



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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December 24, 1998

No. AT-241-1803

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

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

SUBJECT: Citizen Complaints
Eagle/Market Streets Development Corporation
Asheville, North Carolina

In response to a citizen's complaints, we reviewed Community Development Block Grant (CDBG) activities of the City of Asheville, North Carolina, administered by the Eagle/Market Streets Development Corporation (Corporation). The purpose of our review was to determine whether the Corporation maintained proper control over CDBG funds, used the funds for eligible CDBG activities, and complied with applicable laws and regulations.

SCOPE

We interviewed Department of Housing and Urban Development (HUD) North Carolina State Office Community Planning and Development staff and City Community Development staff and reviewed their related files and documents. We interviewed Corporation staff and two members of its Board of Directors, reviewed files and other documents, and toured the South Pack Square area of Asheville. We also interviewed the complainant.

Our review generally covered the period February 13, 1996, through June 30, 1998. The review was extended to other periods when appropriate. We conducted our review in July and August 1998.

BACKGROUND

We received several complaints from a citizen beginning in June 1998. The general theme of the complaints concerned the City and the Corporation not properly controlling CDBG funds, and using funds for ineligible activities in redeveloping South Pack Square.

The Corporation was organized in June 1994 and received 501(c)(3) tax exempt status in 1995. The Corporation's purpose is to address and remedy the blighted condition of South Pack Square, a historic African-American commercial district also known as "The Block." The Corporation is managed by a Board of Directors, limited by its by-laws to 15 members - 5 property owners and 3 renters from the South Pack Square area, and 7 persons from the community at large.

Prior to 1996, the Asheville Housing Authority administered the redevelopment program for South Pack Square. On February 13, 1996, the City contracted with the Corporation to administer the program, with CDBG funding of \$57,517. The City entered into similar agreements with the Corporation on November 25, 1996, and July 1, 1997, providing CDBG funding of \$185,688 and \$136,255, respectively. The contracts authorized the Corporation to plan and implement various activities to improve the blighted condition of South Pack Square. The Corporation also received funding from other sources.

SUMMARY

The Corporation did not administer land acquisition and procurement activities in accordance with CDBG Program requirements. In acquiring a parcel of land, the Corporation paid \$14,000 in excess of the land's appraised value to a Board member, creating the appearance of a conflict of interest. Similarly, it created the appearance of favoritism in awarding a \$60,950 consulting contract by not documenting how it selected the contractor.

The City also paid the Corporation \$6,000 for activities not authorized in the City's contract with the Corporation.

We are recommending the City repay \$14,000 to the CDBG Program and implement certain program improvements. Details of our findings and recommendations are in Attachment A.

We provided the City a draft of the findings and discussed the need to improve the performance of the Corporation with the City's Interim Director of Planning and Development and the Director of Community Development on September 18, 1998. The City submitted written comments that generally agreed with the findings. They provided measures the City will take to ensure that the Corporation implements proper administrative procedures and controls to effectively use CDBG funds. We summarized the City's comments in the findings and included them as Attachment C.

Within 60 days, please give us, for each 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 this review.

We provided a copy of this memorandum to the City.

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

Attachments:

- A - Findings and Recommendations
- B - Program Criteria (Summary)
- C - Auditee Comments
- D - Schedule of Unnecessary/Unreasonable Costs
- E - Distribution

FINDINGS AND RECOMMENDATIONS

Finding 1 - Need to Improve Performance of Subgrantee

The Eagle/Market Streets Development Corporation, a subgrantee, did not administer land acquisition and procurement activities in accordance with CDBG Program requirements. In acquiring a parcel of land, the Corporation paid \$14,000 in excess of the land's appraised value to a Board member, creating the appearance of a conflict of interest. Similarly, it created the appearance of favoritism in awarding a \$60,950 consulting contract by not documenting how it selected the contractor. The City must ensure the Corporation implements administrative procedures and controls over use of CDBG funds.

