



U.S. Department of Housing and Urban Development
District Office of the Inspector General
Office of Audit
Richard B. Russell Federal Building
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Atlanta, GA 30303-3388
(404) 331-3369

September 3, 1998

No. 98-AT-245/255-1811

MEMORANDUM FOR: Ben Cook, Director, Community Planning and Development,
Louisville, Kentucky, 4ID

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

SUBJECT: City of Covington
Hotline Complaints
Covington, Kentucky

In response to citizen complaints, we surveyed aspects of Covington's Community Planning and Development activities. The purpose of our survey was to review the complainants' allegations and determine whether further audit work was necessary.

We interviewed HUD Kentucky State Office Community Planning and Development staff and reviewed their files. We visited the City and interviewed City staff, reviewed loan files, and performed on-site physical inspections. We also interviewed the complainants, program participants and other local citizens. We reviewed a judgmentally selected sample of 21 loans and 3 property acquisitions/dispositions.

Our review generally covered the period January 1, 1992, through December 31, 1997. The review was extended to other periods when appropriate.

BACKGROUND

In September 1997, we received two complaints from Covington citizens through our hotline. The complainants expressed concern regarding Covington's operation of the HUD-funded Urban Reclamation and Investor Rehabilitation Loan Programs. The City-designed programs are funded with Community Development Block Grant and HOME funds, plus program income from the Rental Rehabilitation Program. The City annually receives about \$2.2 million in block grant funds, a half million dollars in HOME funds, and \$200,000 in program income.

The complaints were wide ranging, but the overall theme was that the City's Housing Development Director used his position to give favored treatment to a friend, Covington developer Esther Johnson. The complaints also alleged the City had not implemented HUD recommended improvements and lacked procedures or guidelines for some programs.

Through the Investor Rehabilitation Loan Program, the City awards low interest loans as gap financing to developers rehabilitating dilapidated residential and commercial property. During our review period, the City awarded 56 such loans totaling \$3.3 million. The City's Housing Director recommended loans to the City Manager who recommended them to City Commission for approval. All loans recommended by the Housing Director were approved.

Under the Urban Reclamation Program, the City acquires vacant or blighted properties, then sells them to developers or other citizens, often for rehabilitation, thereby improving the City's tax base. Since the program's inception in 1977 through approximately August 1997, the City acquired about 225 such properties. According to City staff, 95 percent of the purchases were through foreclosure or tax sales. In the 11 years ended April 1998, the City sold approximately 156 properties, including 59 for one dollar each.

During 1997, allegations appeared in local newspaper and television reports that the Housing Director and Johnson were friends, and he favored Johnson's participation in the programs while denying the participation of other developers. The City claimed no one had ever been denied a loan. A local television station reported that the Director and his wife, Johnson, and others traveled to Europe together. The Director and Johnson acknowledged the relationship, which is not a violation of either HUD or City policies, but contributed to the allegations of favoritism.

In an effort to address the allegations, the City hired its auditors, Rankin, Rankin & Company, to (1) determine the number of total sales and the number of sales to Johnson, (2) test documentation of loans to Johnson and to others to determine differences, (3) determine if any loans were denied, and (4) test developer compliance with development agreements. The auditors' report in March 1998 stated the number of sales, disclosed one instance of non-compliance with a development agreement, and concluded no material difference in loan terms, payments, or documentation between Johnson loans and loans of others. They also stated that of 25 questionnaires mailed to program participants, 5 claimed they had been denied loans. Three of the five complained about lack of written procedures for the program, and characterized it as being run by "word of mouth," the "good old boy network," or "behind closed doors." Four respondents claimed that citizens who speak out against the City are punished through selective code enforcement by City building inspectors.

The Housing Director and Johnson sued citizens who made allegations publicly for libel. They also sued a local television station and newspaper which ran stories containing allegations of favoritism. Some citizens expressed fear of being sued by the Director or Johnson or of retaliation by City building inspectors.

SUMMARY

The attached finding describes weaknesses in management controls in the two programs reviewed. Both programs lacked adequate operational procedures, and property acquisition and disposition files as well as loan files were inadequately documented. In addition, some loans in the Investor Rehabilitation Loan Program were disbursed contrary to loan terms. As a result, the City could not document impartiality and fairness in program operation and was susceptible to claims of favoritism such as those made.

