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Audit Report Number 2007-BO-1003

TO: Robert Paquin, Director, Office of Community Planning and Development,
Boston Regional Office, 1AD

FROM: 
John A. Dvorak, Regional Inspector General for Audit, 1AGA

SUBJECT: The Office of Community Development, City of Chicopee, Massachusetts, Did
Not Properly Award and Administer Community Development Block Grant
and HOME Funds Used for its Housing Activities

HIGHLIGHTS

What We Audited and Why

As part of our annual plan, we audited the Office of Community Development, City of Chicopee, Massachusetts' (City) administration of its Community Development Block Grant (CDBG) and HOME programs. The objective of the audit was to evaluate the City's administration of its housing rehabilitation contracts funded through the CDBG or HOME programs and its oversight and monitoring of various for-profit developers (developers) involved in the rehabilitation activities. We also evaluated whether \$700,000 in HOME set-aside funds was committed for an eligible project.

What We Found

The City did not adequately administer more than \$2.2 million in housing rehabilitation contracts funded through its CDBG and HOME programs. It did not perform the required independent analysis of cost estimates submitted by

developers before awarding rehabilitation contracts, did not always enforce procurement and financial management contract provisions included in written agreements with developers, did not adequately address performance problems on the part of developers identified during reviews performed by it, and approved final payments for unfinished projects. In addition, it approved more than \$1.2 million in unreasonable and unsupported rehabilitation contract costs¹, and its use of a \$700,000 community housing development organization set-aside (set-aside) from the HOME program was an ineligible use of these funds.

What We Recommend

We recommend that the director of the Office of Community Planning and Development in Boston require the City to establish written policies and procedures for both the HOME and CDBG programs that meet HUD requirements for awarding, administering, and monitoring program funds. We also recommend that the City provide supporting documentation for the \$1.2 million in unsupported costs, including establishing the reasonableness of the costs, or repay the funds and be directed not to use set-asides on the ineligible project, which will allow \$700,000 to be put to better use on other eligible projects.

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

Auditee's Response

We provided City officials with a draft audit report on February 23, 2007, and requested a response by March 9, 2007. We held an exit conference with City officials on March 1, 2007 to discuss the draft report, and we received their written comments on March 9, 2007. Although the City took exception to some of the wording used in the report, the City generally agreed with the facts, conclusions, and recommendations for Findings 1 and 2. The City disagreed with Finding 3.

The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

¹ The \$1.2 million is part of the overall \$2.2 million.

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BACKGROUND AND OBJECTIVES

The City of Chicopee, Massachusetts, receives annual Community Development Block Grant (CDBG) program funds on a formula basis from the U.S. Department of Housing and Urban Development's (HUD) Office of Community Planning and Development. The CDBG program is a flexible program that provides communities with resources to address a wide range of unique community development needs. The City is also a partner in a regional consortium² that receives annual HOME program funds from HUD each year. Under the HOME program, HUD allocates funds by formula among eligible state and local governments to strengthen public-private partnerships and to expand the supply of decent, safe, sanitary, and affordable housing, with primary attention to rental housing, for very low- and low-income families. Participating jurisdictions may provide assistance in a number of eligible forms, including loans, advances, equity investments, interest subsidies, and other forms of investment that HUD approves.

The City of Chicopee's Office of Community Development (City) administered the CDBG and HOME programs. During our audit period from July 1, 2002, through June 30, 2006, it was responsible for administering 127 activities/projects funded with more than \$10.2 million in HUD funds.³ Our audit looked at eight housing-related rehabilitation contracts that the City awarded and/or administered during the audit period with four developers totaling more than \$2.2 million. Additionally, we looked at its plans to subsidize a \$4.4 million, 25-unit condominium project through a commitment of \$700,000 in HOME program set-asides to a locally established nonprofit agency that had community housing development organization status.⁴

The City awarded its HOME funds for housing rehabilitation contracts either by using word of mouth or by contacting potential developers directly as part of a problem properties task force. The City normally did not award housing rehabilitation contracts using CDBG funds, and mainly used CDBG funds for other community development needs. However, the City used CDBG funds for three of the rehabilitation contracts we reviewed, committing funding as part of a request for proposal process used to dispose of three tax-title properties. These tax-title property transfers were the responsibility of the City's Office of Treasurer. The director of the City's Office of Community Development provided technical assistance to the Office of Treasurer in developing the request for proposals. The director of the Office of Community Development also participated in the evaluation and selection of the proposals submitted for these properties, and authorized the commitment for the use and award of CDBG housing rehabilitation funds for the properties.

² Holyoke/Chicopee/Westfield Consortium.

³ \$9,071,726 for 122 CDBG activities/projects and \$1,204,102 for five HOME activities/projects.

⁴ "Community housing development organization" means a private nonprofit organization that (1) is organized under state or local laws; (2) has no part of its net earnings inuring to the benefit of any member, founder, contributor, or individual; and (3) is neither controlled by, nor under the direction of, individuals or entities seeking to derive profit or gain from the organization.

We audited the City's administration of the CDBG and HOME programs. The objective of the audit was to evaluate the City's administration of its housing rehabilitation contracts funded through the CDBG or HOME program and its oversight and monitoring of the for-profit developers involved in the rehabilitation activities. We also evaluated whether \$700,000 in HOME set-aside funds was committed for an eligible project.

The issues identified in our report deal with administrative and internal control activities that we feel are necessary to bring to the City's attention now. Other matters regarding the City's management may remain of interest to our office as well as other Federal agencies. Release of this report does not immunize any individual or entity from future civil, criminal or administrative liability or claim resulting from future action by the Department of Housing and Urban Development and or other Federal agencies.

