audit report

Issue Date	March 30, 2012
Audit Report Number	2012-CH-1007

TO: Keith E. Hernandez, Director of Community Planning and Development, 5FD

FROM: Kelly Anderson, Regional Inspector General for Audit, 5AGA

SUBJECT: The State of Michigan Lacked Adequate Controls Over Its Use of Neighborhood Stabilization Program Funds Under the Housing and Economic Recovery Act of 2008 for a Project

HIGHLIGHTS

What We Audited and Why

We audited the State of Michigan's Neighborhood Stabilization Program administered by the Michigan State Housing Development Authority. The audit was part of the activities in our fiscal year 2011 annual audit plan. We selected the State based upon our designation of the Program as high risk and citizens' complaints to our office. Our objective was to determine whether the State complied with Federal requirements in its use of Program funds under the Housing and Economic Recovery Act of 2008 regarding the citizens' complaints to our office.

What We Found

The State lacked sufficient documentation to support that it followed Federal requirements in its use of $3.3 million in Program funds for a project. As a result, the U.S. Department of Housing and Urban Development (HUD) lacked assurance that the Authority's use of $3.3 million in Program funds for the acquisition of a building was reasonable and met Federal requirements.

What We Recommend

We recommend that the Director of HUD's Detroit Office of Community Planning and Development require the State to (1) provide sufficient documentation to support that the Authority's use of $3.3 million in Program funds for the purchase of the building was reasonable or reimburse its Program from non-Federal funds as appropriate and (2) implement adequate procedures and controls to ensure that it maintains sufficient documentation to support that the Authority's use of Program funds is for eligible project costs.

For each recommendation in the body of the report without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-4. 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 executive director of the Authority, the attorney of the Authority's Executive Division, the chairman of the Authority's board, and HUD's staff during the audit. We held an exit conference with the Authority's attorney on February 29, 2012. We asked the attorney to provide comments on our discussion draft audit report by March 2, 2012. The attorney provided written comments, dated March 2, 2012. The attorney did not agree with the finding. The complete text of the written comments, except for 75 pages of documentation that were not necessary to understand the attorney's comments, along with our evaluation of that response, can be found in appendix B of this report. We provided the Director of HUD's Detroit office of Community Planning and Development with a complete copy of the Authority's written comments plus the 75 pages of documentation.

TABLE OF CONTENTS

BACKGROUND AND OBJECTIVE

The Program. Authorized under Section 2301 of Title III of the Housing and Economic Recovery Act of 2008, as amended, Congress appropriated $4 billion for the Neighborhood Stabilization Program to provide grants to every State and certain local communities to purchase foreclosed-upon or abandoned homes and rehabilitate, resell, or redevelop these homes to stabilize neighborhoods and stem the decline in value of neighboring homes. The Act states that amounts appropriated, revenues generated, or amounts otherwise made available to States and units of general local government under Section 2301 should be treated as though such funds were Community Development Block Grant funds under Title I of the Housing and Community Development Act of 1974. The U.S. Department of Housing and Urban Development (HUD) allocated more than $3.9 billion in Program funds to more than 300 grantees.

The State. The Michigan State Housing Development Authority administers the State of Michigan's Program. The Authority was created by the Michigan Legislature in 1966 under the laws of the State. It is governed by an eight-member board consisting of the State's treasurer, the director of the State's Department of Human Services, and the director of the State's Department of Transportation. The board includes five other members appointed to 4-year terms by the State's governor and confirmed by the State Senate. The Authority's mission is to provide financial and technical assistance through public and private partnerships to create and preserve decent and affordable housing for low- and moderate-income residents and to engage in community economic development activities to revitalize urban and rural communities. The Authority's records are located at 735 East Michigan Avenue, Lansing, MI, and 3028 West Grand Boulevard, Detroit, MI.

HUD allocated nearly $98.7 million in Program funds under the Act to the State based upon the funding formula developed by HUD pursuant to the Act. On March 19, 2009, HUD entered into a grant agreement with the Authority for the full amount allocated. The Authority reported in HUD's Disaster Recovery Grants Reporting system the following obligations for the nearly $98.7 million in Program funds:

- $42 million to its Rental Development and Homeless Initiatives Division for the purchase and rehabilitation of abandoned or foreclosed-upon homes or residential properties to sell, rent, or redevelop the homes or properties and the redevelopment of demolished or vacant properties;

- More than $29.6 million to its Office of Community Development for (1) establishing financing mechanisms for the purchase and redevelopment of foreclosed-upon homes and residential properties; (2) the purchase and rehabilitation of abandoned or foreclosed-upon homes or residential properties to sell, rent, or redevelop the homes or properties; (3) establishing land banks for foreclosed-upon homes or residential properties; (4) the demolition of blighted structures; (5) the redevelopment of demolished or vacant properties; and (6) subgrantees' planning and administrative costs;

- Nearly $12.6 million to the Michigan Land Bank Fast Track Authority for the demolition of blighted structures, redevelopment of demolished or vacant properties, and planning and administrative costs;

- Nearly $6.1 million to its Urban Revitalization Division for the demolition of blighted structures;

- Nearly $1.8 million to its Homeownership Division for the purchase and rehabilitation of abandoned or foreclosed-upon homes or residential properties to sell, rent, or redevelop the homes or properties; and

- Nearly $6.6 million for planning and administration costs.

The first citizen's complaint to our office alleged that the Authority used $3.3 million in Program funds for the Michigan Land Bank Fast Track Authority's acquisition of a property located at 1249 Griswold, Detroit, MI, known as the Farwell Building, without an appraisal and without notifying the Farwell I Corporation, the owner of the property, that the Land Bank was involved in the acquisition. The Land Bank was not required to obtain an appraisal for the acquisition of the Farwell Building. However, we did find that the Authority lacked sufficient documentation to support that its use of $3.3 million in Program funds for the Land Bank's acquisition of the Farwell Building was reasonable and that the Land Bank did not notify the Corporation that it estimated the fair market value of the Farwell Building before the acquisition of the property (see finding 1 of this audit report).

