



City of Paterson, NJ

HOME Investment Partnerships Program



To: Anne Marie Uebbing
Director Community Planning and Development, 2FD

//SIGNED//

From: Karen A. Campbell-Lawrence
Acting Regional Inspector General for Audit, 2AGA

Subject: The City of Paterson, NJ's HOME Investment Partnerships Program Controls Did Not Ensure Compliance With Regulations

Enclosed is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG), final audit report on our review of Jersey City, NJ's HOME Investment Partnerships Program.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at <http://www.hudoig.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at 212-264-4174.



Audit Report Number: 2015-NY-1005

Date: April 30, 2015

**The City of Paterson, NJ's HOME Investment Partnerships Program
Controls Did Not Ensure Compliance With Regulations**

Highlights

What We Audited and Why

We audited the City of Paterson, NJ's HOME Investment Partnerships Program based on a risk analysis of the City's program that considered the amount of funding, the risk score assigned by the U.S. Department of Housing and Urban Development (HUD), our identification of potential issues, and Congress' general interest in the HOME program. The objective of the audit was to determine whether City officials had established and implemented adequate controls to ensure that the City's HOME program was administered in compliance with HOME program requirements and Federal regulations.

What We Found

The City's HOME program was not always administered in compliance with program requirements. Specifically, HOME funds were (1) not committed in accordance with program requirements, (2) spent on ineligible and unsupported costs, (3) reserved and disbursed to ineligible community housing development organizations (CHDO), (4) drawn down in excess of need and not reimbursed for terminated activities, and (5) used to assist ineligible and unsupported home buyers and homeowners. We attribute these deficiencies to City officials' unfamiliarity with HOME subsidy limits, environmental requirements, and CHDO requirements; weaknesses in controls over subgrantee monitoring; and weaknesses in controls over certifying home buyers and homeowners for HOME assistance. As a result, \$1.8 million was unavailable for eligible activities; \$561,245 was disbursed for unsupported costs, more than \$2.2 million in CHDO reserve was ineligible; the CHDO reserve was underfunded by more than \$1.1 million; and HUD's interest in over \$1.37 million was not properly recorded.

What We Recommend

We recommend that HUD recapture \$844,640 in ineligible committed funds and instruct City officials to reimburse more than \$948,414 spent for ineligible costs, provide documentation to support that \$561,245 was spent on supported costs and activities, remove more than \$2.2 million in ineligible CHDO reserve, provide documentation for more than \$1.1 million in CHDO reserve, and properly record deed restrictions and affordability requirements so that HUD's interest in over \$1.37 million is protected.

Table of Contents

| | |
|---|-----------|
| Background and Objective..... | 3 |
| Results of Audit | 4 |
| Finding 1: Controls Over Administering Funds Did Not Ensure Compliance With Program Requirements | 4 |
| Finding 2: Controls Over Program Administration Did Not Ensure Compliance With Program Requirements..... | 8 |
| Scope and Methodology..... | 14 |
| Internal Controls..... | 16 |
| Appendixes..... | 18 |
| A. Schedule of Questioned Costs and Funds To Be Put to Better Use..... | 18 |
| B. Auditee Comments and OIG’s Evaluation..... | 20 |

Background and Objective

The HOME Investment Partnerships Program, authorized under Title II of the Cranston-Gonzalez National Affordable Housing Act as amended, is designed to create affordable housing opportunities for low-income households. The HOME program is the largest Federal block grant program, through which the U.S. Department of Housing and Urban Development (HUD) has allocated approximately \$2 billion annually in formula grants to States and hundreds of local governments for creating affordable housing for low-income households. HOME program regulations are found at 24 CFR (Code of Federal Regulations) Part 92, and HUD has provided additional program guidance in its guidebook, Building HOME, dated March 2008.

The HOME program allows States and local governments flexibility to use HOME funds for a variety of activities to address local housing needs through grants, direct loans, loan guarantees or other forms of credit enhancement, or rental assistance or security deposits. Participating jurisdictions may choose among a broad range of eligible activities, including home purchase or rehabilitation financing assistance to eligible homeowners and new home buyers, building or rehabilitating housing for rent or ownership, or other reasonable and necessary expenses related to the development of nonluxury housing, including site acquisition or improvement, demolition of dilapidated housing to make way for HOME-assisted development, and payment of relocation expenses.

HUD awarded the City of Paterson more than \$1.06 and \$1.04 million in HOME funds for program years 2013 and 2014, respectively. The City created 32 affordable housing units in program year 2013 and 9 in program year 2014. The City's HOME program is administered by its Community Development Department and is overseen by the city council, which is the legislative branch of the City's government, consisting of six ward councilpersons and three members-at-large.

While the City's HOME program assisted different types of housing activities, including first-time home buyers, homeowners, and rental housing activities, the majority of the City's HOME drawdowns in program years 2010 and 2011 were provided for the acquisition, rehabilitation, and new construction of rental and home-buyer activities rather than homeowner activities. City officials used 69 and 71 percent of their HOME drawdowns for these activities in program years 2010 and 2011, respectively, and made no drawdowns in program year 2012.

The objective of the audit was to determine whether City officials had established and implemented adequate controls to ensure that the City's HOME program was administered in compliance with HOME program requirements and Federal regulations.

Results of Audit

Finding 1: Controls Over Administering Funds Did Not Ensure Compliance With Program Requirements

City officials did not always ensure that the City's HOME entitlement and program income funds were committed, spent, and recorded in compliance with HOME program regulations. Specifically, HOME entitlement funds were (1) not committed in compliance with HOME program requirements, (2) disbursed for HOME activities in excess of HOME program maximum subsidy limits, (3) drawn down in excess of need, and (4) used for unsupported HOME program costs. In addition, HOME program income was not always reported in HUD's Integrated Disbursement and Information System¹ (IDIS) or reconciled with the City's accounting records. We attribute these deficiencies to City officials' unfamiliarity with environmental review and maximum HOME subsidy limit requirements and weaknesses in the City's controls over reviewing payment requests submitted by subgrantees and reconciling financial information reported in IDIS with the City's accounting records. As a result, more than \$1.03 million in HOME funds was not made available for eligible activities in a timely manner; \$344,341 and \$125,810 in HOME funds were used for ineligible and unsupported costs, respectively; and \$119,566 in HOME funds was not accurately recorded in the City's accounting records.

