



Issue Date	July 22, 2011
Audit Report Number	2011-LA-1015

TO: Yolanda Chavez, Deputy Assistant Secretary for Grant Programs, DG

*Tanya E. Schulze*

FROM: Tanya E. Schulze, Regional Inspector General for Audit, Region IX, 9DGA

SUBJECT: Chicanos Por La Causa, Inc., Phoenix, AZ, Did Not Always Administer Its Neighborhood Stabilization Program 2 Grant In Accordance With HUD Requirements

## **HIGHLIGHTS**

### **What We Audited and Why**

We audited Chicanos Por La Causa, Inc.'s (grantee) Neighborhood Stabilization Program 2 (NSP2) grant.<sup>1</sup> We conducted the audit as part of the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) fiscal year 2011 annual audit plan and to support HUD OIG's fiscal year 2011 strategic goal to contribute to the oversight objectives of the American Recovery and Reinvestment Act of 2009. HUD awarded the grantee \$137 million and was 1 of 56 organizations<sup>2</sup> nationwide that received program funds.

Our objective was to determine whether the grantee administered its NSP2 grant in accordance with HUD's program requirements. Specifically our review focused on whether the acquisition and administrative expenses paid to date from the grant funds were for properly supported and eligible expenditures.

<sup>1</sup> NSP2 grant B-09-CN-AZ-0001

<sup>2</sup> The program funds were awarded to consortiums, local governments, nonprofits, and one State.

## What We Found

The grantee did not always administer its NSP2 grant in accordance with HUD's program requirements. Specifically, the grantee expended NSP2 funds for improper procurements, ineligible and unsupported expenditures, and inadequately secured program income. Generally, these issues occurred because the grantee and its consortium members incorrectly applied Federal requirements in certain instances. Nevertheless, our review did not attribute these findings to significant internal control deficiencies. As a result of the improper expenditures, \$754,000 in NSP2 funds was potentially unavailable for eligible activities.

## What We Recommend

We recommend that the HUD Deputy Assistant Secretary for Grant Programs require the grantee to (1) provide HUD with supporting documents for the \$366,000 in NSP2 funds paid to improperly procured contractors or reimburse the unsupported costs to its NSP2 account from non-Federal funds; (2) reimburse its NSP2 account from non-Federal funds \$209,947 for ineligible and unsupported expenditures; and (3) discontinue future payments on the developers' fees to subrecipients totaling \$178,451. Additionally we recommend that the HUD Assistant Secretary for Grant Programs require the grantee to update its NSP2 policies and procedures to include obtaining and reviewing all consortium member contracts.

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

## Auditee's Response

We provided the grantee a discussion draft report on July 8, 2011, and held an exit conference with grantee officials on July 11, 2011. The grantee provided written comments on July 15, 2011. It generally disagreed with the report.

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

# TABLE OF CONTENTS

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Background and Objective	4
Results of Audit	
Finding 1: The Grantee Used NSP2 Funds for Improperly Procured Consulting Services	6
Finding 2: The Grantee Used Program Funds for Ineligible and Unsupported Expenditures	9
Finding 3: NSP2 Program Income was Inadequately Secured	12
Scope and Methodology	14
Internal Controls	16
Appendixes	
A. Schedule of Questioned Costs and Funds To Be Put to Better Use	17
B. Auditee Comments and OIG's Evaluation	18

## BACKGROUND AND OBJECTIVE

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The Neighborhood Stabilization Program 2 (NSP2) was authorized under Title XII of Division A of the American Recovery and Reinvestment Act of 2009 and provided 56 grants nationwide on a competitive basis totaling \$1.93 billion. The grants went to one State, local governments, nonprofits, and consortiums of public or private nonprofit entities. This program was established to stabilize neighborhoods, the viability of which had been damaged by the economic effects of properties that were foreclosed upon or abandoned.

The U.S. Department of Housing and Urban Development (HUD) executed the Chicanos Por La Causa, Inc. (grantee), grant agreement on April 6, 2010, awarding the consortium \$137 million in NSP2 funds. According to the grantee's approved action plan, the anticipated outcomes using the awarded NSP2 funds included acquiring 1,998 affordable housing units,<sup>3</sup> demolishing 165 blighted properties, and land banking 203 foreclosed-upon homes.

The grantee has been a community development corporation in Arizona for the past 40 years. Throughout the organization's history, it has evolved and grown to adapt to the changing needs of its clients, offering programs in the areas of education, economic development, health and human services, and housing.<sup>4</sup>

The grantee's consortium agreement included 12 additional organizations and targeted activities for areas in Arizona, California, Colorado, the District of Columbia, Illinois, Maryland, New Mexico, Pennsylvania, and Texas. The table below identifies the consortium member organizations and their respective program target area(s).

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<sup>3</sup> 707 home-ownership units, 917 rental units, 325 lease-to-purchase units, and 49 cooperative units.

<sup>4</sup> This information was taken from the grantee's 2009 annual report (<http://www.cplc.org/Common/Files/Annual%20Report/CPLC%20Annual%20Report2009.pdf>).