The second citizen's complaint to our office alleged that the Authority awarded Program funds for four developments in which construction had been completed but the developments had not been closed. We found that Program funds were not awarded for the four developments and that the citizen's complaint was not substantiated.

Our objective was to determine whether the State complied with Federal requirements in its use of Program funds regarding the citizens' complaints to our office.

RESULTS OF AUDIT

Finding 1: The Authority Lacked Adequate Controls Over Its Use of Program Funds Under the Act for a Project

The Authority lacked sufficient documentation to support that it followed Federal requirements in its use of $3.3 million in Program funds for a project. The weakness occurred because the Authority lacked adequate procedures and controls to ensure that it maintained adequate documentation to support that its use of Program funds for the acquisition of a building was reasonable and in accordance with Federal requirements. As a result, HUD lacked assurance that the Authority used $3.3 million in Program funds for eligible project costs.

The Authority Lacked Sufficient Documentation To Support That Its Use of $3.3 Million in Program Funds Was Reasonable

We reviewed one of the Authority's redevelopment projects administered by the Michigan Land Bank Fast Track Authority due to a citizen's complaint to our office. The Authority disbursed $3.3 million in Program funds to the Land Bank for the acquisition of the Farwell Building for redevelopment into a mixed use multifamily project.

Contrary to Federal requirements, the Authority lacked sufficient documentation to support that the estimated fair market value of the Farwell Building was $3.3 million before the Michigan Land Bank Fast Track Authority acquired the property or that the Authority's use of $3.3 million in Program funds for the Land Bank's acquisition of the Farwell Building was reasonable.

Attachment A, section C.1., of Office of Management and Budget Circular A-87 requires all costs to be necessary, reasonable, and adequately documented. Further, HUD's regulations at 24 CFR (Code of Federal Regulations) 570.606(e) state that the acquisition of real property for an assisted activity is subject to subpart B of 49 CFR Part 24, which begins at 49 CFR 24.101. Appendix A to the U.S. Department of Transportation's regulations at 49 CFR Part 24 states that for programs and projects receiving Federal financial assistance described in 49 CFR 24.101(b)(2), an agency is to inform the owner(s) in writing of the agency's estimate of the fair market value for the property to be acquired. While section 24.101(b)(2) does not require an appraisal for these transactions, an agency must have some reasonable basis for its determination of the fair market value.

Representatives from the City of Detroit Downtown Development Authority, Lower Woodward Housing Fund, Detroit Investment Fund, and Wayne County Land Bank formed a working group to facilitate the redevelopment of the Capitol Park project. The Capitol Park project included the Farwell Building and two other properties located at 1145 and 1212 Griswold, Detroit, MI. The City of Detroit Downtown Development Authority hired Exclusive Realty, a third-party real estate broker, to negotiate the purchase of the Farwell Building on behalf of the working group to prevent the Farwell I Corporation from discovering the identity of the prospective buyer and trying to sell the property at an inflated price. Exclusive Realty negotiated a purchase price of $3.3 million for the Farwell Building and executed a purchase agreement for the property on behalf of the City of Detroit Downtown Development Authority on June 30, 2009. The president of Exclusive Realty said that a fair market analysis of the Farwell Building was not conducted. The $3.3 million represented the lowest price for which the Corporation was willing to sell the property.

In July 2009, the City of Detroit Downtown Development Authority approached the Authority for assistance in acquiring the Farwell Building. On October 16, 2009, the Authority issued a notice of intent to request a release of funds stating that the Authority intended to award the Michigan Land Bank Fast Track Authority $3.3 million in Program funds to acquire the Farwell Building. On November 16, 2009, Exclusive Realty assigned its rights under the purchase agreement to the Land Bank. On November 19, 2009, the Authority disbursed $3.3 million to First American Title Insurance Company to finance the Land Bank's acquisition of the Farwell Building. On November 20, 2009, the Farwell I Corporation executed a warranty deed conveying the property to the Land Bank. According to the property transfer affidavit, the Land Bank acquired the Farwell Building for $3.3 million. On December 2, 2009, the Authority drew down $3.3 million in Program funds for the Land Bank's acquisition of the Farwell Building.

However, the Authority could not provide sufficient documentation to support that the $3.3 million acquisition price of the Farwell Building was reasonable. Further, the Michigan Land Bank Fast Track Authority did not notify the Farwell I Corporation of its estimate of the property's fair market value before its acquisition of the property.

The Authority provided an interoffice memorandum from the Michigan Land Bank Fast Track Authority, dated February 28, 2010, stating that the Land Bank prepared an in-house comparable analysis to support the reasonableness of the acquisition of the 100,000-square-foot Farwell Building. The Land Bank's analysis used comparable sales information from properties sold in 2008 and 2009 compiled by Exclusive Realty from the Assessment Division of the City of Detroit's Department of Finance. The analysis in the memorandum contained the following information regarding the five properties:

Property address	Sale date	Sale price	Square footage	Price per square foot
220 West Congress	February 2008	$1,500,000	32,000	$47
1959 East Jefferson	February 2008	1,900,000	90,000	21
607 Shelby	March 2008	2,600,000	45,000	58
1145 Griswold	September 2009	1,900,000	80,000	24
1212 Griswold	December 2009	1,750,000	108,000	16
Averages		$1,930,000	71,000	$27

The analysis also included that the price per square foot for the Farwell Building was $33.

