



Issue Date May 17, 2010

Audit Report Number 2010-AT-1004

TO: Charles Franklin, Director, Community Planning and Development Division,
4CD

//signed//

FROM: James D. McKay, Regional Inspector General for Audit, Atlanta Region, 4AGA

SUBJECT: Mobile Housing Board, Mobile, AL, Used HOME Investment Partnerships
Program Funds for Ineligible and Unsupported Costs for Its HOPE VI
Redevelopment

HIGHLIGHTS

What We Audited and Why

We audited the Mobile Housing Board (Housing Board), which serves as both the public housing agency and the administering agency for the City of Mobile, AL's (City) HOME Investment Partnerships Program (HOME) and Community Development Block Grant (CDBG) program. We performed the audit based on a request from the Assistant Secretary, Community Planning and Development. The Assistant Secretary, along with the Director of the Office of Affordable Housing, expressed substantial concerns regarding the eligibility of the HOME and CDBG funds expended on the Housing Board's HOPE VI project, as well as the Housing Board's administration of the HOME and CDBG programs related to its public housing HOPE VI project, given the Housing Board's dual role as administrator of the programs and the public housing authority.

Our audit objective was to determine whether the City adequately monitored the Housing Board and whether the Housing Board's controls and procedures to separate its public housing agency operations from its administration of HOME and CDBG programs were effective in preventing and detecting ineligible and unsupported costs in its HOPE VI redevelopment.

What We Found

The City did not perform annual monitoring of the Housing Board to ensure that its HOME funds were used in accordance with all program requirements. This condition occurred because the City did not maintain an adequate subrecipient agreement with the Housing Board that provided current and sufficient detail as a sound basis on which to effectively monitor the Housing Board's performance. In addition, the City did not establish procedures for monitoring the Housing Board. As a result, due to its lack of monitoring, the City failed to detect or prevent the Housing Board's use of more than \$1.1 million for unsupported and ineligible costs for the HOPE VI redevelopment.

Cost allocation plans were not developed by the Housing Board to properly allocate or prorate its HOME program costs for phases III and IV. The Housing Board arbitrarily charged more than \$1 million to phases III and IV. This condition occurred because the Housing Board expended the funds to meet program expenditure deadlines without regard to HOME regulations. As a result, the Housing Board disbursed \$839,713 in unsupported costs on both phases.

The Housing Board used \$339,657 of its HOME funds to pay for ineligible costs in all four phases of its HOPE VI redevelopment project. This condition occurred because (1) the Housing Board's controls and procedures to separate its public housing agency operations from its administration of CPD programs were ineffective in preventing and detecting ineligible costs and (2) the City did not monitor the Housing Board (see finding 1). As a result, \$339,657 in HOME funds was not used as intended under the HOME program.

What We Recommend

We recommend that the Director for Community Planning and Development ensure that the City (1) establishes and maintains a subrecipient agreement with the Housing Board pursuant to HUD requirements, (2) develops procedures to monitor the Housing Board at least annually, and (3) reallocates the excessive \$1.9 million in HOME and CDBG funds to other eligible activities and program recipients.

In addition, we recommend that the Director for Community Planning and Development require the Housing Board to (1) support the \$839,713 in HOME funds it charged to phases III and IV with either a cost allocation or proration plan, repaying any amount that cannot be supported; (2) lower the sales prices of the HOME units in phase I to within HUD requirements and ensure that they are occupied by qualified low-income persons in a timely manner or repay the \$156,004 in ineligible HOME funds; (3) recapture the \$183,653 in HOME funds

used to pay for ineligible costs for phases II, III, and IV of the HOPE VI redevelopment; and (4) establish controls and procedures to separate its public housing agency operations from its administration of CPD programs so that HOME funds will be used according to program requirements.

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 discussed our review results with the Housing Board, the City and HUD officials during the audit. We provided a copy of the draft report to Housing Board officials on March 30, 2010, for their comments and discussed the report with the officials at the exit conference on April 8, 2010. The Housing Board provided written comments on April 21, 2010. It generally disagreed with our findings.

The complete text of the Housing Board's response, along with our evaluation of that response, can be found in appendix B of this report. Attachments to the Housing Board's comments were not included in the report but are available for review upon request.

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BACKGROUND AND OBJECTIVE

The Mobile Housing Board (Housing Board) serves as the public housing authority for the City of Mobile (City). The Housing Board was incorporated in 1937 and chartered under the laws of the State of Alabama to provide and administer affordable housing programs and related programs for the citizens of Mobile, AL. The Housing Board receives policy guidance and operational approval from its five-member governing board of commissioners. The commissioners are appointed to 5-year terms by the mayor of Mobile. The Housing Board dismissed its long-time executive director on December 2, 2009, and hired Dwayne Vaughn as interim executive director.

The majority of funding for the Housing Board is provided by the Federal Government through the U.S. Department of Housing and Urban Development (HUD). The Housing Board provides housing or housing assistance to more than 7,000 families through the traditional public housing and Housing Choice Voucher programs. In addition to its role as the public housing authority, the Housing Board works in collaboration with the City to administer its Community Development Block Grant (CDBG) program and, operates as a subrecipient for the City's HOME Investment Partnerships Program (HOME).

The Housing Board received a \$20 million fiscal year 2003 HOPE VI revitalization grant from HUD's Public and Indian Housing Division for redevelopment of the Albert Owens/Jesse Thomas public housing developments. The HOPE VI redevelopment was financed with the \$20 million in HOPE VI funds, which leveraged another \$23.9 million in investment that included HOME and CDBG funds.

The audit objective was to determine whether the City adequately monitored the Housing Board and whether the Housing Board's controls and procedures to separate its public housing agency operations from its administration of HOME and CDBG programs were effective in preventing and detecting ineligible and unsupported HOME and CDBG costs in its HOPE VI redevelopment.

RESULTS OF AUDIT

Finding 1: The City Did Not Adequately Monitor the Housing Board

The City did not adequately monitor its subrecipient, the Housing Board. This condition occurred because the City did not maintain an adequate subrecipient agreement with the Housing Board that provided current and sufficient detail as a sound basis on which to effectively monitor the Housing Board's performance. In addition, the City did not establish procedures for monitoring the Housing Board. As a result, due to its lack of monitoring, the City failed to detect or prevent the Housing Board's use of more than \$1.1 million for unsupported and ineligible costs for the HOPE VI redevelopment (see findings 2 and 3).

Monitoring Reviews Not Conducted as Required

The City did not comply with HUD requirements for managing its HOME program. 24 CFR 92.504(a) requires the City to review the Housing Board, at least annually, to ensure that HOME funds are used in accordance with all program requirements. However, the City had not performed monitoring reviews of the Housing Board within the past 10 years and did not have procedures for monitoring the HOME program.

The City did not maintain an adequate subrecipient agreement with the Housing Board. 24 CFR 92.504(b) requires that, before disbursing HOME funds to the Housing Board, the City must enter into a written agreement. The subrecipient agreement in place was executed on August 10, 1999, and had not been revised. The 1999 agreement did not describe, in current and sufficient detail, the use of the HOME funds, including the tasks to be performed, a schedule for completing the tasks, a budget, and the period of the agreement as required by 24 CFR 92.504(c)(2)(i). The agreement did not address the use of program income and did not specify the particular records that must be maintained and the information or reports that must be submitted to assist the City in meeting its requirements as required by 24 CFR 92.504(c)(2)(ii) and (vii). Without a proper subrecipient agreement, the City lacked a sound basis upon which to effectively develop procedures to monitor the Housing Board's performance.

Consequently, the Mobile City Council allocated more than \$1.9 million in excessive HOME and CDBG funds for the HOPE VI redevelopment project. On May 13, 2008, the City allocated \$5.3 million to the Housing Board's HOPE VI redevelopment project without proper documentation to support the funds needed. According to the former executive director, the funds were allocated based on the HOPE VI matching requirements. However, the Housing Board's HOPE VI

status report, dated January 12, 2010, documented that only \$3.308 million in HOME and CDBG funds was needed and the Housing Board confirmed that the HOME and CDBG funding amounts in that status report were still accurate as of March 23, 2010. Therefore, the City reallocated more than \$1.9 million in excessive HOME and CDBG funds to the Housing Board for its HOPE VI redevelopment. These funds were not available for use to benefit HUD's intended recipients, and the City should reallocate these funds to other eligible activities.

Also, due to its lack of monitoring, the City failed to detect or prevent the use of HOME funds for unsupported and ineligible costs for the HOPE VI redevelopment project. The Housing Board used \$839,713 for unsupported costs (see finding 2) and \$339,657 for ineligible costs (see finding 3) that should be repaid.