<b>Consortium member organization</b>	<b>Program target area</b>
<b>Chicanos Por La Causa (grantee/lead member)</b>	Maricopa and Santa Cruz County, AZ
<b>Affordable Homes of South Texas</b>	Hidalgo County/McAllen, TX
<b>Community Development Corporation of Brownsville</b>	Cameron County/Brownsville, TX
<b>El Paso Affordable Housing Credit Union Service Organization</b>	El Paso, TX, and Las Cruces, NM
<b>Tierra del Sol Housing Development Corporation</b>	El Paso, TX, and Las Cruces, NM
<b>YES Housing, Inc.</b>	Albuquerque, NM
<b>Community Housing Improvement Systems and Planning Association, Inc.</b>	The California cities of Salinas, Gonzales, Soledad, Greenfield, King City, and Hollister
<b>NEW Economics for Women</b>	Areas of Los Angeles and San Fernando, CA (San Fernando Valley)
<b>Colorado Rural Housing Development Corporation</b>	Thornton, Westminster, Conejos County, Costilla County, Alamosa, Saguache, Hayden, Walsenburg, Monte Vista, and Del Norte in Southern Colorado
<b>Del Norte</b>	Areas of Denver, CO
<b>Mi Casa, Inc.</b>	Johnston Square in Baltimore, MD, and Eckington and Brightwood Park in Washington, DC
<b>Norris Square Civic Association</b>	North Philadelphia, PA
<b>The Resurrection Project</b>	New City Neighborhood in Chicago, IL

Our objective was to determine whether the grantee administered its NSP2 grant in accordance with HUD’s program requirements. Our review focused on whether the acquisition and administrative expenses paid to date from the grant funds were for properly supported and eligible expenditures.

## RESULTS OF AUDIT

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### Finding 1: The Grantee Used NSP2 Funds for Improperly Procured Consulting Services

The grantee used NSP2 funds to pay for improperly procured consulting service contracts. For two improperly procured contracts consortium members did not believe it was necessary to obtain competitive bids for consulting services. This condition occurred because the consultants already had knowledge of the members' operations. As a result of the improperly procured contracts, payments totaling \$366,000 for consulting services were potentially unavailable for eligible activities because, without the competitive bidding, the entities risked paying more than necessary for services.

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#### **The Grantee Improperly Procured a Contract With the Association**

The grantee had a memorandum of understanding with the National Association for Latino Community Asset Builders to pay \$810,000 over the 36-month grant period; however, the agreement was not the result of free and open competition as required by 24 CFR (Code of Federal Regulations) 84.43.<sup>5</sup> Grantee officials stated that they did not go through a competitive bidding process because the NSP2 consortium was the Association's idea and the NSP2 grant application included the anticipated use of the Association. Therefore, grantee officials thought the procurement requirements did not apply.

The grantee had paid \$315,000 to the Association, and the supporting documents provided during the audit were limited to the contract and the payment documents, which included the statement, "Services provided for NSP2 National Grant Agreement per CPLC/NALCAB [grantee/Association] services MOU [memorandum of understanding] 36 monthly payments of \$22,500 beginning 3/1/2010 ending 2/28/2013." This support was inadequate because the grantee provided no reasonable basis for the amounts charged as required under Office of Management and Budget Circular A-122<sup>6</sup> and the contract procurement file did not contain some form of cost or price analysis as required under 24 CFR 84.45.<sup>7</sup>

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<sup>5</sup> "All procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition."

<sup>6</sup> Office of Management and Budget Circular A-122, attachment A, General Principles, A.2., states that "to be allowable under an award, costs must be ...reasonable and ...adequately documented."

<sup>7</sup> Regulations at 24 CFR 84.45 state, "Some form of cost or price analysis shall be made and documented in the procurement files in connection with every procurement action."

Although the contract was improperly procured, the grantee benefited from the Association's services such as evaluating consortium member processes to identify best practices and problems. HUD officials stated that they planned to consider whether the Association could be reclassified as a subrecipient and the costs could be supported by appropriate source documentation. As a result of this audit, the grantee reclassified the Association as a subrecipient and obtained a summary of the Association's purported actual costs. However, the \$315,000 in fees already paid were not supported as actual costs at the time of the audit review. If the grantee does not obtain supporting documentation for amounts already paid, the costs will become ineligible. In addition, the \$495,000 remaining on the contract would be reimbursed based on actual cost documentation.

### **The Grantee Paid on an Improperly Procured Contract With Avalon Residential**

New Economics for Women used a consultant, Avalon Residential, from a preexisting contract between the consultant and a NEW Economics affiliate without regard for Federal procurement requirements set forth in 24 CFR 84.43. The preexisting contract included a retainer of \$10,000 per month to the consultant. Grantee officials explained that Avalon Residential was used for consulting services because of its familiarity with NEW Economics. Therefore, NEW Economics did not obtain the consulting services through free and open competition.

The Grantee paid the \$51,000 from NSP2 funds for Avalon Residential's assistance with program administration from February 2010 to September 2010. On October 1, 2010, NEW Economics officials hired the owner of Avalon Residential as a director because of the amount of work being dedicated to the program. Once the consultant became an employee, NEW Economics ceased paying for Avalon Residential's consulting services. However, the failure to properly procure the services provided under the consulting contract after the grant award resulted in \$51,000 in NSP2 funds that were no longer available for eligible activities.

