



U.S. Department of Housing and Urban Development
New England Office of District Inspector General
for Audit, 1AGA
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Room 370
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September 25, 2000

Audit Memorandum
No: 00-BO-255-1803

MEMORANDUM FOR: James Barnes, Office of Community Planning and
Development, 1AD

FROM: Stephen D. King, Acting District Inspector General, Office of Audit, 1AGA

SUBJECT: Review of Program Recipients' Complaints
State of Maine FIX ME Program
Maine State Housing Authority
Augusta, Maine

In response to several complaints received from program recipients (homeowners), we performed a review of the Maine State Housing Authority's (MSHA) FIX ME Program. Our objective was to evaluate MSHA's administration of the program.

The complainants alleged the following in regards to the FIX ME Program: shoddy workmanship, violations of local codes, incomplete and illegal electrical work, coercion to pay contractors for unsatisfactory work, and lack of adequate inspections. We determined that, although most of the homeowners (1999 loan recipients) were satisfied with the program, there were still problems that needed to be corrected. Our review identified deficiencies in the following areas: contractors did not obtain the required local building permits and local building inspections, work write-ups/cost estimates were not prepared by CAP agencies, one CAP agency did not properly document the required inspections of repair work, and MSHA's monitoring reviews of CAP agencies (which administer the day to day operations of the program) were limited in scope and did not disclose the type of problems identified by the complainants. In our opinion, the overall design and structure of the FIX ME Program allowed these problems to occur because of a lack of adequate controls. MSHA needs to improve and standardize their procedures, and establish clear lines of accountability to prevent similar problems from recurring.

Your office issued a Monitoring Review report on the FIX ME Program in March 1999. This report addressed the following deficiencies:

- Lack of sufficient oversight of CAP agencies by MSHA.
- Inadequate program complaint resolution procedures.
- Improper charging of management fees to homeowners.
- Use of HOME funds for ineligible activities (garage construction).
- Contractors not adhering to local building codes and obtaining permits.
- Lack of detailed work specifications, cost estimates, and cost reasonableness determinations for repair projects.

At the time of our review, all of the findings and recommendations remained outstanding except for the 2 monetary findings which were recently resolved between your office and MSHA:

Your office's Monitoring Review determined that CAP agencies charged "management fees" to homeowners; up to 8% of the loan or \$400, whichever was greater (Finding No.2 - Improper Charging of Management Fees). Your review initially concluded that these fees were improper charges to the homeowner, especially since, in your office's opinion, the management services provided by the respective CAP agency were inadequate. Since January 1999, MSHA has agreed to no longer charge homeowners this management fee. On August 31, 2000, your office notified MSHA that it was not required to refund the management fees. Since there was no explicit prohibition against charging these fees, MSHA had acted in good faith in interpreting the applicable criteria. MSHA agreed to change its procedures and discontinue charging this fee to homeowners. This issue has been resolved.

Your office's Monitoring Review also noted that MSHA had authorized the construction of 37 new garages (\$209,811), prior to October 1998 (Finding No.3 - Ineligible Projects/Garages). Your office's report concluded that construction of new garages did not constitute reasonable housing improvements, and were not an appropriate use of Federal HOME Funds. MSHA discontinued construction of garages as of January 1, 1999 after a meeting with HUD/CPD in October 1998. On July 24, 2000 MSHA notified HUD/CPD that they had reimbursed the Federal HOME Program \$209,811 for work performed on newly constructed garages, thereby resolving this issue.

Within 60 days please give us, for each recommendation 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 this review.

If you or your staff have any questions, please contact our office at (617) 565-5259.

Background

The State of Maine has designated the Maine State Housing Authority (MSHA, 353 Water St., Augusta, Maine) as its agency to administer the HOME Program. The FIX ME Program, part of MSHA's HOME program, represents a commitment to address a major state housing need, repairing homes of low and very low-income homeowners. The need for such a program was identified as a priority by the state's consolidated housing plan. There were an estimated 85,000 homeowners in the state with incomes of half or less of the median income, including about 30,000 with annual incomes of \$10,000 or less. The FIX ME Program is funded by both State and Federal HOME funds.

