

**U. S. Department of Housing and Urban Development  
Office of Inspector General**



**Evaluation of CDBG and PIH Funding  
Hurricane Katrina Reconstruction  
Biloxi Housing Authority Risk Assessment**

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## **Executive Summary**

The Office of Inspector General, Inspections and Evaluations Division, conducts independent, objective examinations of U.S. Department of Housing and Urban Development (HUD) activities, programs, operations, or organizational issues.

We completed a risk assessment of Community Development Block Grant (CDBG), Office of Public and Indian Housing (PIH), and other funding associated with Katrina Public Housing reconstruction on the Mississippi Gulf Coast. Our objectives were (1) to identify the source, amounts, and disposition of disaster relief funding and (2) to assess the “overlap” risk associated with the multiple funding sources and the extent to which there may be duplication of planned uses for the funds or inappropriate obligations.

We focused our fieldwork and evaluation on the Biloxi Housing Authority and its Katrina recovery activities because of the severity of damage and the multi-million-dollar cost of restoring public housing in the city.

We identified sources and uses of more than \$22 million in disaster recovery funds managed by the Biloxi Housing Authority through September 2007. We concluded that the Biloxi Housing Authority had demonstrated sufficient accounting and management control over these resources to minimize the risk of funding overlaps. However, because the State of Mississippi has allocated an additional \$41 million in CDBG funding to support the Biloxi Housing Authority’s continued recovery, we also recognize that HUD and the Mississippi Development Authority need to exercise close scrutiny of each grant application and the sites selected for redevelopment and carefully monitor the future construction and related expenditure of taxpayer funds.

If you have any questions concerning this report, please call Special Agent in Charge, Kenneth Taylor Jr., at (202) 402-8416.

# Table of Contents

- Introduction..... 1
- Scope and Methodology ..... 1
- Observation 1: Sources and Uses of Disaster Relief Funding ..... 4
- Observation 2: Accounting and Management Controls over CDBG Funds  
Should Be Adequate To Reduce “Overlap” Risk ..... 5
- Appendixes
  - A – Biloxi Housing Authority – Hurricane Katrina Funding ..... 9
  - B – Biloxi Housing Authority – Letter of Intent for CDBG Fund Use ..... 10

## Introduction

More than 2,500 public housing units on the Mississippi Gulf Coast were damaged or destroyed when Hurricane Katrina made landfall on August 29, 2005. Two HUD offices have been instrumental in funding the recovery of public housing on the Mississippi Gulf Coast. The Office of Public and Indian Housing (PIH) obligated more than \$29 million in capital grant reserves to pay for the reconstruction of public housing in Louisiana and Mississippi, \$7.8 million of which was awarded to the Biloxi Housing Authority. The Office of Community and Housing Development (CPD) approved \$105 million in CDBG funds, as set out in Mississippi's State Action Plan, to support restoration of Gulf Coast public housing. The Mississippi Development Authority, the State agency responsible for administering and monitoring the Katrina recovery effort, allocated the CDBG funds to five housing authorities:

Biloxi:	\$41.164 million
Region VIII:	\$36.033 million
Waveland:	\$11.627 million
Bay St. Louis:	\$8.260 million
Long Beach:	\$2.914 million

The Mississippi Development Authority also obligated \$5 million of the CDBG grant to obtain the engineering and oversight services of Camp, Dresser & McKee, a professional services contractor from Texas. The contractor is currently conducting environmental assessments on 30 existing and proposed project sites selected by the five housing authorities for rebuilding.

The Biloxi Housing Authority was providing for the housing needs of 455 families at six developments when struck by Hurricane Katrina. The hurricane destroyed two housing developments, consisting of 172 dwelling units, completely and damaged more than 300 other units seriously enough to make them unavailable for occupancy. Since the storm, the Biloxi Housing Authority has concentrated its recovery efforts on repairing three damaged HOPE VI developments<sup>1</sup>, its Oakview Village conventional housing project, and the adjoining administrative/maintenance buildings. Funded in fiscal year 2000, the HOPE VI projects represent a \$35 million investment of public funds and, with the exception of Cadet Point Senior Village, were substantially complete when the Katrina storm surge hit. The flooding damage was severe, primarily because the HOPE VI projects were sited in historic floodplains on the east end of the Biloxi peninsula within a short walking distance of the Gulf waters. Rebuilding has required a two-year rehabilitation effort that will exceed the original development cost estimate and a funding complexity not commonplace in traditional public housing finance.