### **Conclusion**

The payments on the two improperly procured contracts totaled \$366,000. These contracts potentially reduced funds available for eligible program activities because, without procuring the contracts through free and open competition, the entities risked paying more for services than was necessary. However, because the Association was reclassified as a subrecipient, its consulting expenses may be allowable if properly documented and reasonable.

## Recommendations

We recommend that the HUD Deputy Assistant Secretary for Grant Programs require the grantee to

- 1A. Continue to provide procurement training to the consortium members.
- 1B. Provide HUD with supporting documents for the \$315,000 in prior payments to the Association and reimburse the grantee's NSP2 account from non-Federal funds for any costs HUD determines are unsupported.
- 1C. Reimburse the grantee's NSP2 account from non-Federal funds for the \$51,000 paid on the Avalon Residential contract or provide support that the amount paid was reasonable.
- 1D. Obtain support for all future Association NSP2 payment requests.

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## Finding 2: The Grantee Used Program Funds for Ineligible and Unsupported Expenditures

The grantee used program grant funds for ineligible and unsupported expenditures including developers' fees to subrecipients, vehicle purchases, and real estate commissions. Generally, the ineligible and unsupported fees occurred because the consortium members incorrectly applied the Federal requirements in these instances. As a result, \$388,000 in NSP2 grant funds was not available for eligible activities.

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### **Ineligible Developers' Fees Were Paid to Subrecipients**

The grantee paid Del Norte for the developers' fees totaling \$89,226 to subrecipients NEWSED and North East Denver Housing contrary to the requirements of Office of Management and Budget Circular A-122, attachment B, part 8(m)(1).<sup>8</sup> Further, HUD's answer to the NSP frequently asked question, "NSP FAQ ID: 282,"<sup>9</sup> specified that costs are limited to actual costs incurred by the subrecipient. According to the executed consortium member agreements, these entities were subrecipients to the consortium member Del Norte and, thus, were prohibited from collecting developers' fees. The grantee believed that because termination agreements were later executed between NEWSED and Del Norte and North East Denver Housing and Del Norte, the entities had changed their status from subrecipients to developers. However, the NSP2 consortium agreement was signed with the entities listed as consortium members under Del Norte and was included as an exhibit to the consortium member funding agreement signed by the grantee and Del Norte. The consortium member funding agreement contained a provision that changes could not be made without HUD's approval.

In addition, an estimated \$178,451<sup>10</sup> in developers' fees was payable upon lease or sale of the acquired properties. As a result, the subrecipients NEWSED and

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<sup>8</sup> "Charges to awards for salaries and wages, whether treated as direct costs or indirect costs, will be based on documented payrolls approved by a responsible official(s) of the organization. The distribution of salaries and wages to awards must be supported by personnel activity reports, as prescribed in subparagraph (2), except when a substitute system has been approved in writing by the cognizant agency."

<sup>9</sup> "To be reimbursed, a subrecipient must provide proper documentation that demonstrates the costs are actual costs incurred by the subrecipient."

<sup>10</sup> One-third of the developers' fees, \$89,226, were paid at the time of acquisition. According to the developers' agreements, the remaining two-thirds of the developers' fees will be payable by the time the lease or sale of the property is completed. Therefore, the estimated developers' fees payable were \$178,451 (\$89,225.51 multiplied by 2).

North East Denver Housing received ineligible developers' fees totaling \$89,226 and might be due an additional \$178,451 in future developers' fees, thereby reducing the available program funds for eligible activities by a total of \$267,677.

### **The Grantee Paid for Unapproved Vehicles**

The grantee paid \$57,223 from NSP2 funds for NEW Economics to purchase two vehicles without the approval of HUD as required by Office of Management and Budget Circular A-122, attachment B, part 15(a).<sup>11</sup> However, NEW Economics maintained vehicle mileage logs along with staff requests for vehicle use, which helped ensure that the vehicles were used only for program purposes. The grantee misunderstood the Federal requirements for vehicle purchases. Specifically, it interpreted the Federal requirements to mean that as the lead consortium member, its advance approval for the vehicle purchase was sufficient. Therefore, NEW Economics did not request HUD's approval to purchase the two vehicles as required. As a result, \$57,223 in program funds was not available for eligible program activities.

### **The Grantee Paid Uncustomary Real Estate Agent Commissions**

The grantee approved acquisition expenditures that included uncustomary real estate agency commissions for NEW Economics single-family acquisition transactions totaling \$63,498 for eight properties. These payments were contrary to provisions of Office of Management and Budget Circular A-122, attachment A, part 2(a),<sup>12</sup> which require costs to be reasonable for the performance of the award. NEW Economics officials claimed that buying properties from the open market sometimes required the buyer to pay part of the real estate commission if the seller refused to pay and, further, the seller's decision to pay the commissions was a matter of preference. However, our review of other consortium member acquisition transactions indicated that none of their acquisitions included any type of commission paid by the buyer to the real estate agency. Additionally, we contacted an official at the California Department of Real Estate and were

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<sup>11</sup> "Capital expenditures for general purpose equipment, buildings, and land are unallowable as direct charges, except where approved in advance by the awarding agency."

