



Issue Date	November 19, 2007
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Audit Report Number	2008-CH-1001
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TO: Thomas S Marshall, Director of Public Housing Hub, 5DPH

FROM: *Heath Wolfe* for
Heath Wolfe, Regional Inspector General for Audit, 5AGA

SUBJECT: The Housing Authority of the City of Michigan City, Indiana, Failed to Follow Federal Requirements for Its Nonprofit Development Activities

HIGHLIGHTS

What We Audited and Why

We audited the Housing Authority of the City of Michigan City's (Authority) nonprofit development activities. The review of public housing authorities' development activities is set forth in our annual audit plan. We selected the Authority because it was identified as having high-risk indicators of nonprofit development activity. Our objective was to determine whether the Authority diverted or pledged resources subject to its annual contributions contract (contract), other agreement, or regulation for the benefit of non-U.S. Department of Housing and Urban Development (HUD) developments.

What We Found

The Authority diverted and pledged assets subject to its contract, other agreements, or HUD's regulations for the benefit of Michigan City Housing Development, Incorporated (nonprofit), the Authority's nonprofit entity. It failed to file declarations of trust on 32 properties purchased using Turnkey III Homeownership (Turnkey III) sales proceeds. It also inappropriately transferred ownership of 29 of the 32 properties valued at more than \$1.1 million to its nonprofit without HUD approval and did not ensure that it complied with its HUD-approved plan regarding the use of the sales proceeds. As a result, fewer funds were available to serve the Authority's low-income families.

Further, the Authority did not comply with HUD's property disposition requirements and did not ensure that its nonprofit used the proceeds from the sale of property in accordance with its agreement with HUD. As a result, HUD lacks assurance that the sale of the property served the best interests of HUD, the Authority, and its residents.

We informed the Authority's executive director and the Director of HUD's Cleveland Office of Public Housing of minor deficiencies through a memorandum, dated November 19, 2007.

What We Recommend

We recommend that the Director of HUD's Cleveland Office of Public Housing require the Authority to submit executed declarations of trust for the Turnkey III properties to HUD, negotiate with its nonprofit to transfer ownership of the 29 Turnkey III properties back to the Authority and amend its promissory note with Horizon Bank to remove the properties held as collateral or pay HUD for the properties from nonfederal funds, reimburse its Public Housing program from nonfederal funds for rental income received from the Turnkey III properties, and replenish its Public Housing program to comply with its approved HUD plan or provide a revised plan to HUD for review and approval. We also recommend that the Director require the Authority to implement adequate procedures and controls for monitoring the progress of the urban park development or exercise its right to reversion of title if the park is not fully developed, negotiate with its nonprofit to discontinue using sales proceeds to pay interest payments, and implement a written plan for use of the proceeds. Additionally, we also recommend that the Director take appropriate action to declare the Authority in substantial default of its contract.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We provided our discussion draft audit report to the Authority's executive director, its board chairperson, and HUD's staff during the audit. We held an exit conference with the executive director on October 19, 2007.

We asked the Authority's executive director to provide comments on our discussion draft audit report by November 9, 2007. The executive director provided written comments dated, November 6, 2007. The executive director

generally agreed with our findings and neither agreed nor disagreed with our recommendations. The complete text of the Authority's written comments, along with our evaluation of those comments, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVE

The Housing Authority of City of Michigan City (Authority) was established by the City of Michigan City, Indiana (City), on June 26, 1950, under Section 36-7-18-4 of the Indiana Code to provide decent, safe, and sanitary housing for low- and moderate-income families under the United States Housing Act of 1937. A seven-member board of commissioners, appointed by the City's mayor governs the Authority. The board's responsibilities include overseeing the Authority's operations as well as the review and approval of its policies. The board appoints the Authority's executive director, who is responsible for carrying out the board's policies and managing the Authority's day-to-day operations.

The Authority administers Section 8 Housing Choice Voucher, Public Housing, and Public Housing Capital Fund programs. As of August 28, 2007, under its annual contribution contract (contract) with the U.S. Department of Housing and Urban Development (HUD), the Authority operates 194 units of subsidized housing in the City for its Public Housing program. Under a separate contract with HUD, the Authority manages a Section 8 Housing Choice Voucher (Section 8) program with 261 Section 8 vouchers. The Authority's books and records are located at 621 East Michigan Boulevard, Michigan City, Indiana.