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<sup>1</sup> The HOPE VI program provides appropriated funds to public housing authorities for the purpose of razing obsolete and blighted rental apartments and replacing the units with planned communities of mixed income residents.

## **Scope and Methodology**

We obtained an overview of HUD PIH and CPD program funding dedicated to disaster recovery in Mississippi from HUD headquarters staff before initiating our fieldwork at the Biloxi Housing Authority. At the Jackson, MS, State offices, we gained an understanding of the Mississippi Development Authority and its operations and reviewed the CDBG grant application process. We examined environmental assessments for three Biloxi Housing Authority Housing Authority developments to be funded, in part, from the CDBG allocation; interviewed the supervising engineer for Camp, Dresser & McKee, the contractor responsible for screening the CDBG grant applications, developing the procurement packages and monitoring contract construction; and reviewed the scope of work section of its contract. We also were briefed by HUD Jackson PIH and CPD staff on the status of Katrina recovery at the five Gulf Coast public housing authorities.

We then conducted an on-site evaluation of the Biloxi Housing Authority's accounting and administrative records related to the sources and uses of funds in the disaster recovery, reviewed the audited financial statements for 2006, inspected the existing developments and potential building sites, and interviewed the executive and deputy directors and the contracted accounting services certified public accountant and staff. We did not conduct transaction tests of the accounting controls, as these procedures were outside the scope of our planned evaluation.

At the end of our fieldwork, we briefed HUD Jackson PIH and CPD staff as well as Mississippi Development Authority officials on our observations.

We conducted the inspection in accordance with the *Quality Standards for Inspections* issued by the President's Council on Integrity and Efficiency.

### **Observation 1: Sources and Uses of Disaster Relief Funding**

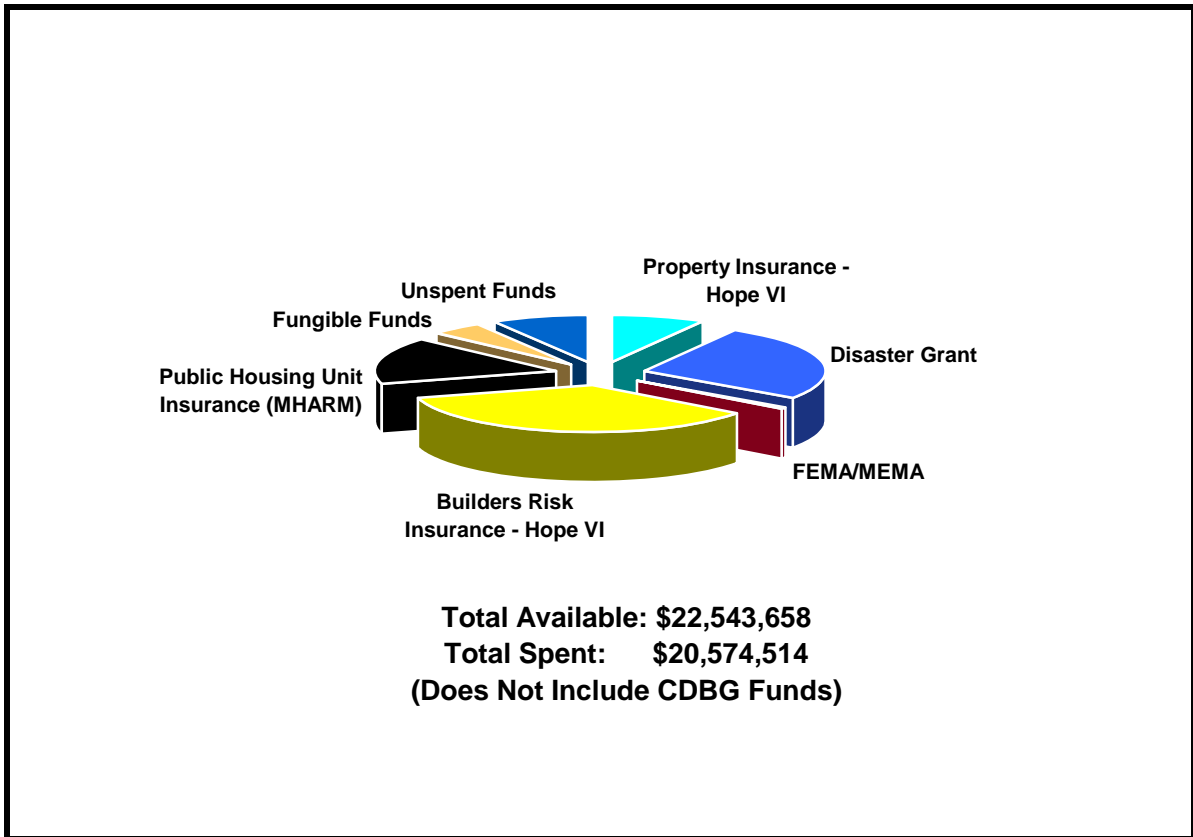
#### **Mississippi Development Authority**

