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Audit Report Number 2005-LA-1006

TO: Steven Sachs, Regional Office Director, Community Planning and Development,
9AD

Joan S. Hobbs

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

SUBJECT: Maricopa HOME Consortium/City of Mesa HOME Program
Maricopa Revitalization

HIGHLIGHTS

What We Audited and Why

We conducted a limited review of the Maricopa HOME Consortium (Consortium)/City of Mesa's (City) use of \$570,000 in HOME grant funds to assist in the rehabilitation of 35 single-family scattered site public housing units, located within the jurisdiction of the City and Maricopa County.

Our objective was to determine whether the use of HOME funds to rehabilitate these public housing units was an eligible HOME activity.

What We Found

We determined that this Consortium/City grant activity was not an eligible use of HOME funds. Although title to the housing units rehabilitated was transferred to a new entity, they remain under an annual contributions contract between the U.S. Department of Housing and Urban Development (HUD) and the Housing Authority of Maricopa County (Authority) and are receiving operating subsidy (including capital grant funding). This is an ineligible activity, according to the HOME regulations set out in 24 CFR [*Code of Federal Regulations*] 92.214, which prohibits the use of HOME funds to assist housing units receiving

assistance under section 9 of the 1937 Housing Act (public housing capital and operating funds). The parties involved, including the nonprofit developer, Community Services of Arizona, which was the managing entity for the activity, failed to adequately review the conditions agreed to by HUD in allowing the Authority to dispose of these units. These conditions significantly and adversely affected the eligibility of this project to receive HOME funds. Additionally, we noted deficiencies in record keeping by the developer involved in this activity.

What We Recommend

We recommend that the Consortium be required to reimburse the \$570,000 in HOME funds to its local HOME investment trust fund. Additionally, we recommend that the Consortium establish sufficient controls/procedures to ensure HUD program requirements are followed by each Consortium member and documentation and records supporting key decisions are maintained by each Consortium member and its subrecipients/developers for all HOME program activities.

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 auditee provided us with a written response to our draft report on July 12, 2005. They generally disagreed with our conclusions relating to the eligibility of subject HOME activity. The complete text of the auditee'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 \$570,000 in HOME funds was used to assist in the rehabilitation of a 35-unit scattered site project called Maricopa Revitalization. This project originally consisted of 56 single-family scattered site public housing units owned by the Housing Authority of Maricopa County (Authority) that were sold (transferred) to a new ownership entity (Maricopa Revitalization Partnership, LLC (Partnership)), which obtained tax credit financing to assist in the rehabilitation of the units. All 56 units were under an annual contributions contract (contributions contract) and receiving operating subsidy at the time the U.S. Department of Housing and Urban Development (HUD) approved the disposition of the 56 units in May 2002.

In accordance with HUD's disposition approval, the units were to be removed from the Authority's contributions contract when sold and then brought back in under a new contributions contract after project completion (after rehabilitation). This disposition approval was subject to the Authority obtaining HUD's approval of a mixed-finance application for the rehabilitation and management of the units. An application/proposal was submitted in July 2002. However, before HUD initiated its review, the Authority informed HUD that the proposal would be changing and that a new application would be submitted. This new application was never submitted, and thus the project never received required HUD final approval.

Although all 56 units were sold (ownership transferred), only 35 units were ultimately included in the new ownership entity that received tax credit and HOME financing. The HOME funds involved in the project were used as "gap" financing. This was necessary as the tax credit funds were not sufficient to pay for the total rehabilitation and administrative costs of the project. The City of Mesa (City), an equal partner of the Maricopa HOME Consortium (Consortium), entered into a HOME agreement with and loaned the \$570,000 in HOME funds to Community Services of Arizona, Inc. (Community Services), the nonprofit developer of the project. Community Services in turn loaned the HOME funds to the Partnership, the owner of the project to assist in the rehabilitation of 22 of the units. The rehabilitation of the 35 units was completed around October 2003.

