
AUDIT REPORT



PONTIAC NEIGHBORHOOD HOUSING SERVICES,
INCORPORATED

HOME INVESTMENT PARTNERSHIP PROGRAM

PONTIAC, MICHIGAN

2004-CH-1004

MAY 5, 2004

OFFICE OF AUDIT, REGION V
CHICAGO, ILLINOIS



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| Issue Date May 5, 2004 |
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| Audit Case Number 2004-CH-1004 |
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TO: Jeanette Harris, Director of Community Planning and Development, 5FD

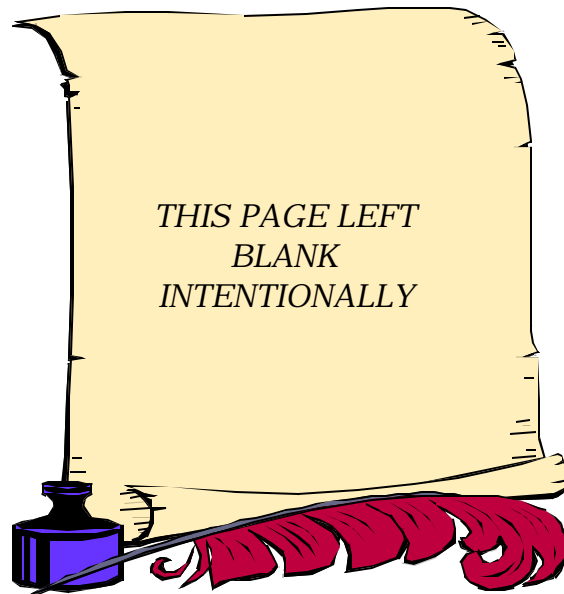

FROM: Heath Wolfe, Regional Inspector General for Audit, 5AGA

SUBJECT: Pontiac Neighborhood Housing Services, Incorporated
HOME Investment Partnership Program
Pontiac, Michigan

We completed an audit of Pontiac Neighborhood Housing Services, Incorporated's HOME Investment Partnership Program. The audit was conducted based on a request from HUD's Detroit Field Office of Community Planning and Development. The objective of our audit was to determine whether HUD's rules and regulations were properly followed for the Martin Luther King Residential Project, funded by the City of Pontiac's HOME Program. The audit resulted in two findings.

In accordance with HUD Handbook 2000.06 REV-3, within 60 days please provide us, for each recommendation without a management decision, 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. Additional status reports are required at 90 days and 120 days after report issuance for any recommendation without a management decision. Also, please furnish us copies of any correspondence or directives issued because of the audit.

Should you or your staff have any questions, please contact Thomas Towers, Assistant Regional Inspector General for Audit, at (313) 226-6280 extension 8062 or me at (312) 353-7832.



Executive Summary

We completed an audit of Pontiac Neighborhood Housing Services, Incorporated's HOME Program. The audit was conducted based on a request from HUD's Detroit Field Office Director of Community Planning and Development for an accounting of how the HOME Program funds were used. The objective of our audit was to determine whether HUD's rules and regulations were properly followed for the Martin Luther King Residential Project funded by the City of Pontiac's HOME Program.

We concluded that Housing Services, Incorporated did not follow HUD's requirements and its Development Agreement with the City of Pontiac regarding the use of HOME funds for the Residential Project. Specifically, Housing Services, Incorporated:

- ❖ Used \$871,057 in HOME funds and another \$457,651 in Program income to pay for the construction of nine homes that did not meet the City's Building Code; and
- ❖ Did not return Program income directly generated from the use of HOME funds through the City's Residential Project.

Homes Did Not Meet The City's Building Code After Housing Assistance

Pontiac Neighborhood Housing Services, Incorporated did not follow HUD's requirements and its Development Agreement with the City of Pontiac to ensure homes assisted through the Residential Project met the City's Building Code. Housing Services, Incorporated used \$871,057 of HOME funds to pay for the construction of nine homes that did not meet the City's Building Code. Housing Services, Incorporated used an additional \$457,651 in Program income from the sale of homes in the Residential Project to cover construction expenses of the nine homes.

Program Income Was Not Returned To The City

Pontiac Neighborhood Housing Services, Incorporated did not return Program income directly generated from the use of HOME funds through the City's Martin Luther King Residential Project. The City provided Housing Services, Incorporated \$1,373,803 in HOME funds to construct 14 homes through the City's Residential Project. Housing Services, Incorporated received \$977,554 in proceeds from the sale of the 14 homes.

Beginning with Fiscal Year 2002, HUD's Detroit Field Office began actions to recover \$574,192 from the City of Pontiac over a four-year period due to disallowed project costs. In July 2002, the Detroit Field Office reduced the disallowance to

\$452,269, but failed to notify Headquarters of the lower grant reduction amount.

Recommendations

We recommend that HUD's Detroit Field Office Director of Community Planning and Development ensure the City of Pontiac implements procedures and controls to correct the weaknesses cited in this report.

We presented our draft audit report to the City's Acting Director of Community Development, the President of the Board for Pontiac Neighborhood Housing Services, and HUD's staff during the audit. We held an exit conference with the City's staff on January 21, 2004. The City provided written comments to our draft audit report. We included paraphrased excerpts of the comments with each finding (see Findings 1 and 2). The complete text of the City's comments is contained in Appendix B. HUD's Director of the Detroit Field Office of Community Planning and Development proposed a management decision dated May 3, 2004 regarding the Recommendations included in this report. Appropriate entries to HUD's Audit Resolution and Controlled Actions Tracking System will be made based upon HUD's management decision.