RESULTS OF AUDIT

Finding 1: The City Did Not Adequately Award or Administer Its Housing Rehabilitation Contracts in Accordance with Federal Requirements

In awarding contracts for rehabilitation of housing projects, the City did not ensure that all preaward requirements were met and did not ensure that all administrative contract provisions were enforced. It also did not perform an independent analysis of cost estimates submitted by developers before awarding contracts, enforce procurement and financial management contract provisions (including Davis-Bacon requirements⁵) included in the written agreements between the City and developers, or adequately address performance problems on the part of developers identified during reviews performed by the City; and it approved final payments for unfinished projects. These deficiencies occurred because of a lack of adequate internal controls, which included a lack of written policies and procedures for the administration of housing-related activities funded under the CDBG and HOME programs and a lack of adequate oversight and monitoring of the developers that received federal funds for rehabilitation activities. As a result, the City could not assure HUD that \$2.2 million in rehabilitation contracts it awarded were reasonable or the rehabilitation work was necessary.



The City Did Not Perform Analyses of Cost Estimates Before Awarding Contracts

The City did not perform the required independent analyses of cost estimates submitted by developers before awarding rehabilitation contracts totaling more than \$2.2 million. These analyses were required to ensure that the estimates were reasonable and necessary and would have included a verification of proposed cost data, projections of the data, and the evaluation of the specific elements of the costs. Detailed costs for every line item should have been examined for cost reasonableness. Instead, the City relied on the developers to provide cost estimates for more than \$2.2 million in rehabilitation work, which it then approved as being reasonable, based on a maximum per-unit subsidy or square footage formula. The proposed work was generally completed by identity-of-interest and/or otherwise affiliated business entities of the developers. The City

⁵ 42 USC 5219 of the Davis-Bacon Act states that Davis-Bacon wages apply when CDBG funds are used for rehabilitation of residential property with 8 or more units. Also, the Davis-Bacon wage information must be posted at the construction site, contractors and subcontractors must pay not less than the prevailing wage rates, and contract and subcontracts must contain Davis-Bacon provisions. These requirements applied to the rehabilitation of properties at 714-718 Chicopee Street and 830 Chicopee Street.

mistakenly believed that this type of “price analysis” of contract costs was acceptable. As a result, there are no assurances of reasonableness or necessity for the costs. For example,

- As part of three HOME-funded housing rehabilitation contracts, the City approved and paid \$14,000 for 217 “window blinds” valued at between \$3,255 and \$5,425. An analysis of the contract costs should have determined that these costs were not reasonable.
- The City did not obtain written plans and specifications for the rehabilitation of three CDBG-funded housing rehabilitation contracts. Without plans or specifications, the City then approved the estimated costs provided by the developer without performing a cost analysis. Further, for one of the three CDBG contracts, the developer requested a \$90,000 contract modification, increasing the original contract by 36 percent (from \$250,000 to \$340,000). The City also failed to perform an analysis of the proposed increase in the contract cost before negotiating the increase to determine whether the cost increase was reasonable and necessary.

The City Did Not Enforce Procurement and Financial Management Contact Provisions

Written agreements between the City and developers contained provisions related to procurement, financial management, and Davis-Bacon requirements, as required by HUD regulations. However, the City did not always enforce these provisions and ensure that they were carried out. For example, the City did not ensure that owners maintained separate books and records for HOME- and CDBG-funded activities. In one instance, an owner/developer acknowledged that he did not keep separate accounting records for his HOME-funded property. In another instance, an owner commingled the books and records of three CDBG-funded projects. In this instance, even though an identity-of-interest general contractor was used, the rehabilitation costs for individual subcontractors were on the owner’s books, not the contractor’s. The owner’s records should have shown payments to the identity-of-interest general contractor, not to the subcontractors.

Additionally, the City did not ensure that Davis-Bacon requirements were met for rehabilitation work performed on the 714-718 Chicopee Street and 830 Chicopee Street projects. Specifically, the City awarded \$490,000⁶ under contracts for the rehabilitation work, but it did not 1) inspect the job sites to ensure that Davis-Bacon wage information was posted, 2) perform employee interviews to ensure that contractors and subcontractors were paying prevailing wage rates, 3) obtain

⁶ Two of the three contracts funded under CDBG were subject to Davis-Bacon. These two projects involved 9 and 15 units. The remaining CDBG-funded contract had six units and was not subject to Davis-Bacon.

copies of the subcontracts to ensure that Davis-Bacon provisions were included, or 4) obtain weekly payroll sheets. Further, the City did not ensure that Davis-Bacon provisions were included in the identity-of-interest general contractor's agreement with the owner.

The City Did Not Adequately Address Performance Problems When Identified

The City did not adequately address performance problems identified during its own compliance reviews of developers. In one instance, a developer did not provide basic project-related documents for three projects, including project plans and specifications, construction contracts and subcontracts, and permits and contractor licenses. The City requested these and other project-related documents from the developer and noted that failure to comply would result in no further payments being processed. The developer did not provide the requested documentation, but the City made the remaining \$384,733 in contract payments.

During its compliance reviews, the City identified problems associated with federal requirements related to contracts and subcontracts involving Minority and Women-Owned Business Enterprises, Inc. (MWBE). Although these problems were noted, the City did not follow up and enforce compliance with the federal requirements. In one instance, a developer stated on an application that one of the major minority subcontractors would be Hispanic. The general contractor then notified the City that "minority subcontractors and minority and female labor were employed extensively" throughout the rehabilitation of the project. When the City requested the names and subcontracts for the MWBE contractors used, however, the general contractor's response stated that "MWBE or State Office of Minority Business Assistance (SOMBA) contractors were not utilized." Given the disparities between the statements about MWBE and SOMBA contractors, the City should have requested an explanation as to why MWBE and SOMBA contractors were not used as originally claimed.

