



Issue Date	December 21, 2004
Audit Report Number	2005-PH-1003

TO: Sean G. Cassidy, General Deputy Assistant Secretary for Housing, H

FROM: Daniel G. Temme, Regional Inspector General for Audit, Mid-Atlantic Region, 3AGA

SUBJECT: The Town of Clifton, VA's, Participation in the Single Family Property Disposition Discount Sales Program

HIGHLIGHTS

What We Audited and Why

In response to a congressional and departmental request, we audited the Town of Clifton's participation in the U.S. Department of Housing and Urban Development's (HUD) Single Family Property Disposition Discount Sales Program (Sales Program). Our objective was to determine whether the Town of Clifton (Town) complied with HUD's rules and regulations in administering the Sales Program. Specifically, we wanted to determine whether the Town appropriately participated under the Sales Program using the competitive sales method, re-sold rehabilitated properties at prices less than 110 percent of their net development cost, and re-sold the properties only to income-eligible homebuyers.

What We Found

The Town of Clifton did not fully comply with HUD's rules and regulations in administering its Sales Program. Specifically, the Town of Clifton could not adequately support property rehabilitation costs it claimed it made to the properties it sold under the program, and it sold several properties at sale prices

above the amount allowed by HUD requirements. However, we did find the Town of Clifton participated under the program using the competitive sales process and it did meet the requirements in selling the homes to income-qualified buyers.

Focusing on properties with the highest dollar repair costs, we selected and reviewed 10 of the 89 properties the Town had purchased and re-sold under the program to see if sales were made to income-qualified buyers and that net development costs met the requirements of Mortgagee Letter 2001-30. The home inspection repair invoices the Town of Clifton provided us to support each property's repair costs did not have sufficient detail to permit us to determine if the claimed costs were reasonable nor to verify contractor or vendor expenditures. However, our on-site physical home inspections of the 10 properties confirmed that some of the work itemized on the home inspection repair invoices had not been performed. In total, we identified \$9,380 of charges for repairs that did not exist in seven homes and thus were ineligible. Also, for many other repairs we were not able to verify if the work was necessary, reasonable or had actually been completed because the home inspection repair invoices lacked sufficient detail. Since we found the process used to identify and pay for repair costs was neither accurate nor reliable, we also question the remaining \$205,615 in repair costs for the 10 homes we inspected.

Further, since the rehabilitation costs are used in calculating the sale price of the homes, we determined the Town of Clifton exceeded the 110 percent of the net development costs requirement for at least five of the properties. By exceeding the allowable sales percentage, the homeowner's mortgage was overstated and in turn the discounts received by the Town were not passed along to the homeowners. Since we could not verify the repair costs associated with the 10 properties we reviewed, and in 7 cases we found evidence that repairs were paid for that were not actually completed, we question the full amount of the discounts (\$140,475) the Town received when it purchased these 10 properties.

What We Recommend

We recommend the Department require the Town of Clifton schedule an independent inspection of the 79 remaining homes it has processed under the discount Sales Program to verify that all work was satisfactorily completed. If work has not been done, the Town should pay down the homeowners' mortgage by the appropriate amount. Additionally, the Department should review the deficiencies noted in this report and determine if the Town of Clifton should be reinstated to participate in the Sales Program. If the Town is reinstated, prior to reinstatement, require the Town of Clifton to set up controls and procedures that fully document and verify the claimed net development costs.

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

Auditee's Response

The complete text of the Town of Clifton's response, along with our evaluation of that response, can be found in Appendix B of this report.

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BACKGROUND AND OBJECTIVES

The purpose of HUD's Single Family Property Disposition Sales Program is to dispose of properties in a manner that expands homeownership opportunities, strengthens neighborhoods and communities, and ensures a maximum return to the mortgage insurance funds. In an attempt to provide increased affordable housing opportunities to low- and moderate-income homebuyers, HUD permits non-profits and government entities to purchase HUD Real Estate Owned properties at a discount. These discounts range from 10 to 30 percent off the "as is" appraised value of the property. The entity must pass along the discounts received in order to increase homeownership opportunities for low- and moderate-income families and individuals.