On September 1, 2011, the Authority provided an undated interoffice memorandum from the Michigan Land Bank Fast Track Authority stating that the price per square foot for the Farwell Building was within the price per square foot range of $16 to $58 for the five properties in the Land Bank's initial in-house market analysis prepared on or before February 28, 2010. Although a computer virus destroyed the archived electronic mail correspondence supporting the details used to prepare the analysis; the Land Bank was able to obtain warranty deeds, real estate transfer tax valuation affidavits, and other documentation to support the sales prices in the original analysis. However, the memorandum included a new in-house comparable analysis that contained different sales prices for the properties located at 220 West Congress, 1959 East Jefferson, and 607 Shelby. The analysis in the memorandum contained the following information regarding the five properties:

Property address	Sale date	Sale price	Square footage	Price per square foot
220 West Congress	February 2008	$2,500,000	32,000	$78
1959 East Jefferson	February 2008	2,000,000	90,000	22
607 Shelby	March 2008	1,500,000	45,000	33
1145 Griswold	September 2009	1,900,000	80,000	24
1212 Griswold	December 2009	1,750,000	108,000	16
Averages		$1,930,000	71,000	$27

The memorandum also stated that the three properties with different sales prices were acquired as part of a pool of five properties purchased for $7.25 million and that the attached schedule A of the title insurance policies for the three properties confirmed that the properties were sold for the amounts contained in the new analysis. The executive director of the Michigan Land Bank Fast Track Authority stated that when the Land Bank reviewed the new documents, it discovered that the sales prices for the three properties in the initial analysis were inaccurate and corrected the sales prices in the new analysis. The executive director also stated that although the sales prices for three of the properties had changed, the change was immaterial and the price-per-square-foot range for the five properties increased to $16 to $78. The increase in the sales prices better supports that the acquisition price of the Farwell Building was reasonable. However, the Land Bank included only an unsigned schedule A of the title insurance policies.

The executive director of the Michigan Land Bank Fast Track Authority stated that the Land Bank compared the age, size, location, and condition of the different properties used in the comparable analyses. The properties used in the analyses were all located in the greater central business district and included class B or C buildings. However, the Land Bank could not provide documentation to support the square footage of the buildings or that the comparable analyses considered the age, size, location, and condition of the properties. Further, the chief executive officer of Exclusive Realty said that building classifications A, B, and C are industry-specific designations used to identify a range of acceptable lease rates for commercial properties. The classifications are based on multiple factors including the location, size, and condition of a building. Buildings in one classification are generally not comparable to buildings in another classification due to the different factors considered. The Farwell Building would not be considered a class A, B, or C property since the building could not be leased in its current condition.

The Authority Lacked Adequate Procedures and Controls

The weakness regarding the lack of sufficient documentation to support its use of $3.3 million in Program funds for the acquisition of the Farwell Building occurred because the Authority lacked adequate procedures and controls to ensure that it used Program funds in accordance with Federal requirements.

The attorney of the Authority's Executive Division stated that the $3.3 million sales price for the Farwell Building was the result of careful negotiations through a real estate broker. The amount was $6.7 million less than the Farwell I Corporation's initial asking price for the Farwell Building. Further, the purchase was necessary for the area as a whole, and the sales price was consistent with the comparables in the Michigan Land Bank Fast Track Authority's analysis. In addition, the Farwell Building was listed in the National Register of Historic Places, was a historically and commercially important keystone building to the City of Detroit, was located in an area subject to extensive redevelopment, and was considered to be in a prime location for a mix of homes and office and retail space.

The executive director of the Michigan Land Bank Fast Track Authority stated that the Land Bank operated with the belief that the Farwell I Corporation received a fair price for the Farwell Building without being overpaid. Although the Farwell Building was an older building that had been vacant since 1984, it contained valuable architectural elements and materials. The rigor of the negotiation process and the undisclosed identity of the working group further protected the Land Bank against an unduly inflated sales price. In addition, the importance of the Farwell Building to the Capitol Park project, the need to protect

the investment already made in the area, and the comparable analysis further support that the purchase price was reasonable. Given the historical significance of the Farwell Building, exact comparables were not available. The executive director also stated that the Land Bank was not fully aware of its responsibilities under the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 since this was the first multifamily development financing project undertaken by the Land Bank. Once the Land Bank became aware of the Relocation Act requirement, it obtained an affidavit of voluntary sale from the Corporation to rectify its oversight. The Corporation stated in the affidavit that the $3.3 million purchase price of the property represented the fair market value. However, the affidavit did not include the Land Bank's estimate of the fair market value of the Farwell Building in accordance with the Relocation Act. Further, the Authority and the Land Bank could not provide sufficient documentation to support that the $3.3 million acquisition price of the property was reasonable.

Conclusion

The Authority lacked adequate procedures and controls to ensure that it maintained sufficient documentation to support that it used Program funds in accordance with Federal requirements. As a result, HUD lacked assurance that the Authority's use of $3.3 million in Program funds for the acquisition of the Farwell Building was reasonable and met Federal requirements.

Recommendations

We recommend that the Director of HUD's Detroit Office of Community Planning and Development require the State to

1A. Perform a reasonable analysis to determine the fair market value of the Farwell Building before the Michigan Land Bank Fast Track Authority acquired the property. If the State does not perform a reasonable analysis, it should reimburse its Program from non-Federal funds for the $3.3 million in Program funds used for the acquisition of the Farwell Building. If the State performs a reasonable analysis and determines that the fair market value of the Farwell Building before the Land Bank acquired the property was less than $3.3 million, it should also provide sufficient documentation to support and justify the Land Bank's acquisition of the property for $3.3 million or reimburse its Program from non-Federal funds for the portion of the $3.3 million in Program funds in excess of the fair market value of the Farwell Building before the Land Bank acquired the property.

1B. Implement adequate procedures and controls to ensure that it maintains sufficient documentation to support that the Authority's use of Program funds is for eligible project costs.

