
AUDIT REPORT



INTERNAL AUDIT UP-FRONT GRANT PROGRAM

00-PH-119-0001

SEPTEMBER 29, 2000

OFFICE OF AUDIT, MID-ATLANTIC
PHILADELPHIA, PENNSYLVANIA



Issue Date	September 29, 2000
Audit Case Number	00-PH-119-0001

TO: Frank M. Malone, Director, Office of Multifamily Asset Management, HTO
Daniel G. Temme

FROM: Daniel G. Temme, District Inspector General for Audit, Mid-Atlantic, 3AGA

SUBJECT: Internal Audit
Up-Front Grant Program

We completed an audit of HUD's administration of the Up-Front Grant Program. Our report identifies two findings with recommendations requiring action by your office. The findings stress a need for HUD to follow established program guidelines in awarding Up-Front Grants, and to implement a system to monitor grantee compliance with the terms and conditions of the Grant Agreements.

Within 60 days, please give us, for each recommendation made 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 as a result of this audit. Note that Handbook 2000.06 REV-3 requires management decisions to be reached on all recommendations within 6 months of report issuance. It also provides guidance regarding interim actions and format and content of your reply.

We also provided a copy of this report to the Atlanta, Georgia and Fort Worth, Texas Multifamily Property Disposition Centers.

We would like to thank the management and staff of your office and the property disposition centers for their cooperation and professionalism during the audit. Should you or your staff have any questions, please contact Allen Leftwich, Assistant District Inspector General for Audit (ADIGA), at (215) 656-3401.

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Executive Summary

We completed an audit of the Department’s administration of the Up-Front Grant Program. The purpose of our audit was to determine whether HUD awarded Up-Front Grants according to its program guidelines, and if HUD monitored grantees to ensure they were complying with the terms and conditions of Grant Agreements.

We found HUD is not following many of its key program guidelines for awarding Up-Front Grants and is not adequately monitoring grantees that have received Up-Front Grants. These areas are summarized below and detailed in the findings of this report.

HUD is not Following Program Guidelines

HUD is not following many of its more significant program guidelines and procedures for selecting and awarding Up-Front Grants. Specifically, the Department does not perform financial feasibility or economic viability studies to determine whether projects it considers and awards Up-Front Grants will be cost effective and self-sufficient after rehabilitation. Additionally, the Department is not determining whether the selected projects are located in tight rental markets to ensure there is a need to develop the affordable housing. HUD officials have indicated program regulations allow the Department to exercise its discretion in awarding grants. However, the Department has not documented its decisions when applying this flexibility. Thus it is questionable whether grants awarded under the Up-Front Grant Program, as currently administered, meet the eligibility requirements and will be viable on a long-term basis. In the long run, this may jeopardize the program mission of preserving affordable rental housing and has resulted in General Insurance Funds being used for projects that are not cost effective.

HUD is not Adequately Monitoring Up-Front Grant Awards

HUD is not adequately monitoring Up-Front Grant awards during the project rehabilitation process, nor has HUD implemented any post rehabilitation monitoring. Due to staff limitations, HUD’s Atlanta and Fort Worth Multifamily Property Disposition Centers rely on contracts with architectural firms and one HUD engineer to monitor the grants during project rehabilitation. However, the architects and engineers only assess grantee progress during rehabilitation, not a grantee’s financial administration and compliance with the Grant Agreements. Because of these monitoring deficiencies, HUD has approved and paid significant funds to a number of grantees that are not

complying with grant requirements and HUD is now in the position of dealing with grantee performance problems. In addition, since HUD has not implemented any post rehabilitation monitoring, it has no assurance completed projects meet the program mission of preserving affordable rental housing.

HUD staff acknowledged the need to strengthen its monitoring process to ensure projects comply with affordability requirements, and units are maintained in a decent, safe, and sanitary condition.

Recommendations

We recommended that HUD ensure Up-Front Grant award determinations are made according to program requirements, and award determinations and decisions are clearly documented in the program files. We also recommended that HUD strengthen its monitoring process during the rehabilitation period and implement a system to monitor grant awards after rehabilitation is completed, to ensure grantees are complying with the terms and conditions of the Grant Agreements.

We discussed the results of our review with HUD staff and officials for the grantees during the audit. We also had an exit conference with HUD officials on September 27, 2000 and provided them a draft copy of the report for comment. HUD officials generally agreed with the report and its recommendations indicating early communication with the audit staff has given them an opportunity to start to address the issues. The Department's written comments are contained in Appendix B and summarized, in pertinent part, elsewhere in the report.