The City Approved Final Payments for Four Unfinished Projects

The City approved final retainage payments of \$36,556 for four unfinished projects. For one CDBG-funded project, the City made the final payment although the rehabilitation of commercial space (included as part of the rehabilitation contract) had not been completed. In this instance, the City then executed a contract modification and provided an additional \$90,000 to the owner almost four months after the final payment was made. After the additional funds

were provided through a contract modification, the City still did not ensure that the commercial space was completed. An August 1, 2006, Office of Inspector General (OIG) inspection of the property showed that the commercial space was still unfinished (see picture below).



830 Chicopee Street - unfinished commercial space

In another example, the City approved final retainage payments for two CDBG-funded housing rehabilitation contracts based on final inspections that reported deficiencies. These deficiencies included a lack of adequate fire blocking in the furnace closets and the units' walls and ceilings. On another project, the City released retainage payments on a HOME-funded rehabilitation contract to an owner without ensuring that unfinished items (punch list items) were completed. Our physical inspections as of November 7, 2006, showed that some of these items were not corrected although the City made the final payment of retainage in December 2004 (see pictures below).



25 Pine Street - unfinished corner boards and cleanup



25 Pine Street - unfinished landscaping and cleanup

Conclusion

The deficiencies described in this finding occurred because of a lack of adequate internal controls, which included a lack of written policies and procedures for the administration of housing-related activities funded under the CDBG and HOME programs, and a lack of adequate oversight and monitoring of the developers that received federal funds for rehabilitation activities. The City needs to implement internal controls and develop adequate policies and procedures to ensure that all preaward requirements for housing rehabilitation contracts are met and that contract provisions are properly enforced. This will significantly improve the City's processes for awarding CDBG- and HOME-funded contracts and its monitoring and oversight of developers.

During our audit, we identified several instances of unsupported and ineligible costs that occurred as part of the rehabilitation work performed under the contracts referred to in this finding (valued at \$2.2 million). These examples of unsupported and ineligible costs are discussed further in finding 2, and the corresponding questioned costs are identified in appendix A.

Recommendations

We recommend that the director of the Office of Community Planning and Development in Boston require the City to

1A. Establish written procurement policies and procedures that are consistent with HUD regulations.

1B. Ensure that sufficient internal controls are established for procurements involving CDBG and HOME funds.

1C. Provide supporting documentation showing that Davis-Bacon wages were paid on the applicable CDBG-funded projects.

1D. Establish written policies and procedures to ensure that retainage or final payments are made only after supporting evidence is obtained, demonstrating that project work was completed.

RESULTS OF AUDIT

Finding 2: The City Approved More Than \$1.2 Million in Questionable Costs for Work Performed under Housing Rehabilitation Contracts Funded with CDBG and HOME funds

The City did not sufficiently review costs charged under housing rehabilitation contracts funded with CDBG and HOME funds before approving them. It approved 1) more than \$1.1 million in disbursements for unsupported costs associated with these rehabilitation contracts and 2) \$116,706 in unnecessary costs of a developer and an affiliated general contractor.⁷ These deficiencies occurred due to a lack of adequate internal controls, including a lack of written policies and procedures for the administration of housing-related activities funded under the CDBG and HOME programs, and inadequate oversight and monitoring of the developers who received the funds. As a result, the City incurred more than \$1.2 million in questioned or unnecessary costs using funds that are now unavailable for other community development needs. In addition, the City cannot demonstrate that the extent of work performed was necessary or that all contract costs were appropriate.

The City Approved More Than \$1.1 Million in Unsupported Disbursements

The City disbursed more than \$1.1 million in CDBG and HOME funds for rehabilitation contract work without adequate support. For instance, the City could not support the use of \$730,000 in CDBG funds awarded to one developer for three housing rehabilitation projects. Specifically, the City did not develop its own work write-ups and cost estimates or obtain project specifications when awarding the contracts. It relied on the developer's cost estimates and approved contract disbursements without comparing budgeted amounts to actual expenditures. Also, the City did not require or obtain the bank drawdown requests to ensure that CDBG funds did not pay for the same items as the bank funds, although bank loans were a substantial project funding source for the three CDBG rehabilitation contracts. In addition to the above, the City did not adequately review the supporting documentation submitted with the contract drawdown requests. We found invoices that were improperly charged to another of the owner's identity-of-interest companies, instead of the identity-of-interest general contractor. In another example, invoices showed materials shipped to the identity-of-interest company(s) address and not the addresses of the CDBG-funded projects. In these instances, the City should have requested further

⁷ The general contractor was the management agent for several of the developer's properties. They shared common office space, physical location, and mailing address; and one employee (bookkeeper) worked for both companies. The general contractor also received other the contractor's bids for these projects before his award for this work .

clarification and documentation regarding the drawdown requests and shipping address.

The City also disbursed \$375,960 in HOME funds without adequate support to two different developers using identity-of-interest general contractor businesses for the rehabilitation contract work. Although OIG site inspections showed that work was generally complete, the developers were unable to produce adequate documentation to support the costs. In addition, payments to these two developers were based on nondescriptive invoices from their identity-of-interest general contractor businesses. For instance, one developer was allowed to draw down \$285,000 in HOME funds for rehabilitation work at the 71 Montgomery Street project by providing an invoice between identity-of-interest entities (owner/developer and identity-of-interest general contractor) and not third-party invoices. The invoice was accompanied by copies of uncashed checks to represent payments made on the invoice. In a second instance, the City paid \$90,960 based on identity-of-interest invoices from another developer for the HOME-funded rehabilitation project at 25 Pine Street without source documentation. Given the identity-of-interest nature of these transactions, the City should have required the developers to submit source documentation with each payment request and/or performed on-site monitoring to verify the actual costs.