The Mississippi Development Authority has allocated \$105 million in CDBG funds, as set out in Mississippi's State Action Plan, to support restoration of Gulf Coast public housing. The application process is place, but application review and approval and the disbursing of funds to the Gulf Coast housing authorities is at the starting point. No disbursements from this source of CDBG funds have be made to the Biloxi Housing Authority.

#### **Biloxi Housing Authority**

The Biloxi Housing Authority has spent about 90 percent of the funds made available from the PIH Katrina disaster grant, public housing hazard insurance proceeds, fungible 2006 and 2007 Section 8 Housing choice vouchers, HOPE VI builders risk proceeds, and other sources to pay for rebuilding the three HOPE VI developments and other severely

damaged housing. (The chart below summarizes the records of fund expenditures, which the Biloxi Housing Authority developed for our review on site.) As a consequence, in planning future recovery construction, the Biloxi Housing Authority will need to find alternative financial resources. Mississippi’s \$41 million allocation of CDBG funds is one source. The Biloxi Housing Authority plans to use the CDBG monies to provide “gap funding”<sup>2</sup> at several proposed construction sites to leverage private investment in low-income multifamily projects. Other feasible sources, such as fungible 2008 Section 8 housing choice vouchers and unspent capital grant funds of about \$1 million, are not sufficient to leverage funding of the planned developments described to us.



As noted in the chart, only \$2 million of the various fund sources remains unspent (See Appendix A). The Biloxi Housing Authority will have obligated these remaining funds before December 31, 2007.

<sup>2</sup> The Biloxi Housing Authority used the term “gap funding” to describe CDBG funds needed to make up the difference between private-sector investor financing and the total cost of project construction.

## **Observation 2: Accounting and Management Controls over Disaster Recovery Funds Should Be Adequate To Reduce “Overlap” Risk**

We found accountability for the sources and uses of disaster recovery funds available to the Biloxi Housing Authority to be sufficient to warrant a “low” overlap risk.

The Biloxi Housing Authority has demonstrated considerable management capacity before and in the wake of the Katrina catastrophe. The Biloxi Housing Authority, through its business associate nonprofit, Biloxi Community Development Corporation,<sup>3</sup> acted as its own developer for the HOPE VI construction. It demolished 322 obsolete units and maintained financial accountability over \$35 million in grant funds. Since Katrina, the Biloxi Housing Authority has effectively rebuilt its HOPE VI senior and mixed income developments. HOPE VI consists of the 76-unit Cadet Point Senior Village, LLC, a 39-unit Bayview Oaks homeownership project, and the 196-unit Bayview Place, LLC, a qualified low-income tax credit community. It also rebuilt its administrative offices and Oakview Village, a conventional public housing residence. Its executive director negotiated a \$10 million line of credit with Fannie Mae to fund predevelopment activities at sites razed after the storm surge and other potential building locations. This evidence of capacity to move reconstruction forward can be attributed to the expertise of its executive director and deputy director as well as the competent CPA services of Casterline Associates, the accounting services firm under contract.

We reviewed the summary schedules used to support the financial data associated with the Katrina recovery, observed related detailed records of checks, invoices, and authorizations, and discussed the control environment and the accounting processes with Casterline’s certified public accountant. These observations

- Satisfied our concerns about the overall control risk associated with multi-funding sources, differing rules of funds application, and the integrity of large dollar transactions. (We did not perform detailed tests of the accounting system, as these procedures were outside the scope of our planned inspection.)
- Were supported by the audited Biloxi Housing Authority financial statements and supplemental data for the year ending September 30, 2006. (The auditors, Yeager & Boyd, LLC, of Birmingham, AL, noted no matters involving the internal control over financial reporting that could be considered material weaknesses.)
- Can be expected to facilitate a comprehensive final cost certification audit at construction completion.