During our review period, Johnson or related entities received Investor Rehabilitation Loans totaling about \$1.1 million, or 32 percent of the loans awarded. We were unable to prove or disprove favoritism; however, Johnson benefited from the loan program to a greater extent than any other investor. As a result, there is the appearance of favoritism, and the absence of either written procedures or documentation made it difficult to refute. The City attributed the high number of Johnson loans to her willingness to undertake projects no one else would do.

It is unfortunate the public lacks faith in the integrity of local programs supported with Federal funds and intended to benefit the entire community. The attached recommendation, if adopted by the City, should improve the public's confidence in the programs.

We provided you a draft of our report on June 18, 1998, soliciting comments and input into recommended corrective actions. We received no response. We discussed the deficiencies and the need for improved controls with the City's Housing Development Director at an exit conference on May 15, 1998. We also provided the City a draft of our report on June 18. The City submitted written comments to us on July 21, 1998, and again on August 6 to replace those received July 21. The City Manager stated he believed the allegations were unsubstantiated. However, he pointed out changes the City had implemented as a result of the adverse publicity, and stated that many of our recommended management control improvements have been implemented or are in the process of being implemented. We summarized the City Manager's comments at the end of the finding and included them as Attachment E. Voluminous attachments to the comments are not included, but we provided you a copy separately.

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

We provided a copy of this memorandum to the City.

If you have any questions, please contact Rudy E. McBee, Assistant District Inspector General for Audit, at (423) 545-4368.

Attachments:

- A - Finding and Recommendation
- B - Schedule of Loans Reviewed
- C - Loan Disbursements Prior to Note/Mortgage Execution
- D - Loans Disbursed Contrary to Development Agreements
- E - Auditee Comments
- F - Distribution

FINDING AND RECOMMENDATION

Finding 1 - Management Controls Need Improvement

Covington needs to improve internal management controls in its Investor Rehabilitation Loan and Urban Revitalization Programs. Neither had adequate written procedures, and program activity was inadequately documented. As a result, the City was susceptible to allegations of favoritism and neither HUD nor the public have adequate assurance the programs were properly run. Two complaints alleged favoritism, also that the City lacked written loan procedures and had not responded to prior HUD recommendations to improve its loan underwriting process. We were unable to verify favoritism, but the allegations regarding process and procedures were valid.

Title 24 Code of Federal Regulations 85.20(b) requires grantees to maintain adequate records and effective internal control for all grant assets.

Investor Rehabilitation Loan Program

Neither the City Commission nor the Housing Development Department had established written operational procedures for the Investor Loan Program. Our review found:

- disorganized, under-documented loan files, and
- loan disbursement deficiencies.

Loan documentation

Investor loan files were generally disorganized and under-documented, with no written record of citizen inquiries about participation in the loan program. None of the loan files reviewed contained evidence of underwriting procedures, and Housing Development staff verified there was no formal underwriting process. Also, the files did not adequately document the history of the loan approval process. Related recommendations in a HUD 1994 monitoring report pertaining to the HOME Program, not implemented by the City, were "...that the City more fully document the underwriting process it uses to approve multi-family rental projects. This includes analysis, reasoning, and supporting documentation, such as appraisals and loan closing statements on acquisition type projects. The basis for approval of each loan should be evident from a review of the individual project file." The basis of loan terms and approval was still unclear.

As a result of negative media attention, the City in August 1997 began using a standardized loan application and named a loan committee to recommend loans for approval. Files for two loans completed under the new application procedures were much improved, and the City began keeping a record of persons inquiring about investor loans. The changes were an improvement, but there were still no written guidelines or procedures to, for example, describe the role the committee will play in the loan approval process, who will serve on the committee, the

methodology the committee will apply as a basis for evaluating loans, and the underwriting process prior to presentation to the committee. For example, the process should evaluate the financial condition of the borrower, the soundness of the proposal, the reasonableness of any assumptions, how the project represents best use of available funds, and how it qualifies under HUD regulations. The procedures should also require file documentation of compliance with the process.

Loan disbursement

The City needs to better control the loan disbursement process. In our sample of 21 loans (Appendix B), the City disbursed loan funds prior to executing a mortgage and/or note in 4 cases, and disbursed funds contrary to the provisions of respective development agreements in another 4 cases. Seven of the eight incidents involved Johnson loans. Details of the transactions are in Appendices C and D. Housing Development staff stated some of the payments occurred because they were unaware the City Attorney put restrictive clauses in the development agreements. In all cases the developers completed the projects as promised. However, such practices are risky as contractors may not finish jobs when they get money prematurely. Also, it presents the appearance of favoritism to the contractors involved. The City should adopt a simple control, such as a checklist, to assure the loan is eligible for payment.