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Abbreviations

CRHA	Chesapeake Redevelopment Housing Authority
HUD	U.S. Department of Housing and Urban Development
NRHA	Norfolk Redevelopment Housing Authority
RBHC	Richmond Better Housing Coalition
RRHA	Richmond Redevelopment and Housing Authority

Introduction

Under the Up-Front Grant Program HUD may provide grants and loans for rehabilitation, demolition, rebuilding and other related development costs as part of the disposition of a multifamily housing project that is HUD-owned, upon making a determination that such a grant or loan would be: more cost-effective than project-based rental assistance; economically viable on a long-term basis; and preserve affordable rental housing in a tight rental market.

These policies related to funding Up-Front Grants from the General Insurance Fund were reaffirmed in December 1996 correspondence to the Appropriations Subcommittee on Housing and Community Development.

Up-Front Grant Program requirements and funding are outlined by Congress in the following Appropriation Acts:

Section 401 of The Balanced Budget Down Payment Act I, Pub. Law 104-99, specifically granted the Secretary authority to manage and dispose of Secretary-owned multifamily properties, including the provision for grants from the General Insurance Fund (12 U.S.C. 1735c) for the necessary costs of rehabilitation and other related development costs and Secretary-held mortgages. This provision was applicable only during Fiscal Year 1996.

Section 204 of the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1997, Pub. Law 104-204, provides that, for Fiscal Year 1997 and beyond, the Secretary may manage and dispose of Secretary-owned multifamily properties and Secretary-held mortgages on such terms and conditions as the Secretary may determine. Section 204 was amended by Section 213 of the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1998, Pub. Law 105-65.

Section 213 clarified that the General Insurance Fund could be used to provide demolition, but limited this authority to Fiscal Years 1997 and 1998. The Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1999, Pub. Law 105-276, extends this authority for an additional year. The FY 1999 Appropriations Act does not provide any Section 8 project-based funds for property disposition. The FY 2000 Appropriations Act, Public Law 106-74, extends funding for an additional year.

Since 1995, HUD has issued written guidance identifying program requirements through memorandums to Multifamily Housing Directors and in 1999 and 2000 published general requirements for Up-Front Grants in the Federal Register.

As of September 30, 1999, HUD has awarded 64 Up-Front Grants totaling \$356 million. The Atlanta, Georgia and Fort Worth, Texas Multifamily Property Disposition Centers are responsible for monitoring all Grants.

Audit Objectives

We audited HUD's administration of the Up-Front Grant Program. Our specific audit objectives were to determine whether: HUD awarded Up-Front Grants according to its program guidelines, and if HUD monitored grantees to ensure they were complying with the terms and conditions of Grant Agreements.

Audit Scope and Methodology

The audit was conducted between December 1999 and August 2000, and covered the period October 1, 1996 to September 30, 1999. The audit period was extended when necessary. To accomplish our objectives we:

- Interviewed HUD's Multifamily staff in the Virginia State Office, the Georgia State Office, the Texas State Office and Headquarters.
- Conducted on-site interviews with HUD's contract inspectors and reviewed their files.
- Judgmentally selected and reviewed Up-Front Grant files maintained in the Atlanta, Georgia and Fort Worth, Texas Multifamily Property Disposition Centers.
- Completed on-site visits at four grantees in Virginia. The four grantees included the Richmond Better Housing Coalition (RBHC), the Richmond Redevelopment and Housing Authority (RRHA), the Chesapeake Redevelopment Housing Authority (CRHA), and the Norfolk Redevelopment Housing Authority (NRHA).

At each grantee we:

- ◇ Reviewed the accounting records to ensure grant funds were separate from other funding sources and expenditures were adequately tracked by the grantees.
- ◇ Selected a sample of draw downs to determine whether they were for eligible and actual expenditures of the Up-Front Grant and supported with appropriate documentation.

- ◇ Obtained Progress and Inspection Reports identifying the status of work performed at Park Lee, Chesapeake Townhouses, and Oakmont North.
- ◇ Performed on-site inspections of the projects and noted areas of completed construction.

We conducted the audit in accordance with generally accepted government auditing standards.