To sell the properties HUD uses several different formats. Our review concentrated on two of them: the direct sales method and the competitive sales method. Under the direct sales method a non-profit or government entity must be pre-approved by HUD to participate in the Sales Program. Once they are approved, they are provided the first opportunity to purchase the homes. Any homes not purchased by an approved non-profit or government entity will be offered for sale under the competitive sales method. Under the competitive sales method, HUD offers to sell the properties to the general public. Both non-profits and government entities can participate in the competitive sales method; however, they do not have to be "pre-approved" by the Department to participate in the program. Under the competitive sales method, HUD sells the properties on an "as-is" basis, without repairs or warranties. Non-profits and government agencies, which bid competitively during this period, and are the successful bidder without any discount being considered, are then given the applicable discount off the gross sale price for that property. Homes purchased under HUD's Sales Program must be sold to an eligible purchaser, whose income does not exceed 115 percent of the median income of the locality of the home.

In addition to selling the home to an eligible homebuyer, the program participants must pass on the discount received from HUD to increase homeownership opportunities. In order to do this HUD limits the net development costs allowed. The net development costs is composed of the allowable property acquisition costs plus allowable rehabilitation, holding, and various other selling costs entities incur when purchasing a HUD home at discount prices. The Department limits the eligible costs and prohibits the entity from reselling the repaired properties at prices in excess of 110 percent of the net development cost calculation. Appendix A of Mortgage Letter 2001-30 identifies costs allowed in calculating net development costs which states costs passed along must be "reasonable and customary." In addition, rehabilitation costs are to be "verifiable contractor and vendor expenditures."

The Town of Clifton used HUD's Single Family Property Disposition Sales Program as a means to raise revenue. The Town entered into an agreement on November 19, 2002, with a "for-profit" entity, Commercial Lending Corporation (Commercial Lending), to handle all aspects of the purchase, rehabilitation, and sale of the properties. The contractor paid for all purchase and rehabilitation costs; or the Town would borrow funds from the contractor to cover these expenditures.

Using the competitive sales method under the program, over a 2-year period the Town of Clifton purchased 98 homes across the State of Virginia for a total purchase price of \$9,451,301. None of the homes purchased were within the Town of Clifton's geographic boundary, nor are they required to be under the competitive sales program. In purchasing these homes, the Town received \$1,417,695 in discounts from HUD. During our audit period, 89 of the 98 properties were re-sold for \$10,581,823. Using the Town's "government" status to purchase the properties, the contractor divided approximately \$721,164 in profits with the Town. Commercial Lending received \$322,337 in management fees and the Town received \$399,305 in net income.

Our overall objective was to determine whether the Town of Clifton and its agent, Commercial Lending Corporation, followed HUD's rules and regulations in administering HUD's Single Family Property Disposition Discount Sales Program. To accomplish this, we wanted to determine whether the Town appropriately participated under the Sales Program using the competitive sales method, re-sold rehabilitated properties at prices less than 110 percent of their net development cost, and re-sold the properties only to income-eligible homebuyers.

RESULTS OF AUDIT

Finding 1: Support Documentation for Property Rehabilitation Costs Was Inadequate and Unreliable

The files maintained by Commercial Lending on behalf of the Town of Clifton did not provide adequate documentation to support the repair costs it claimed it made on the properties it re-sold under the program. In fact, from our review of a sample of 10 of the 89 properties the Town of Clifton re-sold under the program, we found Commercial Lending paid for repairs for items that did not exist in 7 of the homes. Thus, the net development costs used for calculating the sale prices of the homes was not accurate and homeowners paid for repairs through their mortgages that were not made. This occurred because the Town did not provide adequate oversight over Commercial Lending to ensure it properly administered the program according to HUD regulations. Further, Commercial Lending provided limited monitoring of its repair contractors, which caused it to pay its repair contractors for repairs that were not performed. Consequently, both entities delegated oversight functions in a manner that does not provide assurance low- and moderate-income buyers received full value for the amounts paid.

Documentation To Support Home Repair Cost Was Limited

The only document Commercial Lending could provide us to support the repair costs it claimed that it incurred for each property was the home inspection repair invoice it had generated. No detailed documentation, such as invoices from its repair contractors, supported this document. Further, we noted several discrepancies with this document. Dollar values were missing in the “owners estimate” or “contractor estimate” columns, and start and completion dates were left blank. In addition, the description of the work performed was not sufficient enough to determine exactly what work was performed. For example, an inspection report stated a roof repair was made for \$4,000; however, no information was provided to detail exactly what was done (i.e., replacing shingles, fixing leak, etc.). Thus, based on the documentation in the file, it is impossible to determine if the work claimed on the home inspection repair invoice had actually been completed and if the price paid was reasonable.