* * *

During our review period, Johnson, or entities with which she was associated as owner, developer, or general partner, received 15 of the 56 Investor Rehabilitation Loans awarded by the City. Her loans totaled about \$1.1 million of the \$3.3 million awarded (32 percent). We were unable to prove or disprove favoritism; however, Johnson benefited from the loan program to a greater extent than any other investor. As a result, there is the appearance of favoritism, and the absence of either written procedures or historical documentation made it difficult to refute. The City attributed the high number of Johnson loans to her expertise and the fact she was willing to undertake difficult projects others would not.

Urban Reclamation Program

The City had inadequate operational procedures for the Urban Reclamation Program, and did not adequately document its files for property acquired with Federal funds, or for subsequent sales. As a result, the City lacked evidence the transactions were proper, and left itself open to charges of favoritism. HUD Handbook 1378, Tenant Assistance, Relocation and Real Property Acquisition, paragraph 6-3b(4), requires grantees to document compensation for acquired property.

Documentation of the purchase and sale of all three properties reviewed was almost nonexistent. There was no documentation in the files as to how the City arrived at the decision to purchase the properties or how they determined market value. According to City staff, compensation for property acquired through foreclosure or tax sales was the amount of unpaid taxes not to exceed two thirds of appraised value, although this policy was not stated in the program's limited guidelines. However, the files reviewed were not documented with appraised value.

Citizens stated they did not understand how the City determined who it selected to obtain City property and at what price. Allegations of favoritism were made based on claims developer Johnson obtained several properties for one dollar. According to records provided by the City Clerk, Johnson purchased seven properties since 1987, five of those for one dollar each. In addition, the City sold another four properties for one dollar each to Anawim, Ltd., a non-profit organization with which Johnson was affiliated as developer and general partner. Most of the 59 one-dollar sales were to non-profit organizations; no other investor received more than one. The transactions with Johnson may have been proper, but the lack of file documentation related to purchases and dispositions made propriety impossible to determine.

Disposition prices varied widely, but the files did not document a description of the property how best use was determined, or how price was determined. The City advertised each property for sale once in the newspaper. If the property did not sell, as was often the case, housing staff negotiated a sales price with anyone interested. However, files reviewed did not document how they arrived at the price. One citizen who purchased a small adjoining lot for \$5,000 claimed to have no idea how the price was determined. In another case, a citizen claimed attempts to purchase a property and furnished copies of letters written to the City. However, none of the letters appeared in the City's files. The responsible City official stated she did not have time to document inquiries.

Acquisition/disposition transactions should be better documented to establish their propriety and impartiality, and that they are in the City's best interests. We also suggest the City periodically advertise available properties in local newspapers.

Also, there was no evidence of competition for rehabilitation of City-owned property and no explanation of how the transaction was in the City's best interests. For example, in the case of property at 117 East 8th street, which Johnson restored as Historic View Apartments, at least one other contractor discussed plans to restore the property with the Housing Director, but reportedly dropped his plan because \$25,000 in assistance offered him was insufficient to make the project viable. Subsequently, the developer loaned Johnson his plans, Johnson purchased the property for one dollar, and received City rehabilitation loans totaling \$150,000. The Housing Director stated the developer never submitted a final proposal. City files indicated no evidence anyone other than Johnson was interested in the property.

The City should institute written procedures requiring retention in the files of all proposals for purchase and/or rehabilitation of City-owned property and open competition among developers for rehabilitation projects. Also, as with the loan program, procedures should require documentation of the decision process in selecting winning proposals.

Auditee Comments

The City Manager pointed out changes made in their loan processing after the City received adverse publicity generated by complaints in local media. He stated that neither the old nor the revised process resulted in automatic approval of the Housing Director's recommendations, as we implied. He pointed out that the City's Ethics Board dismissed the local complaints because

of a lack of specific dates of alleged infractions. He said the City auditors also concluded they were unable to prove or disprove favoritism and observed no difference in documentation between Johnson's files and the files of others. He said he believed the allegations made locally were unsubstantiated, and the same complainants apparently called our hotline.