Unnecessary HOME Costs of \$116,706 Were Approved by the City

The City approved \$236,204 in unnecessary costs added to the estimate of an affiliated general contractor for two projects involving one developer. Of the total \$236,204 variance, \$114,402 was paid with HOME funds, and the remaining was paid with state funds. The internal cost estimate documents of the developer and affiliated general contractor showed costs for rehabilitation work totaling \$889,796 for the two projects. However, the cost breakout provided to the City by the developer and the general contractor showed a cost breakout and invoices for these costs totaling \$1,126,000 for the rehabilitation work; a difference of \$236,204 (see table).

Property address	Invoices/ cost breakout submitted to the City	Internal estimate of affiliated general contractor	Difference between estimate and cost breakout	Excess costs charged to the HOME program	Excess costs charged to the state housing rehabilitation program
14-16 Charles Street	\$698,000	\$558,000	\$140,000	\$70,000	\$70,000
90 Cochran Street	\$428,000	\$331,796	\$96,204	\$44,402	\$51,802
Totals	\$1,126,000	\$889,796	\$236,204	\$114,402	\$121,802

Although site inspection reports showed that work was completed, the general contractor was unable to produce accounting or bank records to show actual project costs. A letter from the general contractor, sent in response to our request for this information, stated that an “estimate” was provided for the project and that a “contract was signed for that amount” (the bid amount).

The City also approved disbursements of \$2,304 from HOME funds and \$4,896 from state funds to a developer for unnecessary costs of computer design and 3-D modeling consulting services for a building located at 25 Pine Street. The developer purchased these services several months after an engineering contractor it had hired completed the drawings and floor plans for the rehabilitation of the building located at 25 Pine Street.

Conclusion

The deficiencies described in this finding occurred because of a lack of adequate internal controls, including a lack of written policies and procedures for the administration of housing-related activities funded under the CDBG and HOME programs, and inadequate oversight and monitoring of the developers who received the funds. The City needs to implement internal controls and written policies and procedures to ensure that CDBG and HOME funds are disbursed for contract costs that are deemed reasonable and necessary and are adequately supported. Without adequate support of costs for these housing rehabilitation contracts, the City cannot demonstrate that the extent of work performed was necessary or that all contract costs were adequately justified and supported for more than \$1.1 million in expended HOME program funds.

Recommendations

We recommend that the director of the Office of Community Planning and Development in Boston require the City to

2A. Establish written policies and procedures for both the HOME and CDBG programs to ensure that funds are disbursed for reasonable and necessary contract costs and that related costs are adequately supported.

2B. Provide supporting documentation for the \$730,000 in unsupported costs, including the establishment of the reasonableness of costs and, if support cannot be obtained, repay the funds to the CDBG program.

2C. Provide supporting documentation for the \$375,960 in unsupported costs, including the establishment of the reasonableness of costs and, if support cannot be obtained, repay the funds to the HOME program.

2D. Repay the \$116,706 in unnecessary costs to the HOME program.

RESULTS OF AUDIT

Finding 3: The City's Use of \$700,000 in HOME Set-Asides Did Not Meet Eligibility Requirements

The City's use of \$700,000 in community housing development organization (CHDO) HOME program set-asides (set-asides) on a 25-unit condominium project was an ineligible use of funds. The use of the set-aside funds, in this instance, did not meet the HUD requirements that project housing be owned, developed, or sponsored by a CHDO. The ineligible use of funds occurred because the City did not properly interpret the regulations regarding set-aside eligibility requirements for CHDOs. As a result, the \$700,000 in congressionally mandated set-asides was unavailable for use on eligible CHDO-owned, developed, or sponsored housing projects.

Set-Aside Funds Were Not Used Properly

The City subsidized a \$4.4 million, 25-unit condominium project by awarding \$700,000 in set-asides to a locally established nonprofit agency with CHDO status.⁸ This CHDO had a joint venture agreement with the project's for-profit owner.⁹ While this agreement permits the CHDO to sell 5 of the 25 units to qualified HOME program applicants, the project, as structured, did not meet the provisions of the regulations, which require that the housing be owned, developed, or sponsored by a CHDO. Further, the CHDO did not have effective project control (i.e., no decision-making authority) of the project in this instance. Federal regulations provide that when these conditions do not exist, the CHDO is operating as a subrecipient, and set-aside funds may not be used.

The Final Project Was Different Than Originally Planned

According to the City and the CHDO, the original project involved plans to use property on which the City was in the process of foreclosing for outstanding taxes. In the original project, the CHDO planned to develop five units of affordable housing on this property. However, the owner of the property sold it before foreclosure to two investors, and after the sale, the CHDO and investors were unable to reach agreement on a sales price for the CHDO to buy the property. The investors, who had expended approximately \$110,000 in costs for

⁸ Of the \$700,000, \$250,000 is under contract. Draft loan documents provided on January 10, 2007, show an increase to \$700,000.

⁹ The ownership entity has an identity-of-interest relationship with the project developer entity.

acquisitions and payment of back taxes, were asking \$300,000 for the property. The \$300,000 asking price rendered the original CHDO project financially unfeasible. However, the CHDO did acquire the property. According to CHDO officials, they contacted the owner of an adjacent property and were able to negotiate a \$155,000 sales price with the investors for the property on the CHDO's behalf. However, the housing project was changed from a five-unit eligible CHDO project¹⁰ into a 25-unit condominium project that would be owned and developed by the owner (for-profit entity) of the adjacent property, not the CHDO.