Commercial Lending Claims It Conducts Site Inspections To Ensure Only Needed Repairs Are Made and Paid For

According to Commercial Lending, once a home is purchased from HUD, Commercial Lending inspects each home to identify what repairs it will need to make before the property is re-sold. The Commercial Lending inspector documents the results of the inspection by completing a home inspection repair invoice, which includes a cost estimate for each identified repair item. Commercial Lending uses the home inspection document to negotiate a final price with primarily four repair contractors that it uses to make the home repairs. After the repair contractor completes the repairs, Commercial Lending inspects the property and then disburses payment based on the agreed price on the home inspection repair invoice. Commercial Lending does not require the repair contractors to support the repair costs with any other form of documentation. Instead, Commercial Lending requests that the repair contractor sign and date a certification form stating that all repairs specified on the home inspection repair invoice were completed in a workmanlike manner. Our review of Commercial Lending's property files found that the certifications were sometimes signed 9 to 12 months after the work was performed or the date was left blank.

On-Site Home Inspections Showed Not All Repairs Were Completed, Valid or Verifiable

Since we could not determine the repairs reported on Commercial Lending's home inspection repair invoice were actually necessary or completed by the repair contractor, we decided to complete on-site home inspections for a sample of the properties. We selected 10 of the 89 properties the Town had acquired during our review period, with the highest claimed repair costs. The repair costs for these 10 properties totaled \$214,995¹. A HUD housing inspector accompanied us on the inspections. In completing our physical inspections, we walked through each house and compared Commercial Lending's home inspection repair invoice to the work we could see had actually been completed. In addition we interviewed the homeowners. Since Commercial Lending's home inspection repair invoices lacked specific detail, for many items we were not able to determine if the repair was necessary or had actually been completed. However, in 7 of the 10 homes inspected we were able to identify a number of repairs listed on the home inspection repair invoices that either did not exist or were not completed by the repair contractor before the homeowners moved in. In total, we identified \$9,380 of ineligible charges for repairs to items in the homes that did not exist.

¹ The total repair costs for the 89 properties totaled \$1,054,723.

For example,

- Three home inspection repair invoices noted that repairs were made to powder rooms that did not exist.
- Three home inspection repair invoices noted that refrigerators were provided to the homeowners; however, the homeowners provided receipts showing that they had purchased the refrigerators themselves.
- One home inspection repair invoice claimed a sliding glass door was replaced in the family room of the home when there was no sliding glass door in the home.
- One home inspection repair invoice indicated a hot water heater had been replaced. However, when we looked at the picture of the hot water heater on the Federal Housing Administration appraisal (before the Town acquired the property), we noted it had the same marks and tape on it as the current “replacement” hot water heater.

Although these repairs and replacements were not completed, Commercial Lending paid the vendors. In addition, the home inspection repair invoices for the 10 homes we inspected had “soft cost”² items, totaling \$52,935. We could not determine whether these costs were justified or had actually been made because the home inspection repair invoices lacked sufficient detail to describe the specific nature of the repair(s). Further, the repair contractors were not required to provide detailed documentation to support the repair costs, i.e., nature of repair, labor, parts, etc. These included line items such as “repair air conditioner,” “dumping fees,” “fence repair,” and “ceiling/wall repair.” Thus, since we found the process Commercial Lending used to identify and pay for repair costs to be inaccurate and unreliable, we question the remaining \$205,615 in repair costs for the 10 homes we inspected.

Repair Costs Should Be Reasonable and Verifiable

According to Mortgagee Letter 2001-30, in reference to determining the allowable net development costs, rehabilitation costs are the total verifiable contractor and vendor expenditures incurred in the actual reconstruction, repair, restoration and physical improvement of the property. The Town of Clifton and Commercial Lending were aware of Mortgagee Letter 2001-30; however, contractors were paid for repairs that were not actually performed. Commercial Lending and the Town could have verified the costs by completing proper inspections of the property and by obtaining appropriate work orders from the repair contractors.

² For purposes of this audit, a soft cost is defined as the price of a repair item that we could not determine whether it was completed or necessary.