<sup>12</sup> "2. Factors affecting allowability of costs. To be allowable under an award, costs must meet the following general criteria: a. Be reasonable for the performance of the award and be allocable thereto under these principles." Office of Management and Budget Circular A-122, attachment A, part 3, describes reasonable costs as "[a] cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs...."

informed that in the 2010 and 2011 housing market in California (where the properties were purchased), all real estate commissions, including the seller's real estate agent commissions, were ordinarily paid by the seller. According to this official, it was even more likely for this to be the case when the seller was a lender selling foreclosures. As a result of the unsupported commissions, \$63,498 in NSP2 funds was no longer available for eligible program activities.

## Conclusion

The grantee's and consortium members' ineligible and unsupported expenditures included a total of \$209,947 in payments from NSP2 funds and an anticipated \$178,451 in future developers' fees remaining on acquired single-family properties. These ineligible expenditures reduced the amount of grant funds available to provide NSP2 benefits through eligible activities.

## Recommendation

We recommend that the HUD Deputy Assistant Secretary for Grant Programs require the grantee to

- 2A. Continue to provide Office of Management and Budget Circular A-122 training to the consortium members.
- 2B. Reimburse the NSP2 account in the amount of \$146,449 from non-Federal funds for the ineligible expenses.
- 2C. Provide support that buyer paid real estate agent or broker commissions were reasonable and customary or reimburse the NSP2 account in the amount of \$63,498 from non-Federal funds for the unsupported expenses.
- 2D. Discontinue payments from NSP2 funds to the subrecipients NEWSED and North East Denver Housing for developers' fees, including the remaining \$178,451 in developers' fees due upon completion of the rehabilitation and sale or lease of the properties.

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### Finding 3: NSP2 Program Income was Inadequately Secured

The grantee allowed NEW Economic’s affiliate to acquire 16 properties without adequately securing future program income. This deficiency occurred because the grantee misunderstood the arrangement between NEW Economics and McB, LLC, which included an independent contractor agreement that did not contain language for the protection of program income. If the consortium member does not protect its rights to future income, that income may not be available for future approved program activities.

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**The Contract with NEW Economics Did Not Address Future Program Income**

The grantee approved NEW Economics draws for the direct payment to title companies and conveyance of 16 property titles to a contractor without restricting future program income. The agreement between NEW Economics and the contractor, McB, LLC (a wholly owned subsidiary of New Economics), did not provide for use of future income from the sale of the properties. NSP2 requirements in 74 Federal Register 29223/29224 (June 19, 2009)<sup>13</sup> specify that grantees are encouraged to include language in agreements with nonsubrecipients that provides for the grantee to share in the program income.

It was unclear whether the concurrent status of McB, LLC, as a wholly owned limited liability company was sufficient to acquire rights to use the program income for future eligible activities. The grantee approved the acquisition payments and corresponding title conveyances to McB, LLC, because it was unaware that the executed agreement between NEW Economics and McB, LLC made McB, LLC an independent contractor.<sup>14</sup> The grantee thought NEW Economics made arrangements for McB, LLC to be held to the NSP2 requirements. As a result of this audit, the grantee had NEW Economics amend its contract with McB, LLC to include the applicability of NSP2 requirements,

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<sup>13</sup> “grantees are strongly encouraged to avoid the undue enrichment of entities that are not subrecipients. For example, grantees are encouraged to structure assistance to developers that undertake acquisition and/or rehabilitation as loans rather than grants. Grantees are also encouraged to include language in agreements with entities that are not subrecipients that provides for grantees to share in any excess cash flow generated by the assisted project to the extent practicable.”

<sup>14</sup> When the issue was discussed with grantee officials, they believed that without the contract, the wholly owned company would have the same restrictions as NEW Economics under the program agreements, which included the protection of program income.

which include program income provisions. Without this amendment there would be less funds available to the grantee for NSP2 activities.

### **Recommendation**

We recommend that the HUD Deputy Assistant Secretary for Grant Programs require the grantee to

- 3A. To update its NSP2 policies and procedures to include obtaining and reviewing all consortium member contracts.

## SCOPE AND METHODOLOGY

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We performed an audit of the grantee's NSP2 funds limited to administrative and acquisition expenditures. Our audit period covered NSP2 expenditures between February 2010 and April 2011. We conducted our fieldwork at the grantee's office located at 6741 North 7th Street, Phoenix, AZ; New Economics' office located at 303 Loma Drive, Los Angeles, CA; and our Phoenix office from February through May 2011.

To accomplish our objective, we reviewed HUD and Federal program requirements. Additionally, we interviewed appropriate HUD staff, consortium member officials, and contractors. We analyzed the grantee's action plan approved by HUD and determined that \$13.7 million was budgeted for administrative activities and \$38.6 million was budgeted for acquisition activities.<sup>15</sup>

We reviewed a nonstatistical selection of the grantee's and consortium members' administrative and acquisition expenditures and evaluated the corresponding supporting documentation to determine whether the expenditures were eligible and supported. We used computer processed data to select the nonstatistical audit sample and, through our testing, determined the computer processed data was adequate for our purposes. Below is a table that shows the dollar value of the consortium member administrative and acquisition expenditures reviewed during the audit.