Land Acquisition Requirements Not Followed

In acquiring the first parcel of land for its program on April 15, 1998, the Corporation did not comply with the following acquisition requirements:

- a) The Corporation acquired the land from a Corporation Board member. CDBG regulations (Attachment B) prohibit officials of CDBG sub-recipients from receiving a financial interest or benefit from land acquisitions. HUD may waive the prohibition if the recipient demonstrates that an exception would further the objectives of the CDBG Program. The Corporation did not request the City to seek a waiver. The Corporation paid the Board member \$14,000 more than the land's appraised value.
- b) The Corporation did not properly document the basis for the \$85,000 purchase price. HUD procedures (Attachment B) require the recipient to obtain an appraisal of the property's value, establish just compensation, and give the owner a written statement of the basis for the offer. If the owner refuses the offer, the recipient may pay a higher price if an authorized Corporation official approves the settlement as reasonable, prudent, and in the public interest. The Corporation obtained one appraisal which valued the property at \$71,000. The Corporation did not document its files with the basis for the \$85,000 price, did not give the owner a written statement of the basis for the offer, and did not obtain HUD approval of the price.

The cost of the property appeared excessive, and the Corporation's actions created the appearance of favoritism.

Selection of Consultant Not Properly Documented

The Corporation did not document adherence to procurement procedures in awarding a contract for consulting services. As a result, the award created the appearance of favoritism.

The original contract was awarded September 4, 1996, for \$60,950. After reducing the scope of services, the Corporation paid the consultant \$50,950. A subgrantee must document the history of each procurement. It must publish a request for proposals, identify all evaluation factors, and make the award to the responsible firm whose proposal is most advantageous to the program (Attachment B). The Corporation did not comply as follows:

- a) The Corporation did not describe the work to be included in the proposed contract, did not advertise for proposals, and did not document how it otherwise solicited proposals from interested consultants.
- b) The Corporation had written proposals from two consultants, but the proposals could not be effectively evaluated because they did not include the same scope of services or proposed fee information. One of the proposals was submitted to a local church instead of the Corporation. The Corporation provided documents submitted by two other consultants; however, the documents were not proposals.
- c) The Corporation did not document its reason for selecting the consultant who was awarded the contract.

Improvements Needed in Administrative Procedures

The City's contract with the Corporation required the Corporation to comply with CDBG Program requirements; however, the City is responsible for ensuring such compliance occurs (Code of Federal Regulations, Title 24, Part 570.501 [CFR]). The City did not ensure that the Corporation established administrative controls to assure adherence to acquisition procedures, and the Corporation did not have written procurement procedures (Attachment B). Corporation staff and board members needed training in land acquisition and procurement procedures.

City Comments (Summary)

The City generally agreed with the finding. It stated it received unclear guidance from HUD about the Corporation's conflict of interest policy with the result that the City did not require the Corporation to obtain a waiver before acquiring the property. The City planned to issue a written reminder to all subgrantees of conflict of interest provisions in HUD's regulations, and to emphasize the correct procedures in future subgrantee training.

Regarding the land purchase price, the City stated that Corporation staff and Board members mistakenly thought the property appraised at \$78,000, and the Corporation followed incorrect advice from a consultant about the amount which could be paid. The City also stated it mistakenly approved the payment request without reviewing the appraisal. The City plans to provide Corporation staff technical assistance in acquisition procedures, and to review all future acquisition documentation.

Regarding selection of the consultant, the City believed the Corporation acted in good faith but lacked experience in procurement procedures. The City stated it would require the Corporation to develop a formal procurement policy which the City would review for adequacy, and the City would emphasize procurement in future monitoring and technical assistance to the Corporation. The full text of the City's comments is included in Attachment C.

Evaluation of Response

The City's comments were positive and responsive to the finding, but do not support payment of \$14,000 more than appraised value for the land. When implemented, the City's planned steps to improve the performance of the Corporation in procurement and land acquisition procedures should be sufficient to ensure compliance with requirements.

Recommendations

We recommend that you require the City to:

- 1A. Repay \$14,000 to the CDBG Program for payment in excess of appraised land value.
- 1B. Complete its planned steps to (a) provide a written reminder and training to all subgrantees about conflict of interest regulations, (b) provide the Corporation technical assistance in property acquisition procedures, and (c) implement procedures to review all future acquisition documentation.
- 1C. Complete its plans to provide the Corporation technical assistance in procurement requirements, and to require the Corporation to develop a formal procurement policy.

Finding 2 - Activities Not Authorized by Contract

The City paid the Corporation \$6,000 for activities not authorized in its contract with the Corporation. The activities involved eligible uses of CDBG funds; however, failure to include them in the contract weakened the City's control over the activities and left the eligibility of the payments unsupported.