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HUD Is Not Following Program Guidelines When Awarding Up-Front Grants

HUD is not following many of its more significant program guidelines and procedures for selecting and awarding Up-Front Grants. Specifically, the Department does not perform financial feasibility or economic viability studies to determine whether projects it is considering for the Up-Front Grant Program will be cost effective and self-sufficient after rehabilitation. Additionally, the Department is not determining whether the selected projects are located in tight rental markets to ensure there is a need to develop the affordable housing. HUD officials have indicated program regulations allow the Department to exercise its discretion in awarding grants. However, the Department has not documented its decisions when applying this flexibility. Thus, it is questionable whether grants awarded under the Up-Front Grant Program, as currently administered, meet the eligibility requirements and will be viable on a long-term basis. In the long run, this may jeopardize the program mission of preserving affordable rental housing and has resulted in General Insurance Funds being used for projects that are not cost effective.

Criteria

Section 1701Z-11 of the National Housing Act, states the Department's goals in the disposition of multifamily projects are to dispose of projects in a manner that will protect the financial interests of the Federal Government.

Public Law 104-99, Section 401, The Balanced Budget Down Payment Act I, allowed HUD to use General Insurance Funds for rehabilitation and other related development costs of Secretary-owned multifamily properties.

In 1995 and 1996 HUD issued written guidelines for HUD Multifamily Directors to follow when considering HUD acquired property for the Up-Front Grant Program. These guidelines reinforced the intent of the program which was to preserve affordable rental housing. Specifically, guidance included the following provisions:

- Up-Front Grants are for subsidized projects that in the opinion of the local offices should be preserved and are financially feasible, specifically, the grant is more cost effective than amortizing a rehabilitation loan with project based Section 8 assistance;
- Primarily for affordable rental housing; and

- Not complete demolition.

In a February 28, 1997 memorandum from the Director, Office of Multifamily Asset Management and Disposition, HUD clarified its award procedures for Up-Front Grants. Eligibility requirements in the memorandum included the following:

- Projects must be located in an area where the vacancy rate is less than 7%;
- HUD funding is limited to the lesser of 50% of total development cost not to exceed \$40,000 per rehabilitated unit; and
- Projects must be financially feasible without operating subsidy.

The Department Is Not Following Its Award Procedures

In order to evaluate the administration of the Up-Front Grant award process, we judgmentally selected and reviewed 28 grants, including 15 administered by the Atlanta Multifamily Property Disposition Center and 13 by the Fort Worth Multifamily Property Disposition Center. The Atlanta and Fort Worth Multifamily Property Disposition Centers have administered the Up-Front Grant Program since 1998. Except for addressing the vacancy rate for one grant, we found the Department did not follow its grant selection guidelines for any of the grants selected. Even though policy memorandums clearly detailed program requirements, HUD did not: conduct financial feasibility and economic viability studies to determine whether projects were cost effective and would be self sufficient after rehabilitation; nor did they perform a market analysis to determine whether the selected projects were located in tight rental markets.

HUD property disposition staff complete HUD Form 9650, (Sales Analysis, Foreclosure/HUD-Owned Project Multifamily Property Disposition Program), to establish a project's marketability in anticipation of a foreclosure sale. This is done for all multifamily projects coming into inventory. If the project has a negative value it is considered a potential candidate for an Up-Front Grant. This initial determination is the only objective analysis performed prior to the Department entering into

negotiations with local government units and awarding Up-Front Grants. HUD officials asserted financial feasibility, economic viability and vacancy rate issues were discussed on a case-by-case basis, but they did not document the results, and as such, could not provide these determinations to us for our review. HUD Property Disposition staff indicated they use the 9650 disposition analysis to determine the financial feasibility and economic viability of a project.

Our review of disposition narratives and 9650 analysis forms indicated the disposition analysis does not adequately evaluate unique characteristics of the Up-Front Grant Program. Furthermore, there is no indication that the Department used the 9650 disposition analysis in its decision making process. We found:

- The 9650 disposition analysis often did not consider important elements required in post rehabilitation feasibility assessments to include significant unit reduction, demolition, redevelopment, and after rehabilitation debt service requirements;
- In some cases the disposition analysis was not completed or completed after the execution of the Up-Front Grant Agreement;
- In several instances the disposition analysis conflicted with the determination to award an Up-Front Grant. Specifically, analysis determined the projects were located in blighted, crime ridden, and soft rental market areas and recommended complete demolition and/or public sale with no use restrictions.

As discussed, we found no credible evidence that indicated HUD actually considered key selection criteria in its selection process and; therefore, we question the eligibility and long-term viability of the projects that were awarded the grants.