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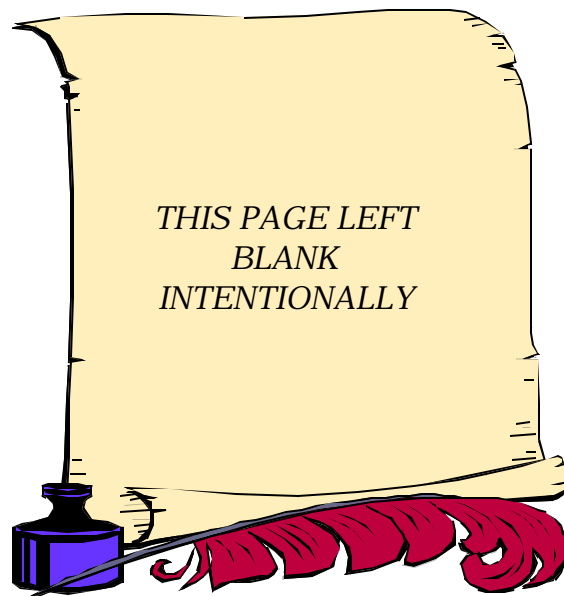
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Introduction

Title II of the Cranston-Gonzalez National Affordable Housing Act of 1990 established the HOME Investment Partnership Program. The Program's objectives include providing participating jurisdictions with various forms of Federal housing assistance. Participating jurisdictions use their funds to accomplish the following objectives: (1) expand the supply of decent, safe, sanitary, and affordable housing for very low and low-income Americans; (2) make new construction, rehabilitation, substantial rehabilitation, and acquisition of such housing feasible; and (3) promote the development of partnerships among the Federal Government, States and units of general local government, private industry, and nonprofit organizations to effectively use all available resources to provide more housing. Another objective of the Program is to expand the capacity of nonprofit community housing development organizations to develop and manage decent, safe, sanitary, and affordable housing.

The City of Pontiac, a participating jurisdiction, established its HOME Program in 1992 to increase the supply of decent, safe, sanitary, and affordable housing for low-income residents. From Fiscal Years 1992 to 2003, the City of Pontiac was awarded \$8,765,771 in HOME funds. HUD made grant reductions of \$143,500 per year for Fiscal Years 2002 and 2003. This represented partial payments to the City's HOME Program for disallowed HOME funds on the residential housing project known as the Martin Luther King Homes Residential Project. HUD's Detroit Field Office of Community Planning and Development agreed to adjust the last year of this annual reduction (2005) based on our audit results.

The City's Community Development Department administers its HOME Program. Within the Department, the Federal Programs Division handles the day-to-day operations of the HOME Program. Mary Gray-Roberson was terminated effective August 1, 2003 as the Director of the City's Office of Community Development. Roger Minard is the current Acting Director of the Department. Patricia M. Lake is the Block Grant Administrator of the Federal Programs Division. The Mayor of the City is Willie W. Payne.

The City entered into a Development Agreement, effective June 30, 1999, with Pontiac Neighborhood Housing Services, Incorporated for the construction, marketing, and sale of 14 new single-family homes on Martin Luther King, Jr. Boulevard to qualified low-income households. The City agreed to pay Housing Services, Incorporated \$1,521,000 for the services it provided through the Martin Luther King Homes Residential Project.

Housing Services, Incorporated was established on December 28, 1979 as a private nonprofit organization. Their mission was to provide low-income housing in targeted neighborhoods. The City certified Housing Services, Incorporated as a community housing development organization. However, the City lacked documentation to show when this occurred. The City revoked Housing Services, Incorporated's status as a community housing development organization, effective February 19, 2002, for the improper use of Program funds. Housing Services, Incorporated discontinued its operations in July 2002.

The City maintains its Program records at the Pontiac Silverdome. The Pontiac Silverdome is located at 1200 Featherstone Road, Pontiac, Michigan.




Audit Objectives

The objective of our audit was to determine whether HUD's rules and regulations were properly followed for the Martin Luther King Residential Project funded by Housing Services, Incorporated's HOME Program.



Audit Scope And Methodology

We conducted the audit at HUD's Detroit Field Office, City Hall, and the City's Community Development Department. We performed our on-site audit work from February 2003 to September 2003.

To accomplish our audit objectives, we interviewed: HUD's staff; the City's former and current staff and officials; an attorney for the City; Housing Services, Incorporated's former staff; Neighborhood Reinvestment Corporation's staff; accountants; bank representatives; and 13 of the 14 owners of the homes constructed through the City's Residential Project. In addition, a HUD Construction Analyst inspected nine of the 14 homes that received assistance through Housing Services, Incorporated's HOME Program to determine whether the homes met the City's Building Code. Due to time constraints, the HUD Construction Analyst was unable to inspect the remaining five homes.

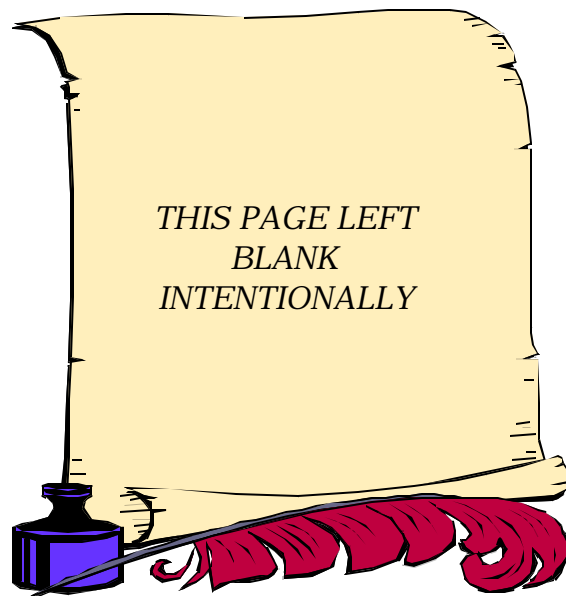
To determine whether HUD's rules and regulations were properly followed for the Residential Project, we reviewed the City's: Development Agreement with Housing Services, Incorporated; HOME Program policies; HOME Program files for the Residential Project; and participant files for the HOME Program. We also reviewed Housing Services, Incorporated's Audited Financial Statements, Board meeting minutes, payment requests and supporting documentation, cancelled checks, and bank statements.

Furthermore, we reviewed: HUD's files for Housing Services, Incorporated's HOME Program; Title II of the Cranston-Gonzalez National Affordable Housing Act of 1990; Parts 58, 84, 85, 92, 200, and 3280 of Title 24 of the Code of Federal

Regulations; Office of Management and Budget Circulars A-87, A-122, and A-133; and HUD's Community Planning and Development Notices 97-9 and 03-05.

The audit covered the period July 1, 1998 through December 31, 2002. This period was adjusted as necessary. We conducted the audit in accordance with Generally Accepted Government Auditing Standards.

We provided a copy of this report to the City's Mayor and its Acting Director of Community Development.