The City Manager said he appreciated our recommendations, and many either have been or are being implemented. He added, however, that since we did not prove or disprove favoritism, we should not infer favoritism existed until facts are submitted to prove it.

In an attached memorandum to the City Manager, the Housing Development Director disagreed with our conclusion that internal controls should be improved, saying nothing requires the City to have fixed, rigid guidelines for loan processing. He said he could not adequately respond to the finding because he was unaware of the specific cases we examined, the details of the complaints, or the deficiencies found. He denied their files were disorganized and under-documented or that loan funds were disbursed improperly. He also claimed the acquisition regulations we cited do not apply because the properties were obtained through judicial action. He said our statements regarding the number of one-dollar properties sold to developers other than Johnson and to non-profits are incorrect, and the reason for lack of competition for rehabilitation jobs is that few individuals, developers, or non-profits are willing to undertake such projects. He said he had preliminary discussions with a contractor, but no developer other than Johnson submitted a final proposal for 117 East 8th Street.

OIG Evaluation of Auditee Comments

Our report recognized improvements the City made, but additional improvements are needed. We revised the draft comment that the Housing Director's recommendations were tantamount to approval, to say all loans recommended by the Housing Director were approved. The City auditors drew no conclusion regarding favoritism, nor were they asked to. They expressed no opinion even on the matters they reviewed, as they were not engaged to perform an audit. Neither were they asked to evaluate the loan approval process or attendant management control system, both related to the allegations of favoritism. We agree with their observation of no material difference between documentation and loan terms for developer Johnson as compared to other developers. There was little documentation in any of the files.

We did not infer favoritism existed; however, developer Johnson's high level of program participation combined with her personal relationship with the Housing Director gave the appearance of favoritism, and the City's lack of management controls tended to exacerbate the problem rather than resolve it.

The City Manager's comments about implementing our recommendations were positive, but were inconsistent with the comments of his Housing Development Director, who disagreed with our conclusions and recommendations. We found no basis in the Director's comments to change our central conclusion regarding the need for better internal control, and find his refusal to consider minor improvements difficult to understand.

We added three attachments to address his concern about lack of details, a list of the 21 loans examined (Attachment B), and details of disbursements prior to mortgage execution and contrary to development agreements (Attachments C and D). Lack of knowledge of the specifics of the complaints did not hinder the City in responding to our review. The draft conclusions were not based on the complaints precipitating the review, but on our review of program operations. The City's procedures can and should be improved, without limiting desirable flexibility. The improvements will provide better accountability to HUD and the public for use of Federal funds, and a basis for responding to complaints more substantively and timely.

Housing Development staff admitted during the review that loan files were disorganized. Documents loose in file folders in no particular order made review of files difficult and time consuming. Under-documentation of files relates to lack of information on the loan underwriting process, such as determination of loan terms and basis of loan approval. The referenced acquisition regulations require documentation of compensation paid for either negotiated acquisitions or properties acquired by judicial action. Similarly, the City must document the necessity and reasonableness of any cost under OMB Circular A-87 guidelines.

The Housing Director provided no support for his claim that our conclusions regarding the number of one-dollar property sales were inaccurate. During the review, Housing Development staff directed us to the City Clerk for sales information because Housing Development had no historical database of such information. Information in the report is based on City Commission resolutions approving property sales as provided by the City Clerk.

If the Housing Director is correct about developer Johnson being the only one interested in rehabilitating certain properties, open and aggressive solicitation of competition, adequately documented, will provide a basis for rebutting future criticism of favoring certain developers.

Recommendation

1A. We recommend that you require the City to develop written operational procedures for the two HUD funded programs, including documentation to demonstrate how future acquisition and disposition prices for properties acquired with Federal funds were determined and open competition for City-owned property to be rehabilitated.

