECEIVED

Miami Capital Development made loans which do not appear to provide sufficient public benefit. According to Title 24 CFR 570.209(b), if the amount of CDBG assistance for an individual activity exceeds $50,000 for each permanent job created or retained, the public benefit received is insufficient. Therefore, the activity may under no circumstances be assisted with CDBG funds. Miami Capital Development made at least two loans which did not provide sufficient public benefit.

On March 31, 1995, Miami Capital Development loaned $401,479 to 1830 Ent. Teatro Marti. As a result of the loan, only four jobs were created or retained. Thus, the average cost for each job was $100,370. In addition, on October 30, 1996, Miami Capital Development loaned $200,000 to Valparaiso United. The loan resulted in the creation or retention of two jobs. Thus, the average cost for each job was $100,000.

Appendices

Appendix A

SCHEDULE OF INELIGIBLE AND UNSUPPORTED EXPENDITURES

Recommendation	Ineligible[4]	Unsupported[5]
1A		$2,133,797
1B	$ 484,999	
1C		2,518,210
1D		551,600
2A	686,270	
2B	368,077	
2C	1,500,000	
3C	144,538	
Totals	$3,183,884	$5,203,607

4 Ineligible amounts obviously violate law, HUD or local agency policies or regulations.

5 Unsupported amounts do not obviously violate law, contract, policy or regulation but warrant being contested for various reasons such as the lack of satisfactory documentation to support eligibility and HUD approval.

Appendix B

SCHEDULE OF DEFAULTED MULTIFAMILY REHABILITATION LOANS

BORROWER	DATE OF DEFAULT	PRINCIPAL BALANCE	0 - 30 DAYS	30 - 60 DAYS	60 - 90 DAYS	90+ DAYS	TOTAL PAST DUE
Urban League of Greater Miami	11/01/96	$ 308,244	$ 2,416	$ 2,416	$ 2,416	$ 9,108	$ 16,356
Indian River Mgmt.	12/01/93	740,788	7,640	7,640	7,640	290,322	313,242
Winwood Nine Inc.	06/01/93	147,415	946	946.	946	41,787	44626
O.T. 12 Inc.	04/01/93	216,507	1,379	1,379	1,379	63,542	67,679
O.T. 15 Inc.	06/01/93	234,247	1,500	1,500	1,500	66,225	70,025
White, Patrick	12/01/92	143,018	1,107	1,107	1,107	56,058	59,379
Douglas, Hilloreen	06/01/96	82,584	817	817	817	6,518	8,969
Dawson, Floyd	unknown	43,390	903	903.	903	555	3,264
Sisto, Omar & Donna	11/01/96	11,268	245	245	245	518	1,253
Bascarchi, Corp	07/01/94	181,033	2,013	2,013	2,013	62,487	68,526
Dalea, Inc.	02/01/95	398,295	2,818	2,818	2,818	70,447	78,901
Gemini Investment & Mgmt.	11/01/94	129,030	1,214	1,214	1,214	30,009	33,650
Chibascar Corp I	07/01/94	180,328	1,645	1,645	1,645	51,054	55,988
Gemini Investment & Mgmt.	03/01/95	148,369	1,138	1,138	1,138	26,667	30,082
Gemini Investment & Mgmt.	05/01/96	2,414	146	146	146	1,459	1,897
Sisto, Omar & Donna	12/01/95	352,116	3,088	3,088	3,088	45,253	54,518
Overtown Development Group	unknown	1,056,322	3,987				3,987
United States Aviation	06/01/95	516,514	2,580	2,580	2,580	52,102	59,843
2368, Inc.	01/01/96	288,267	2,253	2,253	2,253	29,549	36,308
Vives, Manuel & Margarita	06/01/96	391,322	2,004	2,004	2,004	16,157	22,169
EZ 352 NW 11th St.	03/01/96	257,833	1,283	1,283	1,283	14,163	18,013
Hillary Ventures, Inc.	unknown	350,733	1,730				1,730
Vilac, Inc.	unknown	558,425	2,760	2,760	2,760		8,281
TOTAL PAST DUE PRINCIPAL & INTEREST		6,738,462	45,612	39,895	39,895	933,980	1,059,382
LATE FEE @ 4 percent			1,824	1,596	1,596	37,359	42,375
TOTAL PAST DUE		$6,738,462	$47,436	$41,491	$41,491	$971,339	$1,101,757