In its interpretation of the regulations governing CHDO set-asides, the City believed that the CHDO only needed to be a "partner in the development" and that a joint venture agreement would satisfy the set-aside requirements. The City also believed that the project was eligible under the sponsorship category and that it was "sponsoring" the CHDO, which was a nonprofit agency. We disagree with the City's understanding of what qualifies as "sponsored." The "sponsorship" eligibility category cannot apply in this instance since sponsorship involves a project in which the CHDO "sponsors" a for-profit, rather than the City's sponsoring another nonprofit entity. The City has also indicated that it believed that the CHDO had a valid legal title to the property.¹¹ However, our review of the City's land/property records shows that the for-profit entity solely holds legal title to the property. In August 2005, the property was deeded to the CHDO; however, in July 2006, the property was conveyed from the CHDO to the for-profit entity.

Of the \$700,000, \$165,934 was expended for acquisition of the property and other costs. According to plans, the remaining funds were to be used by the City to purchase the five units at market value upon completion of the project.

Conclusion

The ineligible use of funds occurred because the City did not properly interpret the regulations regarding set-aside eligibility requirements. The project, as structured, does not meet HUD regulations, which require that the project housing be owned, developed, or sponsored by a CHDO. The for-profit entity holds legal title to the property. In addition, the for-profit entity is the developer for this project, not the CHDO. Therefore, the use of the \$700,000 does not meet HUD requirements for such use.

¹¹ The purchase and sales for this property were between the investors and the for-profit entity, not the CHDO. At a May 24, 2005, meeting, the CHDO was described as a "funding mechanism," and it was indicated that the CHDO would acquire the property and then reconvey it to the for-profit entity.

Recommendations

We recommend that the director of the Office of Community Planning and Development in Boston direct the City to

3A. Reclaim the \$165,934 provided to the CHDO for the project and discontinue the planned use of the remaining \$534,066 on the project.

3B. Ensure that the \$534,066 in HOME set-asides is used on eligible projects in accordance with HUD regulations.

SCOPE AND METHODOLOGY

To achieve our audit objectives, we reviewed program requirements, including

- Federal laws, regulations, HUD guidebooks, and notices for the CDBG and HOME programs;
- Office of Management and Budget circulars;
- The Federal Acquisition Regulation; and
- Massachusetts general laws over procurement.

We also obtained an understanding of the City's policies and procedures over rehabilitation activities through interviews with City officials from the Office of Community Development, Purchasing Department, Auditing Department, Office of Treasurer, and Building Department and staff from the Chicopee Housing Authority Office of Inspections.

Using information contained in HUD's Integrated Disbursements and Information System, we identified that during our audit period of July 1, 2002, through June 30, 2006, there were 127 activities funded with \$10,275,828 in Office of Community Planning and Development funds. From our universe we selected a sample to examine 100 percent of the CDBG activities funded under the housing and economic development categories, except for the housing rehabilitation administration activity, totaling \$83,229. We also examined four of the five housing rehabilitation projects funded during our audit period, but we did not examine the Elder HOME Safe Program. We also expanded our universe scope to include an activity funded outside of our scope because it was the first of three projects funded to the same developer for which deficiencies were identified.

The proposed Paine Avenue set-aside project (\$700,000) was selected due to the investment amount and because our audit disclosed deficiencies with three other CDBG-funded housing rehabilitation contracts with which the developer was involved. We examined project records and supporting documentation maintained by the Office of Community Development and available records of the for-profit developers and the public records available at the Office of the Secretary of State and Hampden County Registry of Deeds and through Lexis/Nexis.

We performed on-site inspections of the rehabilitation properties to evaluate whether the rehabilitation contracts were completed in a workman-like manner. We interviewed the developers to gain an understanding of the contract award and administration process.

Our fieldwork was performed between June and December 2006. We conducted the majority of our fieldwork at the City's Office of Community Development, located at 36 Center Street in Chicopee, Massachusetts. Our audit covered the period July 1, 2002, through June 30, 2006, but was expanded to include other periods when necessary. We performed our audit in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

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

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

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

Relevant Internal Controls

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

- Controls over procurement of CDBG and HOME funds when using for-profit entities.
- Controls over the disbursement monitoring of CDBG and HOME housing rehabilitation activities.
- Controls over ensuring eligibility of set-aside projects.

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

Significant Weaknesses

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

- Controls over the procurement of CDBG and HOME funds when using for-profit entities (see finding 1).
- Controls over the disbursement monitoring of CDBG and HOME housing rehabilitation activities involving for-profit entities (see finding 2).
- Controls over ensuring eligibility of set-aside projects (see finding 3).

APPENDIXES

Appendix A

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

Recommendation number	Ineligible 1/	Unsupported 2/	Unreasonable or unnecessary 3/	Funds to be put to better use 4/
2B		\$730,000		
2C		\$375,960		
2D			\$116,706	
3A	\$165,934			
3B				\$534,066
Totals	\$165,945	\$1,105,960	\$116,706	\$534,066


- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local polices or regulations.
- 2/ 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 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/ Unreasonable/unnecessary costs are those costs not generally recognized as ordinary, prudent, relevant, and/or necessary within established practices. Unreasonable costs exceed the costs that would be incurred by a prudent person in conducting a competitive business.
- 4/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an OIG recommendation is implemented. This includes reductions in outlays, deobligation of funds, withdrawal of interest subsidy costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings which are specifically identified. In this case, the OIG recommendation will result in \$700,000 in costs not being incurred for this ineligible project.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