The City's chief of staff acknowledged that the City did not monitor the Housing Board and that the subrecipient agreement was inadequate. As of January 27, 2010, the City had begun efforts to develop audit procedures and assigned an internal auditor the responsibility for monitoring the Housing Board. Before that designation, the City did not have an internal audit function in place for monitoring the Housing Board. The City's chief of staff stated that the subrecipient agreement would be revised and maintained to reflect current HOME activities in sufficient detail to provide a sound basis for effective monitoring.

Conclusion

Overall, the City did not comply with HUD requirements for managing the Housing Board's HOME program. It did not establish an adequate subrecipient agreement or have monitoring procedures in place. It allocated more than \$1.9 million in excessive HOME and CDBG funds to the Housing Board for its HOPE VI redevelopment. In addition, due to its lack of monitoring, the City failed to detect or prevent the use of HOME funds for unsupported and ineligible costs for the HOPE VI redevelopment project. The Housing Board used \$839,713 for unsupported costs (see finding 2) and \$339,657 for ineligible costs (see finding 3) that should be repaid.

Recommendations

We recommend that the Director, Office of Community Planning and Development,

- 1A. Require the City to establish and maintain a subrecipient agreement with the Housing Board, as provided by HUD requirements that includes

current and sufficient detail to provide a sound basis on which to effectively monitor the Housing Board's performance.

- 1B. Require the City to develop procedures for monitoring the Housing Board, at least annually, to ensure that HOME funds are used in accordance with all program requirements.
- 1C. Require the City to reallocate the \$1,991,149 in excess HOME and CDBG funds it reallocated to the Housing Board in support of its HOPE VI redevelopment project to other eligible activities and program recipients.

Finding 2: The Housing Board Did Not Develop Cost Allocation Plans for Phases III and IV

The Housing Board did not develop cost allocation plans to properly allocate or prorate its HOME program costs for phases III and IV. It arbitrarily charged more than \$1 million to phases III and IV. This condition occurred because the Housing Board expended the funds to meet program expenditure deadlines without regard to HOME regulations. As a result, it disbursed \$839,713 in unsupported costs on both phases.

Four Phases of the HOPE VI Program

The Housing Board's HOPE VI redevelopment program included four phases: phase I included 9 single-family homeownership units, phase II included an 88-unit senior rental high rise, phase III included 87 family rental units, and phase IV included 48 family rental units.

HUD's Community Planning and Development Notice 98-2 states that HOME funds may be invested in mixed-income projects to assist only the HOME portion of the units in the project. It is necessary to distinguish between HOME-assisted and other units. When the units are comparable, the actual costs can be determined by prorating total development costs. When units are not comparable, the participating jurisdiction must allocate the HOME costs on a unit-by-unit basis, charging only actual costs to the HOME program.

Six of the nine units for phase I received HOME funding, and three units were privately financed. Since the six units were HOME specific, allocation of the costs was not required. Phase II did not include HOME units and was not eligible for HOME funds. However, phases III and IV received mixed funding from several HUD programs and private financing, which required allocation of the HOME costs.

Phase III Development Costs

Phase III of the redevelopment plan consisted of a community building and 47 family buildings containing 87 subsidized units, to include 14 1-bedroom units, 53 2-bedroom units, and 20 3-bedroom units. The Housing Board estimated that it would cost more than \$18.7 million to develop phase III. It planned to use mixed funding from the HOME and HOPE VI programs, along with capital funds and various tax credits, to finance the development.

The Housing Board committed HOME funds of \$990,525 for phase III. As of December 31, 2009, it had drawn \$842,973 in HOME funds but only charged \$835,641 to phase III. The remaining \$7,332 was used to pay for costs associated with phases I and II. A portion of the \$835,641 was used to pay \$130,872 in ineligible expenses for demolition fees. The ineligible costs are discussed in finding 3. The remaining \$704,769 was unsupported because the Housing Board did not have a cost allocation plan to support the distribution of the costs among the various funding sources.

In addition, the Housing Board committed and expended \$22,735 in HOME funds to acquire a parcel of land used for phase III. The Housing Board purchased the parcel of land expecting to receive an earlier HOPE VI grant. However, it did not receive the grant. At the time the land was purchased with HOME funds, there was not reasonable expectation that construction would begin within 12 months, as required by 24 CFR 92.2(2) (i). Because the Housing Board subsequently applied for and was awarded the HOPE VI redevelopment grant, and the land was necessary for that HOPE VI project, purchase of the land was an allowable cost. However, the cost was unsupported since a cost allocation plan was not in place to distribute the costs among the various funding sources.

Phase IV Development Costs

Phase IV of the redevelopment plan consisted of 24 twin buildings containing 48 family units, to include 14 2-bedroom units and 34 3-bedroom units. The Housing Board estimated that it would cost more than \$10.3 million to develop phase IV and planned to finance it using mixed funds from the HOME and HOPE VI programs, along with capital and CDBG funds, to finance the development.

The Housing Board committed more than \$1.2 million in HOME funds to phase IV. As of December 31, 2009, it had expended more than \$7.3 million, charging \$160,709 to the HOME program. A portion of the \$160,709 was used to pay \$48,500 in ineligible expenses for architectural fees. The ineligible costs are discussed in finding 3. The Housing Board did not have a cost allocation plan to support the remaining \$112,209 in costs expended. Therefore, \$112,209 was not a supported cost for phase IV.

Cost Allocation Plan Not Prepared

The Housing Board provided a document between the City and the Housing Board, dated June 16, 2009, signed by the Housing Board's former executive director. The Housing Board identified this document as an allocation plan. The document pertained only to phase IV, and its purpose was for the Housing Board

to acknowledge to the City that 11 of the 48 units built in phase IV would be set aside as HOME units. The document did not identify the units to be set aside, the bedroom size, or the square footage. These elements are necessary to establish unit comparability. There was no evidence that the Housing Board used this document to allocate the program costs.

The Housing Board did not develop an allocation plan because it expended the funds to meet program expenditure deadlines without regard to HOME regulations. According to the former executive director, if a HOME program expenditure deadline was near, the Housing Board would use HOME funds to make a payment even if the costs were not for the HOME program, thus charging the HOME program incorrectly.

The Housing Board was preparing a cost allocation plan. It sought HUD's assistance to ensure that the allocation plan would meet HOME requirements and costs to the HOME program would be accurately stated and supported.

Since the Housing Board failed to develop a cost allocation plan to distribute the costs among the various funding sources, it made \$839,713 in unsupported charges to the HOME program. This process not only resulted in unsupported costs being charged to the HOME program, it will also result in additional staff time needed to revisit and adjust the expenditures once a proper cost allocation plan is developed.

Recommendations

We recommend that the Director, Office of Community Planning and Development,

- 2A. Require the Housing Board to prepare a cost allocation or proration plan to support the \$839,713 charged to its HOME program for phases III and IV or repay the U.S. treasury account the amount that cannot be supported from its nonfederal funds.
- 2B. Require the Housing Board to adjust HOME program costs based on the cost allocation plan developed.
- 2C. Require the Housing Board to adopt procedures that ensure a cost allocation plan is developed for its projects before it commits HOME funds.

Finding 3: The Housing Board Used HOME Funds for Ineligible Costs

The Housing Board used \$339,657 of its HOME funds to pay for ineligible costs in all four phases of its HOPE VI redevelopment project. This condition occurred because (1) the Housing Board's controls and procedures to separate its public housing agency operations from its administration of CPD programs were ineffective in preventing and detecting ineligible costs and (2) the City did not monitor the Housing Board (see finding 1). As a result, \$339,657 in HOME funds was not used as intended under the HOME program.

\$156,004 in Ineligible HOME Funds for Phase I

The Housing Board committed HOME funds of \$312,586 for phase I and disbursed \$156,004 to build six single-family houses. However, the houses were not eligible for HOME funds because the sales prices were above the \$200,160 statutory median sales price limitations for Mobile, AL. The houses were certified for occupancy and offered for sale. The Housing Board must get qualified occupants into the houses.

The Housing Board agreed that the houses were priced above the statutory limits established in 24 CFR 92.254(a). It said it was unaware of and overlooked the requirements limiting the sales prices. Because none of the houses had been sold, the Housing Board had the opportunity to reduce the sales prices. The Housing Board agreed and had begun lowering the sales prices for its existing sales contracts. Two of the houses were under contract with sales prices of \$223,900 and \$229,000. The Housing Board lowered the sales prices for each house to \$200,160 to comply with HUD's sales price limitation. The Housing Board said it would reduce the sales prices for the remaining HOME-funded houses according to requirements.