MSHA has contracted with 11 Community Action Programs (CAP) agencies and one regional non-profit organization to deliver the FIX ME Program to qualified applicants. These contracts stipulate the responsibilities of the CAPs regarding the origination and selling of loans to MSHA. A total of 3,843 homeowners have received \$37.2 million from the inception of the FIX ME Program in June of 1995 through December of 1999. Out of this total, 2,412 were Federal HOME subsidized loans. Federal expenditures on these loans were \$14.2 million of which \$12.9 million represents the Federal subsidy used to reduce the interest rate on each loan, while the other \$1.3 million represents the administrative (project related 'soft') costs for the program.

Your office conducted a Monitoring Review of the FIX ME Program in October 1998, as a result of several complaints by program recipients. The complaints were similar to those received by HUD/OIG in October 1999. The Monitoring Report, issued in March 1999 by your office, confirmed the existence of problems noted by the complainants, and concluded that "the State of Maine was not fulfilling the Federal Statutory requirements of the HOME Program."

The complainants became concerned that the findings in the Monitoring Report were not properly addressed and corrected, and that MSHA had refused to acknowledge the existence of some of the problems. Acting upon these concerns, the complainants contacted members of the Maine State Legislature and the State of Maine Congressional delegation. The complainants also requested that our Office initiate a review of the FIX ME Program.

The Business and Economic Development Committee of the Maine State Legislature conducted an evaluation of MSHA's FIX ME Program and issued their final report in April, 2000. This evaluation considered the effectiveness, efficiency, and performance of MSHA in carrying out the requirements of the FIX ME Program. Their report recommended that MSHA standardize procedures and/or develop written policies for work plans, complaint process, binding arbitration for unresolved complaints, and review procedures. These recommendations, if adopted by MSHA, would address some of the deficiencies identified during our review. MSHA is required to report the progress made in implementing these recommendations to the committee by September 15, 2000.

On March 16, 2000, MSHA placed a moratorium on the FIX ME Program. Maine Governor Angus King appointed a new Director, Michael L. Finnegan, who commenced duties on April 27, 2000, and will be responsible for developing detailed procedures and plans for a new FIX ME Program.

Scope and Methodology

The purpose of our review was to evaluate MSHA's administration of the FIX ME Program in response to the complaints received. To accomplish this objective, we reviewed: applicable HUD regulations, MSHA's brochures and procedural guides, monitoring reviews of CAP agencies, MSHA complaint resolution process, results of MSHA's FIX ME customer surveys, and documentation regarding actions taken by MSHA in response to HUD's monitoring report. We interviewed FIX ME homeowners to determine whether they were generally satisfied with the repair work and with the program. We also interviewed MSHA managers and staff who administer the FIX ME Program to gain an understanding of the program structure and to identify program procedures, policies, and internal controls.

We selected two CAP agencies, Kennebec Valley CAP (KVCAP) and Penquis CAP (PCAP) to perform detailed reviews of the FIX ME Program. At the CAP agencies, we reviewed 20 complaints, identified as resolved by MSHA and the CAPs, to confirm the status of resolution efforts. Our review also included an examination of 20 FIX ME loan files that were originated after the HUD/CPD Monitoring Report of March 1999, and interviews with homeowners who received these loans.

Our review was conducted from December 1999 through May 2000, and covered the operations of MSHA's FIX ME program from June, 1995 through December 31, 1999. We expanded the scope of our review as necessary, and our effort was performed in accordance with generally accepted government auditing standards.

Review Results

MSHA took action on some of the issues disclosed in the HUD Monitoring Review, however, the FIX ME Program has problems that MSHA still needs to correct through program revisions and other administrative changes. Our review of loans initiated after the issuance of the CPD Monitoring Report in March 1999, disclosed several problems in the administration of the program.

FIX ME Program procedures did not always ensure that the contractor's work was in compliance with local building codes and requirements, upon completion of the repair work. Although CAP agencies certify to MSHA that; "the (repair) work has been completed...in compliance with...all applicable building codes and housing standards" for each project on Monthly Completion Certifications, our review disclosed that required building permits had not

been obtained in 3 of the 9 instances where they were required. At Penquis CAP (PCAP), we reviewed ten home repair projects and determined that permits were required for three of them. Of the three permits required, only two were obtained. At Kennebec Valley CAP (KVCAP), we reviewed ten projects and found that of the six permits required, only four were obtained. Program procedures used by the CAPs placed the responsibility for obtaining permits and local building inspections (prior to the start of repair work) primarily with the homeowner, and then with the contractor. The program did not require CAP agencies to take a proactive approach to ensure that either the homeowner or the contractor obtained permits and inspections.