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<sup>3</sup> The Biloxi Community Development Corporation is a nonprofit organization established to operate in partnership with the Biloxi Housing Authority on major project financing.

Future Federal sources of funding, other than the CDBG allocation, will be substantially smaller than the \$22 million from various sources cited in observation 1. The funding “overlap” risk will, therefore, necessarily be diminished. Adequacy of accounting controls over \$41 million in unobligated CDBG funding, however, rests primarily on the competence of the Biloxi Housing Authority’s accounting services contractor(s) and professional services consultants. This concentration of risk alone warrants close monitoring by responsible Mississippi Development Authority and HUD staff as the CDBG application process and related procurement contracting go forward.

### **Sufficient Oversight Resources at State of Mississippi State Offices Are in Place**

We believe that the appropriate level of oversight is in place at the Mississippi Development Authority to effectively oversee the expenditure of CDBG grants to the five housing authorities.

Two control observations support this conclusion. First, the CDBG funding application and process of award approval is detailed and project specific so that housing authorities cannot simply request a wholesale funds drawdown and later determine when and where the monies will be spent. Second, as a State-paid contractor, Camp, Dresser & McKee can provide oversight services that represent arm’s length review of the housing authorities and the construction contractors—a separation of duties necessary and incumbent for effective monitoring, given the scale of proposed spending.

Lastly, it should be noted that the CPD headquarters office issued a report, dated October 12, 2007, of its management review of Mississippi Development Authority that found “substantial controls” in place over CDBG disbursements administered by that office. While not directly related to CDBG funds allocated to Gulf Coast Mississippi housing authorities for disaster recovery, the report is consistent with our limited observations.

### **Risks of Contract Procurement and Construction Will Require Ongoing Vigilance**

The Biloxi Housing Authority envisions an ambitious redevelopment program consisting of nine mixed-finance low-income housing projects with estimated total costs of \$185 million (see Appendix B). This vision can be achieved only through leveraged financing using the \$41 million CDBG allotment to provide “gap” funding at each project as an investor incentive.

- **Capacity Risks.** The executive director and staff believe their experience with HOPE VI construction has provided sufficient knowledge to preclude obtaining a private-sector developer/development partner. However, it should be emphasized that the scope of construction considered by the Biloxi Housing Authority for CDBG “gap” funding will require a number of years to complete, especially the proposed projects in locations that do not yet have city infrastructure. HUD will, therefore, need to revisit the capacity issue periodically to assure that personnel and contracted services capability has not declined.



- **Cost Risks.** The Biloxi Housing Authority went forward with HOPE VI reconstruction without elevating the housing to current Federal Emergency Management Agency (FEMA) advisory base flood elevation standards. Even so, construction costs have exceeded amounts available from PIH disaster recovery sources and hazard insurance proceeds by \$4.8 million (see attachment A). Rebuilding at different proposed sites, but with similar flood risks, will have to meet FEMA advisory base flood elevations and incur correspondingly higher per-unit costs.

We believe these cost risks can be mitigated by thorough review of the CDBG applications at the Mississippi Development Authority. These reviews can provide independent assurance of project feasibility as well as prudent funds use. For example, scrutiny needs to be given to the amounts of CDBG funds that the Biloxi Housing Authority requests for particular developments, especially where added costs must be incurred because of floodplain building. Additionally, when approved, the Mississippi Development Authority must assure that the CDBG funds are only used to fill legitimate funding “gaps” in the construction and are not replacing funds that should be coming from private sources, as set out in the financing agreement for low-income tax credit eligibility.

- **Procurement and Construction Fraud Risks.** Fraud vulnerability must be curtailed through vigilant and independent State of Mississippi oversight. Controls for curtailing fraud vulnerabilities appear to be in place. Mississippi Development Authority has developed procurement guidance for so-called mixed-finance developments based partly on the CDBG requirements found at 24 CFR (*Code of Federal Regulations*) 85.36 and partly on HUD Handbook 7460.8, REV-2, chapter 16. Camp, Dresser & McKee’s inspection and oversight responsibilities, as set out in scope of work section of their contract, can provide an independent and key component of fraud prevention during procurement and construction.