To make phase I eligible for HOME funds, in addition to reducing the sales price, the Housing Board must also comply with 24 CFR 92.216 and 92.217 that requires that it get low-income occupants into the units, either owner-occupants that purchase the houses or tenants that rent from the Housing Board. Also, the Housing Board must impose the affordability requirements provided in 24 CFR 92.252 for rental housing or 24 CFR 92.254 for homeownership units. The houses have stood vacant for long periods of time. As of February 28, 2010, none of the six HOME-funded houses were occupied even though the houses were ready and available for occupants from 170 to 255 days. Despite the low demand for homeownership units, the Housing Board preferred to continue its efforts to sell the houses versus renting them. However, if the houses are not sold soon, the Housing Board understood that either it would have to rent the houses to qualified low-income tenants or repay the HOME funds.

Repaid funds must be deposited into the City's HOME treasury account and used for additional HOME projects in accordance with HOME program requirements. However, the City had no HOME treasury account and the funds should be repaid to the U.S. treasury account.

Because the houses were priced above statutory sales price limits and were not occupied by qualified persons, the activity was ineligible. Therefore, the \$156,004 will have to be repaid unless the Housing Board (1) lowers the sales prices according to requirements, (2) gets eligible low-income occupants into the houses, and (3) imposes the HOME affordability requirements.

\$4,281 in Ineligible HOME Funds for Phase II

The Housing Board used \$4,281 of its HOME funds to pay ineligible costs for phase II, an 88-unit senior center with no HOME designated units. It erroneously charged the \$4,281 to its phase III development, but the vouchers and receipts showed that the costs were for groundbreaking ceremonies for phase II. The Housing Board acknowledged that it had charged \$4,281 to phase III by mistake and agreed that the \$4,281 was an ineligible HOME cost. The \$4,281 in HOME funds should be repaid.

\$130,872 in Ineligible HOME Funds for Phase III

The Housing Board used \$130,872 of its HOME funds for ineligible costs for phase III. The HOME funds were used for the demolition of public housing, a prohibited HOME cost. The Housing Board paid the demolition costs for public housing because it was unaware that HOME regulations made a distinction between costs for demolition and demolition of public housing.

While 24 CFR 92.205(a) (1) states that HOME funds may be used for demolition costs, they cannot be used for the demolition of public housing. 24 CFR 92.214(a)(4) provides that HOME funds may not be used to pay for costs for which public housing receives funding under Section 9 of the Housing Act of 1937 (Act), and funds were provided under the Act for the demolition of public housing. Thus, demolition of public housing was not an eligible HOME cost. The \$130,872 in HOME funds should be repaid.

\$48,500 in Ineligible HOME Funds for Phase IV

The Housing Board used \$48,500 of its HOME funds for ineligible costs for architectural/engineering drawings that were no longer part of phase IV or the approved HOPE VI redevelopment. It paid for architectural/engineering drawings for 150 homeownership units that were intended to have been constructed within phase IV. However, the Housing Board revised its HOPE VI redevelopment by terminating its plan to construct the 150 homeownership units and decided to construct 48 public housing rental units instead. The Housing Board planned to use the drawings to construct 52 homeownership single-family houses when the housing market becomes more stable. However, these units would be constructed outside the approved HOPE VI redevelopment. 24 CFR 92.503(b)(2) provides that HOME funds invested in a project that is terminated before completion, either voluntarily or otherwise, must be repaid. As a result, the \$48,500 in HOME funds was not available to benefit the HOME program's intended recipients. The \$48,500 in HOME funds should be repaid.

Conclusion

The Housing Board used HOME funds of \$339,657 for ineligible costs to support its HOPE VI redevelopment project. It used HOME funds of

- \$156,004 to pay ineligible phase I costs. However, the Housing Board can correct this condition and avoid repayment of the funds if it (1) lowers the sales prices (2) gets eligible low-income occupants into the houses as either buyers or tenants, and (3) impose the HOME affordability requirements.
- \$183,653 to pay for ineligible costs for phases II, III, and IV of the HOPE VI redevelopment that should be repaid.

Overall, the Housing Board incurred the ineligible costs because its controls and procedures to separate its public housing agency operations from its administration of community planning and development grant programs were ineffective in preventing and detecting ineligible costs. Also, the City did not monitor the Housing Board (see finding 1). As a result, HOME funds of \$339,656 were not used as intended under the HOME program.

Recommendations

We recommend that the Director, Office of Community Planning and Development,

- 3A. Ensure that the Housing Board (1) lowers the sales prices of the HOME units in phase I to within HUD requirements and (2) places qualified low-income occupants into the homes within a reasonable amount of time, whether those occupants are home buyers or tenants. Otherwise, HUD should ensure that the Housing Board repays the U.S. treasury account all of the \$156,004 in ineligible HOME funds expended for phase I from nonfederal funds.
- 3B. Ensure that the Housing Board repays, from nonfederal funds, HOME funds of \$183,653 used to pay for ineligible costs for phases II, III, and IV of the HOPE VI redevelopment. Repaid funds must be deposited into the U.S. treasury account for additional HOME projects.
- 3C. Require the Housing Board to establish controls and procedures to separate its public housing agency operations from its administration of CPD programs to provide reasonable assurance that HOME funds are used according to HOME program requirements.

SCOPE AND METHODOLOGY

To accomplish our objectives, we

- Researched HUD handbooks, the Code of Federal Regulations, and other requirements and directives that govern the City's HOME program;
- Interviewed officials of the Birmingham HUD Offices of Community Planning and Development and Public and Indian Housing, headquarters Office of Affordable Housing, the Housing Board, and the City;
- Reviewed HUD's monitoring reports and files for the Housing Board's HOME program;
- Reviewed the Housing Board's procedures and controls used to administer its CPD program activities; and
- Reviewed all costs charged to the HOME program that were related to the HOPE VI program and the supporting documentation.

The HOPE VI redevelopment was financed with \$20 million in HOPE VI funds, which leveraged additional funds, including HOME and CDBG funds of \$5.3 million. We tailored our audit to focus on the \$5.3 million in HOME and CDBG funds used in the HOPE VI program. We did not review and assess general and application controls over the Housing Board's information system. We conducted other tests and procedures to ensure the integrity of computer-processed data that were relevant to the audit objective. The tests included comparison of computer-processed data to written agreements, contracts, and other supporting documentation. We did not place reliance on the Housing Board's information and used other supporting documentation for the activities reviewed.

The review generally covered the period January 1, 2007, through August 31, 2009. We performed the review from September 2009 to January 2010 at the offices of the Housing Board located in Mobile, AL. We adjusted the review period when necessary.

We assigned a value to the potential savings to the HOME program if HUD implements our recommendations. If HUD implements recommendation 1C requiring the City to reallocate the \$1.9 million of excessive HOME and CBDG funds, those funds will not be used for inappropriate expenses, and the funds will be applied to eligible activities.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. 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 an integral component of an organization's management that provides reasonable assurance that the following controls are achieved:

- Program operations,
- Relevance and reliability of information,
- Compliance with applicable laws and regulations, and
- Safeguarding of assets and resources.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. They 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 control was relevant to our audit objective:

- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that its resources are used in accordance with laws and regulations.

We assessed the relevant control identified above.

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

Significant Weaknesses

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

- The Housing Board's controls and procedures to separate its public housing agency operations from its administration of community planning and development grant programs were not effective in preventing and detecting unsupported and ineligible costs in its HOPE VI redevelopment (see findings 2 and 3).

APPENDIXES

Appendix A

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

Recommendation number	Ineligible 1/	Unsupported 2/	Funds to be put to better use 3/
1C			\$1,991,149
2A		\$839,713	
3A	\$156,004		
3B	<u>\$183,653</u>		
Total	<u>\$339,657</u>	<u>\$839,713</u>	<u>\$1,991,149</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 policies or regulations.

2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.

3/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified.