In our review, we did note the Multifamily Property Disposition Centers had made progress in ensuring projects, that were awarded Up-Front Grant funds, planned to retain a substantial portion of the original units after rehabilitation, and planned costs were in line with total development cost

limitations. Although these noted improvements indicate the Department at least considers the program's mission of preserving affordable rental housing, there is no assurance projects selected meet the eligibility requirements and will be viable on a long-term basis because most of the key selection criteria are not used in making the final award determinations.

From our selected sample, we identified a number of grants that clearly did not preserve affordable rental housing and were not cost effective. Three of the more pertinent examples are discussed in more detail below.

Jefferson Village:

In 1996 HUD awarded \$10,625,000 to the RRHA for the complete demolition of Jefferson Village, a 376 unit HUD foreclosed multifamily property. At the time of the award Up-Front Grants could not be used for complete demolition. Under the project award the grantee was to develop 100 single family homes (not for rental) of which only 30 would be made available as affordable housing.

In 1998, the Department allowed the RRHA to amend the terms of the grant, straying even further from the program intent of preserving affordable rental housing. Specifically, under the terms of the amendment the RRHA deeded 11 acres of the improved site to the city for the construction of an elementary school. Consequently, the proposed number of single family homes at Jefferson Village was reduced over 50 percent from 100 to 45. Even though the grant was amended in 1998, and HUD has hinted at reducing the size of the grant to reflect the changes, the Up-Front Grant has not been reduced to reflect the reduced scope as intended. Based on the OIG's calculations, if the dollar amount of this grant is not reduced, the cost of developing each single family home will be approximately \$236,111.

As of November 1999, the RRHA had drawn over \$2.9 million of grant funds and the development of the 45 homes had not begun. However, in a recent drive by we did note construction of the homes has started.

Geneva Towers

In September 1996, HUD awarded \$7,770,000 to the Mercy Charities Housing California and the Geneva Valley Development Corporation. The Grant Agreement called for the construction of 44 low-income rental units and a Community Facility. HUD demolished the existing 576 unit structure prior to awarding the grant. The demolition of 576 units and redevelopment of only 44 townhouses does not appear to meet the program intent of preserving affordable housing.

Hill Manor Apartments:

In 1998 HUD awarded the Newark Housing Authority \$24,659,215 to completely demolish a vacant 420 unit structure and construct 100 townhouses, a community center, and a waste treatment facility. Based on OIG calculations, the cost of developing each townhouse will be approximately \$246,000. Additionally, the demolition of 420 vacant units and the redevelopment of only 100 townhouses as well as a waste treatment facility does not appear to meet the program intent of preserving affordable housing. HUD officials stated that even though the grant was awarded in 1998, subsequent to revised program guidelines, the contract of sale was signed in 1996, and; therefore, the revised guidelines were not applicable.

When asked about the high cost and questionable purpose of these grants, HUD officials stated that because the Up-Front Grant Program guidelines were not statutory, the program has flexibility and certain requirements can be waived. Additionally, Department officials stated that since prior awards were so expensive and funded entirely with HUD funds, they now require that all grants initiated after the February 1997 revised program guidelines meet the total development cost limitations (TDC) of \$40,000 per unit not to exceed fifty percent of total development costs.

* * * *

In summary, the Department has clearly defined program guidelines that need to be followed when awarding Up-Front Grants. Unless these guidelines are followed it is

questionable whether the Up-front Grant Program will successfully accomplish its program mission of preserving affordable rental housing on a long-term basis.

Auditee Comments

HUD officials agreed with the recommendations and indicated they are in the process of revising procedures and working with the property disposition centers' to address the issues. Additionally, HUD officials commented on other areas of the finding they believed needed clarification and/or modification.

Regarding grants that were cited as not being cost effective, HUD officials indicated it was appropriate to reduce the project density from housing that is not feasible to maintain. Specifically, HUD officials indicated in the case of Hill Manor 100 feasible low-income units can be an appropriate replacement for 432 infeasible units. Regarding Geneva Towers, HUD officials indicated the grant was part of a larger affordable housing plan detailed in a Memorandum of Understanding (MOU) with the City of San Francisco resulting in 398 affordable housing units.

HUD officials also stated the report does not appear to support the conclusion that not complying with program guidelines will lead to a program that will not successfully meet the program mission, since even if Housing fully documented awards and watched the grantee closely, problems will arise.

