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TO: William T. O'Connell, Director, Community Planning and Development
Division, 2CD

FROM: *Edgar Moore*
Edgar Moore, Regional Inspector General for Audit, 2AGA

SUBJECT: The City of Binghamton, NY, Did Not Always Administer Its Section 108 Loan Program in Accordance With HUD Requirements

HIGHLIGHTS

What We Audited and Why

We audited the operations of the City of Binghamton, NY (City), pertaining to its administration of its Community Development Block Grant (CDBG) Section 108 Loan Guarantee program. We selected the City for review because of concerns regarding a defaulted Section 108 loan. The objectives of our audit were to determine whether the City (1) administered its Section 108 loan program effectively, efficiently, and economically in accordance with applicable rules and regulations; (2) used Section 108 loan proceeds on eligible activities that met a national objective of the program; and (3) expended additional CDBG funds for subsequent Section 108 loan repayments and other related costs that were necessary, reasonable, and in accordance with all applicable contracts, agreements and Federal regulations.

What We Found

The City did not ensure that its Section 108 loans and related activities were administered effectively, efficiently, and economically in accordance with applicable rules and regulations and that loan proceeds were expended on eligible activities that met a national objective of the program. In addition, the City did

not ensure that additional expenditures of CDBG funds for subsequent Section 108 loan repayments and other related costs were necessary, reasonable, and in accordance with all applicable contracts, agreements, and Federal regulations. Consequently, significant CDBG funds were disbursed for Section 108 debt repayments, and future CDBG funds will be required until the Section 108 debts have been fully paid. Therefore, the ability to provide program benefit to low- and moderate-income residents of the City has been diminished.

What We Recommend

We recommend that the Director of HUD's Buffalo Office of Community Planning and Development instruct the City to (1) establish a Section 108 repayment account and repay more than \$1.5 million in hotel sales proceeds that were used for City expenses from non-Federal funds; (2) transfer the \$81,561 in hotel sales proceeds that remains in the City's trust account to the established Section 108 repayment account; (3) submit documentation to justify the use of more than \$2.4 million in CDBG funds to pay for Regency Hotel Section 108 debt so that HUD can make an eligibility determination; and (4) establish controls to ensure that Section 108 loan proceeds are at all times adequately safeguarded, collateral for Section 108 loans is continually protected until all loan funds have been repaid, the provisions of all Section 108 loan contracts and agreements are followed and promptly enforced, and Section 108 loan activities meet a national objective of the program.

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 the results of our review during the audit, provided a copy of the draft report to City officials, and requested their comments on October 6, 2010. We held an exit conference on October 28, 2010, and City officials provided their written comments on November 1, 2010, at which time they generally disagreed with our findings. The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

The Section 108 Loan Guarantee program is the loan guarantee provision of the Community Development Block Grant (CDBG) program. Section 108 loans provide grantees with a source of financing for economic development, housing rehabilitation, public facilities, and large-scale physical development projects. The principal security for the loan guarantee is a pledge by the applicant public entity of its current and future CDBG funds. Additional security can also be required to assure repayment of guaranteed obligations. The additional security requirements are determined on a case-by-case basis but could include assets financed by the guaranteed loan.

For purposes of determining eligibility, the CDBG rules and requirements apply. As with the CDBG program, all projects and activities must meet the CDBG primary objective, which is that 70 percent of the funds used must benefit low- and moderate-income persons and one of the following three national objectives: (1) principally benefit low- and moderate-income persons, (2) assist in eliminating or preventing slums and blight, or (3) assist with community development needs having a particular urgency. Section 108 guaranteed loans may be for terms of up to 20 years.

The City of Binghamton, NY (City) is a CDBG entitlement recipient that previously applied for and received two Section 108 guaranteed loans to pursue physical and economic revitalization projects. The two Section 108 guaranteed loans reviewed during the audit were primarily for economic development projects with the goal of job creation. They involved a hotel construction project, consisting of both Section 108 loan and Urban Development Action Grant (UDAG) funding, and another hotel refinancing and improvement project, consisting of both private and Section 108 loan funding. The files and records related to the City's Section 108 Loan Guarantee program are maintained in City Hall, located at 38 Hawley Street, Binghamton, NY.

We audited the City's Section 108 Loan Guarantee program because of concerns regarding a defaulted Section 108 loan. The objectives of the audit were to determine whether the City (1) administered its Section 108 loan program effectively, efficiently, and economically in accordance with applicable rules and regulations; (2) used Section 108 loan proceeds on eligible activities that met a national objective of the program; and (3) expended additional CDBG funds for subsequent Section 108 loan repayments and other related costs that were necessary, reasonable, and in accordance with all applicable contracts, agreements, and Federal regulations.

RESULTS OF AUDIT

Finding 1: The City Failed To Properly Administer Its Regency Hotel Section 108 Loan Activity

The City failed to properly administer its Regency Hotel Section 108 loan activity. Specifically, it (1) failed to monitor the \$10.6 million lease and cure defaults in a timely manner, (2) violated a number of provisions of its Section 108 contract with HUD, (3) misused Section 108 program income intended for debt obligations, and (4) failed to ensure that the hotel met the required national objective of job creation. We attribute these deficiencies to the City's failure to establish adequate controls over safeguarding assets, as required by CDBG regulations at 24 CFR (Code of Federal Regulations) Part 85. Consequently, the City (1) was obligated to pay a Section 108 loan balloon payment of \$4.5 million, (2) deprived other CDBG activities of the use of more than \$2.4 million in CDBG funds used to pay down the Section 108 loan, (3) failed to establish a Section 108 loan repayment account and fund it with more than \$2.5 million in sales proceeds/program income, (4) misused \$1.5 million in program income for City expenses to operate the hotel and put another \$81,561 in program income into a City trust account instead of a Section 108 loan repayment account, and (5) failed to ensure that the program activity met the CDBG national objective of job creation.

Background

In 1985, the City combined a \$7.3 million Section 108 loan with \$3.3 million in UDAG funding and loaned \$10.6 million to a developer to construct a hotel in downtown Binghamton. The City, which technically owned the hotel, then leased the hotel back to the developer to recoup the \$10.6 million. The lessee was to repay the loan and would then be allowed to purchase the hotel for \$1. By 1991, the lessee had defaulted on taxes and rent/lease payments, being delinquent on at least \$189,000 in Section 108 payments and more than \$500,000 in property taxes, including penalties and interest. Technically, the borrower was in a major default of the lease agreement(s), but no further action was taken by the City. Instead, the City began a series of subagreements, extensions, and forgiveness of debt, although the Regency Hotel was operating at a loss.