Implementation of our recommendation to require the City to reallocate the excessive HOME and CBDG funds will result in costs not being incurred for inappropriate expenses, and the funds will be applied to eligible activities.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

<p>COMMISSIONERS CLARENCE M. BALL, JR. CHAIRMAN DONALD L. LANGHAM VICE-CHAIRMAN MELVIN CLARK ANTHONY COOPER RUBY LANG</p>	 <p>MOBILE HOUSING BOARD ESTABLISHED 1935</p>	<p>DWAYNE C. VAUGHN EXECUTIVE DIRECTOR EMAIL: dvaughn@mhb.gov</p>
<p>MOBILE HOUSING BOARD www.mhb.gov</p>		
<p>April 21, 2010</p>		
<p>James D. McKay Regional Inspector General for Audit U.S. Department of Housing and Urban Development Office of Inspector General for Audit, Region 4 Richard B. Russell Federal Building 75 Spring Street, SW, Room 330 Atlanta, Georgia 30303-3388</p>		
<p>Re: Response to Draft Audit Report on the Mobile Housing Board's Use of HOME Investment Partnership Program Funds</p>		
<p>Dear Mr. McKay:</p>		
<p>Thank you for the opportunity to respond to the draft audit report examining the Mobile Housing Board's ("MHB") use of HOME Investment Partnership Program ("HOME") Funds in conjunction with its Albert Owens/Jesse Thomas Homes HOPE VI redevelopment. In the draft audit report ("Draft Audit") provided to MHB, the U.S. Department of Housing and Urban Development ("HUD"), Office of Inspector General ("OIG"), concludes that MHB used HOME funds for ineligible and unsupported costs related to its HOPE VI redevelopment activities. MHB has not seen the final audit report or any revised draft (other than an email modification of a paragraph on page 15 of the Draft Audit sent by Rob Burgess on April 12, 2010) since we met for an exit conference with the OIG on April 8, 2010, and therefore, MHB's responses are based on the Draft Audit received on March 31, 2010 and the email revision thereto.</p>		
<p>I. Overview of MHB's HOME Activities</p>		
<p>MHB takes the concerns raised in the Draft Audit very seriously and welcomes the opportunity to enhance the administration of its programs. In fact, MHB had already begun implementing key management improvements, auditing protocols and other procedures designed to address all of the issues described in the Draft Audit. Unfortunately, many of the issues highlighted in the Draft Audit were the outgrowth of a somewhat rigid management approach that was embraced by MHB's former executive administration. That approach did not fully take into account or utilize the diverse strength of resources and technical assistance available from HUD's Birmingham Community and Planning Development ("CPD") professionals or then existing within MHB's mid-management staff. As a result, some HOME program documentation and expenditure concerns arose. With the change in leadership MHB has embraced a more participatory management approach and refined the administration of and accountability within the HOME program. Such changes lessen the possibility that the concerns raised by the OIG will recur.</p>		
<p>Street Address: 151 South Claiborne Street Mobile, Alabama 36602</p>	<p>Mailing Address: Post Office Box 1345 Mobile Alabama 36633-1345</p>	<p>Telephone: (251) 434-2202 Facsimile: (251) 434-2373</p>

MHB's Internal HOME Approach and Analysis

On December 3, 2009, MHB's Board of Commissioners dismissed its then long-term executive director and hired the undersigned as its new interim executive director. Upon assuming office, the undersigned immediately undertook a multi-pronged approach to address several concerns related to MHB's HOPE VI related HOME activities. Some key activities included:

- a thorough internal analysis of MHB's HOPE VI and HOME program related expenditures and activities,
- ensuring that MHB staff engaged and cooperated fully with CPD and OIG staff,
- strengthening cooperation between MHB and the City of Mobile in the administration of the HOME program,
- delineating the precise activities contemplated within the various Phases of MHB's HOPE VI initiative, and
- working to address any actual or perceived problems with the HOME program expenditure and administration activities.

This approach culminated in a detailed review and charting of every expenditure made by MHB in connection with the HOME program by type of expenditure, invoice reference, HOME regulatory authority supporting the expenditure and the categorization of each expenditure by HOPE VI phase. Thus a clear picture of MHB's activities was highlighted and documented in a readily accessible format.

At the exit conference, OIG auditors acknowledged the thoroughness of MHB's efforts and its renewed cooperation with CPD and OIG professionals. MHB plans to use the coming weeks to address the OIG's assessment recommendations as well as MHB's internal assessment, further sharpen the administration of the HOME program, and work with the City of Mobile ("City") to clarify and enhance the relationship between the City, as the participation jurisdiction, and the MHB, as a subrecipient and administrator of HOME funds on behalf of the City. In this manner, MHB is determined to create a stronger agency that is poised quickly to complete its HOPE VI project and achieve the important social mission of the MHB in a financially responsible manner.

MHB's HOPE VI is Severely Hampered by the Continued *Freezing* of HOME and CDBG Funds

MHB has been expeditiously trying to complete its HOPE VI program activities, especially the Phase IV construction of forty-eight (48) affordable townhomes, but unfortunately, these efforts have been severely hampered. The HOPE VI Program redevelopment efforts have been hindered since MHB received a letter from HUD dated August 26, 2009 requesting the suspension of disbursement of HOME funds for any costs related to the HOPE VI redevelopment (see Exhibit "A"). At the request of HUD, MHB froze its expenditures of HOME funds, and later by HUD's separate request, the Community Development Block Grant ("CDBG") funds, pending resolution of HUD program administration and expenditure concerns. MHB has sought authorization from HUD for a lifting of the freeze over the past several months but were told that a decision would not be made until more information arose from the OIG audit process. As there are varied financing sources involved in MHB's redevelopment efforts with their own competing deadlines,

MHB has struggled to keep the HOPE VI projects viable during the course of HUD's examination of MHB's activities and the OIG audit. As discussed at the exit conference, MHB is requesting that HUD *unfreeze* all HOME and CDBG funds in light of its administration enhancements and plan for addressing HUD OIG's recommendations. In the alternative, MHB requests authorization to use any HOME and CDBG funds that the OIG has acknowledged may be addressed through the cost allocation plans. Otherwise, MHB's HOPE VI redevelopment plans will be stalled, jeopardizing other funding that has been committed to those projects, undermining the needed creation of affordable housing in Mobile, forcing a loss of jobs in Mobile, and further limiting the significant contribution that MHB's redevelopment efforts could have in stimulating the local economy.

OIG Audit Findings Should Be *Management Improvement Recommendations*

MHB has learned some valuable lessons through its internal assessment and the OIG's audit process. These lessons include the need to improve its documentation so that it is clear to any reviewer that MHB is carrying out its HOME program in accordance with programmatic requirements. While MHB agrees that improvements should be made in its HOME program and that the Draft Audit illustrates some of the areas for upgrading and enhancement, we continue to believe, as we communicated at the exit conference, that some of the conclusions in the Draft Audit should be management improvement suggestions as opposed to audit findings against MHB. Given the change of administration at MHB and the actions already underway to remedy past shortcomings with the program, we believe that the MHB is poised under this new leadership to better serve its residents and to complete important redevelopment projects while instituting internal controls to better evidence its compliance with HOME program requirements.

Comment 1

II. MHB's Evaluation of OIG Findings and Recommendations

The OIG makes three (3) findings with respect to MHB's HOME program activities relating to (1) monitoring concerns, (2) Cost Allocation Plans for Phases III and IV, and (3) certain ineligible HOME fund costs. MHB disagrees with Finding 1 and Finding 2 and believes that its activities are within the spirit and scope of the HOME regulations. MHB agrees in part, and disagrees in part, with Finding 3 and believes that the OIG has interpreted certain HOME regulations in a manner inconsistent with past HUD guidance.

MHB would like to take this opportunity to address each recommendation made by the OIG. MHB feels that it has made great strides on the issues identified by the OIG, and will continue to implement reforms to its HOME program to address the recommendations. MHB's responses are set forth below. To facilitate ease of discussion, MHB has addressed the responses and recommendations in the order in which each appeared in the Draft Audit.

Comment 2

Finding 1 – MHB's Response

MHB disagrees with the OIG's assertion that the City did not adequately monitor MHB's HOME administration activities. To the contrary, MHB maintains that the City engaged in an extensive, intensive and transparent monitoring protocol. The HOME regulations do not prescribe a "one size fits all" monitoring

protocol for participating jurisdictions. Rather, the regulations recognize that monitoring may take a number of forms and each local jurisdiction is uniquely suited to design a monitoring protocol that best fits its local needs. The City has long instituted a multi-level monitoring protocol that includes semi-annual (and many times more frequent) monitoring and input from:

- Mobile City Council,
- Mobile City Council's Entitlement Committee,
- Mayor and Executive Officials of the City of Mobile,
- other subrecipients,
- internal Community Development Director,
- Independent Public Auditor via the HUD mandated IPA process, and
- members of the public.

Comment 3

The City's process is accountable, informed, open, transparent and highly visible. The City has embraced a paradigm where a multitude of varying and interested sources provides input to the overall monitoring process. Through its finding, the OIG criticizes the City's model based on an OIG preference for an undescribed, but apparently mandated, singular audit model. MHB does not believe that it should receive an audit finding for not adopting an OIG model that had not been previously published or described. MHB's comments on the Finding 1 recommendations are as follows:

Comment 3

Recommendation 1A. Require the City to establish and maintain a subrecipient agreement with the Housing Board, as provided by HUD requirements that includes current and sufficient detail to provide a sound basis on which to effectively monitor the Housing Board's performance.