SCOPE AND METHODOLOGY

To accomplish our objective, we reviewed

- Applicable laws; the Federal Register, dated October 6, 2008, June 19, 2009, and April 9, 2010; HUD's regulations at 24 CFR Parts 85 and 570; the U.S. Department of Transportation's regulations at 49 CFR Part 24; Office of Management and Budget Circular A-87; HUD's policy alert; HUD Handbook 1378, CHG-10; HUD's Relocation and Acquisition Policies, volume 1, number 2; HUD's Program grant agreement with the State; and HUD's Detroit Office of Community Planning and Development's monitoring reports for the State's Program and Community Development Block Grant and HOME Investment Partnerships programs from 2008 through 2011.

- The State's 2008 action plan substantial amendment for the Program, consolidated plans for 2005 and 2010, annual performance reports for 2009 and 2010, and Program data from HUD's Disaster Recovery Grant Reporting system and the Authority's On-line Project Administration Link system.

- The Authority's audited financial statements for 2009 and 2010, annual reports for 2008 through 2010, financial records, policies and procedures, interagency agreement, board meeting minutes, organization chart, and budgets.

We interviewed the Authority's employees, the Michigan Land Bank Fast Track Authority's and Exclusive Realty's personnel, and HUD's staff.

As previously stated, on March 19, 2009, HUD entered into a grant agreement with the State's Authority for nearly $98.7 million in Program funds.

Finding 1

We reviewed one of the Authority's redevelopment projects administered by the Michigan Land Bank Fast Track Authority due to a citizen's complaint to our office to determine whether the Authority used $3.3 million in Program funds in accordance with Federal requirements.

We did not rely on data maintained in HUD's Disaster Recovery Grant Reporting system since it did not contain project-specific data. We also did not rely on data maintained in the Authority's On-line Project Administration Link system since we performed a minimal level of testing and found the data to be unreliable for our purposes.

We performed our onsite audit work from June through November 2011 at the Authority's office located at 735 East Michigan Avenue, Lansing, MI. The audit covered the period July 2008 through May 2011 and was expanded as determined necessary.

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 finding and conclusions based on our audit

objective. 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:

- Effectiveness and efficiency of operations - Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.

- Reliability of financial reporting - 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 applicable laws and regulations - Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

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 and efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws or regulations on a timely basis.

Significant Deficiency

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

- The Authority lacked adequate procedures and controls to ensure that it maintained adequate documentation to support that its use of Program funds for the acquisition of a building was reasonable and in accordance with Federal requirements.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

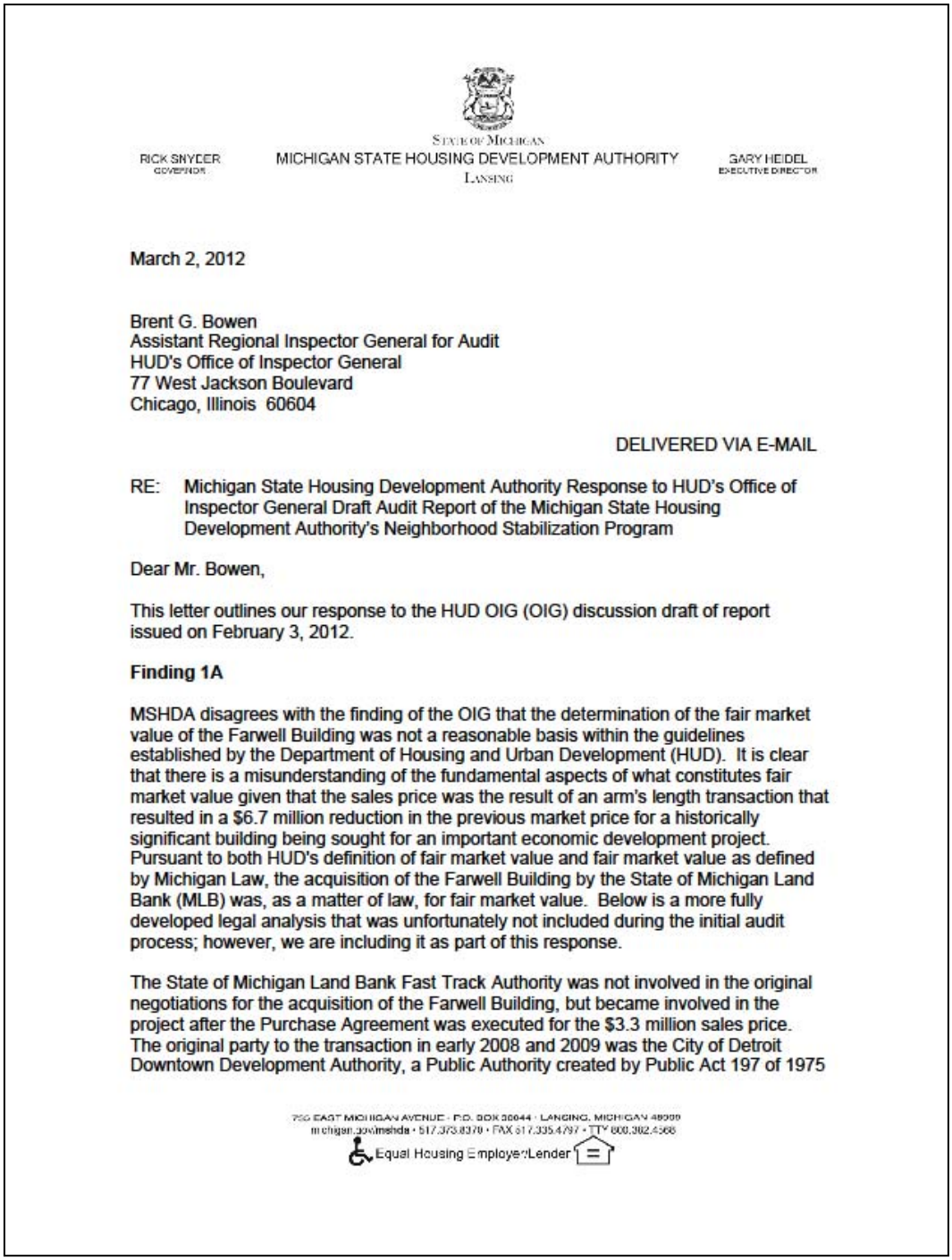
Recommendation number	Unsupported 1/
1A	$3,300,000
Totals	$3,300,000