Appendix C-1

IDEAL REHAB, INC., AND LIBERTY CITY IMPROVEMENT CORPORATION

On February 6, 1987, the City made a $560,000 MFR loan to Ideal Rehab, Inc., to rehabilitate 58 units. Ideal defaulted on the loan in June 1990. As of July 1995, Ideal was $200,135 past due on the loan payments.

On August 15, 1990, the City made a $367,300 MFR loan to Liberty City Improvement Corporation to rehabilitate 18 units. Liberty defaulted on the loan in February 1991. As of July 1995, Liberty was $173,943 past due on its loan payments.

A principal of both Ideal and Liberty was also the president of DC Two Exponent, Inc., which also defaulted on a MFR loan. In fact, when the City made the loan to Liberty, both the Ideal and DC loans were in default.

In July 1991, Housing exercised its option to accelerate the entire balance of $375,104 due on the Liberty loan. The City informed Liberty that the loan must be paid in full by August 15, 1991, or the City would exercise its various rights and remedies against the borrowers. Although Liberty still did not repay the loan, the City did not exercise its rights and remedies to cure the default.

In September 1993, Housing recommended foreclosure on both the Ideal and Liberty loans. However, no foreclosures occurred. On October 26, 1993, the City again accelerated the Liberty mortgage note and requested payment of the remaining principal balance. Again, Liberty did not make the payment and the City did not exercise its rights and remedies to cure the default.

In January 1994, Housing denied Ideal's and Liberty's request to restructure their loan terms. Housing denied the request because the properties were fully occupied. Thus, the properties should have generated sufficient rent revenue to make the loan payments.

On July 27, 1994, the first mortgage holder filed for foreclosure on both Ideal and Liberty. However, prior to the completion of the foreclosure, the City entered into negotiations with Ideal and Liberty. Apparently, the foreclosure was not completed.

In April 1996, Housing restructured the loan terms and combined both loans into a single loan. The restructured agreement required the owner to make two $100,000 payments to reduce past due amounts. The first $100,000 payment was due by April 30, 1996.[6] The second payment was due on May 1, 1997. The agreement also reduced the monthly payments from $6,205 to $800 for six years. At the end of the six years, if all terms and conditions of the agreement were met, the City would re-negotiate the terms of the agreement. Further, the City agreed to forgive $368,077 of past due interest and late fees and forgave all future interest payments.

Around February 1997, Ideal and Liberty requested the City to subordinate its lien to a refinanced first mortgage of $700,000. The existing first mortgages on the properties at the time were about $470,000. Thus, the City's second mortgage would be behind a $230,000 larger first mortgage. In addition to paying off the first mortgage, the loan proceeds would be used to pay delinquent water bills of $105,000 to the Miami-Dade Water and Sewer Authority and to make the second $100,000 payment due under the restructured agreement of 1996. The City's loan committee disapproved the subordination request on March 24, 1997, because of the borrower's poor payment history, including the DC Two loan, and the inadequate compensation offered to the City.

A City Commissioner attended the March 24, 1997, loan committee meeting. At the meeting, the loan committee discussed the payment history of the DC Two, Ideal, and Liberty loans. The loan committee also discussed the City's losses on the DC Two loan. Despite the Commissioner's knowledge of the payment histories and the loan committee's recommendation, the Commissioner recommended approval of the refinancing to the full City Commission. The City Commissioners approved the refinancing on May 7, 1997.