In February 2002, the Authority established Michigan City Housing Development, Incorporated (nonprofit), a 501(c)(3) nonprofit, to provide additional affordable residential accommodations for low- and moderate-income families. The nonprofit is an affiliate of the Authority.

In accordance with its agency plan, a public housing agency may form and operate wholly owned or controlled subsidiaries or other affiliates. Such wholly owned or controlled subsidiaries or other affiliates may be directed, managed, or controlled by the same persons who constitute the board of directors or similar governing body of the public housing agency, or who serve as employees or staff of the public housing agency, but remain subject to other provisions of laws and conflicts of interest requirements. Further, a public housing agency, in accordance with its agency plan, may enter into joint ventures, partnerships, or other business arrangements with or contract with any person, organization, entity, or governmental unit with respect to the administration of the programs of the public housing agency such as developing housing or providing supportive/social services subject to either Title I of the United States Housing Act of 1937, as amended, or state law.

We selected the Authority for audit because it was identified as having high-risk indicators of nonprofit development activity. Our objective was to determine whether the Authority diverted or pledged resources subject to its annual contributions contract, other agreement, or regulation for the benefit of non-HUD developments without specific HUD approval.

RESULTS OF AUDIT

Finding 1: The Authority Did Not File Declarations of Trust for Purchased Properties and Inappropriately Transferred Assets to Its Nonprofit

The Authority failed to file declarations of trust on 32 properties purchased using Turnkey III Homeownership (Turnkey III) sales proceeds. It also substantially defaulted on its contract when it improperly transferred ownership of 29 of the 32 properties valued at more than \$1.1 million, to its nonprofit without HUD approval. Additionally, the Authority did not ensure that it complied with its HUD-approved plan regarding the use of sales proceeds. The problems occurred because the Authority lacked adequate procedures and controls to ensure that it complied with its contract, HUD's regulations, and its approved plan governing the use of its sales proceeds. As a result, HUD's interest in the properties was not secured, and the Authority did not operate its projects in the best interest of its residents.

Turnkey III Units

In December 1991, the Authority requested a debt forgiveness waiver and refund request for the proceeds from the sale of Turnkey III units. The waiver included a request to waive all future available proceeds from the sale of Turnkey III units. In January 1993, HUD approved the Authority's refund request and its planned use of the proceeds from the sale of the Turnkey III units. Therefore, HUD returned more than \$980,000 to the Authority in sales proceeds from June 1986 to September 1993. HUD requested the Authority to inform the appropriate HUD field office of all future Turnkey III sales and when all units had been sold. HUD also requested the Authority to provide documentation to establish the status of proceeds and/or the project at the time of the request in order for future funds to be released in accordance with its approved plan.

As of September 2007, the Authority received more than \$2.5 million in sales proceeds from 171 Turnkey III units sold between 1986 and 2007. HUD's records showed approximately \$980,000 in sales proceeds because the Authority did not inform HUD of the more than \$1.5 million in sales proceeds it received from the Turnkey III units sold.

Declarations of Trust Not Filed and Assets Inappropriately Transferred to the Nonprofit

Using more than \$1.2 million in sales proceeds, the Authority purchased 32 properties, consisting of 21 homes and 11 parcels of land. However, it failed to file

declarations of trust with the county for the purchased properties as evidence (as a restrictive covenant) that it would not convey or encumber the property as required by its contract with HUD.

In 2002, the Authority sold three of the properties, and during 2004 and 2005, it transferred the remaining 29 properties totaling more than \$1.1 million to its nonprofit without HUD approval. As of September 2007, the nonprofit had received more than \$337,000 in rental income for the 29 properties.

Nonprofit's Line of Credit

The Authority pledged assets to obtain a line of credit without HUD approval as required by the contract. From August 1995 through February 2001, the Authority purchased 13 properties with the sales proceeds from the Turnkey III units. In March 2001, it obtained a promissory note for a \$500,000 line of credit with Horizon Bank (bank) to finance the purchase and renovation of additional homes to rent to low-income families. In November 2001, it transferred the note to its nonprofit and used 10 of the 13 properties purchased with sales proceeds as collateral.