The lead agency in the Consortium is Maricopa County (County) through its Community Development Department. As the lead agency, the County has been designated the participating jurisdiction by HUD and as such, is responsible for overall administration of the Consortium's HOME programs. According to County staff and the Consortium agreement, the Consortium members administer and are individually responsible for their subrecipient agreements, including monitoring and processing all financial reimbursements, project setups, revisions, and completion reports through the lead agency. Community Services, the managing partner of the Partnership, was responsible for carrying out and managing the HOME-assisted housing activity.

Our objective was to determine whether the use of HOME funds to rehabilitate public housing units was an eligible HOME activity.

RESULTS OF AUDIT

Finding 1: Inadequate Procedures and Controls over Grant Activities by the Consortium/City Resulted in the Ineligible Use of \$570,000 in HOME Funds

The Consortium/City inappropriately used \$570,000 in HOME funds to assist in the rehabilitation of 35 scattered site public housing units, which were under a contributions contract and receiving operating subsidy. HOME regulations set out in 24 CFR [*Code of Federal Regulations*] 92.214 state that HOME funds may not be used to provide assistance authorized under section 9 of the 1937 Housing Act (public housing capital and operating funds). Accordingly, this activity was not eligible for assistance under the HOME program. In our opinion, the County, the lead agency in the Consortium; the City, a member of the Consortium; and Community Services, the developer, did not apply sufficient oversight and control to ensure that the HOME funds were used in accordance with HUD's requirements. They did not obtain sufficient information relating to HUD's approval of the transfer of the public housing units involved in the project from the Authority to the Partnership and how this affected the units' continued eligibility for capital grant and operating subsidy funding.

**Community Services Received
\$570,000 in HOME Funds to
Assist in the Rehabilitation of
35 Public Housing Units**

Community Services originally executed a subrecipient¹ agreement with the City in February 2002. This agreement called for the City to provide Community Services \$380,000 in HOME funds to be used for the acquisition of a small (8 unit) to medium (20 unit) apartment complex. In November 2002, the agreement was amended to increase HOME funding to \$570,000 for project activities that were to include acquisition and rehabilitation of an unidentified building(s). An agreement for the purchase of an apartment complex was never finalized, and in March of 2003, Community Services requested that the City allow it to use its \$570,000 HOME fund allocation as additional (gap) financing needed to finalize another project it was involved in; i.e., the rehabilitation of the 35 scattered site housing units known as Maricopa Revitalization. This was a tax credit project involving Community Services, the Authority, and a tax credit investor. The units were public housing units, title to which was to be transferred by the Authority to the Partnership. The Partnership (comprised of Community Services, the

¹ Although the agreement was referred to by all parties as Subrecipient Agreement # 8335, Community Services was acting as a developer not a subrecipient for this activity.

Authority, and the tax credit investor) was to use the tax credit funds and the HOME funds for the rehabilitation of the units. The City approved Community Services' request under the terms of its existing subrecipient agreement. The HOME assistance was provided to Community Services as a loan. Community Services in turn loaned the funds to the Partnership, which is to make annual loan repayments only if surplus funds from operations are available. Community Services and the City accounted for the use of the HOME funds by allocating \$570,000 in direct rehabilitation costs attributable to 22 of the 35 units to the HOME activity.

Involved Parties Did Not Obtain a Copy of HUD's Disposition Approval for the Units

Since these were public housing units under a contributions contract between HUD and the Authority, HUD had to approve the Authority's disposition of the units. This approval was granted subject to certain requirements, including the Authority's submission and HUD's approval of a mixed-finance development proposal, setting out the terms of the disposition and the subsequent use of the units. This was never done, and although title has been transferred to the Partnership, the units continue to receive operating subsidy and capital grant funding from HUD. Community Services and City representatives stated that the former director of the Authority verbally informed them that with title transfer to the Partnership, the public housing units would no longer be under the contributions contract and thus would stop receiving the operating subsidy. However, these parties did not obtain a copy of the documentation related to HUD's disposition approval to determine what the Authority had to do to meet the stipulations agreed to by HUD. Had they done so, they would have known that the Authority's plans were to continue obtaining the operating subsidy for these units and, accordingly, HOME funds could not be used for rehabilitation.