1/ 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.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**



STATE OF MICHIGAN
RICK SNYDER, GOVERNOR — MICHIGAN STATE HOUSING DEVELOPMENT AUTHORITY, LANSING — GARY HEIDEL, EXECUTIVE DIRECTOR

March 2, 2012

Brent G. Bowen
Assistant Regional Inspector General for Audit
HUD's Office of Inspector General
77 West Jackson Boulevard
Chicago, Illinois 60604

DELIVERED VIA E-MAIL

RE: Michigan State Housing Development Authority Response to HUD's Office of Inspector General Draft Audit Report of the Michigan State Housing Development Authority's Neighborhood Stabilization Program

Dear Mr. Bowen,

This letter outlines our response to the HUD OIG (OIG) discussion draft of report issued on February 3, 2012.

Finding 1A

Comment 1
Comments 1 and 2
Comment 1

MSHDA disagrees with the finding of the OIG that the determination of the fair market value of the Farwell Building was not a reasonable basis within the guidelines established by the Department of Housing and Urban Development (HUD). It is clear that there is a misunderstanding of the fundamental aspects of what constitutes fair market value given that the sales price was the result of an arm's length transaction that resulted in a $6.7 million reduction in the previous market price for a historically significant building being sought for an important economic development project. Pursuant to both HUD's definition of fair market value and fair market value as defined by Michigan Law, the acquisition of the Farwell Building by the State of Michigan Land Bank (MLB) was, as a matter of law, for fair market value. Below is a more fully developed legal analysis that was unfortunately not included during the initial audit process; however, we are including it as part of this response.

Comment 3

The State of Michigan Land Bank Fast Track Authority was not involved in the original negotiations for the acquisition of the Farwell Building, but became involved in the project after the Purchase Agreement was executed for the $3.3 million sales price. The original party to the transaction in early 2008 and 2009 was the City of Detroit Downtown Development Authority, a Public Authority created by Public Act 197 of 1975

735 EAST MICHIGAN AVENUE · P.O. BOX 30044 · LANSING, MICHIGAN 48909
michigan.gov/mshda · 517.373.8370 · FAX 517.335.4797 · TTY 800.382.4568
Equal Housing Employer/Lender

Ref to OIG Evaluation **Auditee Comments**

Comment 3
Comment 1

(DDA), and it assigned the rights to a purchase agreement for the purchase of the Farwell Building that had been previously negotiated by Exclusive Realty on behalf of the DDA, prior to the involvement of the MLB. The arm's length negotiations that occurred between the DDA's representative and the seller established the fair market value that is documented by the purchase agreement. The MLB's subsequent procurement of the rights to purchase the property after an arm's lengths deal had been reached further establishes that the MLB acquired the property for fair market value established independently from the MLB's purchase.

HUD generally defines fair market value as "the hypothetical price that a willing buyer and seller will agree upon when they are acting freely, carefully, and with complete knowledge of the situation." HUD Glossary <http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/buying/glossary> (accessed February 28, 2012).

Further, as specifically related to NSP, HUD's guidance on procuring an appraisal directs grantees to the HUD's guide to preparing an appraisal scope of work under the URA in HUD Handbook 1378- Appendix 19 found at http://www.hud.gov/offices/adm/hudclips/handbooks/cpdh/1378.0/1378x19CPDH.pdf. In the HUD URA Handbook, Guide for Preparing An Appraisal Scope of Work, fair market value is defined as:

> DEFINITION OF FAIR MARKET VALUE: **This is determined by State law.** Fair market value, however, is generally defined as the price that a seller is willing to accept and a buyer is willing to pay on the open market in an arm's length transaction, and usually includes the following:
> 1. Buyer and seller are typically motivated;
> 2. Both parties are well informed or well advised, each acting in what he or she considers his or her own best interest;
> 3. A reasonable time is allowed for exposure in the open market;
> 4. Payment is made in terms of cash in U. S. dollars or in terms of financial arrangements comparable thereto; and
> 5. The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.
> [emphasis added]

As is evident by the Court's discussion in Mackey v Dept of Human Services, 289 Mich App 688; ___ NW2d ___ (2010), one measure of determining fair market value in Michigan is essentially the same as how fair market value is defined by HUD:

2

Ref to OIG Evaluation **Auditee Comments**

> [T]his Court has explained that the common understanding of "fair market value" is "the amount of money that a ready, willing, and able buyer would pay for the asset on the open market ...." Black's Law Dictionary similarly defines "fair market value" as "[t]he price that a seller is willing to accept and a buyer is willing to pay on the open market and in an arm's-length transaction; the point at which supply and demand intersect." An "arm's-length" transaction, in turn, is defined as "relating to dealings between two parties who are not related ... and who are presumed to have roughly equal bargaining power; not involving a confidential relationship [.]" [internal citations deleted]

Comment 1

Thus, pursuant to both HUD's definition of fair market value and fair market value as defined by Michigan Law, the acquisition of the Farwell Building by the MLB was, as a matter of law, for fair market value.