Consortium member organization	Acquisition expenditures reviewed	Administrative expenditures reviewed
<b>Chicanos Por La Causa (grantee/lead member)</b>	\$501,798	\$ 939,514 <sup>16</sup>
<b>Affordable Homes of South Texas</b>	\$136,977	\$9,334
<b>Community Development Corporation of Brownsville</b>	\$153,081	\$0
<b>El Paso Affordable Housing Credit Union Service Organization</b>	\$0	\$13,059
<b>Tierra del Sol Housing Development Corporation</b>	\$348,087	\$0
<b>YES Housing, Inc.</b>	\$0	\$0
<b>Community Housing Improvement Systems and Planning Association, Inc.</b>	\$584,745	\$13,251
<b>NEW Economics for Women</b>	\$4,433,944	\$ 220,833
<b>Colorado Rural Housing Development Corporation</b>	\$469,262	\$0
<b>Del Norte</b>	\$1,759,166	\$0
<b>Mi Casa, Inc.</b>	\$0	\$0
<b>Norris Square Civic Association</b>	\$0	\$11,602
<b>The Resurrection Project</b>	\$0	\$36,616
<b>Totals</b>	<b>\$8,387,060</b>	<b>\$ 1,244,209</b>

<sup>15</sup> The grantee later revised the action plan to combine the acquisition and rehabilitation budgets.

<sup>16</sup> This amount includes the review of the \$315,000 paid to the Association.

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 objective.

# INTERNAL CONTROLS

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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.

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## Relevant Internal Controls

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

- Effectiveness and efficiency of operations and
- Compliance with applicable 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

We evaluated internal controls related to the audit objective in accordance with generally accepted government auditing standards. Our evaluation of internal controls was not designed to provide assurance on the effectiveness of the internal control structure as a whole. Accordingly, we do not express an opinion on the effectiveness of the grantee's internal control.

## APPENDIXES

### Appendix A

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

Recommendation number	Ineligible <u>1/</u>	Unsupported <u>2/</u>	Funds to be put to better use <u>3/</u>
1B		\$315,000	
1C		51,000	
2B	\$146,449		
2C		63,498	
2D			\$178,451
Totals	\$146,449	\$429,498	\$178,451

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. In this case, the ineligible costs are expenditures related to developers' fees and unapproved vehicle purchases.

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. In this case, the \$315,000 paid to the Association would be allowable as the entity was reclassified as a subrecipient, but the expenses must be properly documented and reasonable. Additional unsupported costs included the improperly procured Avalon Residential contract payments of \$51,000 and the unsupported real estate commission payments of \$63,498.

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 case, the \$178,451 in future developers' fees to NEWSED and North East Denver Housing would either be rebudgeted for an eligible activity or become an eligible use if the entities were appropriately reclassified to allow the fees and they can provide documentation supporting the costs.

## Appendix B

# AUDITEE COMMENTS AND OIG'S EVALUATION

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### Ref to OIG Evaluation

### Auditee Comments



Chicanos Por La Causa, Inc.

A PROMISE OF OPPORTUNITY

July 14, 2011

**VIA EMAIL AND MAIL**

Ms. Tanya E. Schulze  
Office of the Inspector General  
U.S. Department of Housing and Urban Development  
451 7th Street, SW  
Washington, DC 20410

RE: NSP2 grant B-09-CN-AZ-0001

Dear Ms. Schulze:

We appreciate the opportunity to respond to the Office of Inspector General ("OIG") draft Audit ("Draft") concerning the Chicanos Pro La Causa ("CPLC") Neighborhood Stabilization Act ("NSP") Consortium. As you know, the Consortium applied for funding under the HUD Notice (Notice FR-5321N-01) ("NSP NOFA") for the NSP2 program under the American Recovery and Reinvestment Act of 2009 ("Act").

As of the end date of OIG's audit period, April 2011, the CPLC/NALCAB Consortium had acquired 175 single family homes for rehabilitation and resale in 7 states and the District of Columbia, as well as one 400 unit multi-family property in Phoenix, Arizona. The Consortium had obligated and/or expended over \$37 million dollars of allocated funds.

Consortium Members are actively acquiring and rehabilitating homes. The Los Angeles area Consortium Member has started the Redevelopment Activity and several other members are preparing legal documents for discussion and review with the land banking activity. Many Consortium Members are holding Home Buying Workshops to ensure an inventory of potential NSP 2 buyers. Most Consortium Members have completed their Section 3 plans and are actively working to create economic opportunities for Section 3 individuals.

CPLC has developed policy and procedures to support our comprehensive monitoring and audit plan to administer this NSP2 grant. Ongoing interaction and communication from CPLC's National Administration Team and our partnership with NALCAB has truly set the

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Ms. Tanya Schulze  
Page 2

**Comment 1**

stage for the operational success of our NSP2 grant. The support and team work among our Consortium Members minimizes the geographical gap between our communities. As an administrative team we consult with each of our consortium members to ensure they are armed with a viable plan and the resources they need to be successful.

As we understand it, OIG reviewed approximately \$8.3 million of acquisition expenditures and nearly \$1 million of administrative expenses out of approximately \$30 million in NSP2 grant funds expended thus far. On a positive note, we would appreciate it if the final Audit reflected this broad scope and that OIG had no internal control findings. While OIG's role, as we understand it, is to note areas to be addressed, we understand that this was an overall positive result for such a detailed review.