The manner in which the Town of Clifton and Commercial Lending documented its claimed repair costs was consistent for the 10 properties we inspected and was consistent with the method used for the remaining 79 properties. This indicates that there are likely systemic deficiencies with the Town of Clifton's overall administration of its discount Sales Program. Therefore, we have concerns about the reliability of documentation for claimed repair costs of \$1,054,723 associated with all of the 89 properties that were in the program. However, since we only completed site inspections on 10 of the properties, we will request the Department to complete site inspections on the remaining 79 properties to determine if \$839,728 in repair costs for those properties can be supported.

Incorrect Net Development Costs Improperly Increased the Sale Price of Several Homes

As we noted above, in 7 of the 10 properties we inspected, Commercial Lending claimed charges for a number of repairs that were not done or appliances that had not been replaced. These "non-existent" costs were used by the Town to determine the net development costs and in turn the sale price of the home. When we recalculated the sale price of these 7 homes, we found in 5 instances the Town exceeded 110 percent of the net development costs by a total of \$8,378. By exceeding the allowable sales percentage, the homeowner's mortgage was overstated and in turn the discounts received by the Town when it purchased the homes was not passed along to the homeowners. Since we could not verify the repair costs associated with the 10 properties we inspected and, in 7 cases, we found evidence that repairs were paid for, when they were not actually completed, we question the full amount of the discounts (\$140,475) the Town received when it purchased these 10 properties.

The Town of Clifton Provided Limited Oversight of Its Agent

The Town did not adequately monitor the activities of Commercial Lending because it did not actively participate in the administration of the Sales Program. As such, the Town did not ensure proper documentation and approvals were maintained to support repair costs; and its contractor fully complied with HUD's program requirements. The weaknesses contributed to questionable payments for repairs that were not performed.

Under the Town's agreement with Commercial Lending, the Town delegated nearly all aspects of the administration of the program to its contractor. The Town representative emphasized the Town trusts Commercial Lending with the management of the program and allows it to control all repair costs. However, the

agreement does not relieve the Town of its responsibility for executing the program in compliance with HUD requirements.

By not requiring Commercial Lending to obtain work orders and other supporting documentation to fully support the claimed repairs, the Town of Clifton cannot guarantee that the work was completed or was completed at a reasonable cost. Our inspections confirmed that not all the repairs claimed by Commercial Lending and its repair contractors had been completed and as such the Town of Clifton cannot rely solely on Commercial Lending reports. Consequently, payments for non-existent or unnecessary repairs increase the price of the homes and undermines the mission of providing affordable housing opportunities to low- and moderate-income homebuyers.

Income Eligible Recipients Purchased Homes

According to Mortgagee Letter 2001-30 and the Land Use Restriction Addendum, properties in the discount Sales Program must be sold to a purchaser whose income does not exceed 115 percent of the median income, when adjusted for family size, and for the area in which the property is located. Therefore, we reviewed the income eligibility for the home purchasers of the 10 properties we inspected. We also reviewed the income eligibility for the nine homes which were purchased with Federal Housing Administration loans. Based upon the information provided in Commercial Lending's files we determined that all of the purchasers fell below the 115 percent median income limitation.

Recommendations

We recommend the Office of Housing:

- 1A. Require the Town of Clifton to support the remaining \$37,350 in discounts it received when it purchased the homes within the discount Sales Program for the (3 of 10) properties that had unsupported repair costs.
- 1B. Require the Town of Clifton to pay down the mortgages for the properties our review showed incurred ineligible costs by \$9,380.
- 1C. Require the Town of Clifton to support \$205,615 in unsupported repairs we could not verify during our on site inspections. For costs that remain unsupported the Town of Clifton should pay down the mortgages for those properties.
- 1D. Require the Town of Clifton to pay the Department \$103,125 in discounts it received when it purchased the homes within the Sales Program for the

seven properties (7 of 10) found to have non-existent repairs on its home inspection repair invoices.

- 1E. Require the Town of Clifton to schedule an independent inspection of the remaining 79 homes the Town of Clifton purchased under this program and verify that all stated repair work has been adequately completed. If it is found that repairs were inadequate or repairs were not made the Town of Clifton should pay down the mortgages of the homeowners by those amounts.
- 1F. Review the deficiencies noted in this report and determine if the Town of Clifton should be reinstated to participate in the Sales Program. If the Town is allowed to participate in the Sales Program, require it to establish and implement controls and procedures that fully document and verify claimed net development costs.