Comment 1

The OIG report questions if the $3.3 million purchase price was reasonable. The definition of reasonable cost relied on by HUD is defined in OMB Cir A-87(C)(2), revised May 10, 2004, as "[a] cost [] if, in its nature and amount, [] does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost." This is essentially the reasonable person standard. As the Court in Twp of Plymouth v Hancock, 236 Mich App 197, 201-02; 600 NW2d 380 (1999), pointed out, "[t]he reasonable person standard is a hallmark of the Anglo-American legal system" in place "to prevent any ad hoc and subjective application . . ." In furtherance of the goal of avoiding subjective application of the standard after the fact, OMB Cir A-87 further requires the following relevant elements be considered:

In determining reasonableness of a given cost, consideration is given to:

> * * *
> b. The restraints or requirements imposed by such factors as: sound business practices; **arms length** bargaining; Federal, State and other laws and regulations; and, terms and conditions of the Federal award. (emphasis added)
>
> * * *
> d. Whether the individuals concerned acted with prudence in the circumstances considering their responsibilities to the governmental unit, its employees, the public at large, and the Federal Government.

3

Ref to OIG Evaluation **Auditee Comments**

e. Significant deviations from the established practices of the governmental unit which may unjustifiably increase the Federal award's cost.

Comments 1 and 2

As to whether the MLB acted in a manner that a reasonably prudent person would, the facts are, the MLB relied on an arm's length transaction negotiated independently from the MLB that reduced the purchase price by nearly $7 million dollars for a historically significant building being sought for an important economic development project. The question of reasonableness is not an invitation to substitute a subjective opinion, after the fact, on whether purchasing the Farwell Building for $3.3 million dollars was reasonable. The correct measurement of reasonableness is, was the MLB decision to purchase the Farwell Building for fair market value, at a $6.7 million reduction in the previous market price, reasonable when the MLB desired to purchase the building for an important economic development project. That decision is objectively a reasonable business decision. Lastly, there was no significant deviation from the MLB's established practices which unjustifiably increased the cost of acquiring the Farwell Building.

Comment 1

Accordingly, the purchase price of $3.3 million is within the definition of reasonable cost as defined by both OMB Cir A-87 and Michigan Law.

Response to Finding 1B

Comment 4

The Authority's Community Development Division (CD) has recognized that its procedures and controls *vis a vis* partner state agencies for the Neighborhood Stabilization Program 1 (NSP1) needed to be strengthened, so some changes have been made. The Community Development Division has incorporated all of its NSP1 projects, including those administered by partner state agencies such as the Michigan Land Bank, into our electronic tracking database system known as the Online Project Administration Link (OPAL). Under the tracking system, if the pre-disbursement conditions are not met, disbursement under OPAL cannot occur until CD staff reviews and certifies that all of the required conditions have been met.

This concludes our response to the HUD OIG discussion draft of report issued on February 3, 2012. Thank you for allowing us the opportunity to respond, and we look forward to concluding the audit process.

Regards,

Serina Pena Andorfer
Michigan State Housing Development Authority

4

OIG's Evaluation of Auditee Comments

Comment 1 The Michigan Land Bank Fast Track Authority was required to determine the estimated fair market value of the Farwell Building and notify the Farwell I Corporation of its estimate of the property's fair market value before its acquisition of the property. However, the Land Bank did not do this. Further, Exclusive Realty's negotiated purchase price of $3.3 million for the Farwell Building was not an estimate of the fair market value of the building. In addition, neither the Land Bank nor the Authority could provide sufficient documentation to support that the estimated fair market value of the Farwell Building was $3.3 million before the Land Bank acquired the property or that the Authority's use of $3.3 million in Program funds for the Land Bank's acquisition of the Farwell Building was reasonable.

Appendix A to the U.S. Department of Transportation's regulations at 49 CFR Part 24 states that for programs and projects receiving Federal financial assistance described in 49 CFR 24.101(b)(2), an agency is to inform the owner(s) in writing of the agency's estimate of the fair market value for the property to be acquired. While section 24.101(b)(2) does not require an appraisal for these transactions, an agency may decide that an appraisal is necessary to support its determination of the fair market value of these properties, and in any event, an agency must have some reasonable basis for its determination of the fair market value. After an agency has established an amount it believes to be the fair market value of the property and has notified the owner of this amount in writing, an agency may negotiate freely with the owner to reach agreement.

Further, paragraph 5-3.E. of HUD Handbook 1378, CHG-10, states that in cases of voluntary acquisitions under 49 CFR 24.101(b)(2), agencies must inform the property owner in writing of what it believes to be the fair market value of the property (see appendix A to 49 CFR Part 24). Although an appraisal is not required by regulation in these circumstances, HUD encourages the use of an appraisal to establish the agency's estimate of fair market value, especially for high-value or complex property acquisitions. If an appraisal is not prepared, the estimate of fair market value must be prepared by a person familiar with real estate values. The agency's files must include an explanation, with reasonable evidence, of the basis for the agency's estimate of fair market value. Paragraph 5-3.F. states that in the case of voluntary acquisitions under the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970, there is nothing in the regulations to preclude negotiations resulting in agreements below, at, or above the agency's estimate of fair market value after the property owner has been so informed and all applicable requirements have been satisfied (see appendix A to 49 CFR Part 24 and volume 1, number 2, of HUD's Relocation and Acquisition Policies). Recipients should consider alternative properties available for purchase before entering into any agreement for property which exceeds the original estimate of fair market value. Subject to applicable program requirements, alternative properties must be pursued when proposed agreements

which exceed the recipient's original estimate cannot be legitimately supported and justified. Documentation and support for all agreements below, at, or above the original estimate must be at an appropriate level to satisfy a HUD technical review. All such agreements are subject to HUD review and corrective action when deemed necessary.