Homes Did Not Meet The City's Building Code After Receiving Housing Assistance

Pontiac Neighborhood Housing Services, Incorporated did not follow HUD's requirements and its Development Agreement with the City of Pontiac to ensure homes assisted through the Martin Luther King Residential Project met the City's Building Code. Our inspection of nine of the 14 homes in the Residential Project identified \$871,057 of HOME funds used by Housing Services, Incorporated to pay for construction that did not meet the City's Building Code. Housing Services, Incorporated used an additional \$457,651 in HOME Program income generated from the sale of the homes to cover construction expenses for the nine homes. The City lacked adequate procedures and controls to ensure the homes met the City's Building Code. As a result, Home funds were not used efficiently and effectively.

Federal Requirements

Title II, Section 203, of the Cranston-Gonzalez National Affordable Housing Act of 1990 requires that housing units be in decent condition when HOME funds are used to provide housing to low and moderate-income residents.

24 CFR, Subpart F, Part 92.251(a) requires new housing constructed with HOME funds to meet all applicable local codes, ordinances, and zoning ordinances at the time of the projects' completion.

City's Requirements

Article VII(D)(2) of the City of Pontiac's Development Agreement, effective June 30, 1999, with Pontiac Neighborhood Housing Services, Incorporated states the Martin Luther King Residential Project must comply with 24 CFR Part 92.251 relating to applicable State and local property standards. Article VII(D)(2) also provides for the City of Pontiac to use the Building Officials and Code Administrators National Property Maintenance Code as its standard code. Article XIII of the Agreement states the date of completion is the date the City issues a Certificate of Occupancy per each completed home. Article XIX states the City must monitor the performance of Pontiac Neighborhood Housing Services, Incorporated in carrying out its responsibilities through Project progress reports, periodic inspections by the City's staff, on-site monitoring, and financial documentation reviews.

Sample Selection And
Inspection Reports

We selected nine of the 14 manufactured homes constructed with HOME funds through the City's Martin Luther King Residential Project for inspection. We selected the homes to determine whether they met the City's Building Code upon completion of the construction. The City entered into a contract with Pontiac Neighborhood Housing Services, Incorporated, effective June 30, 1999, for the construction, marketing, and sale of the 14 new single-family homes on Martin Luther King, Jr. Boulevard to qualified low-income households.

A HUD Construction Analyst inspected nine of the 14 homes on June 17 and 18, 2003. Although the HUD Construction Analyst was unable to inspect the remaining five homes due to time constraints, he was able to inspect each type of home in the Residential Project. The City declined our invitation to have one of its staff members accompany us during the housing inspections.

We provided our inspection results to HUD's Detroit Field Office Director of Community Planning and Development and the City's Acting Director of Community Development.

HOME Funds Were Used
To Pay For Construction
Work That Did Not Meet
The City's Building Code

Pontiac Neighborhood Housing Services, Incorporated used \$871,057 of HOME funds from the City to pay for the construction of nine homes that did not meet the City's Building Code. The nine homes were assisted through the City's Martin Luther King Residential Project. Housing Services, Incorporated used an additional \$457,651 in HOME Program income generated from the sale of the homes in the Residential Project to cover construction expenses for the nine homes that did not meet the City's Building Code. Based on accounting records maintained by Housing Services, Incorporated, we were able to determine how the Program income was spent, by property, as noted in the following chart:

| Lot No. | Property No. | Total Costs By Home Per Housing Services | Total Reimbursed By City Of Pontiac | Difference (Paid Out Of Program Income) |
|----------------|--------------|--|-------------------------------------|---|
| 1 | 196 | \$145,241 | \$117,051 | \$28,190 |
| 2 | 208 | 136,543 | 105,595 | 30,948 |
| 3 | 234 X | 142,278 | 101,046 | 41,232 |
| 4 | 256 X | 144,554 | 103,845 | 40,709 |
| 5 | 264 X | 149,493 | 91,508 | 57,985 |
| 6 | 272 | 147,515 | 92,457 | 55,058 |
| 7 | 278 X | 146,335 | 93,503 | 52,832 |
| 8 | 284 X | 146,902 | 91,659 | 55,243 |
| 9 | 292 X | 149,014 | 100,051 | 48,963 |
| 10 | 298 | 146,128 | 95,169 | 50,959 |
| 11 | 304 | 148,975 | 92,474 | 56,501 |
| 12 | 310 X | 146,740 | 90,640 | 56,100 |
| 13 | 316 X | 145,495 | 90,722 | 54,773 |
| 14 | 322 X | 157,897 | 108,083 | 49,814 |
| Totals: | | \$2,053,110 | \$1,373,803 | \$679,307 |

Legend: X = inspected by HUD's Construction Analyst

A total of \$367,609 of the \$679,307 in Program income was not approved by the City to use for construction costs (see Finding 2). In all, \$977,554 in Program income was generated through the sale of the 14 homes. The City, through two change orders, permitted Housing Services, Incorporated to use \$320,470 to pay for additional construction costs. Housing Services returned \$289,475 to the City, leaving a balance due of \$367,609.

The City also provided \$339,700 in deferred loans through its Homebuyer Assistance Program to assist participants in purchasing the nine homes. The City recorded forgivable loan repayment agreements and property liens against all nine homes for the homebuyer mortgage assistance provided.

The City established its Residential Project to provide the construction of modular homes to low-income households in the City. The Building and Safety Engineering Division's Building Official in the City's Community Development Department was responsible for the enforcement of the City's Building Code.

HUD's Inspector
Determined The Homes Did
Not Meet The City's
Building Code

HUD's Construction Analyst determined that the homes in the Martin Luther King Homes Residential Project did not meet the City's Building Code when construction was completed. Furthermore, the City lacked adequate procedures and controls to ensure violations cited by the City's Building Official were corrected. The housing construction work that was performed incorrectly or was not provided related to such items as: 1) an electric meter not secured to a house; 2) water penetration into the house; 3) a cover for an electrical panel in a garage was not attached; 4) weeps not provided in brick walls to allow water to escape; 5) an uncovered hole around an outdoor water faucet; 6) no cover plates for electrical fixtures; 7) porch railings not anchored to concrete slabs; 8) no cross-bracing for floor joists; 9) a lack of insulation around ducts and water pipes in unheated areas of a garage; 10) incomplete landscaping; and 11) exterior electrical wiring was not outdoor wiring or in conduit. The following pictures provide three examples of construction work that was performed incorrectly or was not provided.

The bulkhead above the electrical panel in the garage for the house at 278 Martin Luther King, Jr. Boulevard prevented the panel cover from fitting properly. An uncovered electrical panel can be very dangerous to children in the home.