The City's CDBG Multifamily Rehabilitation Program policies provide guidance for the City's subordination to refinanced senior mortgages. If the refinanced senior mortgage is more than the existing senior mortgage, the City should consider subordinating its lien only if the new loan, in addition to all outstanding loans secured by the property, do not exceed 80 percent of the market value of the property. The refinanced senior mortgage for Ideal and Liberty was more than the existing senior mortgages. Thus, the total secured debt could not exceed 80 percent of the property values, according to the City's policies. However, after the refinance the secured debts for the two properties were 94 percent of the property values. Thus, the City Commissioners violated the City's policies by approving the subordination.

The properties had a combined net income of $100,425 from October 31, 1995, to September 30, 1996. According to an August 26, 1996, appraisal, the properties had an estimated fair market value of $1,663,000. As of April 16, 1997, the property's mortgage debts were about $1,334,660, including $864,660 owed to the City. Since the property values exceeded the debts, the City may have been able to foreclose on its mortgage and sell the properties for a price sufficient to recover at least a portion of the $864,660. The City could have pursued personal guarantees to recover any losses resulting from the foreclosure. Alternatively, the City could have assigned the projects' rents to recover the past due amounts.

[6] The agreement required a payment of $52,302 on another City loan owed by a related company. The remaining $47,698 was to be applied to City loans to Ideal.

Instead, the Commissioners were willing to reinstate the April 1996 restructured loan agreement upon payment of the second $100,000. In return the City subordinated its loan to a $230,000 larger mortgage and forgave $368,077 of past due interest and late fees plus all future interest. It appears the only beneficiaries of the refinance were Miami-Dade Water and Sewer Authority and the property owner.

Because of the City of Miami's financial difficulties, an Oversight Board established by the State of Florida oversees the City's financial operations. On July 7, 1997, the Oversight Board denied the City's subordination of the Ideal and Liberty mortgages. The Oversight Board stated, in part, it appears the City of Miami has been extremely lenient with the mortgagors. Payments on the outstanding City mortgage of $836,000 were reduced from $6,204 to $800 per month with no interest. At the current rate, it would require 87 years to repay the loan. Additionally, the Oversight Board concluded that no consideration was offered to the City of Miami in return for its increased risk.

We agree with the Oversight Board's decision. We believe the City should foreclose on the mortgages and sell the properties. The City should pursue collection against personal guarantees for any resulting losses incurred. Also, we do not believe the City took appropriate action to safeguard its assets by forgiving the past due interest and late fees and all future interest.

Appendix C-2

DC TWO EXPONENT, INC.

On April 24, 1986, the City loaned $750,000 to DC Two Exponent, Inc., to rehabilitate 66 units. Verde Capital Corporation provided $550,400 of additional financing to complete the rehabilitation. Verde held a mortgage position behind the City's mortgage.

On the day the loan closed, the president of DC Two resigned and the president of Verde acquired 49 percent ownership of DC Two. Within two years of the loan closing, all of DC Two's principals had resigned and the president of Verde became the president of DC Two.

In June 1987, DC Two obtained a $550,000 loan from First American Bank and Trust. DC Two used the $550,000 in part to pay off an existing first mortgage of about $270,000. DC Two paid the remaining $280,000 to Verde to reduce its mortgage. DC Two did not pay any of the proceeds to the City. The City subordinated its mortgage to First American Bank and Trust, thus allowing First American Bank and Trust to become the first mortgage holder. Thus, the City increased its risk by assuming a second mortgage behind a higher first mortgage. Also, since the president of DC Two was also the president of Verde, he benefited from the First American Bank and Trust loan.

In October 1989, the City allowed DC Two to discontinue its monthly mortgage payments for one year (July 1, 1989 to June 30, 1990). The City allowed the discontinued payments to provide funding to hire police officers in order to reduce vacancies. However, when the agreement expired in June 1990, DC Two failed to resume making the monthly loan payments.

Although DC Two defaulted on the loan payments in July 1990, the City did not file a foreclosure suit until December 18, 1992. However, DC Two also defaulted on the First American Bank and Trust/First Union loan.[7] First Union began foreclosure on its mortgage in about September 1992. First Union received a final foreclosure judgment on December 17, 1992, the day before the City filed its foreclosure suit. Thus, the City's lien was extinguished.