For example, in 1993 the City arranged for the hotel developer/lessee to borrow another \$560,000 from the Binghamton Local Development Corporation to cover a \$732,000 payment to the City for the Section 108 loan. The extent of the hotel's financial problems was further illustrated in 1993, when the City again agreed to accept \$481,915 in delinquent taxes, interest, and penalties over 10 years with no interest. The City could have taken legal action, since the developer/lessee was already in default of the lease agreement to pay the City. However, it was not until October 2005, despite more than 10 years of default issues, that the City formally sent a letter and declared the developer/lessee to be in default. By

December 2006, the City had taken full possession of the hotel from the developer. The City became the hotel’s owner and operator. While trying to sell the hotel, the City executed an operating agreement with a hotel management firm in February 2007. During the years 2007 and 2008, the City lost hundreds of thousands of dollars operating the hotel.

The City finally sold the hotel in 2009 and received \$2.5 million up front, less closing costs and broker fees. The buyer was to pay the remaining \$4.1 million of the \$6.6 million purchase price in October 2009; however, the new buyer of the hotel filed for bankruptcy and did not make the \$4.1 million payment. In April 2010, the City again retook ownership of the hotel and was attempting to resell it. Meanwhile, the City was obligated to pay a \$4.5 million balloon payment in August 2010 on the Section 108 loan. However, in July 2010, HUD allowed the City to refinance the \$4.5 million interim note. In August 2010, the City paid \$500,000 using the hotel sale proceeds that were improperly placed into a City trust account. The new HUD- approved repayment schedule is as follows

<u>Principal due date</u>	<u>Repayment amount</u>
August 1, 2010	\$ 500,000
August 1, 2011	1,000,000
August 1, 2012	1,000,000
August 1, 2013	1,000,000
August 1, 2014	1,025,000

The following subsections describe the deficiencies and reportable conditions in detail.

City Fails To Monitor Regency Hotel and Cure Defaults

The City failed to adequately monitor the loan and enforce the terms of the leasehold mortgage and mortgage note. The developer technically defaulted on lease terms and taxes during the 1990s. However, the City failed to take appropriate actions to protect HUD’s collateral and instead restructured the Section 108 debt and even loaned the developer additional HUD funds to make Section 108 loan payments that were in default. In October 2005, the City sent a letter to the developer declaring default of the loan. This was the first known default notice issued by the City, despite experiencing more than 10 years of borrower default issues. As a result, the City’s CDBG program was burdened with making more than \$2.4 million in Section 108 loan repayments to the detriment of other potential low- and moderate- income activities that could have been funded under the CDBG program. Further, the City jeopardized the HUD collateral for Section 108 by not taking the appropriate action in a timely manner to cure the defaults. CDBG regulations at 24 CFR 85.40 provide that grantees are

responsible for managing the day-to-day operations of grant- and subgrant-supported activities.

The leasehold mortgage and related agreements further required that the developer keep adequate books and records of account and furnish the City with audited financial statements and other information as the City may require. Nonetheless, there was no evidence to show that adequate financial data of the developer had been obtained or reviewed by the City. The only financial statements submitted by the hotel were for the years 1999 and 1998, and they were unaudited. Further, there were a number of related party loans and transaction detailed in these financial statements and their accompanying notes. There was no evidence that the City had analyzed, investigated, or otherwise determined the effect of the hotel's transactions on the legal arrangements between the City and hotel or the possible effect of the hotel's ability to pay the City under its lease obligations. At a minimum, the City should have conducted monitoring to determine why loan payments were not being made. For example, the City should have determined whether the developer had adequate cash flows and reserves to make the loan payments.

City Violates Its Section 108 Loan Contract

Contrary to its Section 108 loan contract, the City failed to establish a loan repayment account and did not maintain adequate financial and programmatic records on the loan receivable from the developer pertaining to the extent of CDBG funding used to repay the Section 108 debt. The Section 108 loan contract requires that all amounts pledged as security for repayment of the note, including program income, as defined by regulations at 24 CFR 570.500(a), shall be deposited immediately on receipt into a separate identifiable custodial account (the "Loan Repayment Account") with a financial institution the deposits or accounts of which are federally insured. The City was unable to provide accounting records identifying the bank account used to deposit its Section 108 program income funds. According to available City records, the City used at least \$2.4 million in CDBG funds to repay the hotel's Section 108 debt, depriving its local program of funding intended to benefit low- and moderate-income residents.

In addition, the City further violated its Section 108 contract when it sold the hotel and failed to place more than \$2 million in sales proceeds into a Section 108 loan repayment account. Instead, the funds were placed into a City trust account and generally used for expenses that were the obligation of the City, as described further below. The City violated regulations at 24 CFR 85.20(b)(3), which require that effective control and accountability be maintained for all grant and subgrant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must ensure that it is used solely for authorized purposes.

City Misuses Section 108 Program Income

Contrary to a 2007 operating agreement with a hotel management group, the City did not cover the operating shortfalls and did not pay all property taxes for the Regency Hotel when it was owned and operated by the City. In February 2009, a new owner obtained control of the hotel, paying the City \$2.5 million up front, less closing costs. The remaining \$4.1 million of the \$6.6 million sales price was due in October 2009. The City then used the program income to pay the hotel's operating expenses and back taxes that were its responsibility as owner under the operating agreement. According to available closing documents and records, sales proceeds were used as follows:

Used for hotel operating costs/losses	\$ 549,463
Used for real property taxes (includes interest and penalties)	<u>\$ 974,105</u>
Total	<u>\$1,523,568</u>

The \$1.5 million in sales proceeds should be reimbursed to an established Section 108 repayment account from non-Federal funds. In addition, as of May 2010, at least \$581,561 of the sales proceeds remained in the City's trust account. In August 2010, the City used \$500,000 of the sales proceeds towards repaying the loan in accordance with the new refinancing agreement with HUD. Thus, the remaining \$81,561 in the trust account should be put to better use and used to pay Section 108 debt payments. The City assumed ownership of the hotel's losses and/or profits when it took title to operate the hotel in 2007. Therefore, City funds should have been used to fund the potentially unlimited operating losses incurred at the hotel. The deficiencies can be attributed to the City's failure to adequately safeguard HUD assets.