<p>City of Chicopee Office of Community Development <i>Jeanne M. Kidwell, Director</i></p> <hr/> <p><small>38 Center Street, P.O. Box 149, Chicopee, MA 01014-0149 Telephone (413) 594-1490 - Fax (413) 594-1495</small></p>		<p>HUD-OIG OFFICE OF AUDIT BOSTON, MASSACHUSETTS</p> <p>2006 MAR 12 AM 11:04</p> <p>RECEIVED</p>
<p>March 9, 2007</p>		
<p>Mr. John Dvorak Regional Inspector General for Audit U.S. Department of Housing and Urban Development Office of Inspector General for Audit, Region 1 Thomas P. O'Neill Federal Building 10 Causeway Street, Room 370 Boston, MA 02222-1092</p>		
<p>Dear Mr. Dvorak:</p>		
<p>Enclosed, please find the City of Chicopee's formal comments to the Office of Inspector General's draft audit report dated February 23, 2007.</p>		
<p>As was discussed in the exit conference of March 1, 2007, the City of Chicopee's Office of Community Development shares the overall goals of the U.S. Department of Housing and Urban Development (HUD) and will strive to find mutually agreeable means and methods to achieve these ends. And, to accomplish those ends the City of Chicopee Office of Community Development will work with HUD's Office of Community Planning and Development and other entities to establish the appropriate policies and procedures that are required.</p>		
<p>However, as was also discussed on March 1st and other occasions, we must vigorously protest the use of inflammatory headlines and captions, innuendo and imprecise and vague language used in the audit report.</p>		
<p>Again, the City of Chicopee's Office of Community Development stands ready to work cooperatively with you and all other agencies to implement those measures which will ensure that both the taxpayers and the beneficiaries of the programs are well served.</p>		
<p>Thank you for consideration of these matters.</p>		
<p>Sincerely,</p> <p> Jeanne M. Kidwell Director</p>		
<p>Enclosure</p>		

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

Comment 1

General Comments

The City of Chicopee appreciates the opportunity to respond to the federal Department of Housing and Urban Development Office of Inspector General draft audit dated February 23, 2007. And, although the City encourages oversight and examination of all of its activities to ensure that both taxpayers and program recipients receive everything they deserve, it must respectfully question the necessity of the Office of Inspector General's use of inflammatory headlines and captions, innuendo and vague and imprecise misleading language in its report. This is especially onerous when applied to non monetized findings and irrelevant inclusions. To this end, the City asks that all inflammatory language and insinuations be eliminated; that dollar amounts where no monetary costs are being sought be eliminated and that references to irrelevant activities be eliminated.

Comment 1

Title Page: The City requests that the reference to \$2.2 million be eliminated and that descriptive language be substituted as reflected in the Springfield 2003 Audit.

Comment 2

Comment 2

Page 2: the City requests that the figure \$700,000 in HOME set-aside be changed to \$250,000 for Hamel Estates to reflect the amount currently setup in IDIS.

Comment 3

Comment 3

Page 2: The City requests that the dates be changed for the exit conference to March 1, 2007 and due date for response to March 9, 2007 to reflect the actual time frame.

Comment 4

Comment 4

Table of Contents: The City requests that corrections agreed upon during the exit conference including the elimination of reference to \$2.2 million in Finding 1 and the change from \$700,000 to \$250,000 for Hamel Estates in Finding 3.

Comment 5

Comment 5

Background

Page 4: Eliminate reference to the City Treasurer's Request for Proposal process. The process is not controlled by the Office of Community Development and is irrelevant.

Comment 6

Comment 6

Page 7: Unreasonable cost. Costs for Charles and Cochran Streets projects were reviewed by Massachusetts Department of Housing and Community Development. The number of windows for all three projects (Charles, Cochran and Montgomery Streets) totaled 217 bringing the average cost to \$64 per window, including installation, which was deemed to be reasonable.

Comment 7

Comment 7

Page 8: Commercial spaces at 830 Chicopee Street were not included in rehabilitation contract, only the housing portion of the project. Difficulties filling neighborhood commercial space is not unique to the City of Chicopee and was thus excluded from the project.

Comment 8

The City will require the contractor show that fire stops and/or other appropriate measures were taken to meet building code requirements.

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Auditee Comments

Comment 8

Comment 9

Retainage was released upon "substantial" completion not "final" completion as stipulated in the agreement. This comports with local policy and practice.

Comment 9

Comment 10

Results

Page 12: The City demonstrated the necessity of work by "before and after" pictures and rehabilitation inspections by the Chicopee Housing Authority. This was further buttressed by numerous code violation reports by both the Chicopee Building and Health departments

Comment 10

Comment 11

Page 14: Costs for the Pine Street project were reviewed by Massachusetts Department of Housing and Community Development. The expense incurred by the contractor included consulting services and application preparation as well as the software required for submittal of second application.

Comment 11

Finding 1

Comment 12

Recommendation 1A: The City will work with Community Planning and Development (CPD) and the City Purchasing Agent to establish appropriate written procurement policies and procedures that are consistent with HUD regulations, as well as local and state regulations.

Comment 13

Recommendation 1B: The City will work with City Auditor and CPD staff to institute appropriate new internal controls for procurement involving Community Development Block Grant (CDBG) and HOME funds consistent with municipal, state and federal regulations.

Comment 14

Recommendation 1C: The City will work with the private developer and contractor to provide additional supporting documentation showing Davis-Bacon wages were paid on applicable CDBG projects.

Comment 15

Recommendation 1D: As in Recommendations 1A and 1B the City will work with the City Auditor and CPD staff to establish appropriate written policies and review procedures on retainage and final payments. However, current language in the loan documents refers to "substantial completion" and not "final completion." Therefore, the City deems it is in compliance with its own standard of releasing funds upon "substantial project completion."