SCOPE AND METHODOLOGY

To accomplish the audit objectives, we

- Reviewed applicable HUD regulations relating to the Town's participation in the Single Family Property Disposition Discount Sales Program.
- Conducted interviews with officials and employees of the Town of Clifton, Commercial Lending and HUD's Single Family Division.
- Reviewed established procedures formulated by the Town of Clifton and Commercial Lending in administering the Sales Program.
- Reviewed home inspection repair invoices for 10 of the 89 properties that were sold during our audit period. The 10 homes selected for our sample were chosen because they had the highest amount of repair costs expended per home.
- Reviewed the income verification documents for the 10 homebuyers sampled during our inspection, to ensure income eligibility.
- Reviewed the income verification documents of the nine homebuyers that obtained Federal Housing Administration loans, to ensure income eligibility thereby ensuring that no risk was placed upon the Federal Housing Administration insurance fund.
- Examined records and related documents for the properties purchased and closed by the Town from HUD's inventory of foreclosed properties.

We performed the majority of our fieldwork between June and September 2004 at the offices of Commercial Lending Corporation, located at 7603 Maple Branch Road, Clifton, VA. The audit generally covered the period of November 1, 2002, through May 31, 2004, but was expanded when necessary.

We performed our review in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

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

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

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

Relevant Internal Controls

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

- Management Oversight Processes - Policies and Procedures that management has in place to reasonably ensure that improper payments would not be made or would be detected in the normal course of business.
- Monitoring of Contractor Performance - Policies and Procedures that management has in place to ensure that adequate supporting documentation substantiates the validity of the work performed.

We assessed the relevant controls identified above.

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

Significant Weaknesses

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

- Lack of management oversight.
- Lack of adequate supporting documentation for repairs performed.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation Number	Ineligible 1/	Unsupported 2/
1A		\$ 37,350
1B	\$ 9,380	
1C		\$205,615
1D	\$103,125	
Total	\$112,505	\$242,965

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local polices or regulations.
- 2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

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December 10, 2004

Ms. Christine Begola
Asst. Regional Inspector General for Audit
Office of the Inspector General of HUD
10 South Howard Street
Room 4610
Baltimore, Maryland 21201

Re: Town of Clifton, Virginia

Dear Ms. Begola:

The Mayor, our attorney and I have reviewed the draft report from Daniel G. Temme to Sean Cassidy, General Deputy Assistant Secretary for Housing, with respect to the participation by the Town of Clifton in HUD's single family disposition program. We appreciate the opportunity to review the draft and to meet with you and your staff to discuss our reactions to its contents.

We have been informed that the Town's opportunity to respond to the draft report will expire on December 13, 2004. To make sure that our comments are recorded, I am responding on behalf of the Town prior to being able to review our response with the whole Town Council at a monthly meeting. Even after December 13, we will inform you of any new facts which we believe may assist in your investigative efforts.

First, let me thank your office for confirming the Town's belief that the standards applicable to it are those relating to the competitive sale program and not the predesignation negotiated sale program as previously asserted by HUD. As the draft report notes, the Town complied with the requirement that homes be sold to income-qualified buyers, and no restriction exists under the competitive sale program on the Town's purchase of homes outside its geographic boundaries. Since these were the two major complaints asserted by HUD as the basis for suspending the Town's right to participate in the program, the Town feels vindicated.

The draft report notes that the Town "could not adequately support property rehabilitation costs it claimed it made to the properties it sold under the Program, and it sold several properties at sales prices above the amount allowed by HUD requirements." It appears that the documentation, including invoices, that our agent, Commercial Lending Corporation, LLC (the "Agent") received from repair contractors was not sufficiently detailed for audit purposes and, in five instances that your staff identified, those invoices indicated work as having been done that your staff determined was not performed. On the basis of your review, your office recommends that the Town should "establish and implement controls and procedures that fully document and verify claimed net development costs." The Town concurs, and has directed our Agent that, for any future work to be done on homes acquired from HUD:

- (i) third party home inspectors be hired for the purpose of inspecting the home two times: after the Town's purchase and before any work is done, for the purpose of developing a scope of required work for delivery to repair contractors; and after the repair

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December 10, 2004

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contractors say that all work has been completed and before any payment is made to the repair contractors, for the purpose of confirming that all work we contract for has been performed in a quality manner; and

(ii) a scope of work be developed with specificity and made part of any contract with repair contractors, so that the Town can have the work inspected by third party inspectors and hold repair contractors accountable for providing all the work for which the Town bargains.

Your recommendation makes sense, and we have adopted it.