In addition, the Section 108 contract provides that program income derived from the sale or lease of any real property acquired with the Section 108 funds is pledged as security for repayment of the note(s). The Section 108 contract requires that said program income and pledged funds be deposited immediately into a separate and identifiable bank account as trustee for HUD to be used only for paying Section 108 principal and interest.

Job Creation Goals Not Achieved

The City could not provide adequate documentation supporting that the activity met a national objective of the program. Under the terms of the UDAG and Section 108 loan agreements, the developer agreed that the use of these funds would create 230 jobs within 18 months of project completion and that at least 51 percent of the jobs would be provided to low- to moderate-income persons. However, only 131 jobs were created, and there was no evidence to support that these jobs had been verified by the City as meeting the low- and moderate-income requirements. In addition, failure to create the jobs is equivalent to a default on the mortgage note, and the principal sum and all unpaid interest may be declared immediately due and payable. Regulations at 24 CFR 570.200(a)(2) provide that each recipient under the Entitlement and HUD-administered Small Cities programs must ensure and maintain evidence that each of its activities assisted with CDBG funds meets one of the three national objectives as contained in its certification. Criteria for determining whether an activity addresses one or more of these objectives are provided in 24 CFR 570.208. Despite provisions of the mortgage agreement, the City could not provide documented evidence that any of the 230 jobs had been created and that they met the low- and moderate-income requirement. Therefore, the City could not demonstrate that a national objective for this activity was accomplished.

Conclusion

The City did not properly administer the Regency Hotel Section 108 activity. Deficiencies identified include that the City (1) failed to monitor the \$10.6 million lease and cure defaults in a timely manner, (2) violated its Section 108 contract with HUD, (3) improperly accounted for and misused Section 108 program income, and (4) failed to ensure that the hotel activity met the national objective of job creation. Consequently, the City (1) was obligated to pay a Section 108 loan balloon payment of \$4.5 million, (2) deprived other CDBG activities of the use of more than \$2.4 million in CDBG funds to pay Section 108 debt, (3) failed to establish a Section 108 loan repayment account and fund it with more than \$2.5 million in sales proceeds/program income, (4) misused \$1.5 million in program income for City expenses to operate the hotel and put another \$581,561 in program income into a City trust account instead of a Section 108 loan repayment account, of which \$81,561 currently remains, and (5) failed to ensure that the program activity met the CDBG national objective of job creation. We attribute these deficiencies to the City's failure to establish adequate controls over safeguarding assets, as required by Federal regulations at 24 CFR Part 85.

Recommendations

We recommend that the Director of HUD's Buffalo Office of Community Planning and Development instruct the City to

- 1A. Submit documentation to justify the use of \$2,403,393 in CDBG funds to pay the Regency Hotel's Section 108 debt so that HUD can make an eligibility determination. For any costs determined to be ineligible, HUD should require the City to reimburse the CDBG program from non-Federal funds.
- 1B. Establish a Section 108 loan repayment account for the Regency Hotel program income, as required by the Section 108 contract.
- 1C. Place any proceeds from a resale of the Regency Hotel asset into the Section 108 repayment account.
- 1D. Repay from non-Federal funds the \$1,523,568 in hotel sales proceeds that were used for City expenses to the established Section 108 loan repayment account.
- 1E. Transfer the \$81,561 in hotel sales proceeds that currently remains in the City trust account to the established Section 108 loan repayment account, so that these funds can be put to better use.
- 1F. Use the funds from the Section 108 loan repayment account to pay all future Section 108 payments that are due in accordance with the HUD-approved refinancing agreement. Should the account contain less than the \$4.5 million required payments, the City should pay the balance from non-Federal funds.

Finding 2: The City Failed To Properly Administer Its Hotel DeVille Section 108 Loan Activity

The City failed to properly administer its Hotel DeVille Section 108 loan activity. Specifically, it failed to (1) ensure the validity of the borrower's personal guaranties, (2) ensure the adequacy of its underwriting of the Section 108 loan, (3) enforce leasehold mortgage terms and properly monitor loan activities in a timely manner, (4) adequately document or support the foreclosure sale of the property, and (5) ensure that the hotel met the required national objective of job creation. We attribute these deficiencies to the City's failure to establish adequate controls over safeguarding assets, as required by Federal regulations at 24 CFR Part 85. Consequently, the City (1) compromised HUD's collateral position by not safeguarding assets; (2) expended more than \$1.7 million in CDBG funds to repay the Section 108 loan, thus preventing other potential low- and moderate-income activities from participating in the program; (3) did not collect \$169,525 in back property taxes; (d) was unable to provide assurance that the purchase price of \$1.55 million represented a fair and equitable sales price for the property; and (5) failed to ensure that the program activity met the CDBG national objective of job creation.

Background

In July 1992, the City applied to HUD for a Section 108 loan totaling \$1.4 million to be used for the refinancing and improvement of the current Hotel DeVille. In April 1993, a leasehold mortgage was executed between the City and Old City Hall Associates (developer), a New York limited partnership. The Section 108 loan proceeds were disbursed by the City to the developer and Binghamton Savings Bank on April 28, 1993. Semiannual repayments of the Section 108 loan principal and interest were scheduled to begin in February 1994 and were to continue until August 2013.

The deficiencies identified relating to this loan were as follows.

City Fails To Ensure the Validity of the Borrower's Personal Guaranties

The City failed to ensure that the borrower's personal guaranties were valid or enforceable by initially agreeing to a letter of credit guarantee that was substantially less than the amount of the loan. As a result, HUD's collateral position was compromised, and assets were not properly safeguarded as required by CDBG regulations at 24 CFR 85.20(b) (3).

To protect HUD's collateral and to induce the City to lend the Section 108 loan proceeds to the developer, the City required personal guarantees from each developer partner guaranteeing prompt and full payment of the developer's

mortgage note to the City in the amount of \$1.4 million. Therefore, in April 1993, each partner of the developer executed personal guarantees with the City.

