



U.S. Department of Housing and Urban Development
District Office of the Inspector General
Office of Audit
Richard B. Russell Federal Building
75 Spring Street, SW, Room 330
Atlanta, GA 30303-3388
(404) 331-3369

December 22, 1998

99-AT-241-1802

TO: Charles T. Ferebee, Director, Community Planning and Development
Division, 4FD

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

SUBJECT: Pine Knolls Neighborhood Revitalization Program
Town of Chapel Hill, North Carolina

In response to citizens' complaints, we reviewed the Pine Knolls Neighborhood Revitalization Program, funded in part by the Town of Chapel Hill, North Carolina (Town), Community Development Block Grant (CDBG) Program. The program was administered by the Pines Community Center, Inc. (Center). The purpose of our review was to determine whether the Center used CDBG funds for eligible activities in an efficient, effective, and economical manner.

SCOPE

We interviewed the complainants, staff of HUD's North Carolina Community Planning and Development Division, the Town Manager, staff of the Town's Planning and Inspections Departments, and Center officials. We reviewed Department of Housing and Urban Development (HUD) records, applicable Town and Center records, and records maintained by the Orange County, North Carolina, Register of Deeds and Department of Health. We conducted cursory inspections of two houses in the program.

Our review generally covered the period February 17, 1994, through August 30, 1998. We conducted our review June through August 1998.

BACKGROUND

We received complaints from residents of the Pine Knolls neighborhood in May 1998. The general theme of the complaints concerned mismanagement of the Pine Knolls Neighborhood Revitalization Program by the Center.

The Center is a non-profit organization established in 1968. It received tax exempt status in 1996 under Section 501(c)(3) of the Internal Revenue Code. It's purpose is to assist in revitalizing the Pine Knolls neighborhood. The Center is managed by a Board of Directors.

The Town entered into three performance agreements with the Center in 1994 and 1995. In accordance with the agreements, the Town loaned \$280,000 in CDBG funds to the Center to purchase seven properties (listed in Attachment B). The Center was to repair the properties with local funds provided by the Town and sell them to low-income families. After selling the properties, the Center was required to repay the \$280,000 to the Town. The Center also acquired and repaired houses not funded by the CDBG Program.

SUMMARY

The Town needed to improve the effectiveness of the Pine Knolls Neighborhood Revitalization Program. The Center, as program administrator, did not timely repair and sell houses purchased with CDBG loans. As a result, the objective of home ownership was not met, and the Center had not repaid \$181,500 of the loans to the Town.

We are recommending the Town: (1) reimburse \$181,500 to the Town's CDBG Program, and (2) if the Neighborhood Revitalization Program is continued, ensure that the administrator implements effective administrative procedures. Details of our finding and recommendations are in Attachment A.

We provided the Town a draft of the finding and discussed the need to improve the effectiveness of the Neighborhood Revitalization Program with the Town Manager and staff on November 3, 1998. The Town submitted written comments that disagreed in part with the finding. We summarized the Town's comments in the finding and included them as Attachment C.

Within 60 days, please give us, 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 Town.

If you have any questions, please contact me at (404) 331-3369, or Bruce Milligan, Senior Auditor, at extension 4056.

Attachments:

- A - Finding and Recommendations
- B - Properties Purchased With CDBG Funds
- C - Auditee Comments
- D - Distribution

FINDING AND RECOMMENDATIONS

Finding - Need to Improve Program Effectiveness

The Town needed to improve the effectiveness of the Pine Knolls Neighborhood Revitalization Program. The program administrator, the Pines Community Center, Inc. (Center), did not timely repair and sell houses purchased with loaned CDBG funds. As a result, the objective of home ownership was not met, and the Center had not repaid \$181,500 of CDBG loans to the Town to be reused for other purposes.

Grantees are required to monitor grant supported activities to assure compliance with applicable Federal requirements and that performance goals are being achieved (24 Code of Federal Regulations, Part 85.40(a)).