The County, the lead agency for the Consortium, stated it had never seen the subject agreement between the City and Community Services as each member of the Consortium draws up its own agreements with subrecipients without review or approval by the County. Additionally, the County stated that each Consortium member is responsible for ensuring that activities it funds meet the requirements of the HOME program. However, it should be noted that as the lead agency for the Consortium, the County is responsible for all activities carried out under the Consortium's HOME program, regardless of which member makes the final funding decisions.

We also noted that Community Services did not maintain many of the source documents/project files related to the HOME activity. These documents,

including the rehabilitation contract, change orders, consultant contract, inspector's contract, and cost certifications, were maintained by its tax credit consultant. The documents should have been maintained by Community Services to assist it in its management of the HOME activity and for review by the Consortium, HUD, and its independent auditor.

Conclusion

In our opinion, the use of HOME funds for the rehabilitation of these public housing units was not an eligible HOME Activity as the units were receiving assistance provided under section 9 of the United States Housing Act. The County and the City disagreed, claiming that with the transfer of the units to Maricopa Revitalization the units became eligible for HOME funding. The County said the City was responsible for this project, including any potential required payback for ineligible uses of the HOME grant funds. The City stated that if the activity is determined ineligible it would pursue repayment from Community Services in accordance with the terms of its subrecipient agreement. However, it should be noted that regardless of whether the County is reimbursed by the City or Community Services, HUD holds the County, as the lead agency, responsible for return of ineligible expenditures of HOME funds.

Recommendations

We recommend that the Consortium be required to

1A. Reimburse its local HOME investment trust fund the \$570,000 improperly expended on the Maricopa Revitalization project and

1B. Establish sufficient controls/procedures to ensure HUD program requirements are followed by each Consortium member and that documentation and records of key decisions are maintained by each Consortium member and its subrecipients for all HOME program activities.

SCOPE AND METHODOLOGY

To achieve our audit objective, our review was limited to

- Review of applicable laws, regulations, and other HUD program requirements;
- Review of accounting records, contract documents, development documents, and correspondence maintained by HUD, the County, the City, and Community Services and its tax credit consultant that related to the rehabilitation activity financed by the \$570,00 in HOME grant funds; and
- Interviews with appropriate HUD, County, City, and Community Services staff.

We performed our review between February and April 2005. The audit period covered the period January 2002 through December 2004.

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

INTERNAL CONTROLS

Internal controls are 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 objective:

- Compliance with applicable laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resources used are 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 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 item is a significant weakness:

- The Consortium's and the City's procedures and controls were inadequate to ensure that HOME program grant funds were expended only on eligible activities (see finding 1).

FOLLOWUP ON PRIOR AUDITS

Prior Report Title and Number

An Office of Inspector General (OIG) audit report related to the Housing Authority of Maricopa County's management of its mixed finance development activities was issued on March 14, 2005. This report included a review of the Authority's involvement in the HOME-funded activity discussed in this report (Report #2005-LA-1002).

APPENDIXES

Appendix A

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

Recommendation number	Ineligible 1/	Unsupported 2/	Unreasonable or unnecessary 3/	Funds to be put to better use 4/
1A	\$570,000			

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.

3/ Unreasonable/unnecessary costs are those costs not generally recognized as ordinary, prudent, relevant, and/or necessary within established practices. Unreasonable costs exceed the costs that would be incurred by a prudent person in conducting a competitive business.

4/ “Funds to be put to better use” are quantifiable savings that are anticipated to occur if an OIG recommendation is implemented, resulting in reduced expenditures at a later time for the activities in question. This includes costs not incurred, deobligation of funds, withdrawal of interest, reductions in outlays, avoidance of unnecessary expenditures, loans and guarantees not made, and other savings.