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We were encouraged that the Biloxi Housing Authority recognized its need for competent and experienced financial services as it started to rebuild after Katrina, and the financial records of disaster recovery reflected that professionalism. Embarking on an even more ambitious rebuilding venture, however, should be viewed as a risk challenge that must be mitigated by the advice and agreement of all levels (Federal, State, and local) of government.

**Appendix A**

**Biloxi Housing Authority – Hurricane Katrina Funding**

**BILOXI HOUSING AUTHORITY**

**Hurricane Katrina Associated Funding**

**Grant / Funding Description:**

<b><u>Description</u></b>	<b><u>Funding Grant Amount</u></b>	<b><u>Expended at 9/30/2007</u></b>
Disaster Grant	7,881,000.00	5,940,718.13
Fungible Funds	1,093,835.00	1,064,972.90
Public Housing Unit Insurance	3,573,590.69	3,573,590.69
FEMA/MEMA	103,575.83	103,575.83
Hope VI Insurance for Bayview Units Placed in Service Before the Storm	1,889,268.39	1,889,268.39
Builders Risk Insurance for Bayview Units Not In Service Before the Storm	8,002,387.86	8,002,387.86
Overall Hope VI Projected Funding Deficits		
Cadet Point	1,188,000.00	
Bayview Place	3,665,000.00	
	<u>27,396,657.77</u>	
<b>Pending/Potential Insurance Receipts:</b>		
FEMA	35,000.00	
Public Housing Units	32,000.00	
	<u>67,000.00</u>	

## Appendix B

### Biloxi Housing Authority – Letter of Intent for CDBG Fund Use

**BILOXI HOUSING AUTHORITY  
LETTER OF INTENT FOR USE OF  
CDBG FUNDS VIA MDA  
February 28, 2007**

PROJECT	PARCEL NUMBERS	CONSTRUCTION TYPE	BUILDINGS/ UNITS	ESTIMATED TOTAL COSTS	ESTIMATED OTHER FUNDS	ESTIMATED CDBG FUNDS
Cedar Pointe	1309D-01-001.000	Conventional Stick	15 / 120	\$ 13,700,000	\$ 11,850,000	\$ 1,850,000
Benachi Ave	1310A-02-044.000 1310A-02-049.000 1310A-02-032.000	Conventional Stick or Modular	9 / 27	\$ 5,495,200	\$ 2,198,080	\$ 3,297,120
Beauvoir Beach	1210L-02-057.000 1210L-02-063.000 1210L-02-064.000 1210L-02-065.000 1210L-02-066.000 1210L-02-067.000	Concrete	10 / 100 Elderly	\$ 11,370,000	\$ 4,548,000	\$ 6,822,000
Woolmarket	1107-33-035.000 1107-33-036.000 1107O-01-070.000 1107O-01-071.000 1107O-01-073.000	Conventional Stick or Modular	250 / 500	\$ 71,136,000	\$ 14,227,200	\$ 21,340,800
Back Bay Senior	1209I-01-007.000	Conventional Stick	6 / 300 Elderly	\$ 44,856,247	\$ 37,356,247	\$ 7,500,000
Bayview Place & Oaks *	Multiple BHA parcels	Conventional Stick	130 / 235	\$ 24,866,460	\$ 23,666,460	\$ 1,200,000
Cadet Point *	1510E-02-020.000	Conventional Stick	1 / 76 Elderly	\$ 6,555,025	\$ 4,609,279	\$ 1,945,747
East End *	1510L-01-019.000	Conventional Stick or Modular	15 / 34	\$ 7,696,800	\$ 5,100,000	\$ 2,596,800
<b>TOTALS</b>			<b>436 / 1392</b>	<b>\$ 185,675,733</b>	<b>\$ 103,555,266</b>	<b>\$ 46,552,467</b>

\* HOPE VI units under repair and construction

## **Acknowledgements**

This inspection was conducted under the direction of Michael Groszkiewicz and Kenneth Taylor, Jr., Special Agents in Charge, Inspection and Evaluations Division

The fieldwork was conducted and the report prepared by John W. Struchen, Deputy Director, Inspection and Evaluations Division, and James Ward, Senior Forensic Auditor