OIG Evaluation of Auditee Comments

We commend Housing's commitment to implementing recommendations and improving its Up-Front Grant Program. Additionally, we agree that decisions to demolish, reconfigure, and reduce unit density may be appropriate in grant awards. However, as stated in the finding, the examples were illustrative of awards that reduced the total number of units over 80 percent, and per unit rehabilitation costs exceeded \$175,000. Housing did not document its decisions and without any compelling rationale to the contrary, the examples cited did not maintain affordable housing and were not cost effective.

Regarding Geneva Towers, the MOU with the City of San Francisco lays the groundwork for a partnership committed to the revitalization of the Visitacion Valley. However, the Geneva Towers Up-Front Grant was specifically funded for the development of 44 townhouses and all additional anticipated development would require funding from other sources.

We also agree that even if awards were made consistent with program guidelines and grantees were watched closely, that problems may still arise. However, effective monitoring and compliance with program requirements would clearly increase the likelihood of the program meeting its mission.

Recommendations

We recommend your office:

- 1A. Establish baseline measures and requirements for field staff to follow when completing financial feasibility studies that incorporate an evaluation of planned rehabilitation activity and that are consistent with program regulations. The HUD Form 9650 disposition analysis could be used in combination with additional analysis that evaluates the specific characteristics of the planned Up-Front Grant.
- 1B. Take appropriate administrative actions to ensure Up-Front Grant award determinations are made according to existing program requirements, and award determinations and decisions are clearly documented in program files.
- 1C. Reduce the size of the Jefferson Village Up-Front Grant to reflect anticipated redevelopment costs associated with the Up-Front Grant as amended.

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HUD Does Not Adequately Monitor Its Up-Front Grant Program

HUD is not adequately monitoring Up-Front Grant awards during the project rehabilitation process, nor has HUD implemented any post rehabilitation monitoring. Due to staff limitations, HUD's Atlanta and Fort Worth Multifamily Property Disposition Centers rely on contracts with architectural firms and one HUD engineer to monitor the grants during project rehabilitation. However, the architects and engineers only assess grantee progress during rehabilitation, not a grantee's financial administration and compliance with the Grant Agreements. Because of these monitoring deficiencies, HUD has approved and paid significant funds to a number of grantees that are not complying with grant requirements and HUD is now in the position of dealing with grantee performance problems. In addition, since HUD has not implemented any post rehabilitation monitoring, it has no assurance completed projects meet the program mission of preserving affordable rental housing.

HUD's Monitoring During Project Rehabilitation is not Adequate

The two Multifamily Property Disposition Centers, Atlanta and Fort Worth, are responsible for administering the Up-Front Grant Program. The Atlanta Center relies exclusively on contract architects to monitor the progress of grantee rehabilitation. The Fort Worth Center has a HUD engineer perform progress inspections of grants located in the Southwest District and a combination of contract architects and field staff to monitor the rest of the grants.

As detailed below, HUD monitoring during the rehabilitation process does not evaluate whether grantees are complying with the terms and conditions of the grant agreement and program regulations.

Atlanta Multifamily Property Disposition Center

The Atlanta Multifamily Property Disposition Center relies on its contract architects to review the progress of Up-Front Grants and the architects recommend whether grantee vouchers should be approved for payment. However, we found the architects are only inspecting the to-date progress of rehabilitation and approve all payments including soft costs (grantee administrative salaries, development costs, etc.) without regard to the status of rehabilitation, as long as the payment request does not exceed the total budgeted amount.

As part of our review of the Up-Front Grant Program we visited four grantees in Virginia whose grants are administered by the Atlanta Center. These grantees included the Richmond Redevelopment and Housing Authority (RRHA), Richmond Better Housing Coalition (RBHC), Norfolk Redevelopment and Housing Authority (NRHA), and Chesapeake Redevelopment and Housing Authority (CRHA). Our review of a sample of draw downs for these grantees disclosed that the grantees were not complying with the terms and conditions of the Grant Agreements. Specifically, we found:

- three of the four grantees did not maintain adequate documentation to support more than \$1.1 million of draw downs;
- two of the four grantees drew down funds exceeding their 30 day needs;
- one of the grantees did not have an executed Grant Agreement; and
- one of the grantees has expended over \$2.9 million including over \$800,000 for administrative salaries and development fees without making any significant progress in meeting its objective of providing affordable housing (see Finding 1).

As previously discussed the contract architects were primarily concerned with monitoring the progress of redevelopment and did not ensure grantees were complying with program regulations.