In March 2004, the nonprofit increased its line of credit with the bank to \$1 million. In addition to 10 properties already held by the bank as collateral, the Authority added 16 properties to the agreement. Of the 16 properties, seven were purchased using Turnkey III sales proceeds; three were purchased with Public Housing operating funds, which were reimbursed to the Public Housing program; and the remaining six properties were not purchased using HUD funds. Therefore, 17 properties purchased from the sales proceeds were used as collateral. As of September 2007, the nonprofit had purchased six properties with the line of credit and owed more than \$752,000 on the loan.

Sales Proceeds Not Used in Accordance with Approved Plan

According to the HUD-approved plan to govern the use of the more than \$678,000 in sales proceeds, the Authority would use \$500,000 or 74 percent of the proceeds to acquire or rehabilitate properties and the remaining 26 percent or \$178,424 to replenish the reserve level of its Public Housing program. However, as of September 2007, the Authority had only replenished its Public Housing program by \$158,424; thus, \$20,000 in additional funding was planned but not used. Additionally, the Authority stipulated in its plan that it did not intend to use the sales proceeds to operate another form of housing program; however, it transferred properties purchased with sales proceeds for its nonprofit to operate a housing program.

Adequate Procedures and Controls Lacking

The Authority lacked adequate procedures and controls to ensure that it complied with its contract, HUD's regulations, and its approved plan governing the use of its sales proceeds. According to the executive director, she thought that since HUD forgave the debt owed on the Turnkey III units, the properties purchased with the proceeds from the sale of the units, which was an approved activity under its administrative use agreement with HUD, were not HUD properties.

As a result of the inappropriate property transfers and the Authority's failure to comply with its plan for the use of sales proceeds, the Authority misused assets totaling more than \$1.5 million for the benefit of its nonprofit. Additionally, HUD's interest in the properties was not secured, and the Authority did not operate its projects in the best interest of its residents.

Recommendations

We recommend that the Director of HUD's Cleveland Office of Public Housing require the Authority to

- 1A. Submit to HUD a listing of all Turnkey III units sold and the associated sales proceeds, as well as all future Turnkey III sales and proceeds.
- 1B. Submit fully executed declarations of trust for the 29 Turnkey III properties to HUD for review to safeguard HUD's interests and prevent future conveyances or encumbrances without HUD's approval.
- 1C. Seek to have its nonprofit transfer ownership of the 29 Turnkey III properties totaling \$1,183,008 purchased with sales proceeds from its nonprofit back to the Authority or pay HUD for the properties from nonfederal funds.
- 1D. Reimburse its Public Housing program \$337,870 from nonfederal funds for the rental income received by its nonprofit from the Turnkey III properties.
- 1E. Negotiate with its nonprofit to amend the promissory note with the bank to remove the 17 Turnkey III properties held as collateral from the terms of the agreement.
- 1F. Transfer to its Public Housing restricted reserve account \$20,000 as required by its HUD-approved plan governing the use of sales proceeds.

We also recommend that the Director of HUD's Cleveland Office of Public Housing

- 1G. Take appropriate action to declare the Authority in substantial default of its contract.

Finding 2: The Authority Did Not Comply with HUD's Property Disposition Requirements

The Authority did not comply with HUD's property disposition requirements. Additionally, it did not ensure that its nonprofit used the sales proceeds in accordance with its agreement with HUD. The problems occurred because the Authority lacked adequate procedures and controls to ensure that it monitored the City and reported to HUD on the progress of approved demolition/disposition activities and that its nonprofit used the sales proceeds for their intended purposes. As a result, HUD lacks assurance that the sale of land, formerly Harborside Homes, served the best interests of HUD, the Authority, and its residents.

HUD Approved the Demolition/Disposition of Project Assets

In November 1995, HUD approved the Authority's request for the demolition of 32 units located on the site of the former Harborside Homes housing project. On April 23, 2002, HUD approved the disposition of the entire site, consisting of 4.12 acres and the remaining 55 units at Harborside Homes, by public bid at the fair market value of \$1.2 million or higher.