Finding 2

Comment 16

Recommendation 2A: The City will work with the City Auditor and CPD staff to establish appropriate written policies and procedures for the CDBG and HOME programs to ensure that funds are disbursed for reasonable and necessary contracts costs and related costs are adequately supported according to municipal, state and federal regulations.

AUDITEE COMMENTS AND OIG'S EVALUATION

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Auditee Comments

Comment 12

Comment 17

Recommendation 2B: Working with the CPD staff and the private developer, the City will provide supporting documentation for \$730,000 in project costs including, if necessary, an independent cost analysis to determine cost reasonableness on the three CDBG projects cited.

Comment 18

Recommendation 2C: Working with CPD staff and the private developers, the City will provide the supporting documentation for \$375,960 in project costs including, if necessary, an independent cost analysis to determine costs reasonableness on the two HOME projects cited.

Comment 19

Recommendation 2D: Working with the State, the City will take the available legal steps necessary to recapture \$116,706 in unnecessary costs to the HOME program.

Finding 3

Comment 20

Recommendations 3A and 3B: The City contends that the project is Community Housing Development Organization (CHDO) eligible for the following reasons and disputes the audit report's rationale and assertions.

Originally Hamel Estates (21 Paine Avenue) was intended as a five-unit in-fill homeownership project to be developed solely by Valley Opportunity Council (VOC), the City's CHDO entity, and after the demolition of an old bar/restaurant which was tax delinquent. Fleet Bank was in the process of foreclosing on the property as well. During the pre-development phase of the project, Valley Opportunity Council and the City agreed that it was prudent and desirable to expand the project to include the adjoining property which was also substandard and dilapidated. Valley Opportunity Council's future joint venture partner had negotiated the purchase and sales agreement due to the illness and eventual death of Valley Opportunity Council's then executive director who had initiated the discussions regarding the purchase of the property. The Valley Opportunity Council, the City's CHDO, purchased the parcel of land at 21 Paine Avenue from the property owner on August 25, 2005 as recorded in the Hampden County Registry of Deeds Book 15278, Page 114. Upon execution of the joint venture agreement in July of 2006, ownership of the property was transferred to Hamel Estates LLC, a joint venture partnership between the Valley Opportunity Council and Gregory Z. Szyluk, a private developer. The joint venture agreement was signed on July 13, 2006. The Valley Opportunity Council continues to hold title to 21 Paine Avenue and 39 Paine Avenue but jointly with the for-profit developer. The Audit report erroneously states that the project was to be owned and developed solely by the for-profit developer. The project is jointly owned and developed by the Valley Opportunity Council and the for-profit developer. In the City's opinion VOC owned and now jointly owns the property (21 Paine Avenue) in addition to the adjoining property at 39 Paine Avenue.

OIG Evaluation of Auditee Comments

- Comment 1** The format used for the Springfield 2003 Audit report was revised effective March 16, 2005. However, we have revised the title to remove the reference of \$2.2 million.
- Comment 2** During the audit, the City had plans to use the \$700,000 referred to in the finding. This amount is supported by draft loan documents. This amount includes \$165,934 in ineligible costs and \$534,066 in the cost category of “funds put to better use.” Funds put to better use includes estimates of amounts that could be used more efficiently if an OIG recommendation is implemented. In this case, the implementation of the OIG recommendation will result in \$700,000 in costs not being incurred for this ineligible project. As a clarification, a footnote has been added in Finding 3 (page 16) to note that \$250,000 (of the \$700,000) is already under contract and that draft loan documents as of January 10, 2007 show an increase to \$700,000.
- Comment 3** The report (page 2) has been changed to reflect the actual dates for the exit conference and response date.
- Comment 4** During the exit conference, we agreed to consider the proposed changes to the report. As detailed in Comments 1 and 2 above, we have made revisions as appropriate.
- Comment 5** We revised (page 4) the reference to the City Treasurer’s request for proposal process.
- Comment 6** The City did not provide any documents to support the claim that \$64 (per window) for blinds was reasonable, or that the costs for two of the projects had been reviewed by the Massachusetts Department of Housing and Community Development. Our inspection of the projects showed that the window blinds were of a basic type that could probably be purchased (and installed) at a much lower cost. As a basis of comparison, we noted that documents in another developer’s files showed the price range for basic window blinds as \$6.00 to \$12.00.
- Also, documents from the general contractor showed that while the blinds were included as a line item in the general construction contract, it was the owner who was responsible for them, not the general contractor. The count of 160 windows as referenced was taken from the project specifications; we have revised the report (page 7) to include the actual count of 217 windows as stated by the City.
- Comment 7** No change was made to the report (page 8) because the commercial spaces were included in the rehabilitation contract under Article One – Scope of Services as follows: “The BORROWER shall utilize CDBG funds for the following

purpose(s): Substantial rehabilitation of the building at 830 Chicopee Street to include the following activities:

- Rehabilitation of the existing ground floor retail space; and
- Rehabilitation of eleven (11) residential units on the first, second and third floors; and
- Rental of six (6) residential units to low and moderate income households for the initial rent-up of the project as defined by HUD regulations for the CDBG program.”

Comment 8 Based on the inspection of the projects, it is questionable whether the City should have made the final retainage payments regardless of its own local policy (page 8). The nature of retainage, as defined by various sources, includes “The amount of money withheld by an owner as security until the contractor completes a job.” Without retention of this final amount, the City does not have the leverage to ensure the contractor completes the project or the funds to complete it themselves. We note that the agreement stipulates that retainage is released upon substantial completion. However, under the City policy, a project can be substantially complete but does not meet HQS. According to the inspectors of the project, they make the determination whether the property meets HQS when the work is substantially complete. After this point, there is still a “punch list” of work items to be completed including those to meet HQS (such as adding fire blocking), and OCD should hold the retainage until this remaining work is complete. Generally, at 30 days after inspection, the inspector returns to check that the “punch list” items are completed, and the retainage is then released. In this case, the retainage was paid in December 2004, and the work was still not complete as of November 2006.