Of course, the Draft contains three findings, which we believe we can reasonably address. We will take each finding in turn.

**Comment 2**

**Finding 1.** Finding 1 contains two allegations. First that the National Association for Latino Community Asset Builders ("NALCAB") was engaged through a Memorandum of Understanding rather than through free and open competition. However, CPLC and NALCAB have been integral members of the Consortium, often referred to as CPLC/NALCAB. The Consortium Agreement is itself entitled "CPLC/NALCAB NSP II Consortium Agreement". We appreciate OIG's concerns but we believe this part of Finding 1 can be resolved with NALCAB's execution of a Subrecipient Agreement, which has already been accomplished and a copy already provided to OIG. In addition, NALCAB has provided a summary of their actual expenditures to CPLC which were forwarded to OIG under separate cover. A summary of the NALCAB actual expenses (Attachment A) indicate their actual expenses exceed the \$315,000 in payments by \$627.46. CPLC has examined a small sampling of their documentation, found it to be in order and will be conducting an audit within the next 30 days. We invite OIG to review NALCAB's records at your earliest opportunity.

**Comment 3**

Second, OIG found that New Economics ("NEW") used Avalon Residential ("Avalon") as a consultant. We believe that under NSP II, it is appropriate for successful NSP2 applicants to incur and repay reasonable pre-application costs. Avalon was hired to assist NEW with its grant writing. The NSP NOFA, Appendix 1.C. provides in relevant part:

**C. Reimbursement for pre-award costs**

Background

NSP2 recipients will need to move forward rapidly to undertake administrative actions, as soon as awards are announced. Therefore, HUD is granting permission for recipients to incur pre-award costs as if each was a new recipient preparing to receive its first allocation of CDBG funds. Applicants taking advantage of this waiver do so entirely at their own risk, as they may not be selected for NSP2 funding.

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Ms. Tanya Schulze  
Page 3

Requirement

24 CFR 570.200(h) is waived to the extent necessary to grant permission to applicants under this notice to incur pre-award costs as described in this Notice. Similarly, in accordance with OMB Circular A-87, Attachment B, paragraph 31, HUD is allowing states applying to HUD under this Notice to incur pre-award costs under the same terms. Nongovernmental entities cannot incur pre-award costs for activities other than administrative and planning because all other activities require an environmental review.

Accordingly, we ask that the recommendation about reimbursing the Avalon payment be removed as the work was performed prior to the award and as such was not subject to federal procurement standards.

**Comment 4**

Finding 2. Finding 2 contains three allegations. First that NEWSED and North East Denver Housing ("North East") were consortium members and as such could not be a developer earning a developer fee. However, NEWSED and North East Denver Housing both signed termination agreements terminating their participation in the Consortium (Attachment B). Both NEWSED and North East Denver Housing were selected through publicly available processes. A review of the timeline of events will help illustrate that NEWSED and North East Denver Housing are developers rather than subrecipients.

July, 2009 the consortium member agreements were signed,  
Fall, 2009 CPLC submitted its proposal/application to HUD for NSP2 funding,  
January, 2010 HUD awards CPLC's application,  
April, 2010 CPLC signs HUD Contract for NSP2 grant,  
April, 2010 Consortium Funding Agreements signed with CPLC Consortium Members  
(Except, DelNorte, NEWSED or Northeast Denver Housing),  
June, 2010 Consortium Funding Agreement signed with DelNorte,  
July, 2010 Consortium Termination Agreement signed with NEWSED,  
August, 2010 Consortium Termination Agreement signed with Northeast Denver,  
December, 2010 Developer Agreements signed with NEWSED and Northeast  
Denver Housing.

As such we would ask that the recommendation to discontinue payments from NSP2 funds to them be removed.

**Comment 5**

Second, NEW used NSP2 funds to purchase two vehicles. New Economics for Women did so only after they prepared a detailed cost benefit analysis, which has been provided to OIG, comparing renting to purchases. NEW was instructed to keep careful records and to reimburse or purchase any residual value in the vehicles at the end of their use under the NSP2 grant. We believe there is a clear cost savings to this purchase. We had understood the Consortium leader

13525358.1

Ms. Tanya Schulze  
Page 4

could approve this purchase, but we now understand HUD has to approve and we have asked HUD to review and approve this purchase as a method to achieve a cost savings (Attachment C).

**Comment 6**

Third, that NEW used NSP2 funds to pay real estate commissions that OIG finds uncustomary. The commissions in question were for buyer-brokers for reasonable and customary real estate services. The eight single-family properties in question were acquired during bank sales. The banks were very restrictive on closing costs they would pay, refusing to pay even the reasonable and customary real estate commissions. It is reasonable and customary to have two real estate brokers or agents; one is the listing agent, representing the seller. The other is the agent hired by the buyer to find and assess the property. This buyer-engaged agent can be an agent for the seller also, or an agent for the buyer. The fees were reasonable in amount as they were the standard percentage for real estate brokers. The fees were not part of the sales price as brokerage work is a transactional cost, not a sales price point. The sellers were all banks, who had foreclosed on the homes, and who had substantial losses and little negotiating flexibility and declined to pay for the buyer's broker.