MHB and the City of Mobile executed a subrecipient agreement, dated August 10, 1999 ("Subrecipient Agreement"), in which the City authorized MHB to administer HOME funds on behalf of the City (see Exhibit "B"). The Subrecipient Agreement was presented to HUD for approval to ensure that the Subrecipient Agreement met all of the applicable HOME requirements and regulations. HUD provided an unconditional approval of the Subrecipient Agreement in the summer 1999 during a HUD monitoring review. Nowhere during the HUD approval process was there any mention or indication that the Subrecipient Agreement would subsequently be deemed deficient merely due to the passage of time and, in fact, the annual action plan and City monitoring protocol were incorporated by reference specifically to ensure that the Subrecipient Agreement did not become outmoded. Even so, the OIG through its Finding criticizes the City and MHB for relying on the HUD approval and not foreseeing a subsequent non-regulatory requirement that the Subrecipient Agreement must be redone periodically. Neither MHB nor the City should be held to a new requirement regarding the Subrecipient Agreement that is neither contained in the regulations nor would otherwise be known to MHB.

**Subrecipient Agreement Annually
Incorporates, by Reference, a Detailed Action
Plan**

The Subrecipient Agreement uses a HUD recognized and legally acceptable tool of incorporating into the Subrecipient Agreement more current documents and program descriptions, by reference. Specifically, Section 1 of the Subrecipient Agreement states that "[t]he Annual Action Plan, as adopted and

amended from time to time by the City, shall be incorporated into the Agreement as *the defining document to establish the use of HOME funds, the tasks to be performed, a schedule for completing the tasks, and budget which shall include program income.* (Italics added). The Subrecipient Agreement goes on to state in Section 2 that MHB "shall undertake the administration of the HOME program as annually established by the adopted Action Plan." The Subrecipient Agreement recognizes that tasks, schedules and budgets will change from year to year and such changes will be reflected in the Subrecipient Agreement by reference. It is MHB's belief that the incorporation by reference of the annual Action Plan was a motivating factor of the initial HUD approval.

The OIG's Finding 1 emphasizes that 24 CFR §92.504(a) of the HOME regulations requires annual reviews and that the Subrecipient Agreement did not meet the requirements of 24 CFR §92.504(c)(2)(i) because it allegedly did not describe in sufficient detail the "use of HOME funds, including the tasks to be performed, a schedule for completing the tasks, a budget and the period of the agreement." That Finding ignored, however, that the mechanism the City used to conduct such reviews was through annual Action Plans which includes more extensive detail than is required by the regulations and involves a public review process. Incorporating another document by reference into an agreement is a standard contractual method of balancing the need to address specific items in a contract with a need for clarity and brevity. Here, given that the Subrecipient Agreement is the umbrella agreement governing the relationship between the City and MHB, it is the only logical manner to structure the agreement since scope of work, schedule, and budget are project-specific characteristics.

City/MHB Subrecipient Agreement Meets All Regulatory Requirements

The Annual Action Plan process and documentation is structured to provide further detail on each project including scope of work, schedule, and budget. For example, the 2009 – 2010 Action Plan consists

of ninety (90) pages and describes each planned activity in detail and shows how the program activity meets a specific goal or category of need the City has identified. A representative sample of the Action Plan document (see Exhibits "C" and "D") highlights each subrecipient's (i) name, (ii) location, (iii) description of the program, (iv) objective category, (v) outcome category, (vi) purpose to which HOME funds will be used, (vii) amount of allocated funds (i.e., budget), (viii) proposed project accomplishments, (ix) proposed outcomes, (x) performance measures, (xi) actual outcomes, (xii) proposed clients to be benefited, (xiii) actual clients benefited, (xiv) tasks to be performed, (xiv) schedule, and (xv) other miscellaneous category tracking information. This level of detail,

<u>Subrecipient Agreement Comparison Matrix</u>	
<u>Required Subrecipient Agreement Provision Under 24 CFR §92.504</u>	<u>Complying Section in City/MHB Subrecipient Agreement</u>
Use of HOME Funds	Section 1
Program Income	Section 1
Uniform Administration Requirements (§92.505)	Section 3
Other Program Requirements (Part 92, Subpart H, except §92.352 and §92.357)	Section 4
Affirmative Marketing (§92.351)	Section 5
Requests for Disbursement of Funds	Section 6
Reversion of Assets	Section 7
Records and Reports	Section 8
Enforcement of the Agreement (§92.252 and 24 CFR Part 85, as applicable)	Section 9 Section 11

incorporated by reference directly into the existing Subrecipient Agreement, meets all of the requirements of 24 *CFR* §92.504(a) for sub-recipients. The Subrecipient Agreement Comparison Matrix set forth herein is a summary of the regulatory requirements for a subrecipient agreement and the content of the City/MHB Subrecipient Agreement. MHB maintains that it has completely satisfied the expressed regulatory requirements and the OIG's assertions to the contrary are factually inaccurate and are not supported by the plain language of the regulations.

Comment 3

OIG's Concern Over the Age of Subrecipient Agreement Has No Support in the Regulations

At the exit conference, the OIG emphasized that its concern was less with the substance of the Subrecipient Agreement than with the fact that it was over ten (10) years old and had not been updated more recently. The OIG could not cite any regulatory requirement or HOME guidance to support its concern about the age of the Subrecipient Agreement. MHB explained that the mechanism for annual updates was through the annual Action Plan process which, as noted above, is expressly incorporated into the Subrecipient Agreement. Given the legal ramification of incorporation, every time the Action Plan is updated the Subrecipient Agreement is also automatically updated. Further, we noted that there was a public review process in conjunction with the annual Action Plans which involved oversight by not less than seven distinct city, subrecipient and public stakeholders (i.e., Entitlement Committee, City Council, Mayor, Subrecipients, Community Development Director, IPA Audit Firm, and general public).

In response to the OIG's contention that the Subrecipient Agreement was not adequate, MHB inquired whether there was a specific HOME program requirement for updating subrecipient agreements. The OIG responded that there was no specific requirement regarding the updating of a subrecipient agreement, but that the agreement should be a current reflection of the HOME activities being undertaken. The OIG also acknowledged that there was no HUD template or model for subrecipient agreements.

Given that it does not appear that there was any specific violation of a HOME program requirement, there is no model to which MHB can compare its Subrecipient Agreement, that HUD previously expressly approved the Subrecipient Agreement, and the dearth of any prior indication by HUD regulations or published guidance that the Subrecipient Agreement was outmoded, MHB reiterates its request that this recommendation be a management improvement suggestion and not an audit finding. If this remains an audit finding, we request that the OIG or the HUD field office provide specific feedback as to the inadequacies of the current Subrecipient Agreement and annual Action Plans so that we can comply with this recommendation. Regardless, we want to implement best practices with our HOME program and therefore will execute an updated subrecipient agreement with the City of Mobile, if required by the HUD Birmingham Field Office. We would welcome any guidance, templates or models that HUD or the OIG could recommend that would improve upon its existing structure.

Comment 2

Recommendation 1B. Require the City to develop procedures for monitoring the Housing Board, at least annually, to ensure that HOME funds are used in accordance with all program requirements.

MHB incorporates by reference its response set forth above to Recommendation 1A. As MHB has stated, annual monitoring is already conducted through an annual Action Plan and public review process.

The OIG's preference for a different, more restrictive monitoring protocol should not be the basis for a finding. Even so, in the event that HUD has additional guidance or clarifications on the contents of the Subrecipient Agreement and approved monitoring protocols, the City and MHB will update the Subrecipient Agreement accordingly.

Recommendation 1C. *Require the City to reallocate the \$1,991,149 in excess HOME and CDBG funds it provided to the Housing Board in support of its HOPE VI redevelopment project to other eligible activities and program recipients.*

As discussed at the exit conference, when the City initially allocated \$5.3 million in HOME and CDBG funds on May 13, 2008, in support of MHB's HOPE VI initiative, the approved HOPE VI Revitalization Plan for Albert Owens/Jesse Thomas Homes included an affordable for-sale homes phase. The homeownership development activities, however, were postponed due to the collapse of the homeownership and mortgage financing market in 2008. The amended HOPE VI Revitalization Plan approval, received on June 1, 2009, contemplated that the HOME and CDBG funding would be used for site work on the homeownership site, but that homeownership component would no longer be part of the HOPE VI Revitalization Plan.

Therefore, while the amended HOPE VI Revitalization Plan no longer expressly included a final affordable homes phase, it did contemplate that the MHB would continue to use the City HOME and CDBG funding to finish redevelopment on adjacent sites. MHB also clarified at the exit conference that it had not spent any of the \$1,991,149 and that, at this point, it had only been *allocated* to the affordable homes development.

At the exit conference, the OIG made clear that its concern was simply that the prior City of Mobile authorizing resolution contemplated that the HOME and CDBG funds in question would be used in conjunction with the "HOPE VI redevelopment" which, technically, was no longer the case. The OIG acknowledged that this recommendation could be satisfied if the City issued a new authorizing resolution that reallocated these funds to MHB for eligible activities related to the additional homeownership activities. MHB requests that the auditors include a clarification in this recommendation that the City can issue a new resolution with respect to additional homeownership activities in order to remedy the finding.