Neither PCAP nor KVCAP performed work write-ups or costs estimates for FIX ME repair work, which would form the comparative basis for determining if the contractor's bid is reasonable. Instead, as provided for in the program procedures, they evaluated the contractor's bids by completing a "Cost Reasonableness Certification", a one page form signed by the homeowner and a CAP agency inspector acknowledging that bids received were reasonable as to cost. These certifications did not identify the work specifications and detailed cost breakdown for each repair project. To be allowable under Federal awards, OMB Circular No. A-87 (Cost Principles for State, Local, and Indian Tribal Governments) requires "costs to be necessary and reasonable for proper and efficient performance and administration of the Federal award." A non profit subrecipient (CAP Agency) must comply with the requirements of OMB Circular No. A-122 "Cost Principles for Non-Profit Organizations," which has the same general cost requirements as A-87 {24 CFR 92.505}. In order to determine if the costs are reasonable beforehand, the CAPs would have to prepare a cost estimate to establish a baseline for comparing costs submitted with the contractor bids. In order to prepare a cost estimate, the CAPs would have to define what work is to be done, i.e., prepare a work write-up.

MSHA (via the CAP agencies) has "empowered" the homeowner with the responsibility of work write-ups/cost estimates. In correspondence to HUD on this issue in April 1999 MSHA stated: "(the FIX ME) repair model, which allows homeowners to take the lead in determining the nature and cost of the work on their homes is different from HUD's standard model. MSHA's approach, a "public assistance" model, allows the homeowner to take the lead in defining the rehabilitation work to be done and negotiating the price." The FIX ME program was designed to assist lower income homeowners who might not have qualified for more traditional bank loans. These homeowners, in some cases, were unable to satisfactorily identify the rehabilitation work to be done and estimate the total cost. As a result, the program was placing responsibilities upon some homeowners who could not properly carry out their assigned responsibilities and experienced serious problems in doing so.

At KVCAP, we noted that interim and final inspections were not adequately documented. Of ten project files reviewed, there was no documentation to support interim or final inspections for any of the projects. Although there were notations in the project files which indicated that KVCAP technical personnel had visited the clients and reviewed the repair work, none of the interim or final inspections were properly documented. (KVCAP had documented the initial inspections,

and believed that this was sufficient for the entire inspection process). KVCAP officials agreed to document the interim and final inspections in the future.

Our review identified other problems that related directly to the overall structure and operation of the FIX ME program. In contracting with CAP agencies to carry out the day to day administration of the program, MSHA delegated responsibilities for complaint resolution to each CAP. In most cases, CAP agencies devised their own procedures for recording and resolving complaints and other problems encountered by homeowners with repair work performed by contractors. MSHA did not have an accurate estimate, at any one time, of the total number and type of complaints recorded at the CAP agencies. Unless the complainant appealed directly to MSHA, MSHA was unaware a complaint was even filed. Without the involvement of MSHA in this resolution process, they could not ensure that complaints from homeowners were resolved on a timely basis. MSHA monitoring reviews of CAP agencies did not fully explore this area.

We identified as many as 120 complaints or problems of FIX ME homeowners, which was significantly higher in number than the 57 recorded at MSHA. (Subsequent to the HUD/CPD Monitoring Review, both KVCAP and PCAP had surveyed their FIX ME clients and identified problems with some completed projects. These problems were not considered as “complaints”, and they were included in the total of 120 complaints/ problems we identified). These complaints/problems were identified from MSHA, KVCAP, and PCAP records.