Houses Not Repaired and Sold

The Center did not timely repair and sell the houses. In 1994 and 1995, the Center purchased seven houses with CDBG funds of \$280,000 loaned by the Town. The Center was to repair the houses and sell them to low-income families. The Center had to repay the \$280,000 to the Town within one year after acquisition or when the houses were sold, whichever occurred first. At the completion of our review in November 1998, the Center had sold only three of the houses and repaid only \$98,500. Three of the four remaining homes were rented; the fourth had not been repaired and was vacant.

Other Related Deficiencies

The Center also did not effectively perform other elements of the program designed to facilitate repair and sale of the houses.

- Originally, the Center was supposed to sell the houses at a price based on the purchase price plus the cost of repairs, or \$50,000, whichever was less. The Town subsequently increased the maximum sales price to \$65,000 which could include an allowance for Center profit and overhead of up to 20 percent. However, the Center did not maintain records of repair costs for each house. A Center representative stated that the Center gave its records of repair costs to the Town. The Town had copies of invoices but not evidence of the Center's payment of the costs.
- The Center required buyers to contribute sweat equity, but did not maintain accurate records of work performed by buyers. In addition, the Center's sweat equity requirement was unreasonable. The Center required as much as 2,000 hours of sweat equity by a purchaser, the equivalent of 40 hours a week for almost a full year. The sweat equity requirement caused misunderstandings and complaints by home purchasers.

- The Center did not have written procurement procedures and did not maintain formal accounting records.

* * *

The Town did not properly monitor the Center's performance. The Town executed three agreements with the Center. Two of the three agreements, covering five of the seven houses, did not include requirements for the amount and quality of housing repairs. The Town did not enforce requirements for the Center to submit quarterly financial and work progress reports. Until recently, the Town did not properly address the Center's slow performance. As a result, only three of the seven CDBG-funded houses met the home ownership objective, and the Town had not recovered CDBG loan funds of \$181,500 for other uses.

In July 1998, the Town proposed to replace the Center as program administrator. At the completion of our review, the Town was in the process of making administrative changes to improve the program.

Town Comments (Summary)

The Town agreed the Center had not repaired and sold the houses as required and that 2000 hours of sweat equity by the buyer was unreasonable. However, the Town believed it had acted timely to improve program effectiveness. The Town thought its responsibility was to ensure the Center complied with HUD regulations and contractual obligations. The Town stated it began a review of the Center in October 1996, submitted a report to Town Council in February 1997, and had been working since then to resolve program issues. The Town said when the Center's compliance was questioned, the Town reviewed Center contractual obligations and put program funds on hold. The Town stated its staff met regularly with representatives of the Center to monitor program progress. The Town stated the Center did not submit reports quarterly as required but did submit occasional progress reports and made periodic reports to Town Council. The Town thought that schedules and invoices the Center submitted adequately supported repair costs.

Evaluation of Response

We disagree the Town acted timely to improve the effectiveness of the program. The four unsold houses were acquired in 1994 and 1995. The Town monitored the performance of the Center and identified problems in 1996, but it was July 1998 before Town Council passed a resolution providing for program changes. In November 1998, the Town was still negotiating corrective actions with the Center. Although the Center submitted schedules and invoices of repair costs to the Town, the Center needed to maintain such records in a manner that they can be related to disbursement records evidencing payment.

Recommendations

We recommend that you require the Town to:

- 1A. Ensure the remaining house is repaired and the four houses are sold.
- 1B. Repay \$181,500 to the Town's CDBG program.
- 1C. Ensure the Pine Knolls Neighborhood Revitalization Program administrator establishes effective management procedures, if the program is continued.

