



U.S. Department of Housing and Urban Development

District Office of the Inspector General
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April 30, 1996

Audit-Related Memorandum
No. 96-AT-244/255-1813

MEMORANDUM FOR: Louis E. Bradley, Director, Community Planning and Development
Division, 4ED

FROM: Kathryn Kuhl-Inclan
District Inspector General for Audit-Southeast/Caribbean District, 4AGA

SUBJECT: City of North Charleston
North Charleston, South Carolina
CDBG and HOME Programs

SCOPE

Our limited probe pertained to selected activities of the City's Community Development Block Grant (CDBG) and HOME programs. We interviewed your staff and the Community Development staff at the City of North Charleston, City or CNC hereafter; reviewed records and reports in your files on the City's administration of HUD-funded programs; examined selected records and reports at the CNC for the HUD-funded programs; and reviewed selected financial records of the North Charleston Housing Corporation (NCHC). The probe was conducted on-site mainly in August, September and October 1995, with related discussions and correspondence through March 1996.

Our emphasis was on use of funds, procurement and related practices of the City and its Community Housing Development Organization (CHDO), which is NCHC. We wanted to see in general whether these programs' benefits went to intended persons and purposes, instead of providing windfalls. The probe was not an audit of any City activities, and our observations are related to the limited emphasis and scope.

SUMMARY

Our findings and recommendations are in Attachment 1. Attachment 2 provides for our findings the City and HUD comments, which also are summarized and evaluated in Attachment 1 following each finding.

We found that:

- The City's senior construction advisor had controlled contractor selection for HOME homeowner-occupied rehab projects, resulting in apparent favoritism and restricted competition.
- Some construction work was not properly inspected, and as a result the rehab was not satisfactory for 7 of 10 inspected homes.
- Better eligibility criteria were needed for HOME loans, resulting in six HOME loans wasting taxpayer-provided funds and creating windfalls to one former owner.

Within 60 days, please give us, for each recommendation in Attachment 1 a status report on: (1) corrective actions taken; (2) the proposed corrective actions and the date to be completed; or (3) why actions are considered unnecessary. Also, please furnish us copies of any correspondence or directives issued as a result of this limited probe.

If you have any questions, please contact Ted Drucker, Assistant District Inspector General for Audit at (404) 331-3369, or our Senior Auditor in Columbia, Rich Pirsig. Please keep in mind the recent reemphasis for timely management decisions on the recommendations in findings.

We are sending the City's Mayor an informational copy of this report.

Attachments:

- 1 - Findings and Recommendations
- 2 - City and HUD Columbia Comments
- 3 - Results of Inspections
- 4 - Schedule of Selected HOME Projects with Excess Loan to Value, and Debt to Income
- 5 - Schedule of Unsupported Costs
- 6 - Distribution

FINDINGS and RECOMMENDATIONS

1. The Senior-Construction Advisor Controlled Contractor Selection for HOME Homeowner-Occupied Rehab Projects.

Of \$1,259,135 in HOME funds awarded through July 21, 1995 for homeowner-occupied rehab projects, \$885,529 or over 70 percent were awarded to the same contractor: ACE Construction Company, Inc. (ACE). Thirty of the 44 homeowner-occupied projects were rehabilitated by ACE. Only six of the 30 ACE projects were competitively bid.

According to information in project files, ACE was selected by the homeowners. However, our discussions with 11 of these homeowners confirmed that they only nominally selected ACE as the contractor; rather the City's senior-construction advisor¹ actually controlled the selection and made arrangements for ACE to serve as the contractor. Such action resulted in apparent favoritism and restricted competition. Without fair and open competitive procurement of all HOME projects, the City cannot know that it has obtained construction at advantageous costs, and maximized the use of its HOME dollars.

The CNC Purchasing Manual requires formal competitive bidding procedures to be used for all purchases over \$5,000, and such competitive bidding practices in the award of federal funds are also required by CFR 85.36. The HOME program regulations do not specifically preclude the use of alternative procurement methods; however, common sense and prudence dictate proper safeguarding of taxpayer-provided funds.