Another problem area noted was in the payment of contractors for work performed, and also the determination of the type of repair work to be performed. The current structure of the program permits the homeowner to have primary responsibility for dealing with the contractor and agreeing on the type of repair work to be performed. CAP agencies review the estimates of work, but the contract for the repair work is between the homeowner and the contractor. CAP agencies were not parties to the repair contract. As a result, CAP agencies were unsure of what control and authority they had to ensure the contractor would perform the work in a satisfactory manner. If a homeowner had a problem with the contractor and/or the work that was performed, they were initially responsible to contact the contractor and request the work be done right. This included cases where the contractor stated that the repair was complete; if the homeowner was not satisfied, they were to instruct the CAP agency not to process the final payment, and it was the homeowner’s responsibility not to deliver the payment to the contractor. Our review determined that, at least for some homeowners, they were unable to carry out their responsibilities in the program, as noted in the following example:

KVCAP Client, MSHA Loan # 16144 - Home repairs included kitchen cabinets, repair of roof leak, and installing insulation under mobile home. An inspection by KVCAP of the repair work concluded; “ *Most of the things the client requested the contractor to do were not in the contractor’s estimate and the client requested them while the contractor was working on the home.*” In a phone interview with HUD/OIG, the homeowner stated that the contractor had been paid even though the work performed was “not completely satisfactory.” When asked why the contractor was paid for

unsatisfactory work, the homeowner responded that the money used to pay the contractor was not “their money”, it was KVCAP’s money, and the homeowner could not object for work that KVCAP was paying for. In this case, the homeowner did not understand that the funds used for payment were indeed from the loan they had obtained, and it was the homeowner’s responsibility to identify unsatisfactory work prior to the contractor being paid.

In our opinion, more control and authority should be exercised by the CAP agencies and MSHA in the operation of the program. MSHA needs to revise its monitoring and oversight procedures for CAP agencies, and develop comprehensive procedures for recording and tracking all FIX ME complaints. In addition, monitoring reviews of the CAP agencies should be more comprehensive in scope and be more thorough in identifying program deficiencies. CAP agencies need to have full authority and exercise a greater degree of control in managing such issues as work write-ups, final inspections, and payments to the contractor.

Auditee Comments

MSHA agreed to revise the complaint process for FIX ME clients, and to ensure that all required permits were obtained and inspections performed for all FIX ME loans. For prior FIX ME projects already completed, MSHA agreed to coordinate its efforts with HUD in determining the most appropriate way to assure that building permits have been obtained, inspections conducted, and these actions sufficiently documented. MSHA also agreed to prepare work write-ups (work specifications/cost estimates) to ensure cost reasonableness for FIX ME projects. MSHA agreed to require the completion of three documented inspections for each project, and to retain final payment to the contractor until completion of the final inspection and satisfactory completion of the project. MSHA noted in their response that it is working closely with HUD/CPD on the implementation of a new HOME program which will replace the FIX ME Program. This new program, currently in draft form, will incorporate the requisite program revisions as noted in MSHA’s response to our report.

OIG Evaluation of Auditee Comments

We believe the actions taken and planned by MSHA will strengthen controls over the FIX ME/ Home program and will correct the identified deficiencies. We recognize the efforts of MSHA in addressing the conditions cited in the audit finding, and we have amended our recommendations accordingly.

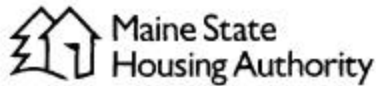


Recommendations

We recommend that you:

- 1A. Resolve all outstanding findings included in the Monitoring Report of March 1999.
- 1B. Review and concur, as appropriate, with MSHA's implementation of a new HOME program which should address the following program issues:
 - Monitoring and oversight procedures for CAP agencies.
 - Developing procedures to record and track all HOME program complaints.
 - Obtaining copies of required building permits and records of local inspections before work is started.
 - Identifying work specifications and cost estimates prior to solicitation of bids.
 - Retaining a portion of the final payment to the contractor until completion of the final inspection.
 - Thoroughly documenting the three required inspections of project repair work.
- 1C. Review and concur with MSHA's plans to: determine which prior completed projects required local building permits and local inspections, ensure the permits are obtained and inspections completed, and document the actions in the FIX ME project files.

Auditee Comments



September 12, 2000

Mr. Stephen King, Office of Inspector General
U.S. Department of Housing and Urban Development
New England Office of District Inspector General for Audit
Thomas P. O'Neill, Jr. Federal Building - Room 370
10 Causeway Street
Boston, MA 02222-1092

Dear Mr. King:

Thank you for the opportunity to respond to your Audit Memorandum concerning our FIX ME program. As noted in your report, we are very proud of what we accomplished with this program. We provided over 4000 homeowners with needed repairs to their homes between 1995 and 1999. Maine has the highest homeownership rate in the nation but ranks 37th in per capita income. Our housing stock is the nation's 7th oldest. Thus, many Maine citizens own old houses they cannot afford to repair at conventional rates. This program offered an affordable alternative to the predatory lending practices of the sub-prime market.

