Formal Session Agenda
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Referrals

# BUDGET, FINANCE, AND AUDIT STANDING COMMITTEE

Office of the Auditor General

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**MEMORANDUM**

**DATE:** February 11, 2020

**TO:** Honorable City Council

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

**RE:** Special Communication on Demolition Supplemental Funding and the Proposed Memorandum of Understanding

**CC:** Mayor Mike Duggan
David Bell, Director,
Buildings, Safety Engineering, and Environmental Department
LaJuan Counts, Director, Demolition Department
Tyrone Clifton, Director, Detroit Building Authority
Katie Hammer, Chief Deputy Chief Financial Officer, Office of the Chief Financial Officer, Policy & Administration Division
Boysie Jackson, Chief Procurement Officer, Office of the Chief Financial Officer, Office of Contracting and Procurement
Arthur Jemison, Group Executive, and Chief of Services and Infrastructure
David Massaron, Chief Financial Officer, Office of the Chief Financial Officer
John Naglick, Chief Deputy CFO/Finance Director, Office of the Chief Financial Officer
Donald Rencher, Director, Housing, and Revitalization Department
Saskia Thompson, Executive Director, Detroit Land Bank Authority

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Attached for your review is a Special Communication on Demolition Related Activities. The purpose of this memorandum is to advise you of new concerns arising from our ongoing Audit of Demolition Activities and our Forensic Audit of the Detroit Land Bank Authority. This Memorandum highlights Supplemental and Other Funding for the Detroit Land Bank Authority, and a review of the proposed "Second and Restated Amendment to the Memorandum of Understanding between the City of Detroit and the Detroit Land Bank Authority."

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## Supplemental and Other Funding for the Detroit Lank Bank Authority

### Background

The original Blight Partnership Agreement between the Michigan Homeowner Assistance Nonprofit Housing Corporation (MHA), the Michigan State Housing Development Authority (MSHDA), and the Detroit Land Bank Authority (DLBA), signed on October, 2013, stipulated that for properties demolished under the Hardest Hit Fund (HHF) demolition program, reimbursement of costs are capped at $25,000.

During the early phases of the HHF demolition program, the City supplemented demolitions costing more than $25,000, through the use of Fire Insurance Escrow (FIE) and Community Development Block Grant (CDBG) funds. Demolition contractors invoiced DLBA for the total costs. In turn, DLBA requested payment of the difference (i.e. – the amount >$25,000), from the City, through the Demolition Program Manager, the Detroit Building Authority (DBA). DBA then coordinated with City agencies (Housing and Revitalization Department (HRD) and the Building, Safety, Environmental and Engineering Department (BSEED)) to pay the remaining costs through the City's normal procurement and payment processes.

In 2016, MSHDA/MHA stated that the City's FIE and CDBG funds could no longer be used to supplement HHF demolitions. MSHDA's revised Blight Manual stated that if such properties were to be demolished, "other" supplemental funding would need to be obtained to perform the demolition. Essentially, this meant that supplemental funds would need to come from the City's General Fund. To facilitate this, an "Approval Committee" was established consisting of representatives from DLBA, DBA, and the City's Office of the Chief Financial Officer (OCFO). Their purpose was to review and approve supplemental funding for HHF demolitions costing more than the $25,000 HHF threshold.

In March 2017, we issued a "Special Report Highlighting Concerns Relative to the City's Demolition Programs." In this report, we reported the following information relative to the dissolution of the Review Committee:

- As a result of the suspension and reinstatement of the Hardest Hit Funds Program (HHF) blight elimination activities, DLBA adopted a Demolition Program Policy which outlined a "Pre-contract Review" process. The process was established to specifically address external audit findings involving the Land Bank's practice of redistributing (or "smoothing") costs among properties in a contract; a practice where prices were changed or redistributed to achieve a final price where the cost of demolition would not exceed the cap of $25,000 per property;

- The Pre-contract Review process required that the "Approval Committee" meet and approve or reject the inclusion of properties with an estimated or actual total pricing of $35,000 or more, and of properties with a total price falling outside a calculated per property total cost reasonableness range;
- A lawsuit was filed against the Land Bank alleging violations of the Michigan's Open Meetings Act and the Freedom of Information Act based largely on how DLBA reviewed bids to demolish properties. Specifically, the Plaintiff noted that the Land Bank "failed to post public notices of the Approval Committees meetings, the meetings were not open to the public, and the public was not allowed to attend, to ask questions, or to engage in the deliberations;"
- A few days after the filing, DLBA's Board of Directors passed a resolution which dissolved and terminated the Approval Committee.

As reported, we immediately reached out to the Demolition Program Management and asked their opinion on the dissolution of the Approval Committee. DBA emphatically responded that the committee was very much intact, still in force, and that they would continue to meet and review funding for properties whose costs exceed the thresholds.

Throughout the Demolition Audit, we requested information in an effort to ascertain all the sources of supplemental funding for HHF demolitions. We acknowledge that some information was given to us, but neither DLBA, DBA, nor City agencies could collectively corroborate or confirm the accuracy of the data.