Comment 3

Finding 2 – MHB's Response

Comment 4

MHB disagrees with the OIG's assertion that it failed to develop appropriate Cost Allocation Plans for Phases III and IV of its HOPE VI redevelopment. MHB believes that the audit finding is not supported by the chronology of events, applicable regulations or HUD guidance and unduly criticizes MHB for timing its submittal of Cost Allocations Plans with proposed or actual financial closings of approved HOPE VI phases. MHB hereby requests the withdrawal of Finding 2. MHB's comments on the Finding 2 recommendations are as follows:

Comment 4

Recommendation 2A. *Require the Housing Board to prepare a cost allocation or proration plan to support the \$839,713 charged to its HOME program for phases III and IV or repay the City's HOME treasury account the amount that cannot be supported.*

The OIG's finding that MHB failed properly to develop cost allocation plans to properly allocate or prorate its HOME program costs for Phases III and IV of the HOPE VI program is not supported by the facts of MHB's HOPE VI redevelopment activities.

MHB Submitted Cost Allocations Plans to HUD

For Phase III, MHB developed and submitted a unit and cost allocation plan to HUD on February 22, 2010, as part of the HUD mixed-finance review process. Phase III has not yet closed and normal protocol in HOPE VI transactions is to finalize the cost allocations from the varying sources after negotiations related to the financing are set and closer to the actual financial closing. This was the process used by MHB on its Phase IV closing during 2009. Then MHB prepared an internal unit and cost allocation plan and transmitted the results of the same to HUD's Office of Public Housing Investments upon that Office's request on June 2, 2009, prior to the closing of Phase IV. The pertinent regulations or guidance do not indicate that MHB's timing for the allocation plans was inappropriate or misplaced.

There is No HUD Prescribed Cost Allocation Form

While the unit and cost allocation plans that were previously submitted to HUD are further described below, we should note that no particular form of allocation plan is required by the HUD regulations. In addition, while CPD Notice 98-2, which is referenced in the OIG's report, discusses methods of allocation, it also does *not require* a specific form or formal cost allocation plan. Moreover, since CPD Notice 98-2 apparently expired March 18, 1999, before the execution of the Subrecipient Agreement, it should not be the support for an audit finding against MHB. Also, no HUD form exists for a cost allocation plan and neither HUD nor the OIG have been able to produce such a form, despite several requests from MHB.

Prior to the closing of Phase III and following the conclusions of negotiations regarding financing, MHB will develop a formal cost allocation plan in a form that is acceptable to HUD and the OIG. A draft of this plan was presented at the exit conference with the OIG. A more formalized submission has been made to HUD's CPD professionals and is attached hereto as Exhibit "E" for approval by the OIG. As evident from the attached Cost Allocation Plans, all units in Phase III will be comparable, in that there will not be significant differences in available amenities, unit size, unit mix or square footage. The HOME units in Phase III shall also be fixed units in accordance with 24 *CFR* §92.252(j). Accordingly, pursuant to expired CPD Notice 98-2, we will employ a pro-rata allocation method. The ratio of HOME units to non-HOME units shall not exceed the ratio of HOME funding to non-HOME funding.

Neither the HUD regulations nor expired CPD Notice 98-2 indicates that a cost allocation plan must be in place *prior* to expenditure of the funds. Rather, that notice speaks to the cost allocation plan occurring with respect to the total development costs of the project upon completion of the project—not during construction. It is also important to note that there is nothing in the HOME regulations or HUD

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guidance that would indicate that HOME funds and other project resources must be spent on a pro-rata basis. In other words, there is nothing to suggest that HOME funds cannot be spent prior to other project resources, so long as at the completion of construction the percentage of HOME funds does not exceed the percentage of HOME units. This was confirmed with the OIG and the CPD field office personnel at the exit conference.

As noted above, in Phase IV, MHB did prepare an internal unit and cost allocation plan and transmitted the same to HUD personnel in the HUD Office of Public Housing Investments upon that Office's request on June 2, 2009, prior to the closing of Phase IV. During that time frame, MHB was holding weekly calls with the HUD team that was overseeing the HOPE VI grant. As part of those calls, the allocation of HOME funds was discussed since MHB was also utilizing public housing capital funds in Phase IV. The cost allocation discussions were intended to show that no HOME funded units would overlap with Capital Fund funded units. All units in Phase IV are comparable since there is no substantial variation in amenities, unit size or square footage between the units. All Phase IV units are to be fixed units. Because the units are comparable, we utilized the proration method of cost allocation and demonstrated to HUD, as well as internally, that the percentage of HOME funding did not exceed the percentage of HOME units. To satisfy the OIG's recommendations, we have developed a formal cost allocation plan for Phase IV. A draft of this plan was presented at the exit conference, and an updated version is attached as Exhibit "E" for the OIG's review and approval. Should there be additional requirements for the cost allocation plan, we will continue to work with HUD and the OIG to ensure that the form of the cost allocation plan meets HUD and the OIG's expectations. Given that no formal HUD guidance exists on the specific requirements for a cost allocation plan, MHB hopes that the OIG will encourage HUD to issue such guidance so that there are clearer compliance standards for all HOME fund recipients.

Comment 5

Recommendation 2B. Require the Housing Board to adjust HOME program costs based on the cost allocation plan developed.

MHB has submitted its formal cost allocation plans for approval and welcomes any feedback from HUD or the OIG on the plans. We do not believe that any HOME program costs need to be adjusted based on the cost allocation plans.

Recommendation 2C. Require the Housing Board to adopt procedures that ensure a cost allocation plan is developed for its projects before it commits HOME funds.

Comment 6

As mentioned above, there is no HUD regulation or guidance that would require a particular form of cost allocation plan. MHB has performed the cost allocation analysis for each of the HOPE VI phases and has communicated those analyses to HUD. As mentioned above, neither the applicable HOME regulations nor CPD Notice 98-2 indicate that a cost allocation plan must be formalized, in place or approved prior to expenditure of the funds. Rather, that notice speaks to the cost allocation plan occurring with respect to the total development costs of the project upon completion of the project—not during construction. MHB has enhanced its internal procedures regarding the development of cost allocation plans when HOME funds are allocated and will provide the same to the HUD Birmingham office for review and approval. MHB believes that such procedures adequately address the recommendation and therefore the OIG should show this recommendation as satisfied. Should there be additional requirements for such cost allocation, MHB

requests that HUD issue formal guidance on this issue in order to facilitate greater compliance than MHB has already demonstrated.

Comment 7

Finding 3 – MHB's Response

MHB agrees with some of Finding 3 related to the sales prices of the affordable homes in Phase I of the HOPE VI. MHB also agrees that a small portion of the OIG identified costs (i.e., \$4,281.00) expended in furtherance of MHB's HOPE VI redevelopment were inappropriately allocated to the HOME program and should be repaid. MHB previously identified these funds through its internal auditing processes and provided a detailed spreadsheet of the costs to the OIG during the audit. Although MHB was prepared to appropriately repay the funds, it was prevented from doing so because of the *freezing* of HOME funds and instructions from HUD not to make any adjustments to the HOPE VI HOME and CDBG accounts. MHB disagrees with the OIG findings concerning the exclusion of costs for approved demolition activities and architectural/engineering drawings for homeownership units within the original Phase IV Redevelopment Plan. MHB's comments on the Finding 3 recommendations are as follows:

Recommendation 3A. Ensure that the Housing Board (1) lowers the sales price of the HOME units in phase I to within HUD requirements and (2) places qualified low-income occupants into the homes within a reasonable amount of time, whether those occupants are home buyers or tenants. Otherwise, HUD should ensure that the Housing Board repays the City's HOME treasury account all of the \$156,004 in ineligible HOME funds expended for phase I.

MHB agrees with the OIG's finding and has reduced the sales prices of the homeownership units to comply with the HOME sales price limitation. All of the sales prices of the six (6) affordable units within Phase I have been reduced to statutory median sales price limitations for Mobile, AL of \$200,160 as recommended in the Draft Audit.

Two Homes Have Been Sold to HOME Eligible Homebuyers at the Median Sales Price of \$200,160

At the time of the OIG audit, two affordable houses were then under contract. The contracts were amended prior to closing to reduce the purchase prices to \$200,160. Copies of the contract amendments showing the price reductions were provided to the OIG auditors. Moreover, MHB sold the homes to low-income occupants in complete compliance with the appropriate HOME regulations. By separate transmittal, to protect the privacy of the homebuyers, MHB is forwarding to HUD and the OIG copies of the following for each homebuyer:

- HUD-1 for the sales of the house executed at closing,
- Asset and income documentation demonstrating the low-income status and eligibility of the homebuyer, and
- Mortgage showing the imposition of the HOME affordability requirements.