**Comment 7**

**Comment 8**

**Comment 9**

**Comment 10**

**Comment 11**

**Comment 12**

As provided in the July 14, 2011 email from CPLC, CPLC asked NEW to have California real estate law reviewed regarding the compensation of brokers. California Civil Code 2079.19 provides that the obligation to pay compensation to a buyer's broker/agent by the seller's listing broker is not necessarily determinative of a particular agency relationship between an agent and the seller or buyer. According to California real estate law, what NEW paid is a permissible cost. Rather these were customary fees that either a seller or buyer pays for. (For example, please refer to the National Association of Realtor's Auction Glossary, which defines "Buyer's Broker" as "A real estate broker who represents the buyer and, as the agent of the buyer, is normally paid for his/her services by the buyer."). NEW reports that the California Department of Real Estate acknowledges the industry has supported the position that listing broker is paid compensation/commission and agrees to compensate the buyer's broker in traditional single family home transactions. However, the CPLC/NALCAB Consortium has experienced just the opposite in this foreclosure market. When the lender is the seller and already has a significant loss in the homes held for sale, there is less room for the seller to entertain additional losses. Five of the 8 properties you cited for NEW were NCST properties, and NCST will not compensate a buyer's broker/agent. This NCST policy is applied nationwide so all of our consortium members are abiding by this when acquiring homes from NCST. Therefore, it is reasonable for the buyer to compensate its broker/agent for the work they perform to acquire the property.

**Comment 13**

**Comment 14**

**Comment 15**

**Comment 16**

A 3% commission is reasonable and customary according to nationwide industry practice for a buyer/broker commission. Given the current economic condition, some geographical areas are paying more than 3% commission to their buyer broker/agent due to the market values of the homes being extremely low. CPLC provided the bid information in previous emails which support the 5 acquisitions from the trust and the bid information from the other 3 sellers. The bid information clearly supports the purchase price is 3% to 4% below the fair market value of the properties acquired.

**Comment 17**

13525358.1

Ms. Tanya Schulze  
Page 5

**Comment 18**

**Comment 19**

**Comment 20**

We appreciate the suggestion to provide additional training to consortium members. Attached are copies of the conferences we have held for our consortium members and other information about current trainings and our Technical Assistance agreement with LISC/HUD (AttachmentD) for ongoing support to our consortium, which may well address this recommendation. We request that the recommendation to reimburse \$209,947 be removed, as well as the recommendation to discontinue developer fee payments to NEWSED and North East Denver Housing.

**Finding 3.** Finding 3 states NEW contracted with its affiliate MCB, LLC ("MCB") as a holding company to limit liability that arises from owning real estate. This is a reasonable and customary practice, that in this case would help shield NEW and the Consortium from potential liability claims that might arise due to owning and operating real property. While NEW regarded MCB as bound under NSP2 standards under its Agreement for Performance of Services, NEW and MCB have executed an amendment that more clearly incorporates the NSP standards and also specifically incorporates NSP2 requires restricting NSP2 program income. We believe this will address the concerns raised in the Draft.

We appreciate the opportunity to review these facts and circumstances with your office and look forward to resolving any remaining findings with the HUD program office as well.

Sincerely,



Judy Stith  
Vice President Contract and  
Corporate Compliance  
Chicanos Por La Causa, Inc.

cc: Mr. Edmundo Hidalgo  
Mr. David Adame  
Mr. Stephen Callahan

13525358.1

## OIG Evaluation of Auditee Comments

**Comment 1** The Scope and Methodology section of the audit report presented specific information regarding the scope of the administrative and acquisition transactions reviewed for the audit.

We agree with the auditee that the audit report should reflect that we did not attribute the findings to significant internal control deficiencies. This information was presented in the report under Internal Controls; however, we added a statement in the Highlights section acknowledging that the OIG did not attribute the findings to significant internal control deficiencies. We agree that the lack of significant internal control deficiencies associated with the findings was a positive result for the scope of the review.

**Comment 2** We acknowledge that the auditee provided the OIG with an executed subrecipient agreement with the Association. However, because the subrecipient agreement resulted from the audit, the questioned cost remained under finding 1 of the report. We also acknowledge receipt of the summary of the Association’s expenditures and modified recommendation 1B to ask HUD to determine whether the \$315,000 in Association expenditures were adequately supported.

**Comment 3** We agree with the auditee that some pre-award costs were allowable under the NSP2 Notice of Availability of Funds, appendix 1C<sup>17</sup>. Upon further review, we determined that \$11,000 of the \$62,000 in Avalon Residential expenses questioned were for pre-award costs. However, the remaining expenditures of \$51,000 were for NSP2 program administration services after the effective date, January 14, 2010, of the grantee award and, therefore, were not pre-award costs (see the table below). We revised the report to reflect the change from \$62,000 in unsupported expenditures to \$51,000. The recommendation for the reimbursement or support of these payments will remain in the audit report because the \$51,000 paid to Avalon Residential was for expenditures outside of pre-award costs and the consulting services were not properly procured.