On December 20, 1995, the City paid the Corporation \$2,000 for appraisals of two parcels of land. The City's first contract with the Corporation was not executed until February 13, 1996. On May 3 and June 21, 1996, respectively, the City paid the Corporation \$2,798 for cleaning a property, and \$1,202 for an asbestos and lead survey of three properties. The contract with the Corporation did not include the cleaning and survey activities.

Eligible CDBG Program activities include removal of slums and blight and land acquisition. Thus, with contractual authorization, use of CDBG funds for the subject services was allowable.

Procurement regulations require a grantee to ensure contractors perform in accordance with their contracts (Attachment B), and 24 CFR 85.20(b)(3) requires a grantee to maintain effective control over all grant funds.

City Comments (Summary)

The City agreed with the finding. The City provided an example of changes made in the format of the scope of work in its grant agreements to make them more specific and performance related. The City also provided steps it will implement to ensure subgrantee activities are within the authorized scope of services prior to reimbursement. The full text of the City's comments is in Attachment C.

Evaluation of Response

The City's comments and planned steps were responsive to the finding.

Recommendation

- 2A. We recommend you follow up to determine that the City implements its planned improved procedures for review of requests for reimbursement.

PROGRAM CRITERIA (SUMMARY)

Conflict of Interest

The Code of Federal Regulations for the CDBG Program, Title 24, Part 570, prohibits appointed officials of CDBG sub-recipients from receiving a financial interest or benefit from the proceeds of a CDBG assisted activity, including acquisitions of real property. HUD may grant exceptions to the conflict of interest provisions on a case-by-case basis upon receipt of a satisfactory written request from the grant recipient. The recipient must provide documentation of the nature of the conflict and assurance that there has been public disclosure of the conflict. In determining whether to grant an exception, HUD is required to determine whether an exception will further the purposes of the CDBG Program (24 CFR 570.611).

Land Acquisition

Land acquisition requirements are in HUD Handbook 1378, Tenant Assistance, Relocation, and Real Property Acquisition, Chapter 5, which is a restatement of Code of Federal Regulations, Title 49, Part 24.

The agency must obtain at least one appraisal of the property's value (two appraisals are encouraged), establish the amount it believes to be just compensation, and give the owner a written offer, along with a statement of the basis for the offer. The purchase price for the property may exceed the amount offered when reasonable efforts to negotiate an agreement at that amount fail and an authorized agency official approves the higher amount as reasonable, prudent, and in the public interest. Written justification explaining the basis for the settlement shall be included in the files (Paragraph 5-2 of the Handbook).

If the property owner has a conflict of interest, the agency must establish safeguards to prevent the appearance of the owner being motivated by personal gain. One safeguard recommended is HUD price concurrence after review of appraisals and the determination of just compensation (Paragraph 5-9 of the Handbook).

Procurement

The Code of Federal Regulations, Part 85, Administrative Requirements for Grants and Cooperative Agreements With States and Local Governments, Section 85.36(b), covers procurement by grantees and subgrantees other than States. Grantees and subgrantees must have written selection procedures for procurement transactions and must maintain records sufficient to detail the significant history of a procurement. The records should include the rationale for the method of procurement, selection of contract type, contractor selection or rejection, and the basis for the contract price. When the competitive proposal method of procurement is used, requests for proposals must be publicized and must identify all evaluation factors and their relative importance. Grantees and subgrantees must have a method for conducting technical evaluations of the proposals received and for selecting awardees. Awards must be made to the responsible firm whose proposal is most advantageous to the program, price and other factors considered. Grantees and subgrantees must maintain a contract administration system to ensure contractors perform in accordance with the terms, conditions and specifications of their contracts.

Auditee Comments



October 7, 1998

Ms. Karen L. Scott Morrison
U.S. Dept. of Housing and Urban Development
Office of Inspector General
2306 West Meadowview Road
Greensboro NC 27407

Dear Ms. Morrison:

I am writing to provide you with the City of Asheville's response to the draft findings of the limited survey you carried out in July, 1998. Both findings relate to the performance of the City's subgrantee, Eagle/Market Streets Development Corporation (EMSDC), in the period 1995-1998, and the City's oversight of the subgrantee.