We discussed our observations with HUD officials from Headquarters and the Atlanta Multifamily Property Disposition Center. The Director said he did not have adequate staff to monitor the grantee and the architects, indicating an actual review of the grantees and the architects will take place when the grants are completed, and an independent audit is conducted. Further, the Director stated that HUD procurement officials indicated that monitoring of the contract architect is not required. However, a Headquarters official acknowledged the need for some oversight over the contract architects.

Fort Worth Multifamily Property Disposition Center

The Fort Worth Multifamily Property Disposition Center's staff engineer reviews and approves all grantee payment requests. The engineer inspects the projects during the rehabilitation and close out phases for grants that are located in the Southwest District and relies on contract architects to inspect projects that are not within the Southwest District.

Even though the engineer approves all requests for payments, we found supporting documentation was not maintained to ensure grantees are complying with the terms and conditions of the grant agreements. The engineer indicated he generally only approves soft costs (administrative and relocation expenses) based on the percentage of rehabilitation completed. However, in our review of grantee draw down requests we found documentation supporting both hard and soft costs was often not provided with the requests. The staff engineer said he only documents inspections when deficiencies are noted and does not require support for draw down requests submitted by the field offices.

We discussed our observations with HUD officials from Headquarters and the Fort Worth Multifamily Property Disposition Center. HUD officials from the Fort Worth Center acknowledged they do not monitor grants outside the Southwest District, and indicated it is the local field office's responsibility to ensure grantees are complying with Grant Agreements.

In addition to the Grantee performance problem identified during our site visit of Jefferson Village, we noted a number of other Grantees were not performing according to program requirements. For example, Up-Front Grant activity reports indicate very little work had been done on six Up-Front Grants awarded to the Cuyahoga Metropolitan Housing Authority even though \$1.8 million has been expended. Additionally, the Atlanta Multifamily Disposition Center staff indicated they were in the process of taking back two Up-Front Grants awarded to non-profits in Florida and New York. These two Grantee's have already expended over \$4 million of grant funds. These Grantee performance problems indicate a need for more effective monitoring of the grant award process.

HUD has not Implemented any Monitoring after projects are Completed

As of August 2000, 15 of the 64 Up-Front Grants have been completed with over \$75 million of HUD funds. However, the Department has not developed any post rehabilitation monitoring protocol to ensure that when projects are completed: (1) grantees comply with requirements to provide affordable rental housing to low-income families; and (2) rehabilitated units are in decent, safe, and sanitary condition.

HUD officials acknowledged that they have not implemented any post rehabilitation monitoring and indicated they are in the process of developing a system to address monitoring responsibility.

Our review also disclosed that HUD does not have an adequate management system for tracking the grantees to ensure that they meet the established timetables for completion of repairs. The Atlanta Multifamily Property Disposition Center has a tracking system, but it appears they are only tracking the status by the amount of funds drawn down and not the status of rehabilitation. The Fort Worth Disposition Center only tracks the amount of funds drawn down. Consequently, there is no assurance that grants are being completed timely.

* * * *

In summary, the Department needs to develop and implement comprehensive monitoring over the entire Up-Front Grant process. We believe that closer monitoring by HUD throughout grant process could have prevented the grantee noncompliance with grant requirements and provide greater assurance that the goals of the Up-Front Grant Program will be met.

Auditee Comments

HUD officials agreed with the recommendations and indicated they are in the process of revising procedures and working with the property disposition centers' and grantees to address the issues.

Recommendations

We recommend your office:

- 2A. Strengthen its monitoring process during the rehabilitation period and develop and implement a system to monitor grant awards after rehabilitation is completed, to ensure grantees are complying with the terms and conditions of the Grant Agreements. At a minimum this process should include:
- quality reviews of contract architects;
 - periodic on-site inspections of projects being rehabilitated with grant funds;
 - annual inspections of rehabilitated projects to ensure they are meeting occupancy requirements and projects are being maintained; and
 - development of a management information system to globally assess whether grants are progressing according to time frames established in the grant agreement.
- 2B. Require the RBHC, RRHA, and NRHA provide documentation for the \$574,797, \$240,631 and \$308,398 unsupported costs, respectively, or repay amounts to HUD.

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Management Controls

In planning and performing our audit, we considered the management control systems of HUD and the grantees in order to determine our auditing procedures and to provide assurance on the management controls.

Management controls include the plan of organization, methods and procedures adopted by management to ensure that its goals are met. These controls include the processes for planning, organizing, directing, and controlling program operations, as well as the systems for measuring, reporting, and monitoring program performance. Management controls can be classified into four general groups: (a) controls over program operations, (b) controls over the validity and reliability of data, (c) controls over compliance with laws and regulations, and (d) controls over the safeguarding of resources.