A section of brick was omitted to allow the placement of a hose bib for an outside water faucet at 278 Martin Luther King Jr., Boulevard. The large hole was not sealed.



Uninsulated pipes were running through an unheated garage for an above bathroom at 316 Martin Luther King Jr., Boulevard. The piping must have an insulated sleeve or the garage must be heated to prevent water lines from breaking.



In his inspection report, HUD's Construction Analyst stated he could not provide an overall cost estimate for the work that was improperly performed or not provided. He said contractors would be needed to provide estimates—mainly due to the uncertainty of the extent of some of the problems. For example, the brick facing on the Stonecreek style homes lacked weep holes to permit moisture to escape. However, to determine the extent of any damage, part of the brick would have to be removed.

Other observations by HUD's Analyst included: 1) bedroom floors over garages were not insulated; 2) vinyl siding was encased in concrete; 3) concrete forms were not removed after the concrete cured; and 4) poured foundation walls on the first

level of all Stonecreek homes. These walls could have been framed out of wood studs and properly finished with vinyl siding or brick. Instead, the concrete walls are cold and not insulated.

The City re-inspected the homes in April 2002 and issued notices of violation to the housing contractors. The contractors never replied to the City's notices. Therefore, the City filed a complaint with the State against the contractors' licenses and decided to have a new contractor complete the repairs. The City obtained and accepted a proposal from a contractor on September 12, 2002 to complete repairs for the 14 homes for \$94,090. The contractor stopped making the repairs when eight of the 14 homeowners would not allow access to their homes due to a joint lawsuit against the City for code violations and deplorable conditions. The City paid the contractor \$55,275 for the repairs the contractor was able to complete.

The City's Building Official issued temporary Certificates of Occupancy for nine homes subject to special conditions. The special conditions in the temporary Certificates of Occupancy for the nine homes were either not detailed or did not contain violations identified by HUD's Construction Analyst. For example, the temporary Certificate of Completion for 278 Martin Luther King, Jr. Boulevard was subject to the special conditions of landscaping and minor repairs.

The City of Pontiac Did Not Have Adequate Procedures For Ensuring Program Income Was Returned

The City of Pontiac lacked adequate procedures and controls to ensure HOME Program income from the sale of the 14 homes was returned by Housing Services, Incorporated (see Finding 2). As a result, HUD lacked assurance that the homes met the City's Building Code. Prior to any sales of the homes, Housing Services submitted payment requests to the City along with supporting documentation as each phase of construction passed inspection, such as electrical and plumbing. However, once these funds were exhausted, Housing Services used Program income after each closing to pay for continued construction expenses without first obtaining inspection and approval from the City. As a result, the City lost control over the Program income and could not ensure that HOME funds were appropriately used.

Reduction Of HOME
Program Allocation
Resulting From HUD
Review

Subsequent to a monitoring review by HUD's Detroit Field Office of Community Planning and Development in 2002, the City of Pontiac's HOME Grant was reduced by \$574,192 over a four-year period to cover costs that exceeded the maximum per unit subsidy allowed (24 CFR Part 92.250(a)). The amount included \$330,346 that exceeded maximum development costs and \$121,923 due to an ineligible over-income homebuyer. However, the amount also erroneously included another \$121,923 as a reduction. The actual reduction should have been \$452,269 over four years. HUD's Detroit Field Office recognized this mistake, but was waiting for the conclusion of our audit before making any adjustments to the reduction that the City previously agreed to.

HUD already reduced the City's HOME Program funds by \$287,000 for Fiscal Years 2002 and 2003 (\$143,500 each year), and is reducing the 2004 funding by another \$143,500. This would leave a balance of \$55,263 due from the City for 2005 (\$452,269 plus \$33,494 identified in Finding 2, less \$430,500 reduced from the Program through Fiscal Year 2004). Since HUD was planning on reducing the Program's funding by \$143,500 in 2005, a total of \$88,237 would need to be put back into the Program.

Auditee Comments

[Excerpts paraphrased from the City of Pontiac's comments on our draft finding follow. Appendix B, pages 25 to 29, contains the complete text of the City's comments for this finding.]

The City disagreed with some statements made in the finding regarding responsibility for: 1) issuing the Certificates of Occupancy; 2) ensuring that the construction work was provided in accordance with the Development Agreement; and 3) ensuring that the homes met the City's Building Code when construction was completed. However, the City indicated that it would work closely with HUD to finish the homes and issue final Certificates of Occupancy. The City also identified various procedural changes to its HOME Program to show that it has already taken corrective actions to assure assisted homes meet the City's Building Code and HUD's regulations.

OIG Evaluation Of
Auditee Comments

The City of Pontiac is in general agreement with our Recommendations. The City stated that it plans to finish the homes and issue final Certificates of Occupancy. The City also identified various procedural changes to its HOME Grant Program that appear to address the control weaknesses found during our audit. We revised the finding to clarify the City's responsibilities.

Recommendations

We recommend that HUD's Detroit Field Office Director of Community Planning and Development ensure the City of Pontiac:

- 1A. Completes the construction work for the nine homes cited in this finding so that final Certificates of Occupancy can be issued. If the City is unable to comply, it should reimburse its HOME Program \$842,945 (\$871,057 plus \$457,651, less HUD's adjusted four-year Program reduction of \$485,763) from non-Federal funds.
- 1B. Implements procedures and controls to assure assisted homes meet the City's Building Code as required by HUD's and the City's requirements.
- 1C. Implements procedures and controls to monitor developers of projects funded under the City's HOME Program to ensure the developers follow the Program's requirements.

Program Income Was Not Returned To The City

Pontiac Neighborhood Housing Services, Incorporated did not return income directly generated from the use of HOME Program funds through the City of Pontiac's Martin Luther King Residential Project despite the requirement in their Development Agreement with the City. The City provided Housing Services, Incorporated \$1,373,803 in HOME funds to construct 14 homes through the City's Residential Project. Housing Services, Incorporated received \$977,554 in proceeds from the sale of the 14 homes. The City lacked procedures and controls to ensure Housing Services, Incorporated remitted \$367,609 of the Program income back to the City. As a result, fewer funds were available for the City's HOME Program.