The City is aware that your office received some serious allegations of misconduct by EMSDC and the City prior to your survey, and I am grateful to you for your quick and thorough response in investigating these allegations. It is my understanding that your findings do not identify any instances of serious misconduct or ineligible use of federal funds. There have, however, been some weaknesses in administrative procedures and controls leading to a lack of compliance with certain aspects of federal grant regulations, and the City is determined to see that these are put right.

Attached is the City's response to each of the draft findings. I look forward to receiving your final report.

Sincerely,

1997

S. Douglas Spell, P.E.
Assistant City Manager/Interim Planning and Development Director

Attachments

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City of Asheville
Response to Draft OIG Report
October 7, 1998

Finding #1 - Need to Improve the Performance of Subgrantees

(1). Land Acquisition Requirements not Followed - Apparent Conflict of Interest

In April 1998, EMSDC used CDBG funds to acquire 70 South Market Street, which was owned by one of its Board members. This gave the appearance of a conflict of interest. CDBG regulations at 24 CFR 570.611 provide for HUD to grant waivers to the conflict of interest rules when it is in the public interest to do so and after full public disclosure of the circumstances. However, no disclosure or request for a waiver was made.

Response

The reasons for this omission can be found in an exchange of correspondence with the HUD field office in March 1997. At that time, several local property owners were on the EMSDC Board, and the City and EMSDC realized that redevelopment plans might involve acquisition of property from one or more Board members. EMSDC had developed a Conflict of Interest Policy according to which Board members would remove themselves from any discussion or voting on property acquisition in which they had an interest. This policy was submitted to HUD with a request for clarification of the conflict of interest rules. The reply from HUD dated March 26 stated: *"It is our opinion that if board members comply with the provisions of the CDC's Conflict of Interest Policy Statement ...the CDC and its Board members will be in compliance with 570.611. It is, nevertheless, the responsibility of the City and the CDC to ensure compliance with 570.611, as well as their own statement, since the two are not identical."*

EMSDC and City staff concluded from this letter, and from conversations with HUD staff, that there would be no conflict provided that EMSDC followed its own policy statement. We now understand that this was a mistaken conclusion. The last sentence of the letter quoted above should have been interpreted to mean that as well as following its policy statement, EMSDC should make a public disclosure of the potential conflict and request a waiver from HUD. If this had been spelled out in the letter, we feel that this finding could have been avoided. There were ample grounds for HUD to grant a waiver, because of the public interest served by EMSDC acquiring and rehabilitating this key property and the fact that the owner did not participate in the discussion or voting on the acquisition.

City staff are now quite clear that any potential conflicts of interest must be publicly disclosed and submitted to HUD for waiver. The City has correctly handled two other potential conflict of interest cases since May 1998. To further ensure compliance, the City plans to issue a written reminder about the conflict of interest regulations to all its subgrantees and to emphasize the correct procedure in its future subgrantee training.

a(2). Land Acquisition Requirements not Followed - Purchase Price

EMSDC paid \$85,000 for the property at 70 South Market Street. An appraisal dated February 18, 1997, assessed the value at \$71,000. The reasons for paying more than the appraised value were not documented, nor did EMSDC obtain City or HUD approval for the \$85,000 price.

Response

It appears that a series of unrelated mistakes occurred in processing this transaction. First, the appraised value appears in EMSDC records as \$78,000. It seems that this was a typographical error that was never corrected; EMSDC staff and Board members believed that the property had appraised at \$78,000. Second, EMSDC sought advice from a consultant and an attorney (but not from the City or HUD) on whether it could pay more than the appraised value and was told that federal regulations allowed payment of up to 15% more. This was erroneous advice. Finally, City staff approved the payment request prior to closing without reviewing the original appraisal.

The City plans to provide EMSDC staff with technical assistance in property acquisition procedures, including copies of the Uniform Relocation Act Regulations (49 CFR Part 24) and the Acquisition/Relocation Handbook (HUD Handbook 1378). City staff will ensure that in each future case involving real property acquisition, all documentation relating to the transaction is reviewed before the subgrantee enters into a contract to purchase real property, and again before CDBG funds are released.

The City would welcome assistance from HUD in training subgrantees in the complex area of real property acquisition. Guidance written specifically for subgrantees would be extremely helpful, since the rules are significantly different for grantees and subgrantees. The subject is not covered adequately in the subgrantee manual, "Playing by the Rules".

b. Selection of Consultant not properly Documented

EMSDC had insufficient documentation on the methods used to procure a contract for consulting services in September 1996.