Management Controls Assessed

We determined that the following management control categories were relevant to our objectives:

- HUD Monitoring of Grantees
- Up-Front Grant Award Process
- Grantee Administration

Significant Weaknesses Found

A significant weakness exists if management control does not give reasonable assurance that the entity's goals and objectives are met; that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data are obtained, maintained, and fairly disclosed in reports.

Based on our review, we believe the following items are significant weaknesses:

- HUD Monitoring of Grantees
- Grant Award Process
- Grantee Administration

These weaknesses are detailed in the findings in this report.

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Follow Up On Prior Audits

This is the first internal audit of the Up-Front Grant Program by HUD's Office of Inspector General. An Office of Inspector General audit related memorandum (report number 98-AO-219-1894) was completed for the Ridgcrest Height Apartments Up-Front Grant in September 1998. All recommendations have been closed or have reached management decision.

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Schedule Of Questioned Costs

Finding Number
2

Unsupported 1/
\$1,123,826

- 1/ Unsupported amounts were not clearly eligible or ineligible but warrant being contested for various reasons, such as the lack of satisfactory documentation to support eligibility.

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Auditee Comments

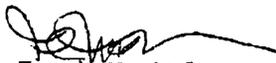


U. S. Department of Housing and Urban Development
Washington, D.C. 20410-8000

OFFICE OF THE ASSISTANT SECRETARY
FOR HOUSING-FEDERAL HOUSING COMMISSIONER

SEP 29 2000

MEMORANDUM FOR: Daniel G. Temme, District Inspector General
for Audit, Mid-Atlantic, 3AGA


FROM: Frank M. Malone, Director, Office of Multifamily
Asset Management, HTG

SUBJECT: Internal Audit
Case Number 00-PH-119001
Up-Front Grant Program

This is in response to your subject draft audit report. At the onset I wish to thank your staff for keeping my staff informed of its findings during the process of the review. Such early notice has given us an opportunity to start to resolve the issues we had not already started to address ourselves.

We are responding to the draft in two attachments. The first addresses your recommendations. The second provides comments on the body of the draft report itself.

I also would like to reaffirm my request that the report be revised to differentiate, to the extent possible, the issues that arose from sales before Housing instituted the \$40,000 per unit limit on grants from the FHA Fund, and the move of the administration of the program to the Multifamily PD Centers.

Attachment 1

Housing's Responses to the Draft Recommendations

1A -

OIG Recommendation. Establish baseline measures and requirements for field staff to follow when completing financial feasibility studies that incorporate an evaluation of planned rehabilitation activity and that are consistent with program regulations. The HUD Form 9650 disposition analysis could be used in combination with additional analysis that evaluates the specific characteristics of the planned Up-Front Grant.

Housing's response. As a result of early communications between Housing and your office, Housing has already begun to review its procedures and will revise them as may be needed to address the IG's recommendation. As part of this effort, Housing already is in the process of revising the Form HUD 9650, and may make revisions to other documents used in the disposition process. For example, Housing plans to develop a disposition checklist to assure Up-Front Grant criteria are met.

1B -

OIG Recommendation: Take appropriate administrative actions to ensure Up-Front Grant award determinations are made according to existing program requirements and award determination and decisions are clearly documented in program files.

Housing's response: As a result of early communications between Housing and your office, Housing has already begun to review its procedures and will revise them as may be needed to address the IG's recommendation. As part of this effort, Housing already is in the process of revising the Form HUD 9650, and may make revisions to other documents used in the disposition process. For example, Housing plans to develop a disposition checklist to assure Up-Front Grant criteria are met.

In addition, Housing Headquarters will re-emphasize to the PD Centers the importance of following existing Up-Front Grant guidelines and documenting each decision.

1C -

OIG Recommendation: Reduce the size of the Jefferson Village Up-Front Grant to reflect anticipated redevelopment costs associated with the Up-Front Grant as amended.

Housing's response: The Atlanta Multifamily Property Disposition Center has been diligently working with the Richmond Redevelopment and Housing Authority (RRHA) on this matter. The RRHA agrees with HUD that the Up-Front Grant should be reduced in proportion to the reduction in the number of single family houses to be constructed on the site.