In January 2002, the Authority, along with the City, submitted a request to HUD proposing the conveyance of the property to the City to develop an urban park with a recreational trail for a negotiated sale price of \$550,000, which was \$650,000 less than the fair market value. The sale proceeds would be paid to its affiliated nonprofit for the construction of affordable housing and/or additional Public Housing units.

In April 2002 based upon the proposal, HUD approved the sale of the Harborside Homes project to the City. In January 2003, HUD provided the Authority with a deed of conveyance for the property. However, the deed contained a requirement that the conveyance of the property be subject to the City's developing an urban park with a recreational train and a core pedestrian precinct as part of its infrastructure. Additionally, if the City failed to develop the property, the Authority would have a right of reversion of title, which expires in 2013.

In June 2002, the Authority entered into a memorandum of understanding with the City. The memorandum outlined HUD's restriction over the conveyance of the land to the City, the requirements for the urban park, and the intended use of the \$550,000 by the nonprofit.

The City Had Not Begun Development of the Park

As of September 2007, the City had not begun developing the land for the park. According to the mayor, the development of the park would not begin until the City purchased another adjacent company. However, he was unable to provide a date or assurance that the purchase would occur. HUD's approval for the negotiated sale of the site of the former housing project was not contingent upon the purchase of another company, nor was the stipulation in the deed of conveyance or the memorandum of agreement between the Authority and the City.

As previously mentioned, the Authority's right of reversion of title expires on July 1, 2013. Although the City had approximately six years remaining, it had not developed any plans for the proposed park as of September 2007. Additionally, the Authority was unable to provide records or progress reports that were required to assist in monitoring the approved demolition/disposition activity.

The Nonprofit Had Not Used the Funds for Their Intended Purposes

The nonprofit had not used the \$550,000 it received from the City to provide affordable housing and/or additional Public Housing units. The Authority used \$145,832 of the \$550,000 to pay the interest on a line of credit used to secure the 17 properties purchased with Turnkey III sales proceeds (see finding 1). As of July 2007, the amount reflected on the nonprofit's financial documents was \$594,838, and the nonprofit had not developed a written plan for the use of the funds.

The Authority Lacked Adequate Procedures and Controls

The Authority lacked adequate procedures and controls to ensure that (1) it properly monitored the City for compliance and reported the development progress to HUD and (2) its nonprofit used the proceeds from the sale for the intended purposes. According to the Authority's executive director and the vice-chairperson of the board, they were unaware that they were supposed to monitor the City's progress in constructing the park and report this information to HUD under HUD's disposition requirements. Additionally, they also did not know about HUD's restriction over the conveyance of the land.

As a result, HUD and the Authority lack assurance that the sale of property served the best interest of HUD, the Authority, and its residents. If the City does not perform according to its agreement with the Authority, the Authority would lose the property and the potential to receive fair market value from the sale of the property.

Recommendations

We recommend that the Director of HUD's Cleveland Office of Public Housing require the Authority to

- 2A. Implement adequate procedures and controls for monitoring the progress of the urban park development or exercise its right to reversion of title if the park is not fully developed before July 1, 2013. This process will include but not limited to monitoring the development of the park and reporting progress to HUD. By implementing adequate procedures and controls, the Authority will help to ensure that the property valued at \$1,200,000 is used for its intended purpose.
- 2B. Negotiate with its nonprofit to discontinue using the proceeds from the sale of Harborside Homes to pay the interest on the line of credit and implement a written plan for the use of \$594,838 to provide affordable housing and/or additional Public Housing units as intended and submit the plan to HUD.