Response

It is clear that the subgrantee did attempt to obtain competitive proposals from at least four consultants and involved Board members in the final selection. However, it failed to advertise for proposals, did not clearly describe the scope of work to be performed and the minimum information required in proposals, and did not develop selection criteria, with the result that the material submitted by the four consultants could not be effectively evaluated. Nevertheless, the Board did agree on its selection of the consultant and received valuable services from the consultant. There is no indication that procurement procedures were deliberately bypassed in order to award the contract

**City of Asheville
Response to Draft OIG Report
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to a pre-determined person. Rather, it seems that EMSDC acted in good faith but with a lack of experience in the procurement process.

The City will require EMSDC to develop a formal procurement policy, and City staff will review the policy to ensure that it is in compliance with Federal standards. City staff will pay particular attention to procurement issues in monitoring EMSDC and in providing technical assistance to its staff and Board members.

Finding #2 - Activities not Authorized by Contract

In February 1996 the City provided its first grant to EMSDC, to establish an office, hire staff, and develop a work program. However, in addition to this, EMSDC was reimbursed a total of \$6,000 for three CDBG-eligible development activities which were not explicitly covered in the grant agreement, that is: an appraisal, an asbestos and lead survey, and interim clean-up of a property. In addition, the appraisal actually preceded the date of the first grant agreement.

Response

During 1996, the agency went beyond the limited scope of work in the grant agreement and started to implement its work program. This should have been formally recognized through an amendment to the scope of work. The appraisal which preceded the date of the grant agreement should have been paid for directly by the City rather than through EMSDC.

Starting July 1998, the City has changed the format for the scope of work in all its grant agreements to make them much more specific and performance-related. The current scope of work for EMSDC is attached to illustrate this. All requests for reimbursement are reviewed in detail by the CD Specialist, and the check request and backup are reviewed again by the CD Director, before payment is authorized. The City will ensure that requests which appear to go outside the existing scope of work are challenged. Either the request will be rejected, or, if it is clearly in the public interest to allow the activity to go ahead, the scope of work will be revised and the grant agreement formally amended. Efforts will be made to educate subgrantees so that they request necessary changes to their scope of work before submitting reimbursement requests.

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**ATTACHMENT A
SCOPE OF SERVICES**

SOUTH PACK SQUARE REDEVELOPMENT

The Eagle/Market Streets Development Corporation will implement the following activities using CDBG and other funds in FY 1998-1999.

South Pack Square Community Center

- Renovate the South Pack Square Community Center, to house a police substation and a community center. [By end of 1998];
- Conduct programming in the Center, to include a Behavior Modification Program with New Hope Community Health Clinic, and a Youth Job Readiness Program;
- Hold community meetings, weekly, monthly and as necessary [ongoing].

Other Property Development

- Continue to evaluate other property for redevelopment [ongoing];
- To the extent that funds are available, to acquire and rehabilitate suitable properties for business and/or residential use.

Assisting Private Investment

- Encourage property owners to invest in renovating their buildings [ongoing];
- Assist property owners in the renovation of property by providing renovation and financing information, including Historic Tax Credits, and by providing contacts to resources for further assistance [ongoing].

Business Development

- Coordinate with AB Tech and The North Carolina Small Business and Technology Development Center for presentations and one-on-one counseling for existing businesses in the area, with particular emphasis on minority and women -owned establishments [on-going];
- Acquire building to house business development activities [end of 1998];
- Begin planning for business development activities, to include a business incubator.

Construction Job Training Program

- Continue developing Construction Job Training Program with AB Tech [on-going];
- Initiate Pilot Phase of Job Training Program [beginning 1999];
- Allow program participants to complete on-the-job-training at building slated for Homeless Education Job Training Program [contingent upon funding availability].

Homeless Job Training/Education Program

- Acquire building for program [end of 1998];
- Begin planning for renovation, including seeking additional funding
- Begin construction [contingent upon funding availability].

Schedule of Unnecessary/Unreasonable Costs

<u>Recommendation</u>	<u>Unnecessary/Unreasonable¹</u>
1A	\$ 14,000

¹ 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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