Appendix B

AUDITEE COMMENTS² AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments



Maricopa County

Community Development

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July 12, 2005

FAXED
7-12-05 PMD

Ms. Joan S. Hobbs
Regional Inspector General for Audit
Office of Inspector General
Pacific/Hawaii Region XI
U. S. Department of Housing and Urban Development
611 West Sixth Street, Suite 1160
Los Angeles, California 90017-3101

SUBJECT: MARICOPA HOME CONSORTIUM/CITY OF MESA HOME PROGRAM MARICOPA REVITALIZATION; QUESTIONED COSTS - \$570,000

Dear Ms. Hobbs:

In response to the Office of the Inspector General's Discussion Draft Audit Report dated June 6, 2005, it is the Community Development Department's opinion that the finding cited by your office is in error. Based on the information contained herein (and in our files), the HOME Program activity known as "Maricopa Revitalization" was an eligible use of HOME funding.

Maricopa County, through its Community Development Department (CD) and acting as Lead Agency of the Maricopa HOME Consortium (Consortium), must rely on the provisions set forth in the HUD-approved Maricopa Home Consortium Agreement (Agreement).¹ This Agreement was in force during the period at issue and included the City of Mesa as a Consortium Member. Provision 3 of the Agreement states that: "CD shall assume overall responsibility for ensuring that the Consortium's HOME Program is carried out in compliance with HUD rules and regulations, and the requirements of the HOME Program." However, under Provision 16 of this Agreement, Consortium members, including the City of Mesa, are responsible for the administration of subrecipient agreements/contracts. Further, Provision 11 of the Agreement states that: "Each Consortium member will indemnify the other Consortium members for damages resulting from negligent acts or omissions or intentional torts of that Consortium member." CD, as Lead Agency, has limited resources and must rely on the various Consortium members to administer the HOME program consistent with HUD and related statutory requirements.

¹ Maricopa Home Consortium Agreement, C-17-02-063-D, (Amended June 2002).
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Comment 1

² The City of Mesa also provided a written response to the draft report. Its response was similar in substance to that provided by Maricopa County, the lead agency for the Consortium. However, where deemed appropriate, OIG has provided additional evaluation of the City's response as footnotes in OIG's Evaluation of Auditee's Response section of this report.

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In 2002, the Maricopa Housing Department (Authority) entered into an agreement to transfer ownership of 56 units of public housing to the Maricopa Revitalization Partnership LLC (LLC). The LLC obtained tax credits to purchase and rehabilitate these units. Community Services of Arizona (CSA), a nonprofit developer and managing partner of the LLC, also contracted with the City of Mesa to provide HOME funds for the rehabilitation activity of 22 of these units.

The City of Mesa Home Investment Partnerships Program (HOME)² contract, between the City of Mesa and CSA, was the subrecipient agreement that controlled the HOME funds allocation to CSA, and ultimately to the Maricopa Revitalization Project ("Project"). CD was not a party to this subrecipient agreement. The Consortium Member, City of Mesa, was responsible for its administration. CD, as Lead Agency, reasonably relied on the City to properly administer the operation of its HOME fund allocation under this subrecipient agreement. The City's administrative duties included monitoring activities to assure statutory compliance and eligibility for funds received by the City under the HOME Program. Such monitoring was possible through the subrecipient agreement provisions whereby project information flowed from CSA to the City³. According to Provision 6 of the subrecipient agreement, CSA had the duty to comply with all Federal laws and regulations, including the specific provision of 24 C.F.R. § 92 addressing ineligible activities for HOME funds.⁴

The Authority was charged with the responsibility to complete the steps necessary to remove the 56 units from the public housing stock. On May 31, 2002, HUD Assistant Secretary Michael Liu issued a letter to the Authority stipulating the tasks that had to be completed in order to remove the units from the public housing stock. These tasks were required to be completed before title of the units could be transferred to the LLC. The stipulations outlined in this letter clearly obligated the Authority and not the other partners in the LLC.