HOME Funds Not Committed and Spent in Compliance With Program Requirements

City officials used an ineligible commitment of \$844,640 to meet the grant year 2009 commitment deadline of July 31, 2011. The funds were committed for an eligible housing activity; however, the City committed the funds without conducting an environmental review as required, and the funds exceeded HOME subsidy limits. The HUD Office of Community Planning and Development's (CPD) Notice CPD-01-11, section IV, provides that a participating jurisdiction must not execute a legally binding agreement for property acquisition, rehabilitation, conversion, repair, or construction until environmental clearance has been obtained, and regulations at 24 CFR 92.250 specify the maximum per-unit HOME subsidy amount. While the maximum HOME subsidy limit, effective as of July 31, 2011, for 10 2-bedroom units was approximately \$1.7 million, City officials committed \$2.6 million for 10 2-bedroom units. We attribute this deficiency to the City staff's unfamiliarity with HOME subsidy limit and environmental review requirements. As a result, \$844,640² of the City's HOME funds was not available for commitment to other eligible HOME activities.

¹ IDIS is the drawdown and reporting system for all of HUD's CPD formula grant programs, including the HOME program.

² Although environmental clearance is required before commitment of funds, since the clearance was obtained after commitment, we are not classifying the entire amount as ineligible, only the amount in excess of subsidy limits.

City officials also spent \$344,341 in excess of HOME subsidy limits. Specifically, they provided more than \$1.4 million in HOME funds to assist in the construction of four zero-bedroom and three three-bedroom rental units when the maximum HOME subsidy limit for the seven units should have been approximately \$1.2 million (($\$132,814 \times 4$) + ($\$239,506 \times 3$)). Regulations at 24 CFR 92.250(a) provide the maximum per-unit subsidy, which may not exceed the per-unit dollar limitations established under section 221(d)(3)(ii) of the National Housing Act. For 2012, the maximum subsidies for zero- and three-bedroom units were \$132,814 and \$239,506, respectively.

City officials spent

- \$592,000 for construction of three two-unit for-sale homes, although the maximum HOME subsidy limit for the three homes should have been \$480,636 ($\$160,212 \times 3$). The City's HOME agreement in effect in 2008 provided that the maximum HOME subsidy for two-unit for-sale homes was \$160,212.
- \$31,132 and \$42,075 in home-ownership rehabilitation deferred loans for the rehabilitation of two one-family owner-occupied dwelling units, although the maximum HOME subsidy limit for each unit should have been \$30,000. The City's rehabilitation policy provides that the limit on the amount of deferred loan payment for a one-family owner-occupied dwelling unit is \$30,000.

We attribute these deficiencies to City officials' unfamiliarity with the HOME subsidy limit. As a result, \$344,341 represented an ineligible subsidy and, thus, was not available for other eligible HOME activities.

Funds Drawn Down in Excess of Need

City officials did not return to the City's HOME program line of credit \$113,849 drawn down in excess of need. Regulations at 24 CFR 92.502(c)(2) provide that any funds that are drawn down and not spent for eligible costs within 15 days of the disbursement must be returned to HUD for deposit into the participating jurisdiction's U.S. Treasury account of the HOME Investment Trust Fund. However, City officials drew down \$30,000 in December 2010 for use as a deferred loan for a first-time home buyer, who later declined the loan, and \$83,849 in April 2011 for a homeowner rehabilitation activity in excess of the deferred loan amount of \$25,941 disbursed. We attribute this deficiency to weaknesses in the City's financial controls over the tracking of drawdowns. As a result, \$113,849 was not available to fund other eligible HOME activities.

Unsupported HOME Program Costs

City officials did not maintain documentation, such as invoices, contractor requests for payment, and canceled checks, to support the use of \$125,810 in HOME drawdowns made for three HOME activities. We attribute this deficiency to weaknesses in the City's financial controls over reviewing payment requests submitted by subgrantees. Regulations at 24 CFR 85.20(a)(6) provide that accounting records must be supported by source documentation, such as canceled checks, paid bills, payrolls, time and attendance records, and contract and subgrant award documents. Therefore, there was no assurance that \$125,810 was spent on eligible HOME costs.

Program Income Not Reported in IDIS

City officials did not report in IDIS \$73,753 in program income generated during HOME program years 2009 and 2010. We attribute this deficiency to weaknesses in the City's financial controls over accounting for and recording HOME program income and inadequate communication between the City's accounting and program departments. Notice CPD-97-09, section III, provides that IDIS is designed to record the receipt and use of HOME program income and the participating jurisdiction should establish a program income fund in IDIS to record the receipt of program income. Therefore, City officials drew down entitlement funds instead of using the unreported program income, and the City's program income recorded in IDIS was understated by \$73,753.

Information in IDIS Not Always Reconciled With the City's Accounting Records

City officials did not always reconcile the information recorded in IDIS with the City's accounting records. Regulations at 24 CFR 85.20(b)(1) require grantees to maintain accurate, current, and complete disclosure of the financial results of financially assisted activities in accordance with the financial reporting requirements of the grant or subgrant. However, \$91,133 and \$28,433 had been included in the City's accounting records as available program income until December 19, 2014, although IDIS information showed that the \$91,133 and \$28,433 had been spent in November 2013 and February 2014, respectively. We attribute this deficiency to inadequate communication between the City's accounting and program departments. As a result, available program income reported in the City's accounting records was overstated by \$119,566.

