

City of Detroit

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Mark W. Lockridge
AUDITOR GENERAL



MEMORANDUM

DATE: October 31, 2016

TO: Honorable City Council

FROM: Mark W. Lockridge, CPA *M.W.L.*
Auditor General

RE: Memorandum Regarding the Suspension and Reinstatement of the Hardest Hit Fund Program With The Detroit Land Bank Authority

CC: Mayor Mike Duggan
John Hill, Chief Financial Officer
Carrie Lewand-Monroe, Executive Director, Detroit Land Bank Authority

Attached for your review is our memorandum regarding the Suspension and Reinstatement of the Hardest Hit Fund Program with the Detroit Land Bank Authority (Land Bank.) This memorandum is based on audit work performed in conjunction with the Audit of Demolition Activities as requested by City Council President Brenda Jones on October 8, 2015.

This is a limited scope performance audit that encompasses demolition and demolition related activities performed within the City of Detroit.

Copies of all of the Office of the Auditor General reports can be found on the City's Website: View City of Detroit Reports at <http://www.detroitmi.gov/How-Do-I/View-City-of-Detroit-Reports/Auditor-General-Audits>.

The purpose of this memorandum is to highlight our concerns relative to the City's role in the establishment of the Land Bank's Five Million (\$5,000,000) Escrow Fund Account the Michigan Homeowner Assistance Nonprofit Housing Corporation (MHA).

Background

On October 17, 2016, the Office of the Auditor General (OAG) was made aware of the U. S. Treasury Department's (Treasury) suspension and reinstatement of the Hardest Hit Fund Program (HHF) with the Land Bank through Mayor Mike Duggan's press conference and other news media. The OAG had no previous knowledge of the suspension or any reports that led to the suspension of funding and has since requested this documentation.

We have learned that on August 15, 2016, the Treasury notified the Michigan State Housing Development Authority (MSHDA) and suspended demolition activities in Detroit. According to the suspension memorandum, the Treasury's decision to suspend funding was based on information provided by MSHDA concerning their investigation and audit of HHF expenditures. OAG has requested the General Counsels of both agencies to provide the documentation to us.

On October 14, 2016, the Treasury authorized MSHDA and MHA to resume the HHF blight elimination activities.

According to news reports, required changes to the Land Bank's program activities include:

- Quality-control audits to ensure compliance;
- A \$5-million escrow account established by the Land Bank to cover any costs deemed ineligible by the U.S. Treasury;
- A 50-house limit on new bid requests;
- A requirement to disclose all subcontractors and cap their markup at 10%.

We will review these new policies and procedures in conjunction with our ongoing audit keeping our focus on all demolition activities in the City of Detroit.

The Five Million Dollar Escrow Fund was established through a "Reimbursement Agreement" (referred to as the "Agreement") between MHA, MSHDA, and the Land Bank. The City of Detroit is not listed as a party to or mentioned in the Agreement.

The agreement was entered on September 29, 2016 (based on original documents supplied by the Land Bank), the same day the Land Bank's Board of Directors called a Special Board Meeting. Three resolutions were discussed and approved authorizing the:

1. Executive Director to sign an addendum to the Blight Partnership Agreement with MHA for HHF demolition funding;
2. Executive Director to sign the Agreement;

3. Adoption of a "Demolition Program Policy."

The Agreement referenced the following five "Blight Partner Agreements" entered into by the Land Bank with MSHDA to secure HHF funds:

Summary of Hardest Hit Funds Awarded to the Land Bank

Name of Award	Amount	Date	
		Awarded/Approved	Award End Date
HHF1	\$ 52,323,388	October 7, 2013	April 30, 2015
HHF1 Additional	5,000,000	September 17, 2014	April 30, 2015
HHF2	49,941,000	February 23, 2015	June 23, 2015
HHF3	21,255,000	January 4, 2016	July 4, 2017
HHF4	41,901,646	May 12, 2016	December 31, 2020
HHF 5 (Future)	88,153,425		
Total HHF Funding to Date	\$ 258,574,459		