Under the CNC's HOME program, its Community Development staff prepared a cost estimate for each proposed homeowner-occupied rehab project. In lieu of competitive bidding, a homeowner may select any contractor on or eligible for the City's list of approved HOME contractors as long as the bid from that contractor is within 10 percent of the estimate prepared by the City's construction advisor. The amount of work awarded to ACE indicated favoritism or abuse was present, which was confirmed in our subsequent discussions with 11 of the homeowners who used ACE as contractor. Only one of the 11 homeowners we contacted was given a list of approved contractors and that one selected ACE because of prompting from the City's construction advisor. According to nine of the 11 homeowners, they had no idea that they had a choice in who did the work.

The method used by CNC to award HOME rehab contracts was subject to abuse because the City's construction advisor could control or affect contractor selection. In addition, the same employee prepared the cost estimates, reviewed the "bids", and was also responsible for certifying that the work was satisfactorily completed in accordance with the contract specifications. (Also, the work by ACE was in some cases not completed in accordance with the contract specifications, See Finding 2).

¹ He became the City Director of Code Enforcement about August 1995.

We were informed during our review that the City was changing its procedures to require competitive bidding on all HOME rehab projects. Based on reading the revised Contractor Guidelines dated April 1995, we believe that those guidelines do not adequately and/or clearly spell out: how many bids were required, to whom bids were to be sent, how the bids were to be controlled, or any permitted exceptions to competitive bidding for rental rehab projects where the owner is active in the construction business. Thus they still can be improved.

Auditee Comments (Summary)

CNC - The former inspector (senior construction advisor) no longer works in the Community Development Office, and will no longer be performing inspections. (The HUD Columbia Field Office, Community Planning and Development Division (CPD) added that the former inspector no longer worked with HUD funded projects.) After the HUD monitoring visit in May 1994, the City Council approved making competitive bids a requirement for all HOME rehab projects. At least three bids are to be required.

CPD - The City is willing to get the contractor to complete "all necessary work" (also see Finding 2). The case for possible administrative sanctions against City staff could be weakened because project files contain a document signed by the homeowner saying that he/she chose ACE for the construction company from the City's list of Minimum Criteria contractors. CPD believed OIG suggested award procedures are sound.

OIG Evaluations

Neither response referred to administrative or other sanctions to be initiated against the former senior-construction advisor or any of the City staff. Also neither responded to some specific revisions or clarifications for the Contractor Guidelines dated 4/11/95, which we had suggested.

The current employment status of the former senior-construction advisor should not influence whether administrative sanctions are warranted for the cited conduct. Regardless of who selected the contractor, the CNC Advisor incorrectly certified documents related to work completed, and/or uncompleted. These false certifications, in our opinion, justify administrative sanctions. Despite signed statements to the contrary, it was apparent from our discussions with individual homeowners that they had not decided the selection of the contractor. This oral advice by CNC customers is reinforced by the fact that 30 of the 44 homeowner rehab projects in the HOME program were done by the same contractor, which indicates undue influence was exercised.

Recommendations

We recommend that you:

- 1A. Initiate administrative sanctions against the City's former senior construction advisor and possibly his supervisor both for: i) improperly controlling and/or influencing the selection of construction contractors for homeowner-rehab projects; and ii) giving final approval to rehab work not complying with the work write-ups (also see Finding 2).
- 1B. Have future CNC awards of HOME funds for rehab projects use competitive bidding (Resolved)
- 1C. Require the procedures, in the CNC Procurement Manual, for the award of HOME rehab funds to be more precise on solicitation, control, and evaluation of bids.

2. Contract Rehab Projects Were Not Properly Inspected

Because most HOME rehab projects were awarded to a single contractor (ACE), we considered the quality and completeness of work performed by this contractor. We initially inspected five homes rehabilitated by ACE; and concluded that some specified work was not completed, and the cost appeared high for certain work. With the assistance of a professional engineer assigned to the HUD Georgia State Office, we did more detailed inspections of the work performed by ACE on 10 HOME rehab projects. The inspection results are summarized in Attachment 3.

Based on the results of these more detailed inspections, the quality and cost of the work performed by ACE varied considerably. Three of the 10 inspected projects generally were satisfactory. Seven had from 2 to 8 work items which were overpriced (\$10,250), not completed to specifications (\$150), or not completed at all (\$9,900). In spite of these deficiencies, the former CNC senior-construction advisor approved the work as being satisfactorily completed. The City needs to improve its inspection practices to preclude less than satisfactory performance by contractors receiving federal funds.

Auditee Comments (Summary)

CNC - The City generally agreed for construction deficiencies on the ten inspected properties, except those not clearly required by local codes.