SCOPE AND METHODOLOGY

To accomplish our objective, we reviewed

- Applicable laws, regulations, the Authority's contract with HUD, HUD program requirements at 24 CFR [*Code of Federal Regulations*] Parts 85 and 970, Office of Management and Budget Circular A-87, declaration of trust between HUD and the Authority, Directive 99-19 requirement for demolition/disposition of Public Housing projects, loan forgiveness amendment to the annual contributions contract (Turnkey III), and Administrative Use Agreement for Proceeds of Sales of Homeownership Projects.
- The Authority's financial and accounting records, annual audited financial statements for 2005, general ledgers for 2000 through 2006, bank statements and cancelled checks, by-laws, policies and procedures, board meeting minutes, organizational chart, and nonprofit development activity documentation.
- The nonprofit's articles of incorporation, bylaws, board of directors, organizational chart, and development activity documentation.
- HUD's files for the Authority.

We also interviewed the Authority's and the nonprofit's employees and/or board members and HUD staff.

We performed our on-site audit work between January and July 2007. The audit covered the period October 1, 2005, through December 31, 2006. We extended this period as necessary. We conducted the audit in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

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

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined 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.
- 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.
- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource 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.

We assessed all of the relevant controls identified above.

A significant weakness exists if internal controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weakness

Based on our review, we believe the following item is a significant weakness:

- The Authority lacked adequate procedures and controls to ensure that it complied with its contract and/or HUD's regulations regarding the protecting of HUD's interest in property by filing declarations of trust, disposing of real property, complying with its plan for the use of sales proceeds, monitoring the City and reporting to HUD on the progress of approved demolition/disposition activities, and ensuring that its nonprofit used the proceeds from the sale for their intended purposes (see findings 1 and 2).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

Recommendation number	Ineligible 1/	Funds to be put to better use 2/
1C	\$1,183,008	
1D	<u>337,870</u>	
1F		\$20,000
2A		1,200,000
2B		<u>594,838</u>
Totals	<u>\$1,520,878</u>	<u>\$1,814,838</u>


- 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 polices or regulations.
- 2/ 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. This includes reductions in outlays, deobligation of funds, withdrawal of interest subsidy costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings which are specifically identified. In these instances, if the Authority implements our recommendations, it will ensure that (1) Turnkey III sales proceeds are used in accordance with its HUD-approved plan and (2) the disposed property, valued at \$1.2 million, and its proceeds from the demolition/disposition are used for their intended purposes.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

	<p>Lenda J. Wilson Executive Director 621 East Michigan Blvd Michigan City, IN 46360 (219) 872-7287 Fax (219) 873-7700</p>
<p>November 6, 2007</p>	<p>2007 NOV - 8 AM 11:12 RECEIVED OFFICE OF AUDIT CHICAGO, ILLINOIS</p>
<p>Ms. Kelly Anderson Assistant Regional Inspector General for Audit United State Department of HUD-Office of Inspector General 77 West Jackson Boulevard, Suite 2646 Chicago, IL 60604</p>	
<p>Re: Draft Audit for the Housing Authority of the City of Michigan City Indiana of Nonprofit Development Activities</p>	
<p>To Ms. Anderson:</p>	
<p>Thank you for your review of the Michigan City Housing Authority Nonprofit Development Activities. Management has reviewed the above referenced report and offers the following response thereto for consideration:</p>	
<p>Finding 1: The Authority Did Not File Declarations of Trust for Purchased Properties and Inappropriately Transferred Assets to Its Nonprofit.</p>	
<p>The Authority is anxious to work with the Department of Housing and Urban Development Indianapolis Field Office to develop a strategy to correct the inappropriate transfer of assets to its nonprofit. It was never the intention of the Authority to fail to operate its project in the best interest of its low income residents and always keep its main objective of providing safe, decent, sanitary, and of good repair housing in a suitable environment for the City's low to moderate income families. In the mission and the goal, as stated in the development plan for the debt forgiveness funding, was to eventually become a Not-for-Profit Organization to develop affordable rental and homeownership opportunities for our cities' low income residents and provide Housing Counseling for families who are delinquent or are in default of their mortgage. The Michigan City Housing Authority believes that it did not receive adequate guidance on developing and operating the Not-For-Profit since its' existence and therefore what has now been determined to be a critical error of transferring "HUD Held Properties" to the Michigan City Housing Development Corp in 2005. No known subject matter in this area was noted in Housing and Urban Development Management and Performance Reviews or Independent Audit comments or findings.</p>	
<p>All closings on future Turnkey III Homeownership units were executed with an Endorsement by Duly Authorized Officer of the United States of America, Secretary of Housing And Urban Development, Releasing Real Estate document prepared by Keith W. Lerch, Chief Counsel for the Department of Housing and Urban Development, and submitted in year end settlement statements for approval before they became obsolete, therefore we concluded that Indianapolis Field Office was made aware of all sales proceeds the Housing Authority received from the Turnkey III units sold.</p>	
<p>The Michigan City Housing Development Corporation sold three units between 2004 and 2005 to Housing Choice Voucher participants under the Homeownership option for qualified families after pre-</p>	