City's Development Agreement

Article XV of the City of Pontiac's Development Agreement, effective June 30, 1999, with Pontiac Neighborhood Housing Services, Incorporated states all repayments, proceeds from the sale of the homes, program income, interest, unspent construction contingency dollars, and other returns on the investment of HOME funds in the Martin Luther King Residential Project will be returned to the City.

Background

Pontiac Neighborhood Housing Services, Incorporated was a community housing development organization. The City's Martin Luther King Homes Residential Project was fully funded with HOME Program funds. The City initially provided Housing Services, Incorporated \$1,373,803 in HOME funds to construct 14 homes through the City's Residential Project. Housing Services, Incorporated received \$977,554 in proceeds from the sale of the 14 homes. The following table shows the proceeds Housing Services, Incorporated received from the sale of each of the 14 homes.

| Property Address | Proceeds From Sale |
|---------------------------------------|--------------------|
| 196 Martin Luther King, Jr. Boulevard | \$78,532 |
| 208 Martin Luther King, Jr. Boulevard | 71,538 |
| 234 Martin Luther King, Jr. Boulevard | 70,515 |
| 256 Martin Luther King, Jr. Boulevard | 71,538 |
| 264 Martin Luther King, Jr. Boulevard | 65,803 |
| 272 Martin Luther King, Jr. Boulevard | 60,682 |
| 278 Martin Luther King, Jr. Boulevard | 74,138 |
| 284 Martin Luther King, Jr. Boulevard | 65,803 |
| 292 Martin Luther King, Jr. Boulevard | 65,803 |
| 298 Martin Luther King, Jr. Boulevard | 71,538 |
| 304 Martin Luther King, Jr. Boulevard | 65,803 |
| 310 Martin Luther King, Jr. Boulevard | 65,803 |
| 316 Martin Luther King, Jr. Boulevard | 71,538 |
| 322 Martin Luther King, Jr. Boulevard | 78,520 |
| Total | \$977,554 |

In accordance with 24 CFR Part 92.503 and HUD’s CPD Notice 97-9, the City required Housing Services, Incorporated to return all HOME Program income from the Residential Project to the City. However, the City amended its Development Agreement effective March 23, 2000 and September 22, 2000 to allow Housing Services, Incorporated to retain \$320,470 in Program income to offset construction costs. Therefore, the City provided Housing Services, Incorporated a total of \$1,694,273 in HOME funds for the Residential Project (\$1,373,803 plus \$320,470). Housing Services, Incorporated returned \$289,475 of the sale proceeds to the City in December of 2001, and discontinued its operations in July 2002. Contrary to the City’s Development Agreement, Housing Services, Incorporated did not remit the remaining \$367,609 of Program income to the City.

The City Agreed To Reductions In HOME Funding

In July 2002, HUD’s Office of Grant Programs and the City agreed to reduce future HOME funding to the City by \$574,000 over a four-year period (Fiscal Year 2002 through 2005). This was based on the Detroit Field Office of Community Planning and Development’s monitoring findings. HUD’s Detroit Field Office staff realized that the actual reduction should have been \$452,269, but failed to notify HUD Headquarters in time to adjust the programmed reduction in Grant funds. HUD’s Detroit Field Office decided to wait for our audit results before making any final adjustments. The reduction in funding was due to the use of HOME funds for

ineligible activities through the City’s Residential Project known as Martin Luther King Homes. The ineligible activities included excessive development costs resulting from Housing Services, Incorporated use of Program income for construction costs and providing housing to one ineligible participant.

HUD Did Not Include \$33,494 In Program Income That Housing Services Failed To Remit

HUD did not include \$33,494 in HOME Program income that Housing Services failed to remit to the City as part of its Agreement with the City. This is noted in the following chart:

| Description of HOME Costs | HUD’s Figures | Audit’s Figures |
|------------------------------|---------------|-----------------|
| Costs Reimbursed By City | \$1,373,803 | \$1,373,803 |
| Engineering Services | 8,880 | 8,880 |
| Total Costs Paid By City | \$1,382,683 | \$1,382,683 |
| Program Income | 944,060 | 977,554 |
| Total Generated By Program | \$2,326,743 | \$2,360,237 |
| Maximum Development Costs | 1,706,922 | 1,706,922 |
| Amount of Cost Overruns | \$619,821 | \$653,315 |
| Program Income Returned | -289,475 | -289,475 |
| Program Income Due the City | \$330,346 | \$363,840 |
| Ineligible/Over Income Buyer | 121,923 | 121,923 |
| Reduction in HOME Grant | \$452,269 | \$485,763 |
| Difference from Audit | | -452,269 |
| Additional Reduction to HOME | | \$33,494 |

The maximum development costs for the Project was based on \$121,923 as the maximum allowable unit development cost for a three bedroom housing unit multiplied by the 14 homes.

The City Lacked Adequate Procedures And Controls

The City lacked adequate procedures and controls to ensure Housing Services, Incorporated returned Program income from the sale of the 14 homes. The City allowed sales proceeds to be paid directly to Housing Services, Incorporated without any recourse for obtaining the Program income. As a result, fewer funds were available for the City’s HOME Program.

During Fiscal Year 2002, the City initiated action to require all Program income generated by community housing and development organizations to be returned to the City before these funds can be spent on eligible HOME activities.

Auditee Comments

[Excerpts paraphrased from the City of Pontiac's comments on our draft finding follow. Appendix B, pages 29 to 31, contains the complete text of the City's comments for this finding.]

The City disagreed with the statement that future HOME Program funds were already reduced by \$452,269 for the four-year period of Fiscal Years 2002 through 2005. The actual Grant reduction for the four-year period was \$574,192. The City did not dispute the \$33,494 in additional Program income owed to the HOME Program, but stated that repaying this amount from the City's General Fund would create an economic hardship. Since the City had taken a greater per year Grant reduction from HUD for its HOME Program in error, it requested that the \$33,494 be included in the calculation of the Grant reduction agreement with HUD.

OIG Evaluation Of
Auditee Comments

The City generally concurred with our draft audit report and Recommendations for this finding. Based on the City's statement, we revised the finding regarding the Grant reduction agreement.

Recommendations

We recommend that HUD's Detroit Field Office Director of Community Planning and Development ensure the City of Pontiac:

- 2A. Reimburses the additional HOME Program income of \$33,494 by including this amount in the Grant reduction agreement with HUD.
- 2B. Implements adequate procedures and controls to ensure developers return Program income to the City in accordance with executed written agreements.