Other highlights of the Agreement include:

- A. The Land Bank to make an initial deposit of Five Million Dollars as immediately available funds in an account designated and controlled by MHA (referred to as the "Account");
- B. Funds would be held in an account (referred to as the "Deposit") controlled solely by MHA through the completion of MHA's investigation; and the Agreement shall remain in full force and effect until the later of March 31, 2021 or until all HHF Program funds allocated to the Land Bank have been disbursed and an audit of the use of those funds has been fully completed
 - a. Any funds remaining in the Deposit thereafter shall be returned to the Land Bank.
- C. Additions to the Deposit are required in increments of \$1.0 million dollars each time the amount of the inaccurate or inappropriate billings identified by MHA's investigators at any time equals or exceeds 75% of the Deposit.
- D. The Land Bank has fifteen business days to object to and dispute the billings from MHA. The Agreement outlines additional procedures to resolve disputes including appealing to the U.S. Treasury Department if matters cannot be resolved within sixty days;
- E. The Land Bank to reimburse MHA for funds that were not spent appropriately or were not billed properly; and the reimbursement funds must not be directly or indirectly from federal sources.

Establishment of the Five Million Dollar Escrow Account

The escrow account was established with monies wired directly from the City's General Fund to MHA's Account. The transfer was made in accordance with a request from the Land Bank to the City's Chief Financial Officer (CFO), dated September 30, 2016, supported by the Agreement and the Land Bank Resolutions.

Based on records from the Office of the Chief Financial Officer (OCFO), the journal entry to record the wire transfer was to reduce cash and establish a new restricted cash account entitled: CASH-RESTRICTED DLB AUTHORITY ESCROW WITH MSHDA. In essence, the five million dollars still remains on the City's books as an asset (cash). The OCFO could not provide any documentation that binds the City to the Agreement, or the requirement to provide the initial deposit.

It was reported to the media by a spokesman for the Land Bank that the funds for the escrow account are "from funds previously approved by City Council for blight." However, the Administration has not identified a source of, or the applicable appropriation for the funds.

Our Concerns

We are concerned with these events given that:

1. The transfer of funds occurred without an agreement or memorandum of understanding between the City and the Land Bank and/or MHA. Instead, the Agreement is strictly between the Land Bank and MHA;
2. These actions were not brought before and approved by City Council or the Financial Review Committee;
3. According to the Governmental Accounting Standards Board (GASB) cash flows when it changes hands (i.e. - that is when ownership of cash legally changes.) We contend that cash flowed out of the City's General Fund and a corresponding expenditure occurred. We feel the Administration should record the transfer appropriately (i.e. – a new subsidy or loan to the Land Bank, or a drawdown of the remaining Demolition Advance Fund, etc.)
4. Since there is no agreement or Memorandum of Understanding, it is unclear as to who will be responsible for making additions to the Account (when required) during the length of the Agreement which ends in 2021:
 - To date, the forensic auditors found over \$1.0 million dollars of ineligible expenses. The Audit Report which prompted the Agreement was based on a review of 173 selected contracts from HHF rounds 1, 2, and 3. The review found that costs were redistributed among parcels between the original bid and final contract. They also found one case where \$0.2 million was redistributed to other parcels and it was not due to the threshold limitations;
 - The summary report noted that Treasury and MSHDA are continuing independent audits and may find broader issues. This could lead to the discovery of more improper billings and ineligible costs (past and future),

and potentially millions of dollars of more money deposited into the escrow account.

5. There is no future guarantee or agreement that funds not used will be returned to the City. The agreement stipulates that the monies "may" be returned to the Land Bank.
6. There are different policies and procedures for demolitions carried out by the Land Bank versus demolitions performed by City agencies.

In closing, it is important that the Administration addresses these concerns and provide clarity to the City's position.