SCHEDULE OF LOANS REVIEWED

<u>Owner/Developer</u>	<u>Property Address</u>	<u>Loan Amount</u>
Emery Row, Ltd.	830-848 Scott	\$225,000
Emery Row, Ltd.	830-848 Scott	225,000
Altevers, D.	1511 Garrard St.	8,256
Anawim, Ltd.	1221 Garrard St.	43,000
Anawim, Ltd.	1236 Garrard St.	10,000
Anawim, Ltd.	1236 Garrard St.	5,000
Anawim, Ltd.	228 13 th St. East, et al	150,000
Classic Properties, Inc.	724 Madison Ave.	9,095
Classic Properties, Inc.	814 Madison Ave.	24,075
Classic Properties, Inc.	724 Madison Ave.	40,000
Garrard St., LLC	517-519 Garrard St.	95,000
Historic View Apts., Ltd.	117-123 E. 8 th St.	110,000
Historic View Apts., Ltd.	117-123 E. 8 th St.	40,000
Johnson Properties, Inc.	130 W. 6 th St.	95,000
Johnson Properties, Inc.	201 E. 12 th St.	20,000
Johnson Properties, Inc.	1210 Greenup St.	15,000
Kukla & O'Neil	6 & 8 W. Pike St.	55,000
McMahon, D.	309 Trevor St.	15,000
Reliance Properties, LLC	709-713 Garrard St.	60,000
Reliance Properties, LLC	709-713 Garrard St.	60,000
Taylor, E.	1224 Scott St.	18,000

LOAN DISBURSEMENTS PRIOR TO NOTE/MORTGAGE EXECUTION

<u>Borrower/Project Address</u>	<u>Date of Note and Mortgage</u>	<u>Draw Approved</u>	<u>Check Date/Amount</u>
Historic View Apts., Ltd. 117-123 E. 8 th St.	04/11/96	04/02/96	04/04/96 \$35,000
Classic Properties, Inc. 724 Madison Ave.	12/10/92 ¹	12/04/92	12/09/92 \$25,000
Johnson Properties, Inc. 201 E. 12 th St.	10/19/95	10/12/95	10/17/95 \$18,000
Johnson Properties, Inc. 1210 Greenup St.	10/19/95	10/12/95	10/17/95 \$13,500

¹ Date of promissory note only.

LOANS DISBURSED CONTRARY TO DEVELOPMENT AGREEMENTS

Emery Row, Ltd. The final draw of \$24,375 for the \$450,000 loan was disbursed by the City in December 1995. The Development Agreement required the developer to spend \$953,000 to develop the project, \$503,000 provided by the developer and \$450,000 provided by the City loan. The agreement stated that City disbursement of the loan was conditioned on proof of expenditure by the developer of the \$503,000. The loan file included no documentation of developer investment in the project.

Kukla & O'Neil The final draw of \$2,000 for the \$55,000 loan was disbursed by the City in September 1997. The Development Agreement required the developer to spend \$15,000 for the site and \$97,000 to rehabilitate the structure. The agreement stated that City disbursement of the loan was conditioned on proof of expenditure by the developer of a minimum of \$100,000 prior to the final draw. The loan file included no documentation of developer investment in the project.

Historic View Apts, Ltd. The final draw of \$6,000 for the \$150,000 loan was disbursed by the City in July 1996. The Development Agreement required the developer to spend at least \$500,000 to rehabilitate the structure. The agreement stated that City disbursement of the loan was conditioned on proof of expenditure by the developer of a minimum of \$500,000 prior to the final draw. The loan file indicated the developer had invested no funds in the project as of the date of the final draw of the City loan.

Johnson Properties, Inc.(130 W. 6th St.) The final draw of \$9,500 for the \$95,000 loan was disbursed by the City in May 1997. The Development Agreement required the developer to spend at least \$511,000 to rehabilitate the structure. The agreement stated that City disbursement of the loan was conditioned on proof of expenditure of at least \$600,000 prior to the final draw. The loan file indicated the developer had drawn only \$33,550 of owner funds, in addition to the \$95,000 City loan, as of the date of the final draw of the City loan. The Housing Director stated he was not aware the above condition was in the Development Agreement.

AUDITEE COMMENTS



CITY OF COVINGTON

638 MADISON AVENUE • COVINGTON, KENTUCKY 41011-2298

August 5, 1998

Rudy E. McBee
Assistant District Inspector General for Audit
U.S. Department of Housing and Urban Development
Knoxville Field Office, Region IV
John J. Duncan Federal Building
710 Locust Street, Suite 300
Knoxville, TN 37902-2526

REPLY TO NANCY H. COOPER'S UNDATED LETTER STAMPED "DRAFT FOR DISCUSSION AND COMMENT ONLY SUBJECT TO REVIEW AND REVISION" WITH A COVER ENTITLED "NOTICE—USE RESTRICTED"

Dear Mr. McBee:

Thank you for your letter of June 18 relative to our housing programs, and for affording us an extension of time to respond to Ms. Cooper's draft memorandum to Ben Cook. I have now had an opportunity to review your draft report prepared following the nine week survey undertaken after HUD's receipt of two hot-line complaints. It is my hope that after considering our response, you will be amenable to changing some of the conclusions reached by the HUD reviewers.