Management Controls

Management controls include the plan of organization, methods, and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Management Controls

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

- Program Operations - Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Validity and Reliability of Data - Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.
- Compliance with Laws and Regulations - Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Safeguarding Resources - Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

We assessed all of the relevant controls identified above during our audit of Pontiac Neighborhood Housing Services, Incorporated's HOME Investment Partnership Program.

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

Significant Weaknesses

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

- Program Operations

The City of Pontiac failed to ensure Pontiac Neighborhood Housing Services, Incorporated: 1) followed HUD's requirements and its Development Agreement with the City to ensure homes assisted through the Martin Luther King Residential Project met the City's Building Code; and 2) returned Program income directly generated from the use of HOME funds through the City's Residential Project (see Findings 1 and 2).

- Compliance with Laws and Regulations

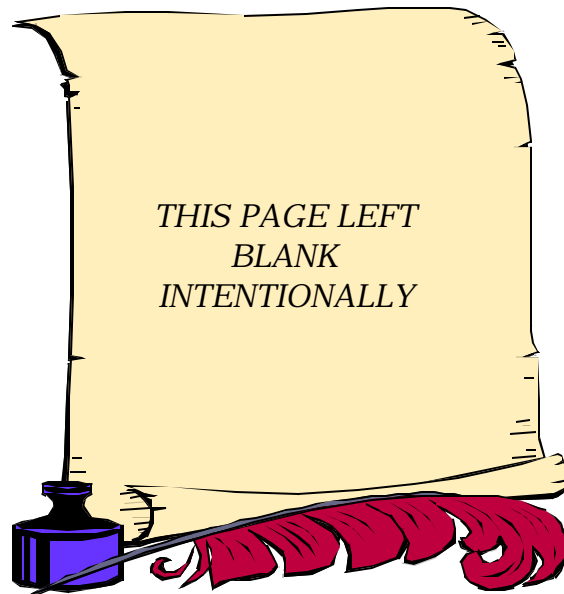
The City did not ensure Housing Services, Incorporated followed Title II, Section 203, of the Cranston-Gonzalez National Affordable Housing Act of 1990 and HUD's regulations regarding homes assisted through the Residential Project and the return of Program income generated from the use of HOME funds (see Findings 1 and 2).

- Safeguarding Resources

The City did not ensure Housing Services, Incorporated: effectively used \$871,057 of HOME funds to pay for the construction of nine homes that did not meet the City's Building Code; and returned \$33,494 of Program income directly generated from the use of HOME funds through the City's Residential Project. Housing Services, Incorporated also used \$457,651 in Program income generated from the sale of the homes to pay for additional construction costs for these nine homes, without full approval from the City (see Findings 1 and 2).

Follow-Up On Prior Audits

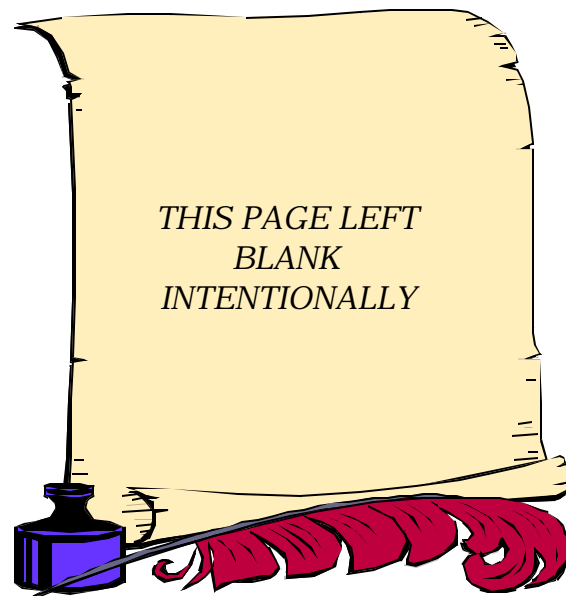
This is the first audit of Pontiac Neighborhood Housing Services, Inc's HOME Program by HUD's Office of Inspector General. The latest Independent Auditors' Report for Housing Services, Incorporated covered the period ending June 30, 2001. The report contained no findings.



Schedule Of Ineligible Costs

| <u>Recommendation</u> | |
|-----------------------|----------------------------|
| <u>Number</u> | <u>Ineligible Costs 1/</u> |
| 1A | \$842,945 |
| 2A | <u>33,494</u> |
| Total | <u>\$876,439</u> |

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



Auditee Comments



CITY OF PONTIAC MICHIGAN

MAYOR WILLIE W. PAYNE

*DEPARTMENT OF COMMUNITY DEVELOPMENT
FEDERAL PROGRAMS DIVISION*

February 17, 2004

Mr. Thomas Towers
Assistant Regional Inspector General For Audit
U.S. Dept. of HUD – Office of the Inspector General
477 Michigan Avenue, Room 1790
Detroit, MI 48226-2592

RE: Draft Audit Report of the Office of Inspector General for Audit, HUD
Pontiac Neighborhood Housing Services, Inc.

Dear Mr. Towers:

The City of Pontiac, Community Development Department, is in receipt of the copy of the draft audit report regarding Pontiac Neighborhood Housing Services, Inc. and the use of City of Pontiac HOME Investment Partnership program funds. After careful review of the draft audit, the City is offering the following response. The bold sections of the letter are direct excerpts from the draft audit report document.

It is important to note that the current staff of the Federal Programs Division including the Department Director and Block Grant Administrator did not have oversight responsibility during the development and construction phases of the Martin Luther King Boulevard Project. Those staff that were involved in this project are no longer in the employ of the City of Pontiac.

Review of the Draft Audit Report:

Finding 1: Homes did not meet the City's Building Code after receiving housing assistance.

Pontiac Neighborhood Housing Services, Inc did not follow HUD's requirements and its Development Agreement with the City of Pontiac to ensure homes assisted through the Martin Luther King Residential Project met the City's Building Code. Our inspection of nine of the 14 homes in the Residential Project identified \$871,057 of HOME funds used by Housing Services, Inc. to pay for construction that did not meet the City's Building Code. Housing Services, Inc. used an additional \$457,651 in Program Income generated from the sale of the homes to cover construction expenses for the nine homes that did not meet the City's Building Code. The City lacked adequate procedures and controls to ensure the homes met the City's

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Building Code. This may disqualify the homes for funding under the HOME program unless all code violations are resolved.