As these are the three (3) requirements necessary to "clear" this portion of the Finding 3 and make the \$156,004 in HOME funds an eligible expense, and MHB has otherwise completely complied with the recommendation related to the sales of the homes, MHB requests that this portion of the finding be deemed "satisfied" and "cleared" and so indicate in the final Audit Report.

**Three (3) Additional Phase I Affordable Homes
Are Under Contract to Qualified Homebuyers**

With regard to the need to sell the remaining affordable homes, MHB currently has an additional three (3) homes within Phase I under contract with sales prices of \$200,160 for each home. These three homebuyers are also eligible low-income families and will be expected to accept the HOME affordability requirements. The parties expect to finalize financing and close on the properties within the next 30 to 45 days.

Recommendation 3B. Ensure that the Housing Board repays HOME funds of \$183,653 used to pay for ineligible costs for phases II, III, and IV of the HOPE VI redevelopment. Repaid funds must be deposited into the City's HOME treasury account for additional HOME projects.

MHB partially disagrees with Recommendation 3B. While MHB acknowledges that certain of the costs incurred were ineligible (i.e., \$4,281), MHB believes that the majority of costs are eligible under the HOME program and 24 CFR §92.206. As noted above, for Phase I, we agree with the OIG's finding and have reduced the sales prices of the homeownership units to comply with the HUD sales price limitation. We also agree with the OIG's finding on Phase II and will repay the \$4,281 spent on Phase II.

**HOME Funds Can Be Used for Demolition of
Public Housing Units**

However, MHB strongly objects to the portion of Finding 3 that deemed \$130,872 in HOME funds as ineligible for Phase III. At the exit conference, the OIG acknowledged that it struggled with this portion of Finding 3 and included it after additional consultation with HUD CPD in Washington. As further detailed below, the OIG analysis in this portion of Finding 3 is inconsistent with an established HUD Office of General Counsel legal opinion and HUD practice, particularly as related to HOPE VI redevelopment activities. Including this portion of Finding 3 effectively puts MHB in the crosshairs of an internal difference of opinion within HUD regarding use of HOME funds with public housing developments.

HUD has made clear to MHB (and other housing authorities) that it is permissible to use HOME, HOPE VI and public housing capital funds in the same public housing project so long as a housing authority can demonstrate an acceptable cost allocation methodology. This cost allocation must demonstrate that the HOME funded public housing units were not also funded with any public housing capital funds and this can be demonstrated through a pro-rata or other reasonable cost allocation. However, this audit finding suggests that pro-rata cost allocation does not apply for public housing demolition. As we detail further below, this is contrary to prior HUD OGC opinions, explicit HUD approvals in prior mixed-finance transactions, and direct discussions between HUD staff and MHB.

While the OIG claims that HOME funds may not be used for public housing demolition, there is no regulatory provision or HUD guidance to support that contention. Rather, demolition is an eligible cost under 24 CFR §92.206. The HOME statute provides that HOME funds may not be used to:

- "4. provide assistance authorized under section 1437g of this title, or

5. carry out activities authorized under section 1437g(d)(1) of this title.”¹

To be precise, “1437(g) of this title” refers to Section 9 of the Housing Act of 1937 (the “Act”). As quoted above, the HOME statute bars assistance or activities “authorized under” Section 9. While public housing demolition is an eligible activity under Section 9, such demolition is only “authorized under” Section 9 if Section 9 funds are actually used. That is, activities that are theoretically eligible for Section 9 funds, but that do not in fact use Section 9 funds, cannot be said to take place *under the authority* of Section 9 of the Act. Therefore, the HOME statute’s prohibition does not refer to public housing demolition in general, but only to public housing demolition actually assisted by Capital Funds provided under Section 9 of the Act.

The OIG’s Regulatory Interpretation Directly Conflicts with HUD’s Office of General Counsel Opinion

A written opinion from HUD OGC on the issue concludes that the HOME statute bans the use of HOME funds to develop public housing units only where public housing capital funds are also used for the units. If no capital funds are used for the units, then HOME funds may be used for public housing development. In an OGC letter, executed by Robert S. Kenison, then-Associate General Counsel, Office of Assisted Housing and Community Development, dated September 10, 2002, (see Exhibit “F”) HUD OGC opined “[The HOME statute’s] prohibition is silent on the issue of whether HOME funds may be combined with HOPE VI funds. . . . For this reason, we believe that HOME funds may be combined with HOPE VI funds to develop HOPE VI public housing or homeownership replacement units, provided that the units are developed and operated in accordance with both the HOME and HOPE VI program requirements. Public housing replacement units that are developed with HOME and HOPE VI funds are also eligible to receive Operating Fund subsidies, ...”²

In sum, OGC’s written opinion clearly support overlapping HOME/public housing units (i.e., public housing units developed with HOME funds), as long as they are not also developed with public housing capital funds. We note that this position is consistent with CPD Notice 97-08, effective June 30, 1997 to June 30, 1998 and now cancelled, which clearly stated that “HOME funds may be used to assist in the construction or acquisition of public housing units . . . HOME funds may be used to provide replacement units for prior HUD-approved demolition or disposition of public housing . . . [U]nits may be both public housing units and HOME-assisted units simultaneously.”³

In accordance with the above stated HUD OGC guidance, HUD requires as part of its mixed-finance review process that a pro-rata cost allocation test be met where the project demonstrates that HOME-funded and public housing capital funds-funded units are separate units. Specifically, with regard to MHB’s HOPE VI redevelopment, HUD was very involved and well aware of the development plan, having provided technical assistance at the request of MHB beginning in the spring of 2009 and continuing until the expenditure deadline in September 2009. At the OIG exit conference, MHB presented the OIG with our cost allocation plans demonstrating compliance with the HOME program’s cost allocation requirements.

¹ 42 U.S.C. § 12742(d)(4-5)(Supp. IV 2000).

² Letter from Robert S. Kenison to Austin J. Simms dated Sep. 10, 2002.

³ As provided in the notice, the statements are of course subject to Section 212(d)’s prohibition, which at the time the notice was issued referred to Section 14 funds (modernization funds) rather than to Section 9 (Capital Funds).

Therefore, it is MHB's respectful position that the portion of Finding 3 declaring the \$130,872 in HOME funding used for demolition as an ineligible cost is not consistent with available HUD guidance and should be withdrawn.

**Demolition Costs Funded by HOME Funds are Permissible
Based on an Appropriate Cost Allocation Plan**

Rather, the HOME funds used for demolition should be subject to a pro-rata cost allocation and included in the cost allocation plan along with the remainder of the HOME funds invested in Phase III. The purpose of expired HUD CPD Notice 98-2 is to provide a mechanism by which to ensure that various funding programs can be used in conjunction with HOME funds but to allow developers, including public housing authorities, to comply with the HOME requirements. As described above in response to Finding 2, MHB has completed a proposed cost allocation plan for Phase III which demonstrates that no unit is funded by both public housing capital funds and HOME funds. This allocation should suffice for demonstrating that the HOME funds were spent for eligible HOME costs and not in violation of the HOME statute or 24 *CFR* §92.206, especially given that there is nothing in either source that differentiates demolition from other development costs.

If it is now HUD's position that, despite the explicit guidance received from HUD through the mixed finance processes for Phases III and IV, HOME funds cannot be used when capital funds are used, MHB should not be penalized for following the available HUD guidance and instruction. More appropriately, OIG should recommend HUD to resolve the conflicting interpretations and issue formal guidance on this issue that can be clearly implemented and followed.

**Architect and Engineering Fees are Permissible
Costs in a HOPE VI Redevelopment**

With respect to the final part of Finding 3 regarding Phase IV, MHB again disagrees with the OIG conclusion that MHB expended HOME funds for ineligible costs. Architect and engineering fees are permissible costs under 24 *CFR* §92.206, and whether or not the costs were expended in conjunction with the HOPE VI development does not impact the eligibility of these costs. We believe that the OIG has conflated whether the costs were "eligible" and whether they were "authorized" by the City. We acknowledge that, since the City originally authorized the expenditure of the funds, the scope of the HOPE VI redevelopment changes. However, this does not make architect and engineering fees ineligible for the purposes of the HOME program.

At the time the City authorized the expenditure of HOME funds, a significant number of homeownership units were included within the HUD approved scope of the HOPE VI redevelopment. The City's authorizing resolution envisioned a comprehensive redevelopment of the site that included the homeownership units. When MHB expended the \$48,500 on the design of the homeownership units, the homeownership units were still part of the HUD approved HOPE VI redevelopment. The homeownership units were not removed from MHB's HOPE VI revitalization plan until June 1, 2009, whereas the HOME funds were expended on the architectural and engineering fees prior to that point. Moreover, the

communications with HUD with respect to the revitalization plan clearly acknowledged that MHB intended to complete the additional homeownership units with non-HOPE VI funding.