However, based on State of New York Supreme Court documents, dated January 18, 2002, before April 1993, the City and developer had agreed that as further security for the loan and in addition to the leasehold mortgage, the developer would provide a letter of credit equal to 1 year's principal and interest payments (stipulated to be \$120,000). On June 1, 1992, the City Council passed a resolution, later approved by the mayor, authorizing the City to provide the loan on these terms. Eventually this matter was brought before the State of New York Supreme Court as part of the City's breach of contract action, which sought to recover more than \$1 million from the developer's partners, which had individually guaranteed payment of the \$1.4 million debt. The court ultimately decided that the City was entitled to recover from the developers the \$120,000 it would have acquired, in the event of a default by the developer, had the developer met the requirements outlined in the City ordinance by providing a letter of credit in an amount equal to 1 year's principal and interest payments.

Consequently, due to the City's actions and the manner in which it obtained personal guaranties from the developer's partners, HUD's collateral position on the Section 108 loan was materially compromised. Instead of having personal guarantees equal to the \$1.4 million Section 108 loan, the City's lack of management controls over processing the loan and safeguarding assets resulted in guarantees of only \$120,000 found to be enforceable by the court.

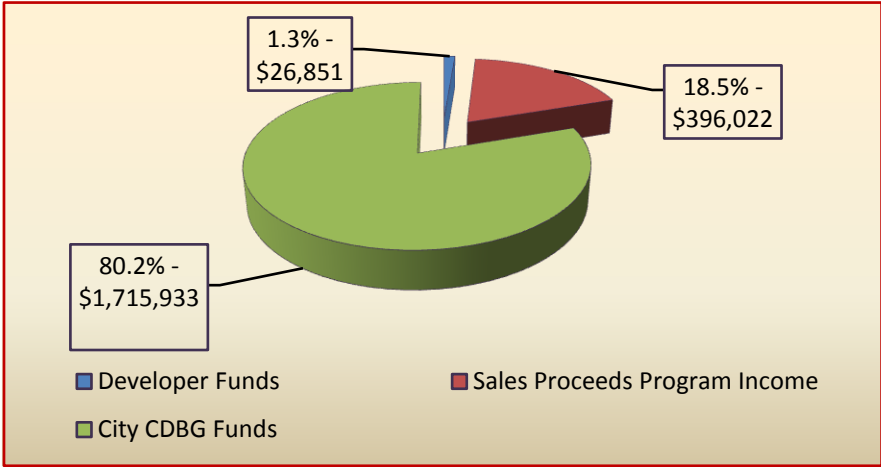
City Fails To Ensure the Adequacy of Section 108 Loan Underwriting

The City failed to ensure the adequacy of its underwriting of the Section 108 loan. As a result, costs that were not necessary or reasonable were charged to the CDBG program contrary to the provisions of Office of Management and Budget Circular A-87.

The Section 108 loan activity for the Hotel DeVille project was underwritten by the City's Economic Development Department staff, which recommended that a \$1.4 million permanent subordinate mortgage loan be approved contingent on approval from HUD. Although the loan was approved and the Section 108 proceeds were disbursed to the developer in April 1993, the developer did not submit its first payment due to the City on February 1, 1994. The developer made only one partial payment of \$26,851 due to the City on August 1, 1994. In addition, the developer made no payments for any amounts due after the August 1, 1994, payment. Therefore, the developer technically defaulted on the terms of its leasehold mortgage and mortgage note within months of receiving the Section

108 loan proceeds. Consequently, since the developer failed to make the initial loan repayment, the adequacy of the City’s underwriting of the project, which recommended that the activity was feasible and worthy of funding, is questionable. As a result, the City expended more than \$1.7 million in CDBG funds to repay the Section 108 loan, thus preventing other potential low- and moderate-income activities from participating in the program. The graphic below details the payment sources for the payments made through June 2010.

Hotel DeVille Section 108 loan payment sources for combined principal and interest payments through June 2010



City Fails To Enforce Mortgage Terms and Monitor Activities in a Timely Manner

Contrary to Federal regulations, the City failed to enforce leasehold mortgage terms and properly monitor the developer activities associated with the loan in a timely manner. The developer technically defaulted on the terms of its leasehold mortgage and mortgage note within months of receiving the Section 108 loan proceeds as evidenced by its failure to make the initial loan repayment due in February 1994. Despite this failure, the City did not issue a notice of default to the developer until June 1998, more than 4 years after the first payment was due on the loan. In addition, the leasehold mortgage required that the developer keep adequate books and records of account and furnish the City with financial statements and other information as the City may require. Nonetheless, there was no evidence in the files nor could the City locate documentation to show that the financial data of the developer were obtained or reviewed by the City after the disbursement of the Section 108 loan proceeds. The monitoring and review of the developers’ financial data would be particularly important in this circumstance since the developer made only one partial payment on the loan. At a minimum,

the City should have conducted monitoring to determine why loan payments were not being made. Regulations at 24 CFR 85.40 provide that grantees are responsible for managing the day-to-day operations of grant- and subgrant-supported activities to ensure compliance with applicable Federal requirements and that performance goals are achieved. The City should have determined whether the developer had adequate cash flows and reserves to make the loan payments. In addition, the leasehold mortgage required the developer to pay for all taxes, assessments, and water rates levied or assessed against the mortgaged property. However, as of August 1998, \$169,525 in back taxes remained unpaid. Consequently, by failing to enforce the terms and conditions of the leasehold mortgage and note in a timely manner, the City was unable to collect the \$169,525 in back property taxes.

City Fails To Document or Support the Reasonableness of the Foreclosure Sale

The City did not adequately document or support the foreclosure sale of the hotel property. This deficiency is attributed to a lack of established controls to ensure that adequate financial records were maintained and that assets were adequately safeguarded as required by regulations at 24 CFR 85.20.

In June 1998, after several years of nonpayment on the loan by the developer, the City provided the developer a notice of default. In December 1998, a deed of surrender from the developer to the City was executed. After foreclosure, the City decided to sell the hotel property for \$1.55 million in December 1998 to Binghamton Associates. However, the City was unable to provide documented evidence that it actively marketed the property for sale or that it had the property appraised before the sale. Rather, a City ordinance authorizing the sale stated that the hotel property was not needed by the City for City-related purposes and the purchase price of \$1.55 million represented a fair price for the hotel property. Despite this assertion, the City's files contained an appraisal for the hotel property, dated August 1992. This appraisal was needed as support for approving and making the Section 108 loan, and it indicated that the current market value of the property at that time was \$4.6 million.