The draft report notes that the Town did not comply fully in five instances with the requirement that homes be resold for a price of not more than 110% of "net development costs," as defined in HUD Mortgagee Letter 2001-30. We have reviewed the facts surrounding those homes with representatives of Commercial Lending Corporation, LLC and wish to respond to each instance:

- | <u>House</u> | <u>Concern</u> |
|------------------------------------|-----------------------------------|
| 1. 2252 Fort Pickens, Dumfries, VA | Hot Water Heater was not replaced |

Mr. Eubank explained to you during our meeting on December 6 that the invoices incorrectly stated that the heater was to be replaced, when in fact the heater *element* was replaced and other repair and adjustment work done to get the water heater operating and a fixing a problem in an electric panel, as explained in the attached contractor's letter. This suspected failure to perform work merely is a mistake in nomenclature on the invoice and not a nonexistent repair or other repair contractor flim-flammy. We welcome you to confirm the facts with the repair contractor or the home owner.

- | <u>House</u> | <u>Concern</u> |
|--|--|
| 2. 607 Red Horse Lane,
Virginia Beach, VA | Refrigerator was purchased by homeowner, not the contractor;
Powder room repairs
(powder room did not exist) |

As to the refrigerator issue, the Agent provided you a letter in the form attached that clarifies that the Town reimbursed the home purchaser for the cost of the refrigerator that was not installed. As to the "powder room repairs," we concur that you can't repair what doesn't exist, and no "powder room" exists on the first floor of this house. While we recognize that a mistake was made, we believe it to be the product of sloppiness on the repair contractor's part, by using an invoice form from a prior home on which he did "powder room repairs" for a home owned by the Town; on the Town's part, the absence of an adequate repair inspection process resulted in paying for this one piece of work that was not done. **In order to make it right, the Town has directed its Agent to reimburse the homeowner \$715, the ascribed cost of the "powder room repairs."**

- | <u>House</u> | <u>Concern</u> |
|--|---|
| 3. 506 Peregrine Street,
Virginia Beach, VA | fence gate repair, sliding glass door replaced in family room does not exist, powder room repairs
(powder room does not exist) |

Our repair contractor says that a repair was made to the wooden fence and a gate; it may not have been all that was desired by the home owner, but it was done. The "sliding glass door" in the family room was in fact the replacement of both the front and rear exterior doors, but, even though mislabeled, the house got what it needed at a reasonable price. Again the "powder room repairs," which was a mistake of the same type, by the same contractor, using the same old form, as explained in paragraph 2 above. **The Town has directed its Agent to reimburse the homeowner \$1,105, the ascribed cost of the "powder room repairs."**

Ref to OIG Evaluation

Auditee Comments

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House
4. 742 Lake Edward Drive,
Virginia Beach, VA

Concern
Refrigerator was purchased by
homeowner, not the contractor

Your staff is correct that the contractor failed to supply the new refrigerator for which the Town paid and the home purchaser contracted. **The Town has directed its Agent to reimburse the homeowner \$700, the ascribed cost of the refrigerator.**

House
5. 3220 Ashaway Drive,
Virginia Beach, VA

Concern
Garage door repair, fence gate
repair, refrigerator was purchased
by homeowner, not the contractor,
Powder room repairs (powder room did
not exist)

In this case, both the chain link fence, including its structural frame, and a gate were repaired; please consult with the repair contractor as to the detail. The garage door was repaired by installing new springs and lifting mechanism; you indicated that the homeowner had to pay for replacing the lock mechanism, which was not broken and therefore not repaired during the Town's ownership. We concur that the refrigerator was not replaced as indicated on the invoice, and that no "powder room repairs" were done since no powder room exists on the first floor. **The Town has directed its Agent to reimburse the homeowner \$1,060, the total ascribed cost of the refrigerator and the powder room repairs.**

Comment 2

The worst thing you found is that we paid for "powder room repairs" to nonexistent powder rooms (for which the home owners have been paid an amount equal to the overcharge), that two refrigerators were not replaced as promised (for which the home owners have been reimbursed), and that the invoices were not specific enough for you to know in detail what work was done on homes. Based on these anomalies, your draft audit report concludes that the standards and inspection processes created by the Town and the Agent are so inadequate that your office "questions" the discount amounts and believes that the oversight weaknesses contributed to questionable and "potentially fraudulent" payments for repairs that were not performed. **This is where we part company.** The Town and its Agent see that the lack of specificity of the required scope of repairs, and the lack of contracted third party inspection, permitted mistakes to be made and not caught. Since being informed of the problem, we have done what's right to correct any concern about the Town's being charged, and consequently charging home buyers, for work that was not performed, and we recognize the appropriateness of changing our contracting and inspection procedures going forward. Nothing in the Town's activities should lead any objective observer, including HUD, to conclude that anything "fraudulent" has occurred, and we specifically request removal of that reference in your final audit report.