Volume 1, number 2, of HUD's Relocation and Acquisition Policies states that when negotiations exceed the original estimate of fair market value, and Federal funds pay for or participate in acquisition costs, an acquiring agency must document and maintain written justification for the higher amount. Such justification must state what available information supports exceeding the original estimate of fair market value. The level of documentation should fit the situation. When proposed agreements exceeding the agency's original estimate of fair market value cannot be legitimately supported and justified, Federal funds may not be used in the purchase.

Attachment A, section C.1., of Office of Management and Budget Circular A-87, revised May 10, 2004, requires all costs to be necessary, reasonable, and adequately documented. Section C.2. states that a cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. In determining reasonableness of a given cost, consideration must be given to (1) the restraints or requirements imposed by such factors as sound business practices and Federal regulations; (2) market prices for comparable goods or services; and (3) whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the organization; its members, employees, and clients; the public at large; and the Federal Government.

We revised the report to state the following:

- Contrary to Federal requirements, the Authority lacked sufficient documentation to support that the estimated fair market value of the Farwell Building was $3.3 million before the Michigan Land Bank Fast Track Authority acquired the property or that the Authority's use of $3.3 million in Program funds for the Land Bank's acquisition of the Farwell Building was reasonable.

We also revised recommendation 1A to state the following:

- Perform a reasonable analysis to determine the fair market value of the Farwell Building before the Michigan Land Bank Fast Track Authority acquired the property. If the State does not perform a reasonable analysis, it should reimburse its Program from non-Federal funds for the $3.3 million in Program funds used for the acquisition of the Farwell Building. If the State performs a reasonable analysis and determines that the fair market value of the

Farwell Building before the Land Bank acquired the property was less than $3.3 million, it should also provide sufficient documentation to support and justify the Land Bank's acquisition of the property for $3.3 million or reimburse its Program from non-Federal funds for the portion of the $3.3 million in Program funds in excess of the fair market value of the Farwell Building before the Land Bank acquired the property.

Comment 2 The Authority did not provide documentation to support that the previous fair market value of the Farwell Building was $10 million and that the $3.3 million sales price for the property was $6.7 million less than the previous fair market value of the property.

Comment 3 We revised the report to state the following:

- Representatives from the City of Detroit Downtown Development Authority, Lower Woodward Housing Fund, Detroit Investment Fund, and Wayne County Land Bank formed a working group to facilitate the redevelopment of the Capitol Park project. The Capitol Park project included the Farwell Building and two other properties located at 1145 and 1212 Griswold, Detroit, MI. The City of Detroit Downtown Development Authority hired Exclusive Realty, a third-party real estate broker, to negotiate the purchase of the Farwell Building on behalf of the working group to prevent the Farwell I Corporation from discovering the identity of the prospective buyer and trying to sell the property at an inflated price. Exclusive Realty negotiated a purchase price of $3.3 million for the Farwell Building and executed a purchase agreement for the property on behalf of the City of Detroit Downtown Development Authority on June 30, 2009. The president of Exclusive Realty said that a fair market analysis of the Farwell Building was not conducted. The $3.3 million represented the lowest price for which the Corporation was willing to sell the property.

- In July 2009, the City of Detroit Downtown Development Authority approached the Authority for assistance in acquiring the Farwell Building. On October 16, 2009, the Authority issued a notice of intent to request a release of funds stating that the Authority intended to award the Michigan Land Bank Fast Track Authority $3.3 million in Program funds to acquire the Farwell Building. On November 16, 2009, Exclusive Realty assigned its rights under the purchase agreement to the Land Bank. On November 19, 2009, the Authority disbursed $3.3 million to First American Title Insurance Company to finance the Land Bank's acquisition of the Farwell Building. On November 20, 2009, the Farwell I Corporation executed a warranty deed conveying the property to the Land Bank. According to the property transfer affidavit, the Land Bank acquired the Farwell Building for $3.3 million. On December 2, 2009, the Authority drew down $3.3 million in Program funds for the Land Bank's acquisition of the Farwell Building.

Comment 4 The Authority's corrective actions should improve the State's procedures and controls to ensure that the Authority's use of Program funds is for eligible project costs.

Appendix C

FEDERAL REQUIREMENTS

HUD's grant agreement with the Authority for the Program under the Act, dated March 19, 2009, states that the following are part of the grant agreement: the Federal Register, dated October 6, 2008; the Housing and Economic Recovery Act of 2008; the State's submission for Program assistance; HUD's regulations at 24 CFR Part 570; and the funding approval.

The Federal Register, dated October 6, 2008, states that except as described in the Federal Register, statutory and regulatory provisions governing the Community Development Block Grant program, including the provisions in subparts A, C, D, I, J, K, and O of 24 CFR Part 570, as appropriate, should apply to the use of Program funds. The Federal Register also states that HUD does not have the authority to provide alternative requirements for the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970. Unless the Federal Register describes how the Housing and Economic Recovery Act of 2008 supersedes the statutes in the Relocation Act, these statutes in the Relocation Act will apply as in the Block Grant program.

HUD's regulations at 24 CFR 85.22(b) state that allowable costs for State, local, or Indian tribal governments will be determined in accordance with cost principles contained in Office of Management and Budget Circular A-87.

HUD's regulations at 24 CFR 570.501(b) state that a recipient is responsible for ensuring that Community Development Block Grant funds are used in accordance with all program requirements. The use of designated public agencies, subrecipients, or contractors does not relieve the recipient of this responsibility. The recipient is also responsible for determining the adequacy of performance under subrecipient agreements and procurement contracts and for taking appropriate action when performance problems arise.

HUD's regulations at 24 CFR 570.502(a) state that recipients and subrecipients that are governmental entities, including public agencies, must comply with Office of Management and Budget Circular A-87. Section 570.502(a)(6) states that recipients and subrecipients that are governmental entities must comply with 24 CFR 85.22.