Conclusion

City officials did not always ensure that the City's HOME entitlement and program income funds were committed, spent, and recorded in compliance with program requirements. HOME funds were (1) not committed in compliance with HOME program requirement, (2) spent on housing units in excess of HOME subsidy limits, (3) Line of Credit Control System drawdowns reported in IDIS for unnecessary needs, and (4) spent on ineligible and unsupported costs. We attribute these deficiencies to City officials' unfamiliarity with HOME requirements for environmental review and maximum HOME subsidy limits, weaknesses in the City's reviewing payment requests submitted by subgrantees, and inadequate communication among City departments. As a result, HOME funds were not made available for eligible activities in timely manner, and there was no assurance that HOME funds were always used for eligible HOME costs.

Recommendations

We recommend that the HUD Director of Community Planning and Development instruct City officials to

- 1A. Repay the \$844,640 in HOME funds committed contrary to program regulations so that these funds can be recaptured in accordance with Federal regulations.
- 1B. Develop financial controls to ensure that HOME funds are committed and reported in compliance with program requirements.

- 1C. Reimburse the City's HOME program line of credit \$344,341 from non-Federal funds for assistance provided in excess of HOME subsidy limits.
- 1D. Strengthen the City's financial controls to ensure that HOME funds are not used to assist HOME units in excess of HOME subsidy limits.
- 1E. Reimburse the City's HOME line of credit for \$113,849 that was drawn down in excess of need so that these funds can be put to better use.
- 1F. Strengthen the City's financial controls to ensure that HOME drawdowns are spent within 15 days of the drawdown date or return the funds to the City's HOME program line of credit as required.
- 1G. Provide documentation to support that \$125,810 in costs charged to the three unsupported HOME activities was for eligible costs, and if such documentation cannot be provided, reimburse the City's HOME program line of credit from non-Federal funds.
- 1H. Strengthen the City's financial controls to ensure that documentation is maintained to support the eligibility of costs paid from HOME funds.
- 1I. Record \$73,753 in program income in IDIS and use it before making further entitlement drawdowns, thus ensuring that \$73,753 in program income is properly accounted for and put to better use.
- 1J. Strengthen controls to ensure that program income is reported in IDIS in a timely manner and used before the City makes entitlement drawdowns.
- 1K. Reconcile the \$119,566 discrepancy between IDIS and the City's accounting records, thus ensuring that this amount will be put to better use.
- 1L. Strengthen the City's financial controls to ensure that financial information reported in IDIS and the City's records is reconciled.

Finding 2: Controls Over Program Administration Did Not Ensure Compliance With Program Requirements

City officials did not implement adequate controls to ensure that they administered the City's HOME program in compliance with HOME program requirements. Specifically, HOME funds were reserved and provided to ineligible community housing development organizations³ (CHDO), to ineligible and unsupported home buyers and homeowners, and for properties without maintaining documentation regarding environmental clearance. In addition, deed restrictions were not always properly imposed on units assisted with HOME funds, and the City's HOME activities' information reported in IDIS was not always accurate. We attribute these deficiencies to weaknesses in the City's administrative controls over certifying CHDOs, home buyers, and homeowners for HOME assistance and City officials' unfamiliarity with environmental review requirements. As a result, the City's CHDO reserve was overstated by more than \$2.2 million; \$604,073 and more than \$1.53 million in HOME funds were used for ineligible and unsupported costs, respectively; and more than \$1.37 million was spent on six HOME projects that did not have deed restrictions or had inadequate deed restrictions.

Ineligible CHDO Reserve Reported in IDIS

City officials reserved and disbursed more than \$2.2 million in HOME funds to three ineligible CHDOs. They had provided more than \$1.9 million in HOME CHDO funds to two organizations to meet the City's 15 percent CHDO reserve requirement as of June 30, 2014, although the two entities had not been certified as CHDOs. Regulations at 24 CFR 92.300 provide that participating jurisdictions must make reasonable efforts to identify CHDOs that are capable or can reasonably be expected to become capable of carrying out the elements of the participating jurisdiction's consolidated plan, and regulations at 24 CFR 92.2 provide that a CHDO means a nonprofit organization that meets 10 specific criteria and has been properly certified. Therefore, the more than \$1.9 million was ineligible as a CHDO reserve.

In addition, City officials reserved and disbursed \$257,445 in HOME CHDO funds to a third CHDO that was acting in the capacity of a developer-nonowner for a real property owned by the City. Notice CPD-97-11, section III(A), provides that a CHDO is a "developer" when it either owns a property and develops a project or has a contractual obligation to a property owner to develop a project and the contractual obligation is independent of the participating jurisdiction. Further, chapter 3 of HUD's Building HOME guidance provides that if a CHDO does not own the property, it must be under contractual obligation with the owner to obtain financing and rehabilitate or construct the project and if the CHDO develops the property for an owner under a written or other agreement with the participating jurisdiction, the CHDO is acting in the capacity of a subrecipient. Therefore, the \$257,445 was ineligible as a CHDO reserve.

³ A CHDO is a private nonprofit, community-based service organization that has obtained or intends to obtain staff with the capacity to develop affordable housing for the community it services.

As of June 30, 2014, the City had reserved more than \$5.8 million, or 18.3 percent, of its more than \$32.2 million in accumulated HOME entitlement to meet its 15 percent CHDO reserve requirement. However, after removing the ineligible CHDO reserve of more than \$2.2 million from the \$5.8 million, the City's CHDO reserve as of June 30, 2014, would have a shortfall of more than \$1.1 million to comply with the 15 percent requirement of more than \$4.8 million. We attribute this deficiency to the City staff's unfamiliarity with CHDO requirements. As a result, the City's accumulated CHDO balance was overstated by more than \$2.2 million, and the City's CHDO reserve was underfunded by more than \$1.1 million as of June 30, 2014.