Description	Invoice month	Amount
“NSP II Program Administration – 30%”	February 2010	\$3,000
“NSP II Program Administration – 45%”	March 2010	\$4,500
“NSP II Program Administration – 75%”	April 2010	\$7,500
“NSP II Program Administration – 75%”	May 2010	\$7,500
“NSP II Program Administration – 45%”	June 2010	\$4,500
“NSP II Program Administration – 50%”	July 2010	\$5,000
“NSP II Program Administration – 95%”	August 2010	\$9,500
“NSP II Program Administration – 95%”	September 2010	\$9,500
<b>Total</b>		<b><u>\$51,000</u></b>

<sup>17</sup> Docket number FR-5231-N-01.

**Comment 4** We acknowledge that NEWSED and North East Denver Housing both signed termination agreements to terminate their participation in the consortium. However, we disagree with the auditee’s interpretation that the entities were developers rather than subrecipients. The timeline presented in the auditee’s response is consistent with the following report statement,

the NSP2 consortium agreement was signed with the entities listed as consortium members under Del Norte [making them in effect subrecipients] and was included as an exhibit to the consortium member funding agreement signed by the grantee and Del Norte. The consortium member funding agreement contained a provision that changes could not be made without HUD’s approval.

Therefore, the termination of the subrecipient status was not effective under the HUD program because HUD had not approved the change as required. As a result, this part of audit report finding 2 remains unchanged.

**Comment 5** We acknowledge that consortium member NEW Economics provided a cost benefit analysis comparing the reimbursement of employee personally owned vehicle mileage<sup>18</sup> to the purchase of the vehicles. We also acknowledge that the auditee, as a result of the audit, has requested HUD approval for the vehicles purchased in December 2010. However, the purchase remains under finding 2 because HUD’s approval would be obtained as a result of our audit.

**Comment 6** The auditee asserted that the buyer-broker service was reasonable and customary. The audit report did not evaluate whether the service was reasonable and customary, rather it considered whether the buyer’s payment of the fee was reasonable and customary.

**Comment 7** The auditee asserted that the banks (sellers) restricted amounts for closing costs and refused to pay the reasonable and customary real estate commissions. However, the auditee did not provide evidence to support this claim. We revised the audit report to reflect the real estate commissions paid as unsupported rather than ineligible.

**Comment 8** The auditee asserted that it is reasonable and customary to have two real estate brokers or agents. The audit report did not evaluate whether the number of commissioned real estate brokers or agents was reasonable and customary, rather it considered whether the buyer paying the fee was reasonable and customary.

**Comment 9** The auditee asserted that the real estate commission amounts were reasonable and customary. The audit report did not evaluate whether the amount of the commission paid was reasonable and customary, rather it considered whether the buyer’s payment of the fee was reasonable and customary.

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<sup>18</sup> In the grantee’s response it states, “comparing renting to purchases.”

- Comment 10** We acknowledge that the real estate commission fees were part of the closing costs and not the sales price.
- Comment 11** The auditee asserted that the banks (sellers) “had substantial losses and little negotiating flexibility and declined to pay the buyer’s broker.” However, the auditee did not provide evidence to support this claim.
- Comment 12** We acknowledge that the California Civil Code 2079.19 states, “[t]he payment of compensation or the obligation to pay compensation to an agent by the seller or buyer is not necessarily determinative of a particular agency relationship between an agent and the seller or buyer.” Furthermore, we acknowledge that under California law the payment of real estate commissions are permissible; however, the audit report considered whether the buyer paying the fee was reasonable and customary.
- Comment 13** The auditee also asserted that the real estate commissions were “customary fees that either a seller or buyer pays for.” However, the auditee did not provide sufficient evidence to support this claim. We acknowledge the “National Association of Realtor’s Auction Glossary” defined the term for the buyer’s broker. However, it appears that the organization is national and not specific to the California housing market. The OIG review showed that not all of the NEW Economics transactions included buyer paid real estate commissions and our discussion with an official at the California Department of Real Estate, as noted in the audit report, informed us that in the 2010 and 2011 housing market in California (where the properties were purchased), all real estate commissions, were ordinarily paid by the seller. According to this official, it was more likely for this to be the case when the seller was a lender selling foreclosures.
- Comment 14** The auditee asserted that the consortium member experience with the payment of real estate commissions was that the seller did not make the payment in foreclosure transactions. However, the auditee did not provide evidence to support this claim. Also see OIG response to comment 11.
- Comment 15** The auditee asserted that the National Community Stabilization Trust policy not to pay the buyer’s broker or agent was applied nationwide and therefore the buyer payment of the commission was reasonable. However, the auditee did not provide evidence to support this claim.
- Comment 16** See OIG response to comment 9.
- Comment 17** See OIG response to comment 10.
- Comment 18** We acknowledge that the auditee has provided multiple training conferences for the consortium members. We have revised recommendations 1A and 2A to reflect the recommendation for continued training.

**Comment 19** We did not remove the recommendation for the grantee to reimburse the \$209,947 as requested by the auditee (see OIG response to comments 4, 5, and 7). Additionally, we did not remove the recommendation for the grantee to discontinue developer fee payments to NEWSED and North East Denver Housing as requested by the auditee (see OIG response to comment 4).

**Comment 20** We acknowledge that NEW Economics and McB, LLC executed an amendment to their agreement that more clearly incorporates the NSP2 requirements. This change was made as a result of the audit and therefore the issue regarding improperly secured future income remained under finding 3 of the audit report.