In addition to failing to foreclose, the City also failed to protect its interest at the foreclosure sale. On August 31, 1992, the property appraised for $1,572,000. The property's mortgage debts were about $1,422,358, including $686,270 owed to the City. Since the property value exceeded the debts, the City may have been able to purchase the property at the foreclosure sale and resale it for a price sufficient to recover at least a portion of the $686,270.

7 Apparently, First Union National Bank of Florida subsequently acquired the mortgage from First American Bank And Trust.

Subsequently, the City wrote off the $686,270 as an uncollectible account. The City did not attempt to recover the loss pursuant to personal guarantees signed by principals of DC Two.

Because the City failed to foreclose, failed to protect its lien upon foreclosure by First American Bank and Trust, and failed to recover losses pursuant to personal guarantees, the CDBG program lost $686,270. We do not believe the City took adequate action to safeguard its assets.

Appendix C-3

INDIAN RIVER INVESTMENT MANAGEMENT, INC.

On July 19, 1989, the City made a $850,000 MFR loan to Indian River Investments Management Company, Inc., to rehabilitate 66 units. Indian River defaulted on the loan payments on December 1, 1993. As of February 1, 1997, Indian River's loan payments were about $298,000 past due.

The City did not properly underwrite the loan. Indian River was to rehabilitate the property in conjunction with the execution of a Housing Assistance Payment contract pursuant to HUD's Section 8 Moderate Rehabilitation Program. When the City approved the loan in February 1989, the monthly Housing Assistance Payment rent amounts had not been determined. However, on the loan application, Indian River estimated the monthly rents at $499 and $584 for one bedroom and two bedroom units, respectively. Based on the estimated rents, the projected annual net income was $34,965. The City approved the loan based on the estimated rents.

On June 30, 1989, HUD approved Housing Assistance Payment rents of only $435 for one bedroom units and $512 for two bedroom units. The City was the moderate rehabilitation contract administrator. Thus, the City knew the approved rents were less than the rents on the loan application. However, the City did not redetermine the net income and expenses based on the reduced rents. Subsequently, the loan closed on July 19, 1989.

The City should have redetermined the net income based on the reduced rents. Based on the reduced rents, the estimated annual income would have been a net loss of about $16,875. Thus, the City should have disapproved the loan.

On March 1, 1997, over three years after Indian River defaulted on the loan payments, the City began withholding the monthly loan payment of $7,640 from Indian River's monthly Housing Assistance Payment check. However, the City did not withhold any additional amounts to reduce the past due amount of about $298,000.

The City obtained an income statement from Indian River that showed a net income of $229,882 for the year ended December 31, 1995. Since the property appears to be profitable, we believe the City should have either exercised its rights pursuant to the assignment of rents or foreclosed on the mortgage.

However, on June 9, 1997, the City Commissioners approved Sentra Properties to purchase the property and assume the loan. We are concerned about Sentra's assumption of the loan because a principal of Sentra was also a principal of Ideal and Liberty at the time those loans became delinquent (See Appendix C-1 for additional discussion). Also, Sentra's principal was the President of DC Two Exponent. DC Two Exponent also defaulted on a MFR loan that was written off by the City (See Appendix C-2 for additional discussion).

The City's loan committee disapproved Sentra's assumption of the Indian River loan. However, the City Commissioners subsequently approved the agreement. Many of the terms of the Commissioners' approval are unclear. Thus, we were unable to analyze the transaction to determine if it was in the City's best interest. However, based on the prior payment history of the Sentra principal, the transaction appears to be very risky.

Also, as a part of the purchase, Sentra planned to assume Indian River's Housing Assistance Payment contract with the City. Indian River originally obtained the Housing Assistance Payment contract in accordance with HUD's Moderate Rehabilitation Program. In accordance with program requirements, the Housing Assistance Payment rents are based, in part, on the property's operating expenses.