Our inspection of the project showed that the work on the interior common areas and the exterior work were not completed in a workman-like manner. We observed that the new concrete floor in the basement was cracked and that the laundry room was not finished. Some of the sheetrock was taped and joint compound was applied but not painted, and the interior hallways did not appear to have been renovated. We found that the retaining wall caps on one side of the building were not glued down and some of the caps had fallen off the retaining blocks, posing a potential hazard. The corners of the building were not yet finished, there was a large hole in the ground in front of the building, and the landscaping had not been finished. The foundation on the exterior of the building had several gaps on the sides and back of the building that were filled with insulation instead of mortar, providing a poor appearance to the building.

Comment 9 The City did not identify the rehabilitation work that needed to be completed or develop a cost estimate for this work (page 12). Instead, the City relied on the contractor to provide an estimate without determining whether the estimate was reasonable and approved disbursements without adequate support for the funds disbursed. The necessity of work (costs) should be demonstrated by a work write-up/estimate of the rehabilitation work. “Before and after” pictures would be in

addition to a work write-up/estimate, and does not demonstrate the need for the work or support the disbursement of funds. Also, Inspections by the Chicopee Housing Authority (CHA) showed that work was done, but did not address whether the work was necessary or whether the costs were reasonable. The CHA generally is not involved with the project until after it has been started, and the CHA receives the request from the OCD to inspect the work in order to make a payment to the owner/developer. The CHA will examine the project plans and specifications, if available, when it performs the inspections to ensure the planned work was completed accordingly.

Comment 10 The City did not provide any documents to support the claim that the project costs had been reviewed by the Massachusetts Department of Housing and Community Development, or that the software in question was required for the second application. As stated in the finding (page 14), the City paid for \$2,304 (from HOME funds) for unnecessary costs of computer design and 3-D modeling software. This payment was made after the engineer had already billed the owner for the work he performed, including the drawings and floor plans for the renovation at 25 Pine Street.

Comment 11 We acknowledge that the City will take steps to implement the recommendation identified in the report.

Comment 12 The project in question is not owned by the CHDO, and as structured, does not meet the any provisions of the regulations that require that the housing be owned, developed, or sponsored by a CHDO (page 16). The application for funding was submitted by the for-profit entity. The purchase and sales agreement for the parcel of land was between the investors and the for-profit entity. Documents from a May 24, 2005 meeting describe a plan that “[CHDO] is not on title, but is a funding mechanism. [CHDO] acquire property, does demo and environmental and then re-conveys back to [for profit]. The agreement between the City and the CHDO for the \$250,000 is dated May 25, 2005, one day after the May 24, 2005 meeting. The property was, in fact, deeded to the CHDO on August 25, 2005, and the deed was later transferred from the CHDO to the for-profit entity (d/b/a Hamel Estates LLC) on July 13, 2006. According to the Massachusetts Secretary of State Records, Hamel Estates LLC is controlled entirely by the for-profit owner (and family members) and does not identify the CHDO as any principle of Hamel Estates LLC.

The transfer of the property deed in August 2005, and again in July 2006, is precisely the same process as described in the document of the May 24, 2005 meeting. Lastly, the for-profit developer for this project has stated that his plan is to wait until the end of the rehabilitation work, and then sell the 5 units to the City for market value.

Appendix C

APPLICABLE REGULATIONS AND VIOLATIONS

<p>24 CFR [<i>Code of Federal Regulations</i>] 85.36(d)(4)(ii), Procurement</p> <p>Federal Acquisition Regulation Part 31</p>	<p>Did not perform the required independent cost analysis of cost estimates submitted by for-profit developers before awarding these rehabilitation contracts.</p>
<p>OMB [Office of Management and Budget] Circular A-87-Cost Principles for State, Local, and Indian Tribal Sound Management Practices</p> <p>24 CFR 92.505, Applicability of Uniform Administrative Requirements</p> <p>Federal Acquisition Regulation Part 31</p>	<p>Approved \$236,204 in unreasonable contractor costs between a for-profit developer and an affiliated business entity acting as the general contractor.</p>
<p>OMB Circular A-87-Cost Principles for State, Local, and Indian Tribal Sound Management Practices</p> <p>24 CFR 570.506(h), Records to Be Maintained</p> <p>24 CFR 92.505, Applicability of Uniform Administrative Requirements</p>	<p>Approved more than \$1.1 million in disbursements for unsupported rehabilitation costs.</p>
<p>24 CFR 92.504, Participating Jurisdiction Responsibilities; Written Agreements; On-Site Inspections</p>	<p>Did not enforce procurement and financial management contract provisions included in the written agreements between the City and the for-profit developers.</p> <p>Did not adequately address performance problems identified during its own reviews of the for-profit developers.</p>
<p>24 CFR 570.501(b), Responsibility for Grant Administration</p> <p>24 CFR 570.603, Labor Standards</p>	<p>Did not enforce procurement and financial management contract provisions included in the written agreements between the City and the for-profit developers, including Davis-Bacon requirements as required by federal regulations</p> <p>Did not adequately address performance problems identified during its own reviews of</p>

	the for-profit developers.
OMB Circular A-87-Cost Principles for State, Local, and Indian Tribal Sound Management Practices	Approved retainage for four unfinished projects.
24 CFR 92.300, Set-Aside for Community Housing Development Organizations (CHDOs) Office of Community Planning and Development Notice CPD-97-11- Guidance on Community Housing Development Organizations	The City committed \$700,000 in HOME program set-asides for an ineligible project.