The Atlanta Multifamily PD Center is working with the RRHA to verify Up-Front Grant expenses and draws. By letter dated September 1, 2000, the Atlanta Multifamily PD Center informed RRHA that HUD cannot approve further draws or obligations until all expenditures have been clearly documented and reconciled against what was allowed under the Up-Front Grant.

The Atlanta Multifamily PD Center is negotiating with the RRHA, a reduced Up-Front Grant to reflect the lesser number of units to be built. We anticipate that both issues will be resolved no later than April 1, 2001.

2A -

OIG Recommendation: Strengthen its monitoring process during the rehabilitation period and developed and implement a system to monitor grant awards after rehabilitation is completed to ensure grantees are complying with the terms and conditions of the Grant Agreements. At a minimum this process should include:

- quality review of contract architect;
- periodic on site inspection of project being rehabilitated with grant funds;
- annual inspection of rehabilitated projects to ensure they are meeting occupancy requirements and that projects are being maintained; and
- the development of a management information system to globally assess whether grants are progressing according to time frames established in the grant agreement.

Housing's response:

1. Housing will direct the PD Centers to conduct periodic quality reviews of their contract architects and perform periodic on-site inspection of projects being rehabilitated with grant funds.
2. Housing will develop a management information system to globally assess whether grants are progressing according to time frames established in the grant agreement.

HUD anticipates that items 1 and 2 will be completed by April 1, 2001.

3. Housing acknowledges the need to monitor properties after completion of Up Front Grant rehabilitation under a grant, and have considered a plan. However, Housing can not agree to annual physical inspections of these properties at this time. Such an effort requires additional staff and funding and neither are provided for in the current budget. This undertaking needs significant analysis before a management action can be implemented.

2B -

OIG Recommendation: HUD should require the RBHC, RRHA, and NRHA provide documentation for the \$574,797, \$240,631 and \$308,598, unsupported costs, respectively, or repay amounts to HUD.

Housing's response: HUD will continue working with RBHC, RRHA, and NRHA to obtain documentation that will support draw downs.

Attachment 2**Housing's Comments on the Body of the Report**

Page iii, 3rd paragraph. Nothing in the regulations or our procedures talk to a goal of providing "additional" housing through the use of an Up front Grant. This should be corrected. Also, in the last sentence, the report says that the lack of documentation "may jeopardize the program mission..." Statements of conjecture should not be in this report.

Page iv, 2nd paragraph. The report uses the word "ensure". These statements are especially interesting, since you informed us that in the Holiday lakes case, the file was well documented, and we monitored the grantee, but the deal failed. We recommend that you balance your statements with an acknowledgment that **even if Housing fully documented the reason for a deal and watched the grantee closely, problems may arise.**

Page 6, last paragraph. The report uses the term "market value". PD never establishes "value" of any kind. PD establishes "as-is" and "as-repaired" prices.

Page 8, Demolition and rebuilding a smaller number of units (Geneva Towers and Hill Manor) . A decision to demolish and rebuild follows a decision that the type and configuration of existing housing is not feasible to maintain. In many cases unit density on the site, and high-rise versus townhouse suitability for family housing are considerations. In those cases it is not appropriate to measure a *feasible* density or unit type against the number and density which were infeasible.

Regarding Geneva Towers, that sale and grant was part of a large affordable housing plan for the area, of which the demolition of Geneva was essential. We have been informed by our San Francisco Hub that the entire plan, which included the Geneva site and several others, resulted in 398 affordable housing units.

Regarding Hill Manor. 100 feasible low-income units can be an appropriate replacement for 432 infeasible units, and can meet the program intent of preserving as much as possible, affordable housing.

Page 9, 2nd paragraph, last sentence. The report does not appear to support the conclusion that the alleged lack of compliance with some program guidelines will lead to an Up Front Grant program that will not successfully accomplish the program mission. Again, **even if Housing fully documented the reason for a deal and watched the grantee closely, problems will arise.**

Page 13, 1st paragraph. We are not aware that local HUD offices have "architects that are hired by local HUD field offices to inspect projects...". We believe this needs to be clarified.

Page 13, 2nd paragraph, last sentence. Please clarify this statement. Is the report saying that the field offices submitting draw requests to the engineer are not doing any monitoring, they just pass the draw requests on to the engineer?

Page 23. Regarding the cumulative amount of HUD funding in a sale, **we recommend you delete this section of the report.** The Up Front Grant \$40,000 limit is an **FHA Fund** limit. It takes multiple sources to rehab/rebuild affordable housing in this country today. And current Up Front Grant guidelines require local commitments.

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