Comment 1

Auditee Comments

Comment 2

assistance homeownership counseling. While we agree that the nonprofit received more than \$337,000 in rental income for 29 properties, the OIG report fails to address the administrative expenses, repair and upkeep of the rental properties during the period reviewed.

The Michigan City Housing Authority omitted to continue to provide HUD-52382 as advised by the Indianapolis Field Office of all future sales. We make reference to form HUD-53010-S Debt Forgiveness Amendment (5/1/92) 2.3 "Any housing developed, acquired or rehabilitated by the HA with proceeds of sale under this Agreement (including local housing program established by the HA with such proceeds) shall be deemed to be outside the scope of the Act, except as otherwise provided herein, and HUD shall have no obligation whatsoever to provide any continuing financial or other assistance to the HA on behalf of such programs or projects." It was assumed that the properties purchased with the proceeds from the sale of the units, which was an approved activity under its administrative use agreement with HUD, were not HUD-Held properties.

Finding 2: The Authority Did Not Comply with HUD's Property Disposition Requirements.

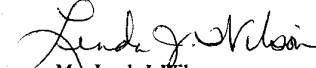
The Michigan City Housing Development Board of Directors has been notified of the need to develop a long-term provisions use of \$594,838 to provide affordable housing and/or additional public housing units as intended and submit the plan to HUD. The Executive Director and certain members of the Board are aware of the progress of the development plan for the City. We were unaware of our obligation to report the progress to the HUD field office. Mr. John Hall, Field Office Director and William P. Shaw, Operations Specialist have met with the Honorable Mayor of Michigan City on more than one occasion and received information regarding the status. The Michigan City Housing Authority was not in attendance. We will request to be invited to all future meeting to be kept aware of the assurance that the sale of property serves the best interest of HUD, the Authority, and its low income residents. We will also request the assistance of the Indianapolis Field Office in negotiating with the affiliated nonprofit to discontinue using the proceeds for the sale of Harborside Homes to pay interest on the line of credit.

Comment 3

If you have any questions or concerns or need additional information, please feel free to contact me at (219) 872-7287.

Respectfully submitted,

The Housing Authority of the
City of Michigan City, Indiana


Mrs. Lenda J. Wilson
Executive Director

Cc: Indianapolis Field Office



OIG's Evaluation of Auditee Comments

- Comment 1** The Authority did not provide any documentation to support its position that the U.S. Department of Housing and Urban Development was aware of all proceeds received from the sale of its Turnkey III units.
- Comment 2** The Authority did not provide any documentation, as evidence, to show the repairs and/or expenses incurred for the upkeep of the properties purchased using Turnkey III Homeownership sales proceeds.
- Comment 3** According to HUD's requirements, the Authority should have kept the appropriate HUD field office informed of significant actions in carrying out the demolition or disposition, including any significant delays or other problems.

Appendix C

FEDERAL REQUIREMENTS

Finding 1

Section 5 of the contract with HUD states that the Authority shall develop and operate all projects covered by this contract in compliance with all of the provisions of this contract and all applicable statutes, executive orders, and regulations issued by HUD, as they shall be amended from time to time, including but not limited to those regulations promulgated by HUD at Title 24 of the *Code of Federal Regulations*, which are hereby incorporated into this contract by reference herein, as such regulations shall be amended from time to time. The Authority shall also ensure compliance with such requirements by any contractor or subcontractor engaged in the development or operation of a project covered under this contract.