Recommendations

1A. Completes the construction work for the nine homes cited in the finding so that final certificates of occupancy can be issued. The City should also consider pursuing a Performance Bond claim against those contractors that performed the deficient work. If the City is unable to comply, the City should reimburse its HOME Program from non-federal funds for the amount of \$842,945 (\$871,057 plus \$457,651, less HUD's planned offset of \$452,269 from future HOME program allocations and \$33,494 due DUD from Finding 2).

1B. Implements procedures and controls to assure assisted homes meet the City's Building Code as required by HUD's Regulations and the City's Development Agreement with Pontiac Neighborhood Housing Services, Inc.

1C. Implements procedures and controls to monitor developers of projects under the City's HOME Program to ensure the developers follow the Program's requirement.

City of Pontiac's Response:

The City did contract with Pontiac Neighborhood Housing Services, Inc. to provide for the construction of fourteen modular homes. Because modular homes are built in a factory in sections and then brought to the site, the City's Building Official is not responsible for the inspection of these units and the issuance of the Certificate of Occupancy. The State of Michigan is responsible for the inspections of these modular units in the factory. These units were inspected by the State of Michigan prior to their delivery to the site on Martin Luther King Boulevard South. The Building Official and the Building and Safety Engineering Division only has oversight responsibilities for those portions of the home constructed or added on site including but not limited to the foundation, the electrical panel, the furnace and site improvements. The City also disagrees with the statement that the Building Official was responsible for assuring that the housing construction work was provided in accordance with the Development Agreement and that it met the City's Building Code. The Building Official and staff of the Building and Safety Engineering Division are responsible for the enforcement of the adopted Building Code but are not responsible for the completion of the construction in the appropriate manner. By the Development Agreement, Pontiac Neighborhood Housing Services, Inc. was responsible for the successful completion of the construction of the fourteen homes to local building standards or codes. While the City's Building Official and his staff can inspect the work completed, they are not responsible for the actual completion of the work to current code.

The City of Pontiac disagrees with the statement that "the City's Building Official did not assure that the homes met the City's Building Code when construction was completed". Again Pontiac Neighborhood Housing Services, Inc. as the builder/developer was

responsible for ensuring that the homes met the City's Building Code when construction was completed. The City's Building and Safety Engineering Division can only inspect the work completed by the builder/developer of the homes. The City at the request of Pontiac Neighborhood Housing Services Inc. inspected the homes and Pontiac Neighborhood Housing Services Inc. was issued a violation notice for each of the fourteen homes for those items, which did not meet current building code. Pontiac Neighborhood Housing Services, Inc. made a decision to not make the necessary repairs and address the unfinished items on the homes. The City did follow through with legal action against the nonprofit organization to try to recoup portion of the funding and to provide assistance to the homeowners to complete the necessary repairs on the houses so that Certificates of Occupancy could be issued and the project completed.

It is the responsibility of the builder/developer to pull the necessary building permits and obtain the necessary variances and site plan approvals from the City to begin construction on the project. As the construction work on the project progresses, it is the responsibility of the builder/developer to call the Building and Safety Engineering Division to schedule an inspection of the work in progress. There was a breakdown in the process during the construction when Pontiac Neighborhood Housing Services, Inc. began to receive the program income from the sale of the homes. City staff (the former HOME Program Administrator) at the time did not properly follow through to collect this program income and receipt the funds into the Integrated Disbursement and Information System (IDIS).

The City has been working to correct the deficiencies noted in the Building and Safety Engineering Division's Notice of Violations sent to Pontiac Neighborhood Housing Services, Inc. As has been mentioned in the draft audit report, the City has contracted with a contractor to make the necessary repairs to the homes in order to issue the final Certificates of Occupancy. While the contractor was working on site to make the final repairs, eight of the fourteen homeowners refused to allow the contractor to complete the work. These eight homeowners then brought a lawsuit against the City effectively preventing the City from completing the repairs on these homes. Of the nine homes inspected by the HUD Construction Analyst, five of the homes are involved in this litigation. In addition, one of the homes inspected at 316 Martin Luther King Boulevard, is also involved in the litigation and is owned by the person who was determined to be over income at the time of purchase. The HOME funds for this home are included in the \$452,269 HOME Program reduction plan that the City is currently on its second year of the four-year reduction.

The final repairs to the six homes not involved in the litigation involve the final grading and landscaping which cannot be addressed until the weather breaks for the season. As soon as weather permits, the City will address these remaining issues using nonfederal funds. These addresses include: 196 MLK, 234 MLK, 284 MLK, 304 MLK, 310 MLK, and 322 MLK. At this time, the City is not able to determine the outcome of the litigation and predict when the City will be allowed to address the remaining concerns at the seven homes. The City will work closely with HUD Detroit Field Office, Office of Community Planning and Development to finish the work on the homes and issue the final Certificates of Occupancy.

The City of Pontiac Community Development Department, Building and Safety Engineering Division reviewed the inspection report from the HUD Construction Analyst. The report identified 31 code violations and 132+ examples of poor workmanship. While the City does agree that some of the items are code violations not addressed by Pontiac Neighborhood Housing Services, Inc., the City does not agree with the entire list of items. Many of the items that do not directly affect health or safety issues cannot feasibly be addressed by the City and other items are not actually code violations. The City also found examples of where the write-ups were inconsistent with the photographs for that particular property.

There are many items that were installed by the homeowners and are beyond the original agreement with Pontiac Neighborhood Housing Services, Inc and were completed without benefit of buildings permits from the City. While there are code violations associated with these repairs and alterations, the City does not feel that it is responsible for these items. Examples of these include improperly installed central air conditioning systems, interior basement finishing including improper wiring and drywall installation, the installation of new doorwalls and decks, and the enlargement of the driveways to the homes.

Based on the great difference between what are legitimate code violations that need to be addressed and the unrealistic expectations of some of the homeowners, it is highly unlikely that there will be complete agreement on the nature of the final repairs needed to issue the final Certificates of Occupancy on these homes between the City officials and the homeowners. The City's Building and Safety Engineering Division will follow the requirements of the City's adopted Building Codes in regards to the inspections on these homes and issuance of the finals.