HOME Assistance for Ineligible Home Buyers and Homeowners

City officials spent \$344,776 in HOME funds on the acquisition, construction, and rehabilitation of housing units that were sold to five home buyers whose annual income exceeded the HOME program income limits, as shown below.

| Home buyer | OIG Calculated annual income | HOME Program income limits |
|------------|------------------------------|----------------------------|
| 1 | \$75,461 | \$73,800 |
| 2 | 73,362 | 68,150 |
| 3 | 75,554 | 72,600 |
| 4 | 58,962 ⁴ | 58,400 |
| 5 | 69,350 | 65,700 |

We attribute this deficiency to weaknesses in the City's administrative controls over certifying applicants in compliance with HOME program requirements. Regulations at 24 CFR 92.254(a)(3) provide that a home buyer family must qualify as a low-income family, and regulations at 24 CFR 92.2 provide that a low-income family is a family whose annual income does not exceed 80 percent of the median income for the area. Therefore, \$344,776 in HOME funds was not available for eligible home buyers.

City officials also disbursed \$163,516 in HOME ownership assistance for the rehabilitation of housing units owned by two homeowners who were not eligible to receive assistance because they owned other real properties. We attribute this deficiency to weaknesses in the City's administrative controls over enforcing its rehabilitation policy. The City's HOME rehabilitation program policy, section (1)(A), provides that applicants who own more than one dwelling are not eligible for a HOME rehabilitation grant. Therefore, \$163,516 was not available for the rehabilitation of properties owned by eligible homeowners.

⁴ OIG calculated annual income did not include interest income on more than \$56,000 in a retirement plan, which should have been included in the household's annual income calculation.

HOME Assistance for Unsupported Home Buyers and Homeowners

City officials spent \$379,494 on the construction and rehabilitation of housing units that were sold to five home buyers whose income eligibility was not supported. We attribute this deficiency to weaknesses in the City's administrative controls over certifying applicants to acquire HOME-assisted units in compliance with HOME program requirements. Regulations at 24 CFR 92.508(a)(v) require that participating jurisdictions maintain sufficient records to support that each assisted family is income eligible in accordance with regulations at 2 CFR 92.203. However, City officials did not maintain documentation to support the income of all members in the home buyer household or income from assets. Therefore, there was no assurance that \$379,494 spent on construction and rehabilitation of HOME-assisted units went to income-eligible home buyers.

City officials disbursed \$55,941 in HOME ownership assistance for the rehabilitation of two properties without maintaining documentation to support that the owners' income made them eligible to receive HOME assistance. We attribute this deficiency to weaknesses in the City's administrative controls over certifying homeowners' eligibility to receive HOME ownership assistance. Regulations at 24 CFR 92.508(a)(3)(v) require that a participating jurisdiction maintain sufficient documentation to demonstrate that each family is income eligible in accordance with regulations at 24 CFR 92.203. Therefore, there was no assurance that \$55,941 in HOME ownership assistance was disbursed to homeowners who met the HOME program income requirements.

HOME Funds Disbursed for Two Undeveloped Properties

City officials disbursed \$95,781 to two subgrantees to construct two new for-sale housing units; however, the projects were terminated before the properties were constructed, and the funds were not returned to the City's HOME Investment Trust Fund. We attribute this deficiency to weaknesses in the City's administrative controls over monitoring its subgrantees' compliance with HOME agreements and ensuring the return of funds allocated to terminated projects. Regulations at 24 CFR 92.205(e) provide that projects that are terminated before completion, either voluntarily or otherwise, constitute an ineligible activity and any HOME funds invested in the project must be repaid to the participating jurisdiction's HOME Investment Trust Fund. Therefore, \$95,781 in HOME funds was not available for other eligible HOME activities.

Proper Deed Restrictions Not Imposed on Properties Assisted With HOME Funds

City officials did not impose or properly record deed restrictions or other mechanisms on six properties assisted with more than \$1.37 million in HOME funds. Regulations at 24 CFR 92.252(e)(1)(ii) and 254(a)(5)(i)(A) provide that a deed restriction, covenant running with the land, or other similar mechanism must be imposed on property assisted with HOME funds. Requirements included in the City's HOME resale restriction and long-term affordability mortgage and loan agreement provide that the HOME resale restriction agreement must be recorded with the recording office of the County of Passaic at the time assistance is provided by the City to the owner. However, City officials did not impose deed restrictions or other mechanisms on four properties assisted with \$527,116 in HOME funds. We attribute this deficiency to inadequate communication among City departments and City officials'

unfamiliarity with deed restriction requirements. Therefore, there was no assurance that the four properties would remain affordable during the affordability period as required.

In addition, City officials incorrectly imposed deed restrictions on two properties assisted with more than \$850,008. Regulations at 24 CFR 92.252(e) require that rental HOME-assisted units meet the affordability requirements for not less than the applicable period beginning after project completion, and regulations at 92.254(a)(4) require that home ownership HOME-assisted units meet the affordability requirements for not less than the applicable period beginning after project completion. Further, regulations at 24 CFR 92.2 provide that project completion means that all necessary title transfer requirements and construction work have been performed, the project complies with the property standards, and the project completion information has been entered into IDIS. However, City officials recorded deed restrictions on the four properties, which were effective from the date of the subgrantee agreements between the City and the subgrantees, despite the fact that the four properties had not been completed as of July 9, 2014. We attribute this deficiency to inadequate communication among City departments and City officials' unfamiliarity with deed restriction requirements. As a result, there was no assurance that the four properties would remain affordable during the correct affordability period as required.

Inadequate Information Entered Into IDIS

City officials entered incorrect completion status and home-buyer information into IDIS for three HOME activities. Regulations at 24 CFR 92.2 and 92.502(d) provide that necessary title transfer requirements, compliance with property standards under regulations at 24 CFR 92.251, and project completion information must be entered to complete a project in IDIS. However, City officials recorded these activities as complete in IDIS, although they had not obtained a certificate of occupancy showing compliance with local codes for one activity and not all units in the other two activities had been sold to home buyers. We attribute this deficiency to weaknesses in the City's administrative controls over monitoring subgrantees and ensuring the accuracy of information entered into IDIS and miscommunication among City departments. As a result, there was no assurance that the City's information entered into IDIS was accurate.