PROPERTIES PURCHASED WITH CDBG FUNDS

<u>ADDRESS</u>	<u>DATE</u> ¹	<u>STATUS</u>	<u>AMOUNT</u>
122 Johnson Street	2/17/94	Sold 5/3/95	\$ 22,500
108 Johnson Street	12/12/94	Sold 3/23/98	48,000
110 Johnson Street	12/12/94	Rented	48,000
104 Johnson Street	8/18/95	Sold 9/8/97	28,000
140 Lincoln Lane	8/18/95	Rented	45,000
142 Lincoln Lane	8/18/95	Rented	45,000
150 Lincoln Lane	8/18/95	Vacant	<u>43,500</u>
Total			<u>\$ 280,000</u>

¹ Date Of Performance Agreement between the Town of Chapel Hill and the Pines Community Center, Inc., which was the same date the properties were purchased.

Auditee Comments

TOWN OF CHAPEL HILL

306 NORTH COLUMBIA STREET
CHAPEL HILL, NORTH CAROLINA 27516

Telephone (919) 968-2888

November 13, 1998


Mr. Bill Fair, Senior Auditor
U. S. Department of HUD
2306 West Meadowview Road
Greensboro, NC 27407

Dear Mr. Fair:

Thank you for sending the Town a copy of the draft audit finding of the Pines Community Center Homeownership Program for review. Enclosed please find the Town's comments to the Department of Housing and Urban Development's audit report of the Pines Community Center Homeownership Program.

If you should have any questions, please contact Loryn Barnes, Community Development Coordinator or Chris Berndt, Long Range Planning Coordinator at (919) 968-2728.

Sincerely,


W. Calvin Horton
Town Manager

Town Comment

The Pine Knolls Neighborhood Revitalization Program was designed in 1993 by the members Pines Community Center Board. This idea was presented to the Town Council as a homeownership program that would use volunteer labor to provide affordable housing opportunities to families earning less than 60% of the area median income.

We offer the following comments about the draft audit report:

1. We recommend that the first sentence in the finding "Need to Improve Program Effectiveness" be changed. We believe that the Town's responsibility was to insure that the Pines Community Center was in compliance with HUD's regulations and with its contractual obligations with the Town. When the organization's compliance was questioned, we promptly began a review of the organization's contractual responsibilities with the Town and funds were put on hold.
2. We note that the terms of the Performance Agreements require the Town's Community Development funds used for acquisition of the properties to be repaid in one year, or when the house was sold to a low-income buyer, whichever occurred first.
3. We note that the Town Council modified the guidelines of the program to establish a maximum sale price, and to allow the Center to include a profit.
4. We would like to point out that the Pines Community Center did provide records to the Town regarding the renovation costs of each unit. Original receipts and copies of cancelled checks written for supplies were submitted to the Town for review prior to issuing each loan. We would like to clarify that the Town used local funds for the renovation expenses for each house. Community Development funds were used to acquire properties.
5. We concur with your comment that the required 2000 hours of sweat equity is too high and should be reduced.
6. We add that the Town staff met regularly with members of the Pines Community Center Board to monitor progress. Although we agree that they were not submitted each quarter as required, the Pines Community Center did submit occasional progress reports and made periodic reports to the Town Council.
7. We would like to clarify that the Town executed Performance Agreements with the Pines Community Center for each house in the program, and we have legal instruments in place to recover these funds (Promissory Notes and Deeds of Trust).

8. The Town began its review of the Pines Community Center's performance in October, 1996 and submitted a report to the Town Council in February 1997. Since that time, we have been working to find a mechanism to resolve program issues. We believe that we have acted in a timely manner.

Schedule of Unnecessary/Unreasonable Costs

<u>Recommendation</u>	<u>Unnecessary/Unreasonable²</u>
1B	\$181,500

² Unnecessary costs are those not generally recognized as ordinary, relevant, and/or necessary within established practices. Unreasonable costs exceed the costs that would be incurred by the ordinarily prudent person in the conduct of a competitive business.

Distribution

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 Director, Housing and Community Development Issue Area, U.S. GAO, 441 G Street N.W.,
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 Ms. Cindy Sprunger, Subcommittee on General Oversight and Investigations, Room 212,
 O'Neil Office Building, Washington DC 20515
 Town Manager, Chapel Hill, North Carolina