



U.S. Department of Housing and Urban Development

Office of Inspector General

451 7th St., S.W.

Washington, D.C. 20410

JAN 26 2012

Mr. Jim Ridenour, Mayor
City of Modesto
1010 10th Street Place
Modesto, CA 95353

Dear Mayor Ridenour:

This letter serves as confirmation that the U.S. Department of Housing and Urban Development (HUD) Office of the Inspector General (OIG) conducted an audit of the Neighborhood Stabilization Program 2 (NSP2) grant that the City of Modesto (City) received. This audit started in May 2011 and ended with the issuance of a final report, dated December 22, 2011.

As stated in the audit report, the purpose of the audit was to “determine whether the City administered its NSP2 grant in accordance with HUD requirements.” Specifically, we focused on “whether the City administered the program to ensure that