HOME Activities Not Always Administered in Compliance With Program Requirements

City officials did not always administer acquisition, rehabilitation, and new construction activities for rental, home-buyer, and home-ownership properties assisted with HOME funds in compliance with HOME program requirements. Specifically,

- HOME funds were committed in IDIS for 10 of the 22 rental, home-buyer, and home-ownership activities reviewed before HOME subgrantee agreements were executed, contrary to regulations at 24 CFR 92.2, which provide that funds must be committed when a legally binding agreement is executed between the grantee and the subgrantee.
- HOME funds were spent for 4 of the 22 rental, home-buyer, and home-ownership activities reviewed before HOME subgrantee agreements were executed, contrary to regulations at 24 CFR 92.504(b), which require a grantee to enter into a written agreement with a subgrantee that ensures compliance with requirements of Part 92 before disbursing any HOME funds to any entity.

- 2 of 7 housing units had an estimated value after rehabilitation in excess of 95 percent of the median purchase price for the area, contrary to regulations at 24 CFR 92.254(b)(1), which require that the estimated value of the property after rehabilitation not exceed 95 percent of the median purchase price for the area.

We attribute these deficiencies to City officials' use of a city council resolution instead of an executed HOME subgrantee agreement to commit and spend HOME funds and City officials' misunderstanding of HOME program requirements for the maximum value of home-ownership property after rehabilitation. As a result, there was no assurance that the City's HOME housing activities were always administered in compliance with program requirements.

Conclusion

City officials did not always administer the City's HOME program in compliance with program requirements. HOME funds were reserved and disbursed to ineligible CHDOs, spent on housing units for ineligible and unsupported home buyers and homeowners, and spent on a property without documentation regarding environmental clearance as required. In addition, deed restrictions were not always imposed on units assisted with HOME funds, and the City's information entered into IDIS was not always accurate. We attribute these deficiencies to weaknesses in the City's controls over certifying its CHDOs, home buyers, and homeowners in compliance with program requirements. As a result, HOME funds were used for ineligible and unsupported costs, and the City's IDIS information was not always accurate.

Recommendations

We recommend that the HUD Director of Community Planning and Development instruct City officials to

- 2A. Reduce the City's CHDO reserve balance reported in IDIS as of June 30, 2014, for the ineligible CHDO reserve of \$2,229,445.
- 2B. Provide documentation to support the additional CHDO reserve of \$1,163,598 or reimburse the City's HOME program line of credit from non-Federal funds.
- 2C. Reimburse the City's HOME program line of credit \$344,776 from non-Federal funds for HOME assistance spent on housing units acquired by five ineligible home buyers.
- 2D. Reimburse City's HOME program line of credit \$163,516 from non-Federal funds for the two ineligible homeowners who owned other real properties.
- 2E. Provide documentation to support the income eligibility of the five home buyers assisted with HOME funds and if documentation cannot be provided, reimburse the City's HOME program line of credit \$379,494 from non-Federal funds.

- 2F. Provide documentation to support the income eligibility of the two homeowners who received home-ownership assistance and if documentation cannot be provided, reimburse the City's HOME program line of credit \$55,941 from non-Federal funds.
- 2G. Strengthen the City's administrative controls to ensure that CHDOs, home buyers, and homeowners are certified in compliance with HOME program requirements.
- 2H. Reimburse the City's HOME program line of credit \$95,781 from non-Federal funds for funds spent on the development of two housing properties that were later terminated from the program.
- 2I. Strengthen the City's administrative controls to ensure that HOME funds spent on terminated and undeveloped properties are returned to the City's HOME program line of credit.
- 2J. Impose deed restrictions or other mechanisms approved by HUD on the four properties assisted with HOME funds to enforce affordability requirements or repay \$527,116 from non-Federal funds to the City's HOME program line of credit.
- 2K. Revise deed restrictions to correct effective affordability periods for the four properties that had not been completed or repay more than \$850,008 from non-Federal funds to the City's HOME program line of credit.
- 2L. Strengthen the City's administrative controls to ensure that a deed restriction or other mechanism approved by HUD is imposed on properties assisted with HOME funds to ensure that HUD's interest in assisted properties is protected.
- 2M. Correct the reported completion status and home-buyer information recorded in IDIS for the three HOME activities for which incorrect information was recorded.
- 2N. Strengthen the City's administrative controls to ensure that information entered into IDIS is accurate and supported.
- 2O. Strengthen the City's administrative controls to ensure that HOME funds are committed in IDIS only after the City has an executed agreement and the estimated value of home-ownership property, after being rehabilitated, does not exceed 95 percent of the median purchase price for the area.

Scope and Methodology

The audit focused on whether City officials had established and implemented adequate controls over the City's HOME program to ensure that the program was administered in compliance with HOME program requirements and Federal regulations. We performed our onsite audit work at the City's Community Development Division located at 125 Ellison Street, 2nd Floor, Paterson, NJ, from August 2014 through January 2015. Our audit generally covered the period July 1, 2010, through June 30, 2013, and was extended as needed to meet our audit objective.

To accomplish our objective, we

- Reviewed relevant HOME program requirements and applicable Federal regulations to gain an understanding of the HOME administration requirements.
- Interviewed HUD and City officials.
- Obtained an understanding of the City's management controls and procedures through analysis of the City's responses to management control questionnaires.
- Reviewed the City's consolidated annual performance and evaluation reports and action plan for HOME program years 2010 through 2012 to gather data on the City's expenditures and planned activities.
- Reviewed reports from IDIS to obtain HOME disbursements and program income data for the audit period and reports from LexisNexis⁵ to obtain information related to real properties assisted with HOME funds. Our assessment of the reliability of IDIS and LexisNexis data was limited to the data sampled, and the data were reconciled with data in the City's records; therefore, we did not assess the reliability of these systems.
- Reviewed the City's organizational chart for its HOME program and its HOME program policies, including its first-time home-ownership, home Paterson pride rehabilitation, and accounting policies.
- Reviewed the latest HUD monitoring report, dated September 30, 2011, for the City's HOME program and city council resolutions for program years 2010 through 2012.
- Reviewed documentation for the annual recertification of two nonprofit entities that received CHDO reserve funds during program years 2010 through 2012.
- Selected and reviewed a nonstatistical sample of more than \$1.6 million, or 72 percent, of the City's total HOME funds drawn down in the years 2010 through 2012 and more than \$3.5 million from the City's HOME drawdowns made before or after the years 2010 through 2012. The sample was selected based on one or more of the following risk

⁵ LexisNexis maintains a vast collection of public records obtained from Federal, State, and local sources and various licensing agencies.

factors: a lien or deed restriction was not imposed on the assisted property, projects were progressing slowly, a HOME-assisted property was owned by the City, minor drawdowns were made for activities reported in IDIS as complete, and IDIS activities appeared to be over-subsidized.