CPD - Agreement in general was expressed with our suggestions for corrective actions, except CPD endorsed the City's views on dropping inspection citations not required by local codes. In lieu of using an independent inspector as OIG suggested, the City should be allowed to use its new rehab inspector.

OIG Evaluation

The CNC and CPD proposed or alternative actions are acceptable to the extent specified, and we will close the related recommendations (2A and 2C) when advice is received that the promised actions have been satisfactorily accomplished. However, neither responded sufficiently on what will happen for the remaining 20 units done by ACE which were not reinspected, or on administrative sanctions which -- we believe -- should be taken against the contractor and its employees or affiliates.

Recommendations

We recommend that you have the City CPD staff to:

- 2A. Require the contractor (ACE) to correct the deficiencies or reimburse \$20,300 for the items noted in Attachment 3.
- 2B. Have an inspector independent of the City's HOME program inspect all of the remaining 20 homeowner units rehabilitated by ACE and determine whether work items were over priced, not done, or not fully completed.

- 2C. Reimburse the HOME program from non-federal funds for any work not satisfactorily corrected or completed by the contractor, and for the costs of the independent inspections.

- 2D. Initiate administrative sanctions against the contractor, its principal officers or any successor identity-of-interest company for performance of identified rehab work not in compliance with the work write-ups. The administrative sanctions should preclude them from doing any new business with HUD funded programs for a period of not less than six-months, and until ACE has fully reimbursed the City and corrected all construction deficiencies.

3. Better Eligibility Criteria Were Needed for HOME Loans

We identified six homeowner rehab projects totaling \$184,670 arranged by one former short-term owner, and having first mortgages and HOME loans which exceeded their tax-appraisal values. Two of these same projects have homeowners whose monthly mortgage payments require an unreasonable portion of their total income; e.g., 42 and 57 percent respectively of their total income to cover just the mortgage payment. The HOME program does not have specific requirements for judging the credit capacity of potential HOME borrowers. However, prudent business practice requires that any mortgage loan be supported by property value which protects the lender in the event of default. Lack of adequate income level of the homeowner can lead to default and foreclosure by the mortgage-holders. Without an adequate balance between mortgage amounts and a home's value, there is undue risk which could result in significant waste of taxpayer-provided funds. Also, the former owner obtained significant windfalls as a result of the first mortgages, which he held, being far in excess of market values.

Mortgage Loan to Value Excessive -

Three of the examined homeowner properties (Attachment 4, projects 41, 59, 67) had mortgage debts, excluding their HOME loan, which exceeded their tax-appraisal values after rehab. Including their HOME loans, all six exceeded values after rehab; however, each received an additional mortgage debt as a result of the HOME Program loan.

The City's legal counsel recommended for two properties that the CD staff carefully consider whether the City's interests would be adequately protected and whether the property would be over-leveraged if the HOME loan was consummated. The City still consummated the loans.

Although the HOME program does not have specific requirements for credit capacity of potential HOME borrowers, the general criteria used by HUD with its insurance programs provides that there should be a loan-to-value ratio of no more than 98.75 percent.

Mortgage Debt to Income Excessive -

The homeowners' income level should be sufficient to adequately meet their monthly mortgage payment. Two of the six projects (see Attachment 4) have homeowners whose monthly mortgage payments required an unreasonable portion of their total income; one project (#52), which closed in January 1994, had its owner default about February 1995.

City Permitted Windfalls on Six Properties to the Former Owner -

The short-term owner purchased run-down houses for about \$10,000 each. He would find low-income persons (LIP) living in public housing, and persuade them to sign purchase contracts for houses, recently bought for about \$10,000, for \$26,000-\$36,000. The deal was contingent upon the LIP applying for and getting a HOME-loan to rehab the house.

He would transport and assist the individual in applying for the HOME rehab loan. When the loan was approved, he would close the deal selling the LIIP the house at an excess price, and at the same time the new owner would close a second mortgage deal with HUD for the HOME loan. The first mortgage was held personally by the former owner at an interest rate of 12 percent.

In essence, the former owner took advantage of six low-income persons who bought dilapidated houses at fixed-up values but taxpayer funds actually paid the fix-up costs. The City permitted the abuses but stopped the practice after we raised the issue.