The Authority, aware of its responsibilities in this transaction, verbally informed CSA that with the title transfer to the Maricopa Revitalization Partnership, LLC, the public housing units would no longer be under the Authority's contributions contract, and thus would stop receiving the HUD operating subsidy. Upon the proper and legal transfer of title of the 56 units to the Partnership, the units **were no longer public housing units**. The fact that the Authority mistakenly continued to accept operating subsidy for these units was not within the control of the LLC, and did not alter the substance of the asset transfer. Therefore, CSA did indeed "apply adequate oversight and control to ensure that the HOME funds received were used in accordance with HUD HOME Program requirements".

Comment 2

² City of Mesa Home Investment Partnerships Program (HOME), A Federally Funded Project #8335, (Feb. 21, 2002).

³ See *Id.*, Attachment II, Statement of Work, at 2.

⁴ Housing and Urban Development Part 92--Home Investment Partnerships Program, 24 C.F.R. § 92.214 (2005).
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Furthermore, it was not the responsibility of the Consortium to “obtain a copy of the documentation related to HUD’s disposition approval to determine what the Authority had to do to meet the stipulations agreed to by HUD”.⁵ In fact, neither the Consortium nor the City of Mesa had the authority to do so. It appears the responsibility to meet the required stipulations rested entirely with the Authority.

Comment 3

Assistance to the Maricopa Revitalization Project under Section 9 of the United States Housing Act of 1937 (“Section 9”) was arranged and administered by and between the Authority and CSA through its association with the Maricopa Revitalization Partnership, LLC; the scattered unit ownership entity. This Section 9 assistance activity was independent from, and had no direct connection to, the HOME Program Funding administered by CD and its Consortium Member, the City of Mesa. As discussed below, the only reporting mechanism to the City by the HOME subrecipient, CSA, that could have formally disclosed the coexistence of the Section 9 subsidy and HOME fund assistance, was in a source and use budget report item required under the City of Mesa’s HOME Agreement. If the City was made aware of this dual federal program assistance, then it would have had to report this information to CD, the Lead Agency, in order for the Department to become aware and take any necessary corrective action(s). CD’s records include no such communications between it and the City.

As previously mentioned, there is no direct correlation between assistance from Section 9 of the United States Housing Act of 1937 and HOME allocations to this specific project. Under the subrecipient agreement, and its statement of work, reports from CSA to the City included a “detailed sources and uses budget, and a HOME budget.”⁶ This report appears to be the only reporting linkage between these two independent assistance programs that could have alerted the City, and eventually CD, of the possible co-existence of these programs for the Maricopa Revitalization Project. An inquiry as to the level of detail in this report will be initiated to clarify specifically what the City could have known about the existence of possible Section 9 assistance in this project.

Comment 4

With regard to the operating subsidy and capital grant funding, we believe the fact that the Authority continued to receive this funding on the 56 housing units does not negate the fact that the units were legally transferred to the LLC and removed from the public housing stock. This position is fully supported by the Office of the Inspector General’s March 14, 2005 audit report (Audit Report No. 2005-LA-1002) on the Housing Authority of Maricopa County. This report included the following statements:

⁵ Office of the Inspector General Discussion Draft Audit Report dated June 6, 2005.

⁶ See Sub agreement, Attachment II, p.2.

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- On page 2, the report states that the Authority “has received more than \$500,000 of operating and capital grant funds for the units in these projects to which it is **not legally entitled**”.
- On page 5, the report states that “in the end ... all 56 units were sold (ownership transferred) by the Authority.”
- On page 7, the report states that “the Authority did not develop and manage its two mixed-finance housing projects in compliance with pertinent regulations and requirements ... and receipt of more than \$500,000 of operating subsidy and capital grants to which the Authority was **not legally entitled**”. Furthermore, the report indicates that these and other “deficiencies noted were **a result of negligence by the Authority’s former Executive Director, compounded by HUD’s failure to provide appropriate oversight**”.
- On page 10, the report states that the LLC “still owns the properties”. In addition, the report indicates that “**the sale of the units invalidated the existing contributions contract for the units**”. Since the units are no longer under contract and are no longer considered by HUD to be public housing units, CSA and the City did not expend \$570,000 of HOME funding on public housing.

No where in this report did it state that the Maricopa HOME Consortium was in any way responsible for ensuring the Authority complied with HUD’s public housing regulations and requirements.