Section 7 of the contract with HUD states that the Authority shall not demolish or dispose of any project, or portion thereof, other than in accordance with the terms of this contract and applicable HUD requirements. With the exception of entering into dwelling leases with eligible families for dwelling units in the projects covered by this contract and normal uses associated with the operation of the project(s), the Authority shall not in any way encumber any such projects, or portion thereof, without the approval of HUD. In addition, the Authority shall not pledge as collateral for a loan the assets of any project covered under this contract.

Section 8 of the contract with HUD states that promptly upon the acquisition of the site of any project, the Authority shall execute and deliver an instrument (which may be in the form of a declaration of trust, a trust indenture, or such other document as may be approved by HUD), confirming and further evidencing, among other things, the covenant of the Authority not to convey or encumber the project except as expressly authorized in the contract. Such instrument and all amendments shall be duly recorded or filed for record wherever necessary to give public notice of their contents and to protect the rights and interests of HUD and of any bondholders. The Authority shall furnish HUD with appropriate evidence of such recording or filing. From time to time, as additional real property is acquired by the authority in connection with the projects, the Authority shall promptly amend such instrument to incorporate all such real property and shall record the instrument, as amended.

Section 15(A) of the contract with HUD states that the Authority must maintain complete and accurate books of account for the projects of the Authority in such a manner as to permit the preparation of statements and reports in accordance with HUD requirements and to permit timely and effective audit.

Paragraph 5 of the declaration of trust states that the right to require the local authority to remain seized of the title to said property and to refrain from transferring, conveying, assigning, leasing, mortgaging, pledging, or otherwise encumbering said property or any part thereof, appurtenances thereto, or any rent revenues, income or receipts there from or in connection therewith, or any of the benefits or contributions granted to it by or pursuant to the contract.

The loan forgiveness amendment to the contract for Turnkey III, section (B), states “Where the Government approves the disposition of real property, the local authority shall dispose of it promptly by public solicitation of bids for not less than fair market value, unless the Government authorized a negotiated sale for reasons found to be in the best interests of the local authority, or federal government, or sale for less than fair market value (where permitted by state law) based on commensurate benefits to the community, the local authority for the federal government justifying such an exception.”

Section (e) of the amendment states that the deposit and use of funds transferred into the replacement reserve are subject to and conditioned upon waiver of any regulatory requirements providing for return of such funds to HUD, the development and submission of a plan by the local authority and approved by HUD for the use of such funds, and a contractual agreement between the local authority and HUD governing the use of replacement reserve funds.

Administrative Use Agreement for Proceeds of Sales of Homeownership Projects, section 3.1, states that proceeds of sale may be used only for any lower income housing approved by HUD, including locally sponsored and directed homeownership programs. Eligible uses include the development, acquisition, or rehabilitation of housing for use by low- and very low-income families, as well as other forms of assistance (referrals, loans, buydowns, and etc.) to such families for the purpose of obtaining decent, safe, and sanitary housing.

Section 3.2 of the agreement states that proceeds of sale must be used in accordance with the requirements and provisions of this agreement (including any exhibits hereto and the plan used of sale proceeds) and shall be retained in the appropriate replacement reserve account until so used.

Section 3.6 of the agreement states that the Authority’s board of commissioners shall be responsible for ensuring that proceeds of sale are used in accordance with the requirements of this agreement. The board of commissioners also shall be responsible for all authorities of any program development with or for use with such proceeds of sale.

Section 3.7 of the agreement states that the Authority must obtain HUD approval under section 17.2 to modify any of the provisions of the plan for use of sale proceeds.

Section 3.8 of the agreement states that the use of proceeds of sale in conjunction with existing HUD-assisted projects in operation (subject to a contract) shall require, if approved by HUD that such funds shall be subject to the statutory, regulatory and contractual requirements of HUD-assisted project in operation, in addition to the requirements of this agreement.

Section 15.1 of the agreement states that the agreement, which consists of part 1, the plan for the use of sale proceeds incorporated as part II and any exhibits attached hereto, constitutes the entire agreement between HUD and the Authority with respect to the subject matter hereof. This agreement may be amended or modified only by written instrument duly authorized and executed by the parties hereto.

Section 16.2 states that this agreement, or any part hereof, may be amended only in writing duly authorized and executed by HUD and the Authority. The Authority must obtain HUD approval under this section to modify any of the provisions of this agreement, including without limitation, any provision of the plan for use of sale proceeds under part II.

Section 17(B) of the contract states that a substantial default is a serious and material violation by the Authority of any one or more of the covenants contained in the contract. Events of substantial default include the disposition of any project, or portion thereof, without HUD approval. Upon the occurrence of a substantial default, as determined by HUD and in accordance with the contract, HUD shall be entitled to any or all of the remedies set forth in paragraphs (E), (F), and (H) in this section.

Section 17(C) states that delivery of a notice of substantial default shall be required before HUD exercises any remedy under the contract. The notice shall identify the specific covenants, statutes, executive orders, or regulations alleged to have been violated; identify the specific events, actions, failure to act, or conditions that constitute the alleged substantial default; and provide a specific timeframe for the Authority to cure the substantial default, taking into consideration the nature of the default.

Section 17(E) states that upon occurrence of substantial default or expiration of any applicable cure period provided by HUD, the Authority shall convey to HUD title to the project(s) as demanded by HUD if, in HUD's determination, such conveyance of title is necessary to achieve the purposes of the United States Housing Act of 1937, or deliver possession and control of the project(s) to HUD.

Section 17(F) states that nothing contained in the contract shall prohibit or limit HUD from exercising any other right or remedy existing under applicable law or available at equity. HUD's exercise or nonexercise of any right or remedy under this contract shall not be construed as a waiver of HUD's right to exercise that or any other right or remedy at any time.

Section 17(H) states that HUD may at any time by notice to the Authority declare the contract terminated with respect to any project that at such time has not been permanently financed if a substantial default exists in connection with any of the projects, provided that no such termination shall effect any obligation of HUD to make annual contributions pursuant to section 12 of attachment VI, part B, of the contract.

Finding 2

HUD's requirements at 24 CFR [*Code of Federal Regulations*] 970.1 state: "Where HUD approves the disposition of real property of a project, in whole or in part, the authority shall dispose of it promptly by public solicitation of bids for not less than fair market value, unless HUD authorizes negotiated sale for reasons found to be in the best interest of the authority or the Federal Government."

HUD's requirements at 24 CFR [*Code of Federal Regulations*] 970.14(a) state that after HUD approval of demolition or disposition of all or part of a project, the authority shall keep the

appropriate HUD field office informed of significant actions in carrying out the demolition or disposition, including any significant delays or other problems. When demolition or disposition is completed, the authority shall submit to the field office a report confirming such action, certifying compliance with all applicable requirements of federal law and regulations, and in the case of disposition, accounting for the proceeds and costs of disposition. Section (b) states that the authority shall be responsible for keeping records of its HUD-approved demolition or disposition sufficient for audit by HUD to determine the authority's compliance with applicable requirements of federal law and this part.

The deed of conveyance between HUD and the Authority states that the conveyance of the subject property is subject to the grantee's developing an urban park with recreation trail and a core pedestrian precinct as part its infrastructure. If the grantee fails to develop the property as described, the grantor shall have an exercisable right of reversion of title. Grantor's right of reversion shall expire on July 1, 2013, such that this restriction shall not be construed to run with the land in perpetuity. The conveyance shall be further subject to all liens; encumbrances; taxes; and matters of record including but not limited to covenants, limitations, restrictions, easements of record, and legal rights of way.

The memorandum of understanding between the Authority and the City, section 1(A), states that the City will acquire the property from the Authority. The deed shall contain a restriction that the conveyance is for the purpose of the development of a recreational park and the property shall revert to the Authority if this purpose is not met.

Section 1B of the memorandum, states that the City shall pay, as the purchase price for the property, the sum of \$550,000. The purchase price shall be paid to the Authority's affiliated not-for-profit entity to be used for construction of affordable housing and/or additional units of public housing.

Section D of the memorandum states that the City will develop an urban park and extend a recreational trail through the property and will create a core pedestrian precinct as part of the infrastructure, allowing residents of the adjacent boulevard gardens to access a safe and aesthetically pleasing walkway to the waterfront recreation area.