Our concerns were highlighted in our "Interim Audit Report on Contract Administration for City-funded Demolitions" *(November 2019)*, and we reported this specific issue as an "Audit Impediment Relating to Timely Receipt of Audit Documentation" *(page 3 of the report)*:

> One item on the request related to the amount of dollars the City has spent supplementing demolitions funded by Hardest Hit Funds (HHF) and performed by the Land Bank. [At the time of the report, we had] not received a response from the Program Manager (DBA) who was directly responsible for coordinating [the] payments.

**Detroit Land Bank Authority Invoices Submitted Directly to the OCFO**
In conjunction with our "Forensic Audit of the Detroit Land Bank Authority" (commenced November 2019), the Office of the Chief Financial Officer (OCFO) provided us with documentation and the amount of supplemental funding provided to DLBA totaling $5.9 million dollars thus far.

Supplemental Funding for HHF Demolitions - $5.2 Million
Our review of the invoices submitted directly from DBLA to the OCFO, revealed that $5.2 million related to supplemental funding for demolitions consisting of the following types of expenses:

A. Gap funding for the cost of demolitions over $25,000 and not covered by MSHDA/MHA
B. Other HHF related demolition costs deemed non-reimbursable by MSHDA, including but are not limited to:
    a. Failed post-abatement verification inspections;
    b. Cost related to asbestos surveys and abatement estimates;
    c. Reimbursements for demolitions that were pulled from the MSHDA system by DLBA;
    d. Other demolitions rejected by MSHDA for various reasons.

Based on the documentation provided, we noted that DLBA began submitting invoices to the OCFO in February 2019 relating to supplemental funding for demolitions. The $5.2 million remitted to DLBA in 2019 covered demolitions that occurred between June 2017 and June 2019.

From the start of the HHF program through October 31, 2019 there were 1,084 demolitions with costs exceeding the MSHDA/MHA threshold of $25,000. Based on the total cost of the demolitions, versus the amount reimbursable by MSHDA/MHA, we calculate a total requirement of $7.0 million in additional funding may be required to supplement these HHF demolitions. DLBA has confirmed that there will be additional invoices from them to the City throughout the remainder of the HHF demolition program.

Other Supplemental Funding Provided to DLBA - $0.7 Million
In May 2017, DLBA invoiced the City for $0.7 million for legal and other expenses they incurred in 2016 and 2017. The City reimbursed DLBA for these costs, which was over and above the annual subsidies provided to them to cover administrative and other costs.

The following table is a recap of the budgeted annual subsidies for DLBA for fiscal years 2015-2020:

| Fiscal Year | Budgeted Amounts (Millions) |
|---|---|
| 2015 | $ 14.5 |
| 2016[A]) | 11.8 |
| 2017 | 11.4 |
| 2018 | 14.0 |
| 2019 | 14.0 |
| 2020 | 13.0 |
| **Total Budgeted Subsidies for DLBA Fiscal Years 2015-2020** | **$ 78.7** |

*Note (A): Fiscal Year 2016 Actuals totaled $5.0 million, or $6.8 million less than budgeted.*

We reviewed the details supporting the single-invoice for $717,988.22 (dated May 2017), and found that DLBA billed, and was reimbursed by the City for legal representation, consulting fees, the salary of an DLBA employee, and office renovations, as detailed in the table below:

| Name of Contractor or Description | Description of Service | Period Covered | | Total Amount Invoiced and Paid by the OCFO |
|---|---|---|---|---|
| | | From | To | |
| Plante Moran[A] | Forensic Audit | May 2016 | March 2017 | $201,356.25 |
| Wilmer Hale[A] | Legal Counsel | June 2016 | February 2017 | 185,287.21 |
| Miller Canfield[A] | Legal Counsel | June 2016 | March 2017 | 88,091.18 |
| Experis[A] | Forensic Audit | November 2016 | March 2017 | 75,615.75 |
| Salary and Benefits Expenses for Legal Director | Legal Counsel | May 2017 | | 60,652.83 |
| Lease/ Build Out of Office Space | Office Renovations | May 2017 | | 56,000.00 |
| Corporate FACTS | Financial System Consulting | June 2016 | March 2017 | 50,985.00 |
| **Total Other Supplemental Funding Provided to DLBA** | | | | **$717,988.22** |

It should be noted that the vast majority of the expenses above relate to legal expenses incurred during the US Treasury's suspension and reinstatement of the HHF program.

The table below is a summary of those expenses that we are aware of, based on information provided to us:

| Item/Description | Amount |
|---|---|
| City Paid to MSHDA/MHA To Reimburse Itself for their cost of the Investigation of DLBA (Paid via the $10M Escrow Account, June 2017) | $2,569,181.17 |
| Legal Expenses Reimbursed to DLBA (Paid by the City May 2017(ΣA)) | 550,350.39 |
| **Total Other Supplemental Funding Provided to DLBA** | **$3,119,531.56** |

**Our Concerns Relating to Supplemental Funding for HHF Demolitions**
We asked the OCFO about the process surrounding the $5.9 million of supplemental funding provided to date, which allows for DLBA to invoice the City directly to the OCFO. Payments are reviewed and processed as "Non-PO" payments. This is in contrast to other City-funded demolitions which require a contract, purchase order, and an invoice.