Despite the program's success, there are areas of the program that could be improved. We appreciate the comments we have received from HUD's Office of Community Planning and Development (HUD CPD), from your office, from the Maine Legislature's Business and Economic Development Committee, from the Community Action Agencies, and from the public. As a result, we have designed a new home rehabilitation program and we hope to introduce this program to the citizens of Maine in the near future.

Below are our responses to the recommendations in your Audit Memorandum to James Barnes of HUD CPD.

Recommendation 1A - Resolve all outstanding Findings included in the Monitoring Report of March 1999.

Response: We have resolved all of the substantive issues cited in HUD CPD's Monitoring Report of March 1999. We will continue to work with HUD CPD on the implementation of our new program. We appreciate the fact that we were able to resolve the issue of management fees to our mutual satisfaction, relying on the HOME regulation as it is currently written. We deferred to HUD CPD's interpretation of the HOME regulation with respect to garages and has reimbursed the HOME account for the newly constructed garages assisted with HOME funds. We are currently compiling and will forward to HUD CPD the source documentation for these newly constructed garage projects, as requested.

MSHA takes great care in assuring that all of its programs meet HUD's regulations. The FIX ME program was no different. In areas where HUD's regulation was unclear and open to interpretation, we made every effort to reasonably interpret the regulation. We feel we

acted in good faith throughout and ceased certain practices once HUD CPD's position became known to us.

Recommendation 1B – Require MSHA to revise its monitoring and oversight procedures for CAP agencies and develop comprehensive procedures for recording and tracking all FIX ME Program complaints.

Response: We have enhanced our complaint tracking system to ensure that we are aware of, and know the status of, every FIX ME program complaint. The CAP agencies now provide us with a monthly report summarizing any outstanding complaints and the actions taken to resolve the complaints. We review the report and monitor the CAP's progress toward resolution of the complaints. We are incorporating the complaint resolution procedures recommended by HUD CPD in its redesigned program.

Recommendation 1C – Require MSHA to ensure CAP agencies obtain copies of required building permits and records of local inspections from the contractor or the client before work is started.

Response: We agree that all projects must have the appropriate permits in place before work begins. Loans will not be purchased under the new home rehabilitation program unless documented evidence is received by MSHA that any and all building permits and local inspections have been properly obtained.

Recommendation 1D – Require MSHA to instruct the CAP agencies to determine which prior completed projects required local building permits and local inspections, ensure the permits are obtained and inspections completed, and document the actions in the FIX ME Program project files.

Response: The audit uncovered a few files lacking evidence of required local building permits and local inspections. Program procedures required that contractors or homeowners obtain the permits and inspections; however, program procedures were not clear that *there* needed to be documented evidence in the files of the permits and local inspections obtained. We will work with HUD CPD to determine the best way to assure local building permits and local inspections were obtained.

Recommendation 1E – Require MSHA to ensure CAP agencies identify work specifications and cost estimates prior to solicitation of bids.

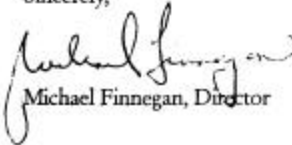
Response: MSHA assured cost reasonableness in the FIX ME program by requiring the CAPs to review bids and certify to cost reasonableness. We audited the CAPs to ensure this was being done. HUD would prefer the CAPs to prepare work write-ups with specifications and cost estimates to ensure cost reasonableness. We are incorporating this method in our redesigned program. MSHA staff recently attended HUD CPD's new training on this topic. We plan to provide the training in Maine for the CAP agencies.

Recommendation 1F - Require MSHA to ensure CAP agencies retain a portion of the final payment to the contractor until completion of the final inspection, and thoroughly document the three required inspections of FIX ME Program repair work.

Response: The new home rehabilitation program will require the completion of at least three documented inspections for each project. Final payment to the contractor will be withheld until both the homeowner and CAP agency are satisfied the job is properly completed.

If you have any questions concerning this response, please do not hesitate to contact me.

Sincerely,



Michael Finnegan, Director

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