The City also was unable to provide us with official closing documents for the sale; however, noncancelled copies of closing checks were provided that indicated the following distribution of the December 1998 sales proceeds:

Check #	Payee	Amount	Description
004115	BSB Bank and Trust	\$ 1,050,000	Balance due on first mortgage
004117	City of Binghamton	59,363	Taxes, water, and sewer
004118	City of Binghamton	10,791	Taxes
004119	City of Binghamton	2,729	Water and sewer
004123	City of Binghamton	35,000	Attorney fees
004125	City of Binghamton	396,021	108 loan payments
		\$ 1,553,904	Total sales proceeds

Although closing check #004125 listed above shows that the \$396,021 in sales proceeds would be earmarked for Section 108 loan repayments, the City was unable to provide accounting records identifying the bank account used to deposit the funds or evidence of the disbursement of such funds to make payments on the outstanding loan. Consequently, the City was unable to provide assurance that the purchase price of \$1.55 million represented a fair and equitable sales price for the property or that HUD's collateral in the property was adequately protected. Regulations at 24 CFR 85.20(b)(2) provide that grantees and subgrantees must maintain records, which adequately identify the source and application of funds provided for financially assisted activities. Further, these records must contain information pertaining to grant or subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income.

City Fails To Document or Verify the Number of Jobs Created

The City could not provide adequate documentation to support the number of jobs created by the activity. We attribute this deficiency to the City's lack of established controls to ensure and maintain evidence that each of its activities assisted with CDBG funds met one of the three national objectives required by regulations at 24 CFR 570.200.

The developer had agreed, under the terms of the mortgage note, that the use of funds would create at least 34 jobs within 2 years of the date of the note and that at least 51 percent of the jobs would be provided to low- to moderate-income persons. Despite this provision, the City could only provide documentation to support that nine full-time jobs were created. However, no evidence or documentation was provided by the City to show that these jobs had been verified. Nonetheless, the nine jobs claimed to have been created fell far short of the 34 jobs required to be created in accordance with the mortgage note. Consequently, the City failed to ensure that the program activity met the CDBG national objective of job creation. Regulations at 24 CFR 570.200(a)(2) provide that each recipient under the Entitlement and HUD-administered Small Cities programs must ensure and maintain evidence that each of its activities assisted

with CDBG funds meets one of the three national objectives as contained in its certification. Criteria for determining whether an activity addresses one or more of these objectives are provided at 24 CFR 570.208.

Conclusion

The City failed to properly administer its Hotel DeVille Section 108 loan activity. Deficiencies identified included that the City failed to (1) ensure the validity of the borrower's personal guaranties, (2) ensure the adequacy of its underwriting of the Section 108 loan, (3) enforce leasehold mortgage terms and properly monitor loan activities in a timely manner, (4) adequately document or support the foreclosure sale of the property, and (5) ensure that the hotel activity met the required national objective of job creation. Consequently, the City (1) compromised HUD's collateral position by not safeguarding assets, (2) expended more than \$1.7 million in CDBG funds to repay the Section 108 loan and keep the loan current, thus preventing other potential low- and moderate-income activities from participating in the program, (3) did not collect \$169,525 in back property taxes, (4) was unable to provide assurance that the purchase price of \$1.55 million represented a fair and equitable sales price for the property, and (5) failed to ensure that the program activity met the CDBG national objective of job creation. We attribute these deficiencies to the City's failure to establish adequate controls over safeguarding assets, as required by Federal regulations at 24 CFR Part 85.

Recommendations

We recommend that the Director of HUD's Buffalo Office of Community Planning and Development instruct the City to

- 2A. Establish controls to ensure that Section 108 loan proceeds are at all times adequately safeguarded against waste and loss.
- 2B. Establish controls to ensure that any future Section 108 loan applications are carefully underwritten before approval and disbursement of funds.
- 2C. Establish controls to ensure that collateral for Section 108 loans is sufficient to cover the full amount of the loan to ensure that all loan funds will be repaid.
- 2D. Establish controls to ensure that the provisions of all contracts and agreements related to Section 108 loans are followed and promptly enforced.
- 2E. Establish controls to ensure that Section 108 loan activities meet a national objective of the program.

SCOPE AND METHODOLOGY

We performed our onsite audit work at the City's offices, located in Binghamton, NY, between January and July 2010. Our audit scope covered the period January 1, 2007, through December 31, 2009. To accomplish our objectives, we

- Reviewed applicable HUD regulations, the Code of Federal Regulations, and other requirements and directives that govern the Section 108 Loan Guarantee program.
- Reviewed the City's applicable policies and procedures used to administer its Section 108 loan activities.
- Reviewed the City's action plans, grant agreements, and agreements between the City and its developers, including verifying whether national and project objectives were met.
- Gathered historical background information on the City's economic development activities.
- Interviewed City personnel responsible for administration of its Section 108 Loan Guarantee program.
- Interviewed HUD Financial Management Division staff.
- Obtained and reviewed documentation from the City's corporation counsel pertaining to any litigation, underway or pending, relative to the Section 108 Loan Guarantee program.
- Reviewed HUD's monitoring reports and files for the City's CDBG and HOME Investment Partnerships programs, including verifying any reported corrective actions.
- Reviewed all costs charged to the CDBG program that were related to the Section 108 Loan Guarantee program, along with the supporting documentation.

The City applied for and received two Section 108 guaranteed loans to pursue physical and economic revitalization projects. The two Section 108 guaranteed loans reviewed during our audit were primarily for economic development projects with the goal of job creation, including a hotel construction project, consisting of \$7.3 million in Section 108 loan funds and \$3.3 million in UDAG funding, and another hotel refinancing and improvement project, consisting of both private funds and \$1.4 million in Section 108 funding.