- Reviewed documentation, including subgrantee agreements, environmental reviews, appraisal reports, deeds, invoices, contract requests for payment, and canceled checks, to support the eligibility of the 22 IDIS HOME activities included in our sample and to support the eligibility of costs associated with these 22 IDIS HOME activities.
- Reviewed a copy of bank statements associated with the City's HOME program and traced deposits to IDIS reports. Our assessment of the reliability of data included in bank statements and IDIS was limited to the data sampled, which were reconciled among different sources; therefore, we did not assess systems generating the data.
- Reviewed the eligibility of 15 home buyers of housing units developed by subgrantees, and 3 tenants occupying rental units assisted with HOME funds.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Internal Controls

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objective:

- Program operations - Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Compliance with laws and regulations - Policies and procedures that management has implemented to reasonably ensure that resources use is consistent with laws and regulations.
- Safeguarding resources - Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.
- Validity and reliability of data - Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiencies

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

- City officials did not always establish or implement adequate internal controls to ensure that resources were used in compliance with laws and regulations because HOME funds were (1) not committed as required, (2) provided to HOME activities in excess of HOME subsidy limits, (3) disbursed to ineligible CHDOs, (4) disbursed for housing units that were sold to

ineligible and unsupported home buyers, and (5) disbursed to rehabilitate home-ownership units that were owned by ineligible and unsupported owners. In addition, a deed restriction was not always imposed on properties assisted with HOME funds, and program income was not always reported in IDIS (see findings 1 and 2).

- City officials did not always implement adequate internal controls to ensure the achievement of program objectives because HOME housing activities were not always administered in compliance with program requirements and units assisted with HOME funds were sold to ineligible home buyers (see finding 2).
- City officials did not always establish or implement adequate internal controls to ensure that resources were safeguarded against waste, loss, and misuse as HOME funds were used for unsupported and ineligible costs (see findings 1 and 2).
- City officials did not always establish or implement adequate internal controls to ensure the validity and reliability of data because information in the City's accounting records was not always reconciled with that in IDIS, information listed in IDIS was not always supported and accurate, and the receipt of program income was not always reported in IDIS (see findings 1 and 2).

Appendixes

Appendix A

Schedule of Questioned Costs and Funds To Be Put to Better Use

| Recommendation number | Ineligible 1/ | Unsupported 2/ | Funds to be put to better use 3/ |
|-----------------------|--------------------|--------------------|----------------------------------|
| 1A | \$844,640 | | |
| 1C | 344,341 | | |
| 1E | | | \$113,849 |
| 1G | | \$125,810 | |
| 1I | | | 73,753 |
| 1K | | | 119,566 |
| 2A | 2,229,445 | | |
| 2B | | 1,163,598 | |
| 2C | 344,776 | | |
| 2D | 163,516 | | |
| 2E | | 379,494 | |
| 2F | | 55,941 | |
| 2H | 95,781 | | |
| 2J | | | 527,116 |
| 2K | | | 850,008 |
| Totals | \$4,022,499 | \$1,724,843 | \$1,684,292 |

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.
- 2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to

obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.


- 3/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. In this instance, if HUD directs City officials to implement our recommendation to
- Ensure that unnecessary drawdowns are returned to the City's HOME program line of credit, \$113,849 will be available for eligible HOME activities.
 - Ensure that program income receipts are reported in IDIS, \$73,753 in program income will be available for eligible HOME activities.
 - Reconcile the discrepancy between IDIS and City records, it can be assured that \$119,566 has been properly reported.
 - Require that deed restrictions be imposed or revised on the eight assisted properties, HUD's and the City's interest of more than \$1.37 million in HOME funds will be protected, and affordability requirements will be enforced.

Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments



City Hall
155 Market Street
Paterson, New Jersey 07505
(973) 321-1600
Fax: (973) 321-1555

RECEIVED
2015 APR 22 AM 8:12
US HUD
D16A

José "joey" Torres
Mayor

April 20, 2015

Ms. Karen A. Campbell-Lawrence
Acting Regional Inspector general for Audit
U.S. Department of Housing and Urban Development
Office of Inspector General
New York/New Jersey Region 2
26 Federal Plaza, Room 3430
New York, NY 10278

Dear Ms. Campbell-Lawrence:

I have reviewed with my staff a draft copy of the March 31, 2015 audit report of the City of Paterson's HOME Investment Partnership Program (HOME) prepared by the U. S. Department of Housing and Urban Development (HUD) Office of Inspector General (OIG) and would like to incorporate the following responses and comments into the report. My staff and I would first like to take this opportunity to express our continued appreciation to HUD for the support they have provided the City of Paterson in the past and we look forward to building on our relationship to improve our City's neighborhoods.

Our review of the various findings identified in the draft OIG audit report indicated that all of these issues took place during the time period of 2010 to 2014. Since I took office in July, 2014, I have implemented a program to ensure these issues are not replicated in the future. I have hired a new Director of Community Development who has significant experience in implementing community development projects and overseeing programs that utilize federal assistance. I have also reorganized the Department so that a focus can be placed on community development activities funded through HUD. I have given the new Director the mandate to strengthen policies and procedures within the Department to ensure that all federal rules, requirements and regulations are properly followed. I have authorized staff to obtain additional training so they gain a more comprehensive understanding of overseeing community development programs, HUD regulations and City policies. I have also retained the services of a consultant who specializes in real estate and community development and is certified by HUD in regulations. In addition, the new Director of the Department of Community Development is taking proactive measures to improve our financial controls, implement process improvement practices and ensure that the City is more effective in meeting our deadlines with regard to committing and expending our annual allocations of funds and reporting to HUD on our progress.