As you may be aware, the City of Covington has won numerous HUD awards for the effectiveness and innovation of its housing programs. The City of Covington, Kentucky, and the Department of Housing and Urban Development have always enjoyed an excellent relationship. We certainly hope that this relationship will continue.

I have analyzed the three-page letter submitted by Nancy H. Cooper, District Inspector General for Audit, Southeast/Caribbean, 4AGA, labeled "Draft for Discussion and Comment Only – Subject To Review and Revision".

The reviewers made the following statements:

1. Two wide-ranging hot-line complaints from Covington citizens were received regarding Covington's operation of the HUD-funded urban reclamation and investor rehabilitation loan programs alleging favored treatment to one individual.
2. The complaints also alleged that the City has not implemented HUD recommendations for needed improvements, and lacked procedures or guidelines for some programs.
3. Hodge recommended the approval of loans to the City Manager, and the City Manager recommended approval of loans to the City Commission.
4. Since the City Commission approved these recommendations, the reviewers concluded that "Hodge's recommendation appeared tantamount to approval."

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5. During 1997 allegations appeared in local newspaper and television reports that Hodge favored Johnson's participation in the programs at the expense of other developer.
6. That the certified public accountant's report was of limited use in addressing the allegations because the scope of the review was very limited.
7. That there is a pending libel suit filed by Hodge against the news media and others making it difficult for the reviewers to obtain interviews as some citizens expressed fear of being sued by Hodge or Johnson.
8. These same complainants, as well as other citizens, that the reviewers contacted, believe that Hodge uses building inspectors to harass citizens who speak out against him.

I believe that this appropriately summarizes the statements upon which the reviewers have reached their conclusions.

The reviewers' conclusions are contained in the summary that begins in the middle of page 2 of the letter:

1. Both programs lacked adequate operational procedures and property acquisition/disposition files, as well as loan files, were inadequately documented.
2. Some loans in the investor rehabilitation loan program were dispersed contrary to loan terms.

The conclusion of these findings is that the City could not document impartiality and fairness in program operations, and was susceptible to claims of favoritism such as those made. However, the reviewers admit that they were unable to prove or disprove favoritism. They infer that since Johnson had more loans, 32% of the total, that there is at least the appearance of favoritism. The recommendation is that the City take action to improve the public's confidence in the federally-funded program. There is one finding attached to the letter entitled "Management Controls Need Improvement" with several recommendations for improvement. The summary recommendation is that the City develop written operational procedures for HUD-funded programs, including required file documentation to show how future acquisition and disposition prices for properties acquired with federal funds were determined, and open competition for City-owned property to be rehabilitated.

The City of Covington, in the fall of 1997, immediately after being exposed to the adverse publicity generated by the complainants, performed an internal management review of the allegations. As a result of that review, several internal control procedures were implemented, including amending the oversight of our investor loan program to expand the staff committee which reviews the loan application packages. The committee is now comprised of the Assistant City Manager, Housing Development Director, Finance Director, Staff Accountant, Cost/Contract Specialist and myself. Each member of the committee brings a unique expertise to the loan review process. Before I recommend any loan to the City Commission for approval, each application receives a comprehensive review of its merits and of the necessity for City financial assistance. We believe that even if this committee approves all or most of Mr. Hodge's recommendations, it is no more of a rubber stamp as implied by the reviewers as the Mayor and

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Board of Commissioners is under the preexisting process. Mr. Hodge and the City Manager are members of the executive branch of the City of Covington and the Mayor and Board of Commissioners are the legislative branch. To imply that an approval of the legislative branch of the City is not an independent review, seems inappropriate. In fact, the federal system of government also has a legislative and executive branch, part of the system of checks and balances. Certainly the reviewers would not suggest that because the House or Senate approves most recommendations from the Executive branch on a particular subject, that they are therefore not independent decision makers.