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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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 objectives:

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

Significant Deficiencies

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

- The City did not have adequate controls over effectiveness and efficiency of operations when it did not establish adequate controls to ensure that Section 108 loan activities achieved a national objective of the program and that assets were properly safeguarded (see findings 1 and 2).
- The City did not have adequate controls over its reliability of financial reporting, as it could not provide accounting records to support the sources and uses of funds for the two Section 108 activities (see findings 1 and 2).
- The City did not have adequate controls over compliance with laws and regulations, as it did not always comply with HUD regulations while disbursing CDBG and program income funds (see finding 1).

APPENDIXES

Appendix A

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

Recommendation number	Ineligible 1/	Unsupported 2/	Funds to be put to better use 3/
1A		\$2,403,393	
1D	\$1,523,568		
1E			\$81,561

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.

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

3/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. In this instance, if the City implements our recommendation to place the remaining sales proceeds into the established Section 108 loan repayment account, HUD can be assured that these funds will be properly used to repay the Section 108 loan debt.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments



Office of the Mayor

Mayor, Matthew T. Ryan
Executive Assistant, Andrew Block
Secretary, Rebecca Browne

November 1, 2010

Mr. Edgar Moore
Regional Inspector General for Audit, 2AGA
U.S. Department of HUD, Office of Inspector General
26 Federal Plaza, Room 3430
New York, NY 10278

Dear Mr. Edgar Moore,

The City wishes to thank the Office of Inspector General for the opportunity to comment on the Draft Audit Report on the City of Binghamton Section 108 Loan Guarantee Program, specifically as it applies to the Regency Hotel and the Hotel DeVille.

We would first like to comment on three specific references in the report, and then provide a more general response to The Regency Hotel loan analysis.

The City agrees with many of the findings, but raises some concerns about select language included in the report.

Comment 1

1. On page 2, the auditors recommend that the City submit documentation to HUD to justify the use of CDBG funds to pay for Regency Hotel Section 108 debt. The recommendation gives the perception that the City did not provide documentation for these payments. In fact, the City provided the auditors a copy of every invoice sent to us by the loan servicer over the years of this loan. Approximately \$2.4 million in CDBG funds was used to service the debt after the prior tenant went into default, and this amount covered all principal and interest payments from August 2005 to current. The auditors were provided the invoices for these payments, and a summary sheet titled "108 Loan Principal and Interest Paid by the City of Binghamton," which indicated the principal and interest payments made with CDBG funds prior to taking title, and the interest payments made with CDBG funds after taking title. The City objects to the use of language that falsely gives the perception that such documentation was not made available at the time of the audit.

Comment 2

2. On page 7, the auditors state "The City was unable to provide accounting records identifying the bank account used to deposit its Section 108 program income funds." Again, the City objects to the use of this language. We believe it to be true that when this loan was originated in 1985, the City did

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Comment 2

not establish a Section 108 repayment account as required by the loan contract. It is true that the City's accounting of loan repayments (program income) over the years (1985 – 2005) was inadequate. It is also true that the City and the auditors disagree on how recent sales proceeds were used (explained below). However, the above truths need to be distinct and separate from whether or not the City provided accounting records for sales proceeds. In fact, the City did provide a complete accounting of all sales proceeds—how much went to back taxes, operational expenses (payroll, management firm, facility repairs), Section 108 loan interest payments, etc.—and provided full documentation of relevant journal entries and remaining balance of proceeds. We request that the final report better reflect these separate issues, and avoid sweeping characterizations that may wrongly represent certain actions taken at different intervals during this 25-year old loan.

Comment 3

3. On page 10, the auditor's recommend (recommendation 1F.) that the City should use all remaining sales proceeds to pay down the \$4.5 million debt, and then be required to commit non-federal funds to cover whatever balance remains. The City strongly objects to this recommendation, since the loan documents between City and HUD clearly identify future CDBG payments as collateral to the loan. We regret the loss of community development dollars to failed 108 loans, and this administration has worked diligently and cooperatively with HUD to make the best of a very difficult situation to avoid future losses. The City is in no position to cover any balance that may remain from the Regency Loan. Having experienced double-digit tax increases, major cuts to the city workforce (including police and fire positions), a downgrade of our bond rating in 2009, new challenges introduced by the nation's worst recession in generations, and the loss of revenue from decisions made by the County and State, the City must reserve the contractual right to use future CDBG funds to service the remaining debt on this Section 108 loan.

Thank you for taking the above comments into consideration when preparing the final report. Below, the City endeavors to put our efforts to sell the hotel into better context, something we recognize is not the primary responsibility of the Inspector General's Office.

The Regency Hotel

Comment 4

In 1985 construction of the Regency Hotel was financed by a Section 108 loan and UDAG funding. The purpose of the Hotel was to spur economic development in the City, including providing a downtown destination and employment opportunities. Over the past 25 years the Hotel's on site management estimates that over 2 million guests have stayed at the Hotel, there have been over 3,000 weddings, and the Hotel has hosted tens of thousands of conferences and other gatherings. This downtown asset has supported the Broome County Arena, the Broome County Forum, and such regional attractions as the Dick's Open (a professional golf tournament), SPIEDIE Fest, the Chris Thater Races (professional bike race), an Air show, and many more events that the region may not have been able to attract without the Hotel. The Hotel has generated millions of dollars in sales tax and guest tax revenues for Broome County and the City. The Hotel employed 100 to 150 people and, despite its current situation, the Hotel still employs over 70 people today.

Comment 5

Pursuant to the May 9, 1985 Contract for Loan Guarantee Assistance Under Section 108 of the Housing and Community Development Act, the collateral for the loan was (a) All grants approved for the City under the

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Comment 5

Housing and Community Development Act, i.e., the City's CDBG allocation, (b) the program income derived from the sale or lease of the property, and (c) a first mortgage on the property. At no time did the City directly or indirectly agree to pledge its general fund for the Hotel or for repayment of the debt.

Comment 6

It is well documented that over the next 20 years until 2005 the Hotel had various operating and accounting issues. The Draft Audit Report notes that the City's BLDC made loans to help cure defaults and there were various amendments to the original agreement with the tenant. The City also accepted a payment in satisfaction of a personal guaranty from the tenant which left the City in the position that its sole security for the loan was the value of the property. Apparently some accounting procedures were not followed. For 20 years neither the City nor HUD took any actions regarding these shortcomings in oversight.