After the departure of the HOME Program Administrator and the consolidating of the two federal programs under the Federal Programs Division, new policies and procedures have been implemented to address these concerns that came up from this project. The standards previously set for the subrecipients of the Community Development Block Grant program have been applied to the organization receiving funding under the HOME program. These requirements include standardized monthly progress reports for each current grant. These monthly reports allow the federal programs staff to maintain communication with these organizations to address any issues that may come up during the implementation of the program on a consistent and timely basis. A majority of the problems with the Martin Luther King Residential project may have stemmed from a lack of communication between the organization and the City. In addition, the City also does monitoring on a regular basis including during the grant period as well as at the close out of the project. There are also new timeliness standard that have been included in the contract documents for the timely expenditure and reimbursement of the federal funds. The contracts also speak directly to program income and staff more closely monitors the income generated by the projects, if any, and these funds must come back to the City and be receipted into the IDIS system prior to the nonprofit having any further access to these funds. The failure of the nonprofit to remit program income funds to the City will result

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in them losing access to their other funding from the City until these funds are remitted to the City.

In addition to the lack of the communication and monitoring of the Martin Luther King Boulevard Project between the City and the nonprofit, there were problems within the organization itself in regards to its ability to administer the program and construct these fourteen homes. This lack of experience created situations in the construction process that contributed directly to the high number of cost overruns. Other problems with this project include the actual design of the project including the number of units, the type of housing selected and the process for selecting the homeowners. The City also no longer provides full financing of the construction project with the HOME funds as was done in the Martin Luther King Residential Project. The City now requires that the nonprofit secure construction financing from an outside financial institution. The nonprofit can only access the funds set aside as a subsidy for the house during the construction process and must obtain additional funding for the completion of the construction. This eliminates any concern over exceeding the maximum per unit subsidy amount, the generation of program income from the sale of a home, and brings in a third party inspector from the financial institution to review the progress of the construction and compliance with building codes in addition to staff review and inspectors from the City's Building and Safety Engineering Division.

The effectiveness of the City's new procedures is evidenced in the ability of the City and its current nonprofit housing organizations to construct new single-family housing in our community on time and within budget. Since the consolidation of the federal programs under one division, the City has completed construction on 23 new homes with an additional 22 new homes currently in process. Each of these 23 new homes has been issued final Certificates of Occupancy prior to the home being occupied by the income-eligible first-time homebuyer. The City has also provided financing for and completed two senior rental apartment complexes consisting of 45 and 50 units respectively. The HOME funds were used to subsidize the construction of four units in each of the two complexes. All of these projects have been completed since the Martin Luther King Boulevard project without any of the problems that have been associated with the Martin Luther King Boulevard Project and Pontiac Neighborhood Housing Services.

The City of Pontiac just completed a monitoring visit with our HUD representative in early February of this year that showed no findings with our current nonprofit housing organizations that are engaged in the construction of new single-family housing under the HOME program. Each of the organizations that were monitored was able to show the necessary information as required by HUD to show that the organizations and projects were in compliance with the HOME Program requirements. In addition, there have been no complaints from the homeowners of these homes that the City is aware of in regards to the quality of the construction and the affordability of the projects.

Finding 2: Program Income was not returned to the City

Program Income was not returned to the City.

Pontiac Neighborhood Housing Services, Inc. did not return program income directly generated from the use of HOME funds through the City's Martin Luther King Residential Project despite the requirement in their Development Agreement with the City. The City provided Housing Services, Inc. \$1,373,803 in HOME funds to construct 14 homes through the City's Residential Project. Housing Services, Inc. received \$977,554 in proceeds from the sale of the 14 homes. The City lacked procedures and controls to ensure Housing Services, Inc. remitted \$367,609 of the program income back to the City. As a result, fewer funds were available for the City's HOME program.

Recommendations

2A. Reimburses its HOME Program \$33,494 from nonfederal funds for the program income Pontiac Neighborhood Housing Services, Inc. did not remit to the City.

2B. Implements procedures and controls to ensure developers return program income to the City in accordance with executed written agreements.

City of Pontiac response:

The City disagrees with the statement that future HOME funding to the City was reduced by \$452,269 for the period fiscal year 2002 through fiscal year 2005. The actual amount of the grant reduction for the four-year period was \$574,192.33. For fiscal years 2002 and 2003, the City has seen a reduction in its HOME funding in the amount of \$287,096 or \$143,548 per year. It is the understanding of the City that the auditors have determined that the correct amount of the grant reduction should be \$452,269 taken over the four-year period.

In reviewing the information in the draft audit report, the City does not dispute the inclusion of the additional \$33,494 identified as program income. Because the City has taken a greater per year grant reduction than the Audit found to be necessary, the City is requesting that the \$33,494 currently being requested from the City in nonfederal funds be included in the grant reduction that the City is currently subject to as part of the agreement with HUD. The yearly grant reduction based on the audit amount of \$452,269 would be \$113,067. This is \$30,481 lower than the amounts the City has seen the HOME program funds reduced by for fiscal years 2002 and 2003 based on the original \$574,192 amount. Due to the limited funding available to the City, the repayment of the \$33,494 from the City's General Fund would create an economic hardship for the City.

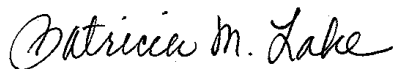
The City and the staff of the Federal Programs Division have made great strides in addressing the problems that were identified during the Martin Luther King Boulevard Residential Project. The consolidation of the HOME Program with the Community Development Block Grant program under the Federal Programs Division and the change of staffing have helped to address many of the problems with the City's prior HOME program management. The handling of program income since the 2001 program year has allowed the City to retain control over these funds and to ensure the expenditure of these

funds in a manner consistent with the HOME program requirements. A review of IDIS will show that the City has been consistently receipting program income into this system as a means to maintain control over the use of these funds in an appropriate manner.

The City of Pontiac appreciates the assistance from the staff of the HUD Detroit Field Office and the HUD Office of the Inspector General during the process of this audit of Pontiac Neighborhood Housing Services, Inc. The City will continue to work with the staff of the HUD Detroit Office to address the final repairs to the homes on Martin Luther King Boulevard by providing timely updates on the progress of these repairs and the status of the current litigation.

If additional information is required of the City on this audit report, please contact my office at 248-857-5746.

Sincerely,



Patricia M. Lake
Block Grant Administrator
City of Pontiac

Cc: Mayor Willie W. Payne
Deputy Mayor Leon Jukowski
Michael Willis, Executive Assistant to the Mayor
Roger Minard, Acting Community Development Director
Tom McIntyre, Building Official
Juanita Moody, Community Development Specialist