* * * * *

Auditee Comments (Summary)

CNC - Recent revisions to the City's HOME Homeowner Rehabilitation guidelines include 1) the homeowner is required to have lived in the home for a minimum of three (3) years prior to rehabilitation, and 2) all eligible applications now go before a committee for review and approval, as well as full City Council. The Community Development staff will make a more prudent effort in the future to assure that rehabilitated properties are not overleveraged.

CPD - The City's response indicated corrective actions have occurred. The City's form of assistance under this program has consisted of 10- year deferred loans which are in effect grants, if the person continues to reside on the property, which should be factored in when assessing the total debt on the property. The City could have made grants in these cases. In short, the City did not actually expect that the deferred loans would be repaid, but employed the deferred loan arrangement and mortgage instrument as appropriate financial safeguards.

OIG Evaluation

The actions for future cases are acceptable. They do not however make whole the six cited homeowners who already have been put at disadvantage, or affect the speculator who received windfalls at the expense of the taxpayers underwriting the HOME program. Thus we do not consider CPD's discussion of grants vs loans to be directly relevant.

Recommendation

- 3A. We recommend that you coordinate with the Columbia HUD Office Chief Counsel, and provide guidance to CNC on needed actions to eliminate from its HOME rehab program the six properties involving the short-term speculative owner who obtained windfalls, or to otherwise obtain appropriate redress from him.

* **OIG NOTE** - This Attachment is a five-page listing of comments pertaining to the ten properties. It has been separately provided.

RESULTS of INSPECTIONS

<u>Location Number</u>	<u>Address</u>	<u>Work Not Completed</u>	<u>Work Not Completed Correctly</u>	<u>Work Items Overpriced</u>	<u>Totals</u>
1	6810 Ward Avenue				\$ 0
2	1779 Disco Street				0
3	1772 Disco Street	\$ 850			850
4	1905 Token Street				0
5	1902 Norwood Street	4,575			4,575
6	5242 Jury Lane		\$ 50	\$ 3,650	3,700
7	4680 Gaynor Avenue	2,000			2,000
8	3433 Osceola Street	175			175
9	1911 Graham Street	1,550		6,500	8,050
10	1922 Norwood Street	<u>750</u>	<u>100</u>	<u>100</u>	<u>950</u>
		<u>\$ 9,900</u>	<u>\$ 150</u>	<u>\$ 10,250</u>	<u>\$ 20,300</u>

SCHEDULE of SELECTED HOME PROJECTS
with EXCESS LOAN to VALUE,
and DEBT to INCOME

Excess Loan to Value:

(a) Project Number	(b) Owner	(c) Amount of HOME Loan Mortgage	(d) Amount of Senior 1st Mortgage Debt	(e) Post-Rehab Value	(f) Loan to Value Without HOME Mortgage <u>(d)/(e)</u>	(g) Loan to Value With HOME Mortgage <u>(c)+(d)/(e)</u>
34	G	\$ 29,700	\$ 29,000	\$ 33,700	86.05%	174.18%
41	W	34,975	32,000	31,600	101.27%	211.95%
51	S1	25,000	26,000	29,100	89.35%	175.26%
52	B	29,995	34,000	34,100	99.71%	187.67%
59	M	35,000	36,000	33,000	109.09%	215.15%
67	S2	<u>30,000</u>	34,000	31,300	108.63%	204.47%
		<u>\$ 184,670</u>				

Excess Debt to Income:

(a) Project Number	(b) Owner	(c) Monthly Mortgage Payment	(d) Monthly Family Income	(e) % Mortgage Payment to Income <u>(c)/(d)</u>
52	B	\$ 349	\$ 833	41.88%
59	M	370	646	57.28%

SCHEDULE OF UNSUPPORTED COSTS

<u>Finding/Recommendation</u>	<u>Unsupported Costs</u> ²
2A	\$ 20,300
3A	184,670

² Unsupported amounts do not obviously violate law, contract, or HUD or local agency policies or regulations, but warrant being contested for various reasons such as lack of satisfactory documentation and HUD approval.

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CNC Mayor R. Keith Summey

SUMMARY OF COMPLAINTS

The various allegations of mismanagement and irregularities primarily concerned the CNC's management of its CDBG Program, but were also related to the North Charleston Housing Corporation (NCHC), its CHDO.

- (1) City Officials misused CDBG funds.
- (2) Steering of development related contracts to the same contractors.
- (3) NCHC spent \$30,000 on advertising for River Place.
- (4) City officials did not bid out CDBG legal services.
- (5) The law firm double billed for some CDBG assisted housing services. Real estate closings contracted to cost \$600 were billed at \$1,200; and
- (6) NCHC Board was selected from a special interest group.