24 C.F.R. 92.214 states, in part, that HOME funds may not be used to provide assistance authorized under section 9 of the 1937 Act (annual contributions for operation of public housing).⁷ Here, the issue is whether the mere existence of Section 9 assistance renders all HOME funding ineligible. If the intent of this statute is to prevent HOME funding from being used to supplant an authorized use under Section 9; i.e., prevent possible overlapping assistance, then it should be shown that such assistance redundancy existed in this project. According to a CSA representative, Section 9 Operating Funds were not received by the Project after the units were sold to Maricopa Revitalization Partnership, LLC. Further, according to the March 14, 2005 Audit Report reviewing the Housing Authority of Maricopa County’s development and management of two mixed-finance housing projects, including this Project, the sale of the units invalidated the existing contributions contract.⁸ The Project had to be under a valid contributions contract to be eligible for

Comment 5

⁷ 24 C.F.R. § 92.214(4).

⁸ Office of Inspector General Audit Report, p.10 (March 14, 2005).
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operating subsidy under Section 9.⁹ Therefore, upon the sale absent a revised contributions contract, the Project no longer consisted of public housing units eligible for operating funds, and subsequently did not receive such funds under Section 9. Subsequent to the sale, HOME funds were allocated and used for rehabilitation of 22 of the Project units. This sequence of events suggests the possibility that there actually was no simultaneous use of HOME and Section 9 operating funds during the Section 9 eligibility period.

Based on the information presented above, Maricopa County Community Development disagrees with the findings of the Inspector General Draft Audit Report, Number 2005-LA-XXXX, dated June 2005, and reasonable concludes that there was no ineligible use of HOME funding under 24 C.F.R. § 92.214(4) for rehabilitation of some of the units. Maricopa County Community Development did not have any duty to police the disposition of all of the units and assure compliance with HUD requirements under public housing. This was solely the responsibility of the Authority. Therefore, we respectfully request that the finding and all related discussions be removed from the final audit report.

Sincerely,



Jim Prante
Director

JP/mro

c: Charles Johnson, Assistant Regional Inspector General for Audit
Lou Kislin, Acting CPD Manager, Phoenix HUD Office
Bill Scalzo, Assistant County Manager, Community Services

⁹ *Id.*, at 7.

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OIG Evaluation of Auditee Comments

Comment 1

We agree that the Consortium Agreement states that each Member, including the City of Mesa, is responsible **to the Consortium** for administration of subrecipient³ agreements and contracts. However, this is an agreement between the individual Consortium members, not HUD. As set out in 24 CFR 92.504(a), HUD holds the Participating Jurisdiction/lead entity (Maricopa County) responsible for ensuring that all Consortium members carry out HOME funded activities in accordance with program requirements. Accordingly, HUD looks to Maricopa County for the resolution of any deficiencies identified in any Consortium member's HOME program, including reimbursement of any funds spent on ineligible activities, regardless of which member incurred the ineligible costs. It would then be up to Maricopa County to enforce the requirements of the Consortium, Agreement, including obtaining reimbursement from any members for ineligible activities they may have carried out.

Comment 2

We concur that the Housing Authority of Maricopa County (Authority) was responsible for ensuring that the requirements stipulated by HUD for the disposition of the 56 units⁴ discussed in the report were met. The Authority failed to meet these requirements, and accordingly violated the terms of HUD's disposition approval agreement, effectively invalidating the agreement. This failure of the Authority does not negate the responsibility of Maricopa County or the Consortium to ensure that all legal matters are appropriately resolved prior to the commitment and expenditure of any HOME funds. This would have included identifying the circumstances involving the Authority's disposition of the units; requiring the Authority to demonstrate and document that HUD imposed requirements for the disposition of these units had been met; and denying the use of HOME funds for the project if this could not be accomplished. This was not done, and none of the parties involved identified the significant unresolved problems related to the transfer/sale of these units or the fact that (in all practical effects) they continued to be public housing units receiving operating and capital grant subsidies. Had appropriate investigation of these matters been completed, it would have become clear that HOME funds could not be used for this project.