1

Comment 1

Auditee Comments

Ref to OIG Evaluation

Comment 2

Finally, I have instructed my staff to take the necessary corrective actions to address the findings in the OIG report. Much of our efforts to date in resolving these findings are outlined in this letter to you along with areas where the City is making changes. We are confident that over the coming years my administration will be successful in implementing a successful community development program that creates affordable housing opportunities and improves our City's communities while adhering to HUD's rules, requirements and regulations.

The draft OIG audit report identifies on page 5 that the City used \$344,341 in HOME funds that were in excess of the HOME subsidy limits. The majority of this finding is associated with one activity where the OIG auditors indicated to the City that the City spent \$219,769 in excess of HOME subsidy funds on seven units within a twelve unit rental housing development. To resolve this finding, the City negotiated with the developer of the housing complex to spread the subsidy across ten of the twelve units in this project thereby reducing the per unit HOME subsidy to below the HOME subsidy limit. The developer executed the revised document effectuating this change and a copy was sent to OIG evidencing that this finding has been resolved. Despite having addressed this finding, the draft OIG audit report does not reflect that the finding was satisfied.

Comment 3

Department staff has recently been trained on the per-unit HOME subsidy limits and ensuring that HOME funding in all projects is below these limits. The City's revised deed restriction for continued affordability documents that the City is now using for all HOME projects clearly states in the body of the document the per-unit HOME subsidy limit at the time the HOME assistance is provided so Department staff have a reference point in the future to ensure they are below this amount.

Comment 4

The draft OIG audit report identifies on page 5 that the City did not maintain proper documentation to support \$183,696 in HOME funds spent on three HOME activities. This finding is actually associated with two activities since the City satisfied one of these findings prior to OIG issuing the March 31, 2015 draft audit report. The two findings are broken down between \$177,699 for an affordable housing development and \$5,997 associated with a failed homeowner rehab program which was determined by City staff to be ineligible for the HOME program. The City researched the costs associated with the \$177,699 finding. We reached out to the developer to provide the required missing documentation to support these costs. Documentation associated with \$58,127 was identified by the developer and supplied to the City. The City has submitted this documentation to OIG. The City requested the developer of this project reimburse the City the balance of the unsupported costs in the amount of \$119,572.

Comment 5

Comment 3

As part of the organizational development activities underway in the Department of Community Development, the staff is being trained on the process of reviewing and approving vouchers. In the past, developers have attempted to rush the City's process to expedite payment often by intimidating the Department's program monitors. The training has been designed to instill in the Department staff that they have a fiduciary responsibility to make sure that HOME funds are spent in accordance with HUD regulations. Part of the training has been intended to improve the review process so staff has the knowledge to ensure that the supporting documentation is complete before seeking approval for funding. The other part of the training has been to build confidence in the program monitors to reject incomplete vouchers and not be intimidated by irate developers. Also,

2

**Ref to OIG
Evaluation**

Auditee Comments

Comment 6

the new Director of the Department has extensive experience in reviewing and approving construction vouchers for payment so she is well equipped to supervise the process to ensure that all required documentation is in place prior to approving vouchers for payment.

The second finding in the amount of \$5,997 is associated with staff salaries to review a failed homeowner rehab program that was incorrectly entered into the Integrated Disbursement and Information System (IDIS) as a program delivery activity instead of an administrative expense. These costs have been transferred in IDIS to the City's HOME administration account. Consequently, this finding should be satisfied.

Comment 7

The draft OIG audit report identifies on page 10 that the City did not impose or properly record deed restrictions on nine properties assisted with more than \$1.9 million in HOME funds. The City has restructured or created proper deed restriction documents on seven of these properties representing \$1.6 million in HOME funds. All of these documents have been properly executed and sent to Passaic County to be recorded. Six of the recorded documents have been returned to the City. Copies of these six documents have been forwarded to OIG evidencing that the City has addressed these issues. Despite having addressed these findings, the draft OIG audit report does not reflect that the findings were satisfied.

Comment 8

The City has also met with the developer of one of the three remaining properties to negotiate a deed restriction for their property representing an additional \$238,726 in HOME funds. The grantee in this project placed a deed restriction on the property so the housing units are restricted to benefit low-income households during the affordability period; however, the deed restriction in place only provides the grantee with the rights to enforce the deed restriction and not the City. The City requested that the developer execute an assignment of the existing deed restriction to provide the City with rights of enforcement. The grantee's lawyer is reviewing the proposed document and the City expects a resolution to this finding by the end of the second quarter of 2015.

Comment 3

For many years, the City always imposed a standard deed restriction and long-term affordability mortgage on all HOME-funded activities. During the period of 2010 to 2014, this document was either not used or was improperly executed resulting in many of the findings the City is facing in the draft OIG audit report. The new Director of the Department has once again implemented the use of this deed restriction document and has taken steps with the City's attorney and the City's consultant to ensure the document addresses all HUD regulations. While my administration can not erase the mistakes of the past four years, our actions have demonstrated that we are taking corrective active measures to prevent them in the future.

Comment 9

The draft OIG audit report identifies on page 11 that the City disbursed \$120,000 for a Home-assisted project without maintaining documentation to support that environmental clearance had been obtained. This finding is associated with a three-unit housing development built on three contiguous vacant properties. The City ordered the environmental report on all three properties; however, the environmental report in the file lists the address for only one of the three properties. Staff is confident that the inspector prepared one report for all three properties but did not reference all three addresses; however, this conclusion does not address the audit finding. To resolve this matter, the City provided OIG with the environmental review for the one property, which reduced the finding from the original \$180,000 to \$120,000. The City then approached the developer of this

**Ref to OIG
Evaluation**

Auditee Comments

Comment 9

project to ascertain if he had a copy in his file. While the developer did not have a copy of any environmental report on the properties, they approached their lender who did have an environmental report on the two remaining properties in question. A copy of this environmental report was provided to OIG, which should satisfy this finding.