Even though the additional homeownership activity was removed from the HOPE VI revitalization, this did not constitute a "termination" of the project for HOME purposes. The pertinent regulation cited in the Draft Audit provides that "any HOME funds invested in a project that is terminated before completion, either voluntarily or otherwise, must be repaid..." 24 CFR §92.503(b)(2). MHB never terminated homeownership as a component of its overall HOPE VI design of the site but delayed the commencement and removed the phase from the HOPE VI Revitalization Plan. 24 CFR §92.2 clearly defines the term "project" to embrace the entire site and not merely an attendant activity within the site.

MHB acknowledges that it may have communicated to the City the changes to the HOPE VI revitalization plan in more detail and sought reauthorization for the continued support of the homeownership component of the development. However, the HOPE VI revitalization plan is independent from the City's original resolution and the character of the expenses for the design of the homeownership units—consequently the changes to the revitalization plan did not alter the scope of the City's original resolution or the character of the expenses. While this issue will be further discussed between MHB and the City of Mobile, the expenses were not ineligible under the HOME program and MHB should not be required to repay the funds. Additionally, similar to our response to Recommendation 1C, at the exit conference, the OIG acknowledged that this concern could be resolved if the City were to reauthorize the expenditure of HOME funds for the additional homeownership development.

Recommendation 3C. Require the Housing Board to establish controls and procedures to separate its public housing agency operations from its administration of CDBG programs to provide reasonable assurance that HOME funds are used according to HOME program requirements.

Comment 8

MHB has already undertaken efforts internally to establish controls and procedures to separate its public housing agency operations from our administration of CDBG programs to ensure compliance with HOME program requirements. MHB has established a separate Department of Community Development Division (the "Division") currently staffed by a Director and two other staff members. The Division has exclusive jurisdiction over the administration of City HOME and CDBG funds and MHB's role as administrator. The members of the Division have no significant role in public housing agency operations nor does any member charged with day-to-day public housing agency operations interfere with or impede the Division's activities. As a cross-check, periodic reviews and audits by MHB's finance professionals have been instituted to ensure that the Division's expenditures are in complete harmony with applicable CDBG and HOME regulations. Moreover, the City has instituted an annual auditing process to ensure even heightened scrutiny over MHB's activities as required by the OIG. This synergy of activities coupled with MHB's annual independent public audit ensures a three-fold check on the Division and its administration activities. As such, MHB believes that it has implemented Recommendation 3C and the Recommendation should be deemed cleared.

II. Conclusion

Thank you for the opportunity to respond to the Draft Audit. MHB hopes that its entire response and attached exhibits will be included in the final report and receive favorable consideration by HUD and the OIG. In general, MHB agrees that it can benefit from improvements in its HOME fund administration activities. Even so, MHB's management improvements already underway address virtually all of the recommendations contained in the Draft Audit. With the renewed compliance focus of MHB's new administration coupled with the submission of the cost allocation plans, and increased auditing protocols, MHB has adequately addressed the findings set forth in the Draft Audit. MHB would request the swift clearance of any remaining recommendations so that MHB may complete the scheduled activities and more effectively pursue future redevelopment efforts.

MHB is determined to create a stronger agency that is poised to move forward and achieve its important social mission of providing quality affordable housing to the Mobile community. To effectively do so, however, MHB needs permission to move forward with our redevelopment efforts that have been hindered since MHB received a letter from HUD on August 26, 2009 suspending disbursement of HOME funds (and later the CDBG funds) for any costs related to the HOPE VI redevelopment.

As discussed at the exit conference, we are requesting that HUD lift the freeze of HOME and CDBG funds and formally approve MHB's cost allocation plans for Phases III and IV. This will allow MHB to complete HUD approved activities timely without an increase in cost that a further suspension of construction activities will entail. Otherwise, MHB's redevelopment plans will continue to be frustrated, jeopardizing other funding that has been committed to those projects, undermining the needed creation of affordable housing in Mobile, causing Mobile to lose jobs and further limiting the significant contribution that our redevelopment efforts could have in stimulating the local economy.

In conclusion, we would like to thank the OIG for its professionalism and courtesy in conducting its audit of the MHB's activities. It has been a valuable experience for us and we look forward to implementing management improvements based on the recommendations in the Draft Audit.

Respectfully yours,



Dwayne C. Vaughn
Executive Director

Enclosures:

- Exhibit "A" – Letter from Charles Franklin dated August 29, 2009
- Exhibit "B" – Subrecipient Agreement between the City of Mobile and the Mobile Housing Board dated August 10, 1999
- Exhibit "C" – 2009 – 2010 Action Plan detail sheet for Boys & Girls Clubs – Kiwanis Branch
- Exhibit "D" – Action Plan detail sheet for Dumas Wesley Community Center
- Exhibit "E" – HOME Unit Cost Allocation Plans for:
 - Phase III – 87 Multi-family Units / Phase IV – 48 Townhome Units
- Exhibit "F" – Office of General Counsel Opinion dated September 10, 2002

OIG Evaluation of Auditee Comments

- Comment 1** The OIG develops findings, instead of management improvement suggestions, to put deficiencies in the proper perspective, in this case by describing the relationship of the deficiencies to the Housing Board's administration of its HOME and CDBG programs.
- Comment 2** The City's chief of staff acknowledged that it did not monitor the Housing Board as required and recently assigned an internal auditor to monitor the Housing Board. Before the designation, the City did not have a function in place to monitor the Housing Board.
- Comment 3** The subrecipient agreement between the City and the Housing Board was more than 10 years old. The agreement did not contain detailed information about the current HOME activities, tasks, timeliness, or budgets. The subrecipient agreement is more than a document to be executed and archived; rather, the subrecipient agreement is a key management tool for the City to monitor the Housing Board's proper use of HOME funds. HUD regulations 24 CFR 92.504 require that the City must enter into a written agreement with its subrecipient that assists the City in meeting its requirements under the HOME program. The agreement in place, while fulfilling the basic requirement that an agreement be established, was insufficient as a monitoring tool for the City, and did not provide the City with a sound basis to effectively develop procedures to monitor the Housing Board's performance.

The Housing Board requested that we include a clarification in the recommendation that the City can issue a new resolution with respect to additional homeownership activities in order to remedy the finding. However, the recommendation is written to allow the City to make the decision to fund a HOME activity the Housing Board desires or other eligible activities preferred by the City.

- Comment 4** During the audit, we requested cost allocation plans from the Housing Board several times and the Housing Board did not provide the plans. The Housing Board informed us that it was trying to develop them. The Housing Board provided draft allocation plans at the exit conference. Thus we did not verify the draft allocation plans. The Housing Board should provide the draft allocation plans to HUD for review.

The Housing Board stated that no particular form of allocation is required by HUD and it also does not require a specific form or formal cost allocation plan. Although HUD does not prescribe or provide an example for the form of an allocation plan this does not preclude the Housing Board from preparing one. Regardless of the format, an allocation plan is needed from the beginning of the project to properly administer the HUD funds from the different funding sources.

Comment 5 The allocation plan submitted to HUD did not show any cost adjustments. HUD's Office of Affordable Housing reviewed and rejected the plans submitted by the Housing Board. HUD rejected the plans because the proration method of allocation is prohibited in a project that will contain public housing units. Because HOME funds can never be used in a unit that receives capital funds and HOME-funded units can only be used in a public housing unit that receives HOPE VI funds, the cost allocation must identify, in detail, the actual costs paid for with Capital and HOPE VI funds. Since the Housing Board's allocation plans were based on a prorated method, it will have to go back and reallocate the funds based on actual costs.

Comment 6 We did not review the internal procedures. The enhanced procedures will be considered by HUD during the management decision process.

Comment 7 The \$130,872 of HOME funds used for demolition of public housing was a prohibited cost based on the HOME requirements in 24 CFR 92.214(a)(4) that do not allow HOME funds to be used for any costs that would otherwise be funded under Section 9 of the Housing Act. That Act authorizes public housing funds for demolition of public housing units; therefore, HOME funds may not be used to pay for the demolition of public housing units. The \$48,500 was ineligible because HOME funds cannot be invested in a project that is terminated before completion, either voluntarily or otherwise. The Housing Board's comments on HUD's Office of General Counsel written opinion are not relevant to the finding because the determination that the costs were ineligible was not based on overlapping of HOME funds with public housing units, which is permissible based on the Office of General Counsel opinion.

The Housing Board has reduced the sales price of the homeownership units to comply with HOME sales price limitations. The Housing Board acknowledged that the \$4,281 was ineligible. The Housing Board's comments indicated its willingness to make the necessary improvements.

Comment 8 The Housing Board's comments indicate its agreement and willingness to implement recommendation 3C, that HUD require the Housing Board to establish controls and procedures to separate its public housing agency operations from its administration of CDBG programs to provide reasonable assurance that HOME funds are used according to HOME program requirements.