Comment 7

In August 2005, the tenant commenced an action against the City and former Mayor Buccì alleging a breach of an agreement to refinance the debt due and owing to HUD (which would have amended the tenant's repayment schedule). Upon commencement of the action, the tenant stopped making rent and tax payments. Mayor Buccì filed an action to foreclose on the leasehold mortgage in late December 2005. Thus on January 1, 2006, a new administration inherited a loan in default and collateral of questionable value. In June 2006 the value of the Hotel was further diminished when the Hotel was damaged by a historic flood. There was minimal insurance to pay for the damage¹. Insofar as the City's only collateral for the loan was the property, the City had to first defeat the tenant's lawsuit and then prevail on the foreclosure action to obtain possession of the Hotel. The City did so and obtained possession of the Hotel on February 1, 2007. The Draft Audit Report does not acknowledge the time delay caused by the tenant's lawsuit.

Comment 7

Upon repossession the City immediately and continuously sought to sell the Hotel. At that juncture the City was faced with the decision to either close the hotel and sell the vacant building or to continue to operate the hotel to maximize the sale price (program income) and thus continue the original purpose of the Hotel, to provide economic development and local jobs. After much formal and informal discussion with City Council members, community leaders, hotel industry experts, and HUD representatives, the City elected to keep the Hotel open pending a sale.

Comment 7

The most significant recommendation in the Draft Audit Report is that since the City elected to operate the Hotel (at a loss) pending a sale, that such losses cannot be deducted from the sale price (program income), and must be reimbursed from the City's general fund. While the City agrees that Section 8 and CDBG money should not be used to finance an ongoing operation that is losing money, the City does not believe that it was doing so. At all times the City was attempting to sell the Hotel and to maximize the program income by deriving the highest possible sale price. For example, if the City had simply elected to close the Hotel, then there would have been no operating losses and limited real property taxes². However the City believed that closing the Hotel would have resulted in nearly 100 jobs lost; a dramatic reduction in tax

¹ Also, since the City was in the process of foreclosing on the Hotel and had an equitable interest in the condition of the Hotel at the time of the flood, the City requested FEMA to reimburse it for some of the damages; FEMA refused because the foreclosure was not complete.

² Even closing the Hotel would not have addressed the issue of the back taxes and penalties owed by the tenant. Payment of taxes is necessary to convey clear title and the City would have been required to pay the back property taxes even if it had closed the Hotel.

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Auditee Comments

Comment 7

revenue (occupancy and sales); a decline in economic activity in the downtown district (CDBG-eligible area) related to conventions, events, weddings, etc; and a disastrous devaluation of the Hotel. For example: if the City had closed the Hotel and avoided the operating losses and future real property taxes, but because the Hotel went dark it sold for 2.5 million dollars, then the City would have been obligated to pay the \$2,545,000 remaining balance on the HUD loan (at that time the HUD loan balance was \$5,045,000) and, pursuant to the 1985 Agreement, it is undisputed that the balance would be deducted solely from the City's CDBG funds, not the City's general fund.

If the City had elected to close the Hotel and take a lesser value, the City suspects the auditors would criticize this decision because the City did not maximize the sale price (program income). In fact, please note that in the comments to the Hotel DeVillie, one of the conclusions is that the City failed to properly administer the Hotel DeVillie loan because the "City (1) compromised HUD's collateral position by not safeguarding assets..." Here, the best way to safeguard the asset was to operate the Hotel. Operating the Hotel also safeguarded the original purpose of the Section 108 loan—to create jobs and support economic development.

Comment 7

From the City's perspective, it had the obligation to maximize the sale price (program income) for the benefit of the federal and local taxpayers. Unless it can be established that in February 2007 the City's decision to operate the Hotel was not a prudent strategy to maximize the sale price (program income), then the decision should not be criticized in hindsight. The Draft Audit Report fails to put the City's decisions in context. In February 2007, the decision to operate the Hotel was made about a year before the United States (and much of the industrialized world) went into a depression. As the City's records reflect, the first proposed sale of the Hotel was unsuccessful because the purchaser could not obtain financing at a time when the financial crisis was just starting to implode. Subsequent sales were then limited to proposed purchasers who did not require bank financing. This further limited the market and the sale price of the Hotel.

Comment 8

The City never concealed its strategy or intent from HUD. By letter dated December 18, 2008, the City was clear that the net proceeds of sale would deduct all closing costs and real estate taxes. HUD released its mortgage on this basis. Subsequent e-mails and closing documents showed the net proceeds of sale, including deductions for operating expenses, and once again HUD accepted this information without comment or objection. If any City action was contrary to the regulations or was not in the best interest of maximizing the sale price, then HUD should have so advised the City. To the contrary, the HUD representatives were and have continued to be very cooperative and helpful in this difficult process. They have acknowledged the reality of this unique situation and made every effort to help the City sell the Hotel for the best possible price. Despite what may have happened over the first 20 years of this loan, the past five years have been a "perfect storm" of what can go wrong. The City and HUD worked together to make the best out of a bad situation.

Comment 9

The City has always acknowledged that its CDBG funds are collateral for the loan. The loss of these funds will have a very negative impact on the City. However, the demand that the City establish an account for the operating expenses and all real estate taxes from the general fund while putting the sale proceeds, which those expenses made possible, solely towards program income is simply unfair. Even in hindsight, no one can say whether closing the Hotel or deciding to operate it on a temporary basis pending a sale (which

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Auditee Comments

Comment 9

resulted in net losses) was the better economic decision. The City contends that it took the most prudent steps at the time to insure maximum program income. The 1985 agreement makes all program income from the sale or lease of the Hotel collateral for the loan. Inherent in this requirement is that the City must protect the collateral to maximize the sale or lease price. Therefore the "program income derived from the sale... of the property" necessarily includes the expenses required to sell the Hotel. Since the tenant's default in 2005, the City and HUD have worked together to maximize the program income and preserve the purpose of the original investment, to have a downtown hotel and create jobs.

The Hotel DeVille


This administration has no comment on the report regarding the Hotel DeVille. The problems associated with this Hotel date back to 1998 and the City has been making payments from its CDBG allocation to repay the loan.