³ As the City of Mesa pointed out in its response to our draft report, this activity was carried out by Community Services of Arizona as a developer, not as a subrecipient. However, the City in its correspondence with Community Services, refers to the agreement as "Subrecipient Agreement #8335". We have made changes to our report to show that the activity was carried out by a developer, but continue to refer to the "subrecipient agreement".

⁴ The final project consisted of only 35 units of which HOME funds were arbitrarily allocated for the physical rehabilitation of 22 units. The City of Mesa contends that only 31 of the units were part of the HOME funded project.

Comment 3

There is a direct relationship between assistance (operating and capital grant subsidies) provided to the Authority for Maricopa Revitalization Partnership, LLC, and the HOME funding provided to Community Services of Arizona for rehabilitation purposes. Both sources provided funding for the same units and, as mentioned previously, this should have been resolved during the approval process. It is clear from documentation found in the City of Mesa and Community Service of Arizona files that all parties involved were, or should have been, aware that the final plan called for the project units to be under an Annual Contributions Contract with the continuation of funding under section 9 of the United States Housing Act.

Comment 4

The units were not properly and legally transferred to Maricopa Revitalization or removed from public housing stock. Legal and program requirements necessary to finalize removal of these units from public housing stock have not yet been completed, and may never be finalized. OIG's previous report relating to the Authority's implementation of this (and another project) did not address the eligibility of the HOME assistance and Consortium involvement in the project. Rather the report dealt with public housing program requirements and the legalities relating to the Authority's attempted transfer of ownership; the failure to adhere to the HUD imposed disposition requirements; and the resultant lack of safeguards to protect the authority's and HUD's interest⁵ in the projects. The report does not imply that the Maricopa HOME Consortium was responsible for ensuring that the Authority complied with HUD's public housing regulations and requirements. However, as previously stated, Maricopa County and the Consortium had the responsibility to determine whether HOME requirements were met (which would have included the unresolved issues relating to the Authority's disposition/transfer of the affected units to Maricopa Revitalization) and the failure to do so directly affected the subject activity's eligibility for funding under the HOME program.

The previous OIG report does bring into question the continuing validity of the Annual Contribution Contract as it affects the project and the eligibility of the project units for operating and capital subsidies until the questions are resolved. This public housing matter does not negate the fact that HOME

⁵ This investment by the Authority and HUD included the \$2,170,000 value of the properties transferred to the project, a \$120,000 advance of capital funds, and over \$413,000 of operating subsidy and capital grant funding provided for the units after their transfer to Maricopa Revitalization.

funds cannot be used to fund activities authorized under section 9 of the United States Housing Act, applicable to these properties. Specifically, HOME funds cannot be used to provide rehabilitation funds for public housing units eligible for modernization/rehabilitation funding provided through the public housing program. At the time this project was initiated, these units were eligible for (and continue to receive) funding provided through section 9 of the U.S. Housing Act of 1937.

Comment 5

The housing units comprising this project, through its management agent and member, the Housing Authority of Maricopa County, have received operating and capital grant subsidy (section 9 funding) prior to and during the time of the project's existence⁶. The eligibility of this continued subsidy is currently under review. Notwithstanding, HOME funds were provided for units that were concurrently authorized for and receiving assistance under section 9 of the United States Housing Act. Accordingly, in our opinion, the \$570,000 used for the rehabilitation of these units was an ineligible use of HOME funds.

⁶ The City of Mesa in its response claimed that the provision of the regulations cited was not applicable for this project, as the amended language was not added until October 2002. However, this amended language did not change project eligibility, but simply reflected 1998 Congressional amendments to the Housing Act, moving Section 14, Public Housing Modernization to a revised Section 9, Public Housing Capital and Operating Funds. These changes were effective October 1, 1999. Prior to the cited changes to the HOME regulations, activities eligible under the Modernization program were not eligible for HOME funding. After the change activities eligible for Capital Grant funding, which replaced the Modernization program, were not eligible for HOME funding.