Comment 3

The training for the Department staff includes a major component on the required documents needed prior to committing HOME funds to a development projects. Checklists have been created for the Department staff to use in creating project files for each HOME-assisted development. These checklists will assist staff in tracking the development process and ensuring that the City obtains the necessary documents prior to committing HOME funds to future housing development activities. The checklists are also designed to assist staff in creating consistent project files and reducing time spent searching for various documents. Finally, the Department is implementing an electronic file management system so that back-up documents are housed on the City's server and available should the paper document be misplaced.

Comment 10

Many of the remaining audit findings outlined in the draft OIG audit report are associated with ineligible homeowners in the City's homeowner rehab program. The Department staff is diligently working with our consultant to review program files and attempt to certify to HUD that these homeowners are eligible. We have reached out to many of the homeowners in question to verify income and obtain missing documentation. In some instances where fraudulent information was provided to the City during the approval process, we are prepared to take the necessary legal actions available to the City to recoup the expended HOME funds.

During the previous administration, the City's homeowner rehab program experienced reduced funding and staff turnover which resulted in a lack of proper knowledge of the required HUD regulations governing the use of HOME funding. The dwindling resources from HUD have translated into a lack of adequate funding to cover the required staff salaries to properly oversee this labor-intensive program. Although the City views this program as an important component of our community development efforts, the City regrets that the homeowner rehab program has been placed on hold until the City can increase staff capacity. We are currently exploring alternative implementation strategies to this program; however, until one is designed that ensures the City that the program can be successfully implemented without compromising our adherence to HUD's regulations, the program will remain on hold.

Comment 11

Another area where the draft OIG audit report cited that the City did not adhere to HUD regulations is in meeting commitment deadlines. Since taking office, I have worked with my new Director of the Department of Community Development to identify worthy housing development programs where the City intends to invest our existing and future allocations of HUD funds. Some of these development activities are being implemented by local CHDO's to fulfill the City's CHDO set-aside requirements. We currently have a mix of developments in our pipeline that include two affordable homeownership developments for low to moderate-income households, rental housing for low-income seniors, and rental housing for low-income veterans. We also are actively working with a pipeline of first-time homebuyers to provide down payment and closing cost assistance. Through working with the active development community in our City, the Department has committed all past HOME funds and is creating a process to solicit proposals for future allocations of HOME funding. We are also cultivating relationships with developers who have a proven track

4

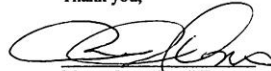
**Ref to OIG
Evaluation**

Auditee Comments

record of completing development projects on time and within budget while offering technical assistance to developers who lack the capacity to properly implement a housing development agenda.

I am confident that the actions the City has implemented since I took office are demonstrating that we are committed to ensuring that the City of Paterson properly implements the various HUD-funded programs. We have been working to improve the Department for less than one year and already we are seeing improvements in the timely delivery of our programs and services as well as enhanced staff capacity and more efficient and effective organization structure. I am excited about the improvements my administration is implementing and also the housing developments projects that the City is considering for HOME funding. With HUD's continued support, the City has a chance to build a critical mass of new activity to stabilize some of the more distressed communities in the City while improving the lives of our residents.

Thank you,



Mayor Jose "Joey" Torres

OIG Evaluation of Auditee Comments

- Comment 1 The audit scope generally included HOME funded activities that were on-going during the period July 1, 2010 through June 30, 2013; however, some of these activities were approved and initially funded prior to July 1, 2010. While City officials stated that actions have been taken since July 2014 to ensure that the deficiencies found during the audit are not replicated, the period after July 2014 was not generally within the audit scope.
- Comment 2 City officials provided an amended subgrantee agreement; however, it has not been recorded with the County clerk's office. Therefore, City officials will have to provide evidence of this recording to HUD field office staff during the audit resolution process.
- Comment 3 Actions taken or planned by City officials are responsive to our recommendations.
- Comment 4 The report was revised to reflect that the unsupported costs are associated with two activities.
- Comment 5 City officials said they provided documentation to support \$58,127 of the \$183,696 unsupported costs. Review of this documentation, which was provided at the exit conference, disclosed that it supports \$57,886 of the unsupported costs. Consequently, we reduced the unsupported costs from \$183,696 to \$125,810.
- Comment 6 City officials said that the questioned cost of \$5,997 has been properly reclassified, however, documentation to support the reclassification will have to be provided to HUD field office staff during the audit resolution process.
- Comment 7 While City officials state that deed restrictions were not imposed or properly recorded on 9 properties assisted with more than \$1.9 million in HOME funds, the audit report questioned 8 properties.
- City officials stated that copies of six recorded deed restrictions had been forwarded to OIG. However, City officials provided four recorded deed restriction, not six, at the exit conference, and only two of the four recorded deed restrictions satisfied the recommendation. The remaining two deed restrictions were not acceptable because one was for an amount greater than the HOME assistance provided to the homebuyer, and the other recorded deed restriction was not executed by the trustees who control the assisted property. Therefore, we reduced the number of properties without properly recorded deed restrictions from eight to six properties and reduced the questionable amount from \$1.9 to 1.37 million.
- Comment 8 City officials stated that they are in the process of having a properly recorded deed restriction executed; evidence that such a deed has been executed will need to be provided to HUD field office staff during the audit resolution process.

- Comment 9 The environmental review documents provided at the exit conference satisfied the environmental review finding; therefore, we eliminated the environmental review finding from the audit report.
- Comment 10 City officials stated that their consultant is working to resolve findings associated with ineligible homeowners, and where fraudulent information was provided to obtain HOME assistance, City officials are prepared to take actions needed to recoup HOME funds. City officials will have to work with HUD field office staff to address these findings during the audit resolution process.
- Comment 11 City officials stated that they have committed all past HOME funds. However, our review of grant year 2009 commitments revealed that \$844,640 was not properly committed as of the commitment deadline, July 31, 2011.