Conclusion

Comment 10

In conclusion, the City is aware of the significant economic distress caused by these two investments. The City should not be eligible for projects of this nature until it establishes oversight procedures similar to the Binghamton Local Development Corporation's controls which were approved by the auditors. The City has worked with HUD for many years on lesser, more community-based projects, and has performed in accordance with HUD's regulations. The City requests that HUD review the Regency Hotel project in context, recognize that the City made the best decisions possible to maximize the sale price of the Regency Hotel, and not require the City to repay HUD the operating losses and real estate taxes associated with the sale of the Regency Hotel.

Sincerely,



Matthew T. Ryan, Mayor

OIG Evaluation of Auditee Comments

- Comment 1** Officials for the City contend that the recommendation instructing them to submit documentation to HUD to justify the use of more than \$2.4 million in CDBG funds to pay for the Regency Section 108 debt falsely gives the perception that such documentation was not made available at the time of the audit. However, the officials' contention is not the issue raised in the report. The issue is that OIG recommends the City provide HUD with documentation to justify the necessity and reasonableness of using CDBG funds for the Section 108 debt. During the audit we determined that the City failed to properly administer its Regency Hotel Section 108 loan activity by not monitoring and curing defaults in a timely manner, violating the provisions of the Section 108 contract, misusing program income, and failing to ensure the activity fully met the required national objective of job creation. Further, at no point in the audit report is it stated that the City could not provide detail of the actual payment invoices.
- Comment 2** Officials for the City contend that adequate accounting records were provided identifying the bank account used to deposit its Section 108 program income funds from the sale of the Regency Hotel. However, the records that were provided to account for the sales proceeds were not adequate. Not only were the proceeds not properly deposited into a required custodial account titled "Loan Repayment Account", but also the monies were apparently deposited into a citywide trust account that contains mostly non-federal funds. Given this fact, there is no reasonable assurance that the records provided included the full extent of the use of the proceeds. Moreover, the support for the use of the proceeds consisted of mostly schedules and journal entries.
- Comment 3** Officials for the City object to using all remaining sales proceeds from the Regency Hotel sale to pay down the \$4.5 million Section 108 debt and then using non-federal funds to cover any balance that remains. However, the City is required by the Section 108 contract to use all sale proceeds for the Section 108 debt. We acknowledge that program regulations allow CDBG funds to be used for Section 108 loan repayments, however, the use of such CDBG funds to repay the Regency loan may not have been necessary had the City exercised its fiduciary responsibility to safeguard HUD assets. The City failed to adequately administer the loan and enforce the loan provisions. Specifically, the City allowed the developer to ignore nearly all of the loan conditions for many years, without any substantial action by the City to enforce the provisions of the loan agreement. As such, during the resolution process HUD should consider the City's failure to properly monitor the activity over the years and help determine the best course of action that would allow the City to cease using CDBG funds for the hotels operating losses.
- Comment 4** Officials for the City provide background information and cite the economic success of the Regency Hotel, emphasizing that the hotel employed 100 to 150 people and currently employs over 70 people. However, we would like to point

out that the hotel was supposed to create 230 jobs from the use of the HUD funding. In addition, procedures should have been set up to ensure that the program income earned was applied to help reduce the Section 108 debt.

Comment 5 Officials for the City state that the CDBG allocations and program income derived from the sale or lease of the property (i.e. hotel) are pledged as collateral for the Section 108 loan, and that they did not pledge their general fund for the hotel or repayment of the debt. The results of our audit do not dispute these facts. Nevertheless, since CDBG funds were not geared to pay for the operations of the hotel a more viable method needs to be devised to find a better way to use the CDBG funds.

Comment 6 Officials for the City state that the Regency Hotel had various operating and accounting issues over a 20 year period and that some accounting procedures were not followed, as confirmed by our audit. The officials further contend that neither the City nor HUD took any action regarding the oversight shortcomings. We remind the officials that they are responsible for the proper and prudent administration and oversight of their HUD funded programs, and now is the time to provide a stronger effort to determine a way to better utilize the CDBG funds.

Comment 7 Officials for the City provided a history of events occurring with the Regency Hotel and state that they continuously sought to sell the property upon taking possession and that they elected to keep the hotel operating pending a sale. They agree that CDBG funds should not be used to finance an ongoing operation that is losing money, and contend that the best way to safeguard the Regency Hotel asset was to operate the hotel. Officials believe that their decision to operate the Regency Hotel was made to maximize the sale price of the hotel for the benefit of federal and local taxpayers. We do not dispute that City officials attempted to operate and then sell the hotel; however, we remind the City officials that it was their decision to continue hotel operations. This may have been a viable option for the City at the time; however, HUD was not a contractual partner to the operating losses of the hotel. As such, going forward City Officials need to reassess the situation considering the losses and come up with a more viable means of spending CDBG funds

Comment 8 Officials for the City state that their intent to operate the hotel was never concealed from HUD. The officials' further state that they are aware that the CDBG funds act as collateral on the loan, but deem it unfair that the City should pay for the operating expenses and back taxes from their general fund. The fact that the officials informed HUD of some details does not alleviate the City from abiding by its Section 108 contract and operating agreement for the hotel. The Section 108 contract requires that the program income be used only for paying Section 108 principal and interest. The City did not adhere to its own operating agreement with the hotel operator, whereby the City was required to fund from local dollars all taxes and operating losses. Moreover, HUD was not a party to

the City's decision to operate the Regency Hotel and CDBG funds should not have been used to fund its operating loss.

Comment 9 Officials for the City assert that the program income from the sale of the property necessarily includes the expenses required to sell the hotel. The City seems to confuse the HUD collateral for the hotel debt with operating losses incurred by the City. Again we remind the officials that it was their decision to operate the hotel and now because it is operating at a loss this does not mean that a lender (in this instance, HUD) would allow collateral that has been pledged for debt to be used for operations.

Comment 10 Officials for the City conclude that the City should not be eligible for projects of this nature until it establishes oversight procedures similar to the Binghamton Local Development Corporation's (BLDC) controls. Further, the officials request that HUD recognize their decisions to maximize the sale price of the Regency Hotel, and not require the City to repay HUD the operating losses and real estate taxes associated with the sale of the Regency Hotel. While we surveyed certain activities of the BLDC and found that the BLDC's loan portfolio appeared to be generally current with few write-offs, the BLDC operations were not included in the scope of our audit, thus we offer no opinion on the adequacy of the BLDC's management controls; however CDBG funds should not have been expended on the hotel's operations.