The agreement approved by the Commissioners allowed Sentra to reduce the monthly payments on the MFR loan from $7,640 to $4,500. Since the Housing Assistance Payment rents are based on the operating expenses, the Housing Assistance Payment contract should be reduced to reflect the lower payments.

Appendix D

AUDITEE COMMENTS

JOSE GARCIA-PEDROSA
CITY MANAGER

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FAX (305) 400-5043

March 9, 1998

Ms. Sonya D. Lucas
Assistant Inspector General for Audit
Southeast/Caribbean
Richard B. Russell Federal Building
7 5 Spring Street, SW Room 3 1 0
Atlanta, GA 30303-3388

Dear Ms. Lucas:

Please consider this correspondence as a follow up to our telephone conference call on Friday, March 6, 1998, whereby the City of Miami concurred with the issues stated in the draft audit findings of the Office of the Inspector General for the Audit dated November 21, 1997. Specifically, this correspondence serves to respond to finding No. 2 and No. 3, and to reiterate corrective actions which the City of Miami plans to undertake immediately in the coming months. Finding No. 1 is being addressed under separate cover.

In our telephone conversation, both parties agreed to the solutions proposed below and the City's administration welcomes any additional assistance related to the findings.

FINDING No. 2
Multi-Family Rehabilitation Program Loan Underwriting and Collection Procedures

In reference to findings No. 2, within the next thirty (30) days, the City Administration plans to secure City Commission approval to impose a voluntary moratorium relative to the administration of the City's CDBG and HOME Program funded Multi-Family Rehabilitation Loan Programs. This action would afford the City an opportunity to work closely with the Coral Gables HUD Regional Office, in addressing the weaknesses and deficiencies cited in the audit relative to the City's loan underwriting and collection procedures.

Ms. Sonya D. Lucas
Assistant Inspector General for Audit
Page 2

The City plans to aggressively pursue collection and legal actions against all delinquent loan accounts under the City's Multifamily Rehabilitation programs. Attached, for your perusal, is a draft copy of the City's strategy for handling currently defaulted Multi-Family Loans (Exhibit 1) and revised CDBG Multi-Family Rehabilitation Program Guidelines. (Exhibit 2)

FINDING No. 3
<u>Northwestern Estates Housing Project</u>

In reference to finding No. 3, the City Administration proposes to, within the next thirty (30) days, secure from the Miami City Commission, approval to retain the services of a consultant to assist City staff in re-assessing the economic feasibility of moving forward with the development of the proposed Northwestern Estates Housing Project. As you are aware, a letter was forwarded to the developer of Northwestern Estates by the City, to request payment of the $144,538.00 in program income and submission of the files/records for the relocation phase of the project (Exhibit 3). The City Administration will also seek City Commission authorization to terminate any future allocations to the developer if the requested payment is not received within thirty (30) days.

As a result of the Audit, the City of Miami is making a commitment to restructure and review all administrative and operational procedures to safeguard against future deficiencies. We welcome your offer of technical assistance during this phase.

Per our discussion, the City's administration appreciates the opportunity to include the corrective actions currently being undertaken as in integral part of the final audit report.

In closing, the City is eager, and looks forward to working in partnership with the U.S. Department of Housing and Urban Development and more specifically, with the Coral Gables HUD, Regional Office, in resolving the issues and concerns cited in the draft audit.

If you have any questions, please feel free to contact me at (305) 416-2088.

Sincerely,

Gwendolyn C. Warren, Director
Department of Community Development

GW:kc

C: Angelo Castillo, Director, HUD Regional Office
Christina M. Cuervo, Assistant City Manager
Linda Kelly Kearson, Assistant City Attorney
Jeffery B. Hepburn, Assistant Director, Community Development

March 12, 1998

Ms. Sonya D. Lucas
Assistant District Inspector General
for Audit, Southeast/Caribbean
U.S. Department of Housing and Urban Development
District Office of the Inspector General
Richard B. Russell Federal Building
75 Spring Street S.W. Room 330
Atlanta, GA 30303-3388