HUD's regulations at 24 CFR 570.506 state that recipients must establish and maintain sufficient records to enable HUD to determine whether the recipients have met the requirements of 24 CFR Part 570. Section 570.506(a) states that recipients need to maintain records providing a full description of each activity assisted with Community Development Block Grant funds; the amount of Block Grant funds budgeted, obligated, and expended for the activities; and the provisions under which the activities are eligible. Section 570.506(h) states that recipients need to maintain financial records in accordance with the applicable requirements in section 570.502. Recipients must maintain evidence to support how Block Grant funds are expended. The documentation must include invoices, schedules containing comparisons of budgeted amounts and actual expenditures, construction progress schedules signed by appropriate parties, and other documentation appropriate to the nature of the activity as applicable.

HUD's regulations at 24 CFR 570.606(b) state that 49 CFR Part 24 contains the government-wide regulations implementing the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970. Section 570.606(e) states that the acquisition of real property for an assisted activity is subject to subpart B of 49 CFR Part 24. Section 570.606(g)(1) states that a grantee is responsible for ensuring compliance with the requirements of 24 CFR 570.606, notwithstanding any third party's contractual obligation to the grantee to comply with the provisions of 24 CFR 570.606. For purposes of the State Community Development Block Grant program, the State should require recipients to certify that they will comply with the requirements of this section.

The U.S. Department of Transportation's regulations at 49 CFR 24.101(b)(2) state that the requirements of subpart B do not apply to acquisitions for programs or projects undertaken by an agency or person that receives Federal financial assistance but does not have authority to acquire property by eminent domain, provided that such agency or person should, before making an offer for the property, clearly advise the owner that the agency or person is unable to acquire the property if negotiations fail to result in an agreement and inform the owner in writing of what the agency or person believes to be the market value of the property. Appendix A to 49 CFR Part 24 states that for programs and projects receiving Federal financial assistance described in 49 CFR 24.101(b)(2), an agency is to inform the owner(s) in writing of the agency's estimate of the fair market value for the property to be acquired. While section 24.101(b)(2) does not require an appraisal for these transactions, an agency may decide that an appraisal is necessary to support its determination of the fair market value of these properties, and in any event, an agency must have some reasonable basis for its determination of the fair market value. After an agency has established an amount it believes to be the fair market value of the property and has notified the owner of this amount in writing, an agency may negotiate freely with the owner to reach agreement.

Attachment A, section C.1., of Office of Management and Budget Circular A-87, revised May 10, 2004, requires all costs to be necessary, reasonable, and adequately documented. Section C.2. states that a cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. In determining reasonableness of a given cost, consideration must be given to (1) the restraints or requirements imposed by such factors as sound business practices and Federal regulations; (2) market prices for comparable goods or services; and (3) whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the organization; its members, employees, and clients; the public at large; and the Federal Government.

Paragraph 5-3.E. of HUD Handbook 1378, CHG-10, states that in cases of voluntary acquisitions under 49 CFR 24.101(b)(2), agencies must inform the property owner in writing of what it believes to be the fair market value of the property (see appendix A to 49 CFR Part 24). Although an appraisal is not required by regulation in these circumstances, HUD encourages the use of an appraisal to establish the agency's estimate of fair market value, especially for high-value or complex property acquisitions. If an appraisal is not prepared, the estimate of fair market value must be prepared by a person familiar with real estate values. The agency's files must include an explanation, with reasonable evidence, of the basis for the agency's estimate of

fair market value. Paragraph 5-3.F. states that in the case of voluntary acquisitions under the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970, there is nothing in the regulations to preclude negotiations resulting in agreements below, at, or above the agency's estimate of fair market value after the property owner has been so informed and all applicable requirements have been satisfied (see appendix A to 49 CFR Part 24 and volume 1, number 2, of HUD's Relocation and Acquisition Policies). Recipients should consider alternative properties available for purchase before entering into any agreement for property which exceeds the original estimate of fair market value. Subject to applicable program requirements, alternative properties must be pursued when proposed agreements which exceed the recipient's original estimate cannot be legitimately supported and justified. Documentation and support for all agreements below, at, or above the original estimate must be at an appropriate level to satisfy a HUD technical review. All such agreements are subject to HUD review and corrective action when deemed necessary (see paragraph 5-4.H.). Paragraph 5-4.H. states that acquiring agencies must also comply with applicable HUD program regulations and policies in negotiating agreements for a property which exceeds the agency's fair market value determination. If there is a conflict, HUD program regulations and policies prevail. If HUD grant funds are used to acquire properties, acquiring agencies must also be guided by the applicable Office of Management and Budget circulars when considering the original estimate of fair market value and any agreement which exceeds that amount. A fundamental requirement in the Office of Management and Budget circulars is that costs charged to a Federal grant be reasonable. In particular, Office of Management and Budget Circular A-87 states that costs must be necessary and reasonable for the proper and efficient performance and administration of Federal awards.

Volume 1, number 2, of HUD's Relocation and Acquisition Policies states that when acquiring property under 49 CFR 24.101(b)(1) through (5) of the Relocation Act, an acquiring agency must have a reasonable basis for its determination of the property's fair market value. After an acquiring agency has established an amount it believes to be the fair market value of the property and has notified the owner of this amount in writing, an acquiring agency may negotiate with the owner to reach agreement on a final purchase price. Negotiations may result in agreement below, at, or above, the agency's original estimate of fair market value. When negotiations exceed the original estimate of fair market value and Federal funds pay for or participate in acquisition costs, an acquiring agency must document and maintain written justification for the higher amount. Such justification must state what available information supports exceeding the original estimate of fair market value. The level of documentation should fit the situation. When proposed agreements exceeding the agency's original estimate of fair market value cannot be legitimately supported and justified, Federal funds may not be used in the purchase.