During our limited review, we found inconclusive evidence to support the allegations made by the complainant except as discussed below.

RESULTS OF REVIEW

1. City Officials Misused CDBG Funds .

This complaint was not specific. As stated in our 5/19/95 memorandum, we discussed this concern with Noel Morphis of your staff. He was not aware of CNC misuse of CDBG funds.

Since your staff reviewed CNC's CD programs in May 1994, we did not review the CDBG program in depth. Your findings and concerns, outlined in the report dated 6/2/94, were cleared on 8/24/94. Based on your reviews of the CNC's grant fee reports for the fiscal years ending 6/30/93 and 6/30/94, the CNC's CDBG program activities met eligibility requirements.

Based on our limited review of CDBG contracting, competitive procurement usually existed. You concluded in your June 2, 1994 monitoring report that in general the CNC's procurement actions were handled in accordance with applicable requirements. However, you did recommend corrective action for contractor-procurement for housing rehabilitation projects. (Also see Item 2 below and Finding 1 in Attachment 1.)

2. Steering development-related contracts to the same contractors .

We found inconclusive evidence within the CDBG program for this allegation. As discussed above, CDBG appeared to be competitively procured. However, we did find problems with the procurement process under the HOME program. You were aware of this problem as discussed in your monitoring review memorandum to the CNC dated 6/2/94. Our conclusions appear in Finding 1 of Attachment 1.

3. NCHC spent \$30,000 on advertising for River Place.

River Place is a market-rate apartment complex owned by the North Charleston Housing Authority (NCHA). Until the NCHC hired its own executive director in October 1993, the NCHA managed the activities of the NCHC.

We discussed this allegation with the Acting ED of the NCHA. She stated that the NCHC never expended funds for advertising River Place Apartments. The ED of the NCHC stated that he knows of no expenditure of their funds for such purpose after his employment.

Although not performing a detailed review of accounting records for the NCHA, NCHC or River Place, we did scan disbursements from the checking account of the NCHC for the periods 7/1/91 to 6/28/94 and did not identify any payments for such purpose.

4. City officials did not bid out CDBG legal services.

The CNC's general counsel has responsibility for administering the legal matters of the City's CD programs. City Council has adopted policy and ordinances to use their general counsel in this capacity. CNC's Purchasing Manual provides that all contracts for professional services shall be negotiated by City Council and are specifically exempt from formal bid/proposal requirements. The CNC Code of Ordinances provides that City Council shall appoint or contract with any attorney to represent the City as legal counsel. In addition, the CNC City Council adopted an ordinance dated 8/10/95 which gave the chief legal counsel the authority to retain, appoint or hire as an independent contractor such additional attorney(s) or co-counsel(s) as may be required to provide adequate legal representation for the City.

5. The law firm double-billed for CDBG-assisted housing services, and Real-estate closings contracted to cost \$600 were billed at \$1,200.

As a result of inquiries by a newspaper reporter and by the CNC finance director, the CNC's former legal counsel because of apparent clerical errors adjusted and reimbursed two invoices submitted by their firm.

We reviewed records related to the payment for legal services associated with CD programs and discussed this matter with CNC staff. We found that one invoice in the amount of \$360 was submitted twice by the law firm and was erroneously approved and paid twice by CNC. Another billing in the amount of \$350 for a title examination was paid in January 1993; the CNC was billed and paid \$350 for a title search for this property in Sept 93. In response to our inquiries, the CD staff has written the former legal counsel, requesting reimbursement of the \$360 double billing. In addition, they have requested an explanation for billings related to the two title searches for the same property.

Upon inquiry, the CNC's CD manager explained that there was never any contract with the former legal counsel to perform real estate closings for \$600 or any other set amount. The NCHC did pay a \$1,200 annual retainer to the attorney whose firm formerly represented the CNC. In addition, in 1990 the NCHC also paid the Gonzales firm \$1,900 in one check for 5 title searches.

Except for the double-billing described above, we found no doubled-billings for CDBG housing services.

6. NCHC Board was selected from a special interest group.

HUD's HOME regulations include requirements on the composition of a Community Housing Development Organization (CHDO) governing board. The NCHC's Board, in our opinion, met those requirements.