Dear Ms. Lucas:

The attached schedule is submitted in response to HUD's request for an explanation of the retro-active adjustment which the City recorded in Fiscal Year 1991

Our records reflect that in 1991, the City performed a review of indirect costs charged to the CDBG program for Program Years 1986 thru 1991 inclusive. The resulting determination was that the amounts charged to the grant program for Program Years 1986 thru 1991 was grossly understated and an adjustment was subsequently prepared to recover indirect costs totaling $2,066,379

In conformity with the guidelines of OMB-A-87, the City had prepared Cost Allocation Plans for the years 1986 and 1990, however there were no plans prepared for the years 1987,1988, &1989. Based on the consistency of the data captured in the plans for 1986 and 1990 it was determined that an average of the two years' charges should be applied to each of the analyzed years for which the indirect costs were understated. These amounts are supported by the Cost Allocation Plans for the years 1986 and 1990, and justifiably represented the basis for allocating these costs.

Based on this average it was determined that the total of $605,916 should have been recovered from the CDBG program as indirect costs for each of the five years (I 986/7-1990/91) which were analyzed. The adjustment, which was recorded in Fiscal Year 1991; therefore, represents the difference between indirect costs which were previously recorded, and the revised calculation of $605,916 as per the 1991 analysis. (Refer to line item "RETRO-ACTIVE ADJUSTMENT" on attached schedule entitled - "ANALYSIS - CDBG INDIRECT COSTS”).

The attached schedule further illustrates that the twenty percent (20%) cap allowable for administrative expenses was not exceeded in any of the referenced years as a result of processing this recovery adjustment. This is clearly indicated on the attached schedule of Indirect costs. (Refer to the line item "AVAILABLE UNDER 20% CAP AFTER ADJUSTMENT" on attached schedule).

Page 2 of 2
March 12, 1998
Ms. Sonya D. Lucas
Assistant District Inspector General
for Audit, Southeast/Caribbean
U.S. Department of Housing and Urban Development

As a result of the finding in the draft audit report related to the issue of Cost Allocation Plans to support indirect costs for the years 1995, 1996 and 1997, City staff met with 14UD Regional Office Administrators in Coral Gables. We proposed and obtained approval to prepare the Cost Allocation Plan for the FY ended September 30, 1997, which is due March 31, 1998. Based upon the timely submission of the 1997 Cost Allocation Plan and pending the approval by HUD of the Indirect Cost Rate Proposal, there-in contained, City staff requested that HUD consider allowing us to use that Indirect Cost Rate Proposal retroactively, for FY's 1995 and 1996. Furthermore, the Finance and Community Development departments will work together with David M. Griffith and Associates, Ltd. (DMGA) to ensure that each City department responsible for providing support services prepares accurate and timely documentation consistent with the provisions of OMB A-87.

The City of Miami, for at least the last ten (10) years, has contracted the services of DMGA to annually prepare a Cost Allocation Plan, according to OMB Circular A-87. DMGA is one of the largest, if not the largest, company specializing in the preparation of Cost Allocation Plans for government entities in the State of Florida.

Sincerely,

Lourdes Reyes,,
Comptroller

LR:KE/Is

Attachments: (1)

c: Angelo Castillo, Director, HUD Regional Office
Christina M. Cuervo, Assistant City Manager
Michael G. Lavin, Assistant Director of Finance
Kenneth Edwards, Grants Financial Manager
Linda Kelly Kearson, Assistant City Attorney
Gwendolyn Warren, Director - Department of Community Development
Jeff Hepburn, Assistant Director of Community Development
Jose Cerdan, Acting Assistant Director - Department of Community Development
Frank Castenada, Federal and State Liaison
Jose Romano, Staff Auditor Principal

Appendix E

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The Honorable John Glenn, Ranking Member, Committee on Governmental Affairs, United States Senate, Washington, DC 20510-6250
Mr. Pete Sessions, Government Reform and Oversight Committee, Congress of the United States, House of Representatives, Washington, DC 20515-4305
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