Comment 1

The draft audit report makes additional recommendations, including that:

- o the Town pay down the mortgage loans of owners of homes in which contracted-for work was not performed, which the report states totals \$9,380. The Town concurs that home purchasers should not be charged for what they did not receive, and therefore has reimbursed the mortgagors directly in the amounts relating to work that clearly was not performed, which totals \$3,580, involving the amounts per house listed in the attached chart.
- o if the Town is reinstated in the HUD program, HUD should require establishment and implementation of controls and procedures that fully document and verify claimed net development costs. The Town concurs with this recommendation and already has adopted a change of procedure relating to specifying scopes of work and third party inspection. We are willing to work with HUD to develop a full set of procedures for this purpose.
- o the Town pay to HUD \$103,125 of undeserved discounts for the 7 properties that had "nonexistent" repairs. As I have pointed out, an amount equal to the cost of the repairs determined by your staff that the Town paid but for which it did not receive repairs has been paid

Comment 3

Comment 1

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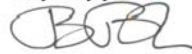
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to each mortgagor, as shown on the attached chart, which reduces the sales price of each home and causes the Town to be in compliance with HUD's requirement that homes not be sold for more than 110% of net development costs. Therefore, this recommendation has the effect of imposing a draconian punishment on the Town after it has righted the identified wrong. The recommended punishment does not fit the crime here.

- o the Town "support" \$205,615 of remaining costs for the 10 inspected homes that your staff could not verify by on-site inspection, that HUD inspect the remaining 79 homes under the same standards that your office postulated for the 10 homes you inspected, and require the paydown of mortgage loans for which costs are not "supported". While we are happy to provide any information in our possession about repairs, their costs and what the Town paid, the report makes clear that the Town has no third party inspections or any other method to prove to an auditor's required level of certainty what repairs were requested and in fact performed. Therefore, these recommendations really mean "Pay Up Now Without Further Protest." The recommended inspection process seems a futile act, especially in light of the Town's determination to retain third party inspectors to create the reliability of records and process for future activities. We can supply the evidence contained in the signed repair contractor invoices for each home, the voluminous accounting records our Agent keeps (which even your staff auditors said were among the best of their type they'd seen), the record of satisfied home purchasers, none of whom has complained of any major problem in their homes to your staff or to us, and on our belief that the Town, and folks who purchased homes from us, achieved good value for the funds spent.

While the Town may not have performed perfectly in its acquisition, repair and sale of HUD homes, we are proud to have produced so many opportunities for low income persons to buy quality homes. We have learned the importance of establishing a process by which the Town can better assure compliance with applicable HUD requirements and intend to implement them if we ever get another chance to continue to participate in purchasing HUD homes competitively.

Very truly yours,



Brant Baber

cc: Mayor and Town Council
Gifford Hampshire, Esq.
Hon. Thomas Davis

OIG Evaluation of Auditee Comments

Comment 1

We are encouraged by actions the Town plans to implement to move forward in resolving the outstanding issues, including the reimbursement of several questioned costs to the homeowners. However, it will be HUD's decision as to whether these proposed actions are acceptable or an alternative course of action is warranted. Consequently, we have not removed any of the questioned costs from the report.

Comment 2

As stated in the report, we only looked at a limited number of homes purchased by the Town to determine if the work that was paid for was actually completed and to determine if the net development costs were properly accounted for. Based upon our testing, we noted discrepancies in 70% of the homes we visited. This high percentage should lead an objective observer to conclude that the questioned costs are more than just an oversight by the Town or its agent. The entire process used by the Town and its agent to document the work completed created an environment where repair items could easily be added without any accountability. However, we did adjust the report to take out the word "fraudulent".

Comment 3

As explained at the exit conference, the OIG makes recommendations based upon what we believe will correct the problems. The Department will then take those recommendations and determine if they should be implemented or not. Since the Town did violate the 110 percent net development requirement in the homes we reviewed, it will be HUD's decision to determine if the proposed corrective action by the Town will be enough to disregard this recommendation.