In response to our inquiry, the OCFO explained that:

- The Plan of Adjustment (POA) dictated that it was prudent to set aside additional funds for the cost of demolition related to HHF activity. In 2014, even before any HHF demolition occurred, the POA stated that another funding source would be needed in order to cover all costs related to HHF activity;
- Additional funds were appropriated in the budget (in Non-Departmental), and are included in the City's Blight Investment totals. Documentation provided showed that the original set aside recommended in 2014 was $6.8M, however, for FY2019, it was recommended and approved that $7.5M be set aside.

The OCFO further explained the rationale for these invoices "by-passing" what we feel are the normal processes for procurement and payment of demolition related activities, including City Council's approval, based on a "Legal Opinion" they received from the City's Law Department, dated May 10, 2019. The Law Department stated that:

> The COD - DLBA MOU provides that, among other things, DLBA will provide demolition services and COD will provide funding subject to "approval by the Detroit City Council." Para 1, 13, 14. Provided City Council approves funding for the demo costs in question (above the $25,000 threshold authorized under the state/federal program), there is no impediment to COD providing such funding.

Based on discussions with the OCFO, this "opinion" was interpreted to mean that since City Council approved the budget, and these monies were specifically budgeted for this specific purpose, then the invoices could be then "gathered" and paid.

We noticed that the payment of the $0.7 million invoice (discussed above), predates the Law Department's opinion.

We believe that the OCFO's interpretation of the Law Department's opinion does not negate the Charter and Purchasing Ordinance requirements for demolition contracts over $25,000 to be approved by City Council.

**Review of the Proposed Second and Restated Amendment to the Memorandum of Understanding between the City of Detroit and the Detroit Land Bank Authority**

The Office of the Auditor General has reviewed the proposed "Second and Restated Amendment to the Memorandum of Understanding (MOU) between the City of Detroit and the Detroit Land Bank Authority (DLBA)", as submitted to City Council on January 21, 2020. The following are our concerns stemming from our review of the MOU, and ongoing concerns raised during the recent hearings on the Mayor's "$250 Million Blight Elimination Bond Project":

Detroit Land Bank Authority Duties (Section 4c on pages 2-3)

We recommend stronger language on reimbursements and reporting relating to the City providing supplemental funding for HHF demolitions. Specifically, we recommend that:

A. The City determine if a review process is necessary for demolitions where the cost is expected to exceed the $25,000/$35,000 threshold, and memorialize the process in the MOU;

B. DLBA report on the total amount of supplemental funding provided to them in the quarterly reports provided to City Council. The amounts should be clearly detailed as to the nature of the reimbursements (i.e. – Costs in excess of $25,000, Pre-demolition property survey costs, other costs not reimbursed by MSHDA/MHA, administrative, and other non-demolition related costs over and above the annual subsidy, etc.);

C. City Council review the OFCO's current process for reimbursing DLBA for their supplemental funding needs (i.e. DLBA invoice the OCFO directly) as reported in this Memorandum, to determine if any additional approvals are warranted and/or necessary. The final adopted and approved process should be included in the MOU.

Demolition Inventory Management System - Sales Force

The proposed amendment to the MOU between the City and the DLBA states that DLBA "shall operate and maintain an Inventory Management system." Today, that system is Sales Force which is owned by DLBA.

We want to bring to your attention, ongoing issues with the demolition data being reported from Sales Force to the general public through the City's Open Data Portal and the Demo Tracker.

During a cursory review of demolitions in the Open Data Portal, two demolitions caught our attention because of the high prices reported. In one case, the demolition cost of a

single residential property was reported at $129,273.50, when in fact, the actual cost was $24,273.50. Another error we found involving a single HHF residential property's demolition cost reported at $134,967.90, when in fact, the actual price was $19,947.90. We brought these discoveries to the attention of DLBA, during a recent demonstration of Sales Force. It was explained that "an extra digit" was the result of a "typographical error" when the costs were entered into Sales Force. DLBA went on to explain that the amounts reported in the Open Data Portal and Demolition Tracker come from a field in Sales Force called the "Socrata Reported Price." DLBA emphasized this was not a field that they use or control. DLBA went on to state that there are parts of Sales Force that DLBA uses, fields that DBA uses, and other fields that City entities use. They were not sure where the "Socrata Reported Price" originates, but they "corrected" the price during the demonstration.

This may explain the data integrity issues as detailed in our most recent published interim audit report. It certainly underscores our continuing concerns with data integrity, ownership, and accountability for City-wide demolitions and the current property/inventory management system.

City of Detroit Demolition Department

In closing, DLBA's request to amend and extend the MOU should be analyzed, reviewed, and (if satisfactory) approved, in the context of the City's overall plans to bring demolitions in-house, under the newly formed Demolition Department. At one point during the "$250 Million Blight Elimination Bond Project" hearings, the Administration stated that they would submit the plan by December 19, 2019. We believe that the Administration should submit the City's overall Demolition Program plan prior to, or at the very least, concurrent with future consideration of the proposal to amend and restate the City's MOU with DLBA.