Since the OIG hot-line complainants are making similar allegations as the individuals who made allegations in the local newspaper and television reports, it is reasonable to assume that these allegations are coming from at least two of the same people.

In addition to the change regarding the recommendation process, the City administration worked with the complainants to assist them in the procedure for filing ethics complaints to the City of Covington Ethics Board. The City of Covington Ethics Board was established to investigate and report on allegations of conflicts of interest and other malfeasance in office. This independent board appointed by the Mayor and Board of Commissioners consists of three respected members of the community: (1) a retired Kenton Circuit Judge who served on the bench for more than thirty years, (2) a retired Scripps-Howard Newspaper executive, and (3) a successful pharmacist. Two complainants, Toni Allender and James Macke, filed wide-ranging complaints with an overall theme that the City's Housing Development Director, Howard Hodge, used his position to give favored treatment to a friend, Covington developer Esther Johnson. The Covington Ethics Board, after giving Ms. Allender and Mr. Macke numerous opportunities to document their allegations were forced to dismiss the complaints based upon the complainants' failure to make the allegations specific enough to grant the Covington Ethics Board jurisdiction.

In addition, and in response to the adverse publicity, the City hired the certified public accounting firm of Rankin, Rankin & Company to perform a special review of the Housing Department's operations, specifically directing their attention to the allegations made in the press by the complainants. Based upon the documentation that we have reviewed, the certified public accountant did a more complete review of the operations than the HUD reviewers did. However, it was also their conclusion that they were unable to prove or disprove favoritism, and in fact they stated that they "observed no material differences between the documentation, loan terms and loan payments in the Esther Johnson and related entities files as compared to the files of other owners and developers."

In summary, we believe that the complainants have made unsubstantiated allegations that were aired in the printed and electronic media. Apparently these same complainants called the OIG hot-line with these unsubstantiated allegations and the HUD reviewers have now concluded that as a result of the adverse publicity created by the unsubstantiated allegations, the City should take measures to restore public trust in the programs. As indicated above, the City has and will continue to take measures to bolster public trust in the programs.

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We very much appreciate the findings and recommendations that suggest increased loan documentation and loan disbursement and additional internal controls, as well as, additional written program procedures. Many of these recommendations have already been implemented, or are in the process of being implemented. However, we suggest that since the reviewers were unable to prove or disprove favoritism, they should not infer that favoritism existed until facts are submitted to prove such favoritism. We believe that it is the duty of a citizen who makes such serious complaints against a public employee, to produce some evidence to back up their allegations. We agree with the reviewers that it is unacceptable that the public lack faith in the integrity of local programs supported with federal funds and intended to benefit the entire community. We suggest that it is unacceptable that a HUD review should infer favoritism when they have documented that they are unable to prove or disprove favoritism.

It is my hope that the draft memorandum to Ben Cook will be amended to accurately reflect the facts as documented by this letter and supporting attachments.

We look forward to working with the Department of Housing and Urban Development to continue to make the City of Covington housing program a leader in Kentucky.

Sincerely,



Gregory T. Jarvis
City Manager

/pks

Attachments: Ethics Board Finding dated December 30, 1997
Rankin, Rankin & Company Report dated March 20, 1998
Appendix-Remaining Rehab Funds
Memorandum from Howard Hodge dated August 5, 1998
August 1997 Urban Reclamation Program Report
August 1997 Rehabilitation Programs Report

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Associate General Counsel, Office of Assisted Housing and Community Development,
CD (Room 8162)

Assistant Secretary for Community Planning and Development, D (Room 7100)

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Chief Financial Officer, F (Room 10166) (2)

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Assistant to the Deputy Secretary for Field Management, SDF (Room 7106)

Assistant to the Secretary for Labor Relations, SL (Room 7118)

The Honorable John Glenn, Ranking Member, Committee on Governmental Affairs,
United States Senate, Washington DC 20515-4305

The Honorable Fred Thompson, Chairman, Committee on Governmental Affairs,
United States Senate, Washington DC 20515-4305

The Honorable Dan Burton, Chairman, Committee on Government Reform and Oversight,
United States House of Representatives, Washington DC 20515-6143

Mr. Pete Sessions, Government Reform and Oversight Committee, Congress of the United States, House of
Representatives, Washington, DC 20510-6250

Ms. Cindy Sprunger, Subcommittee on General Oversight and Investigations, Room 212,
O'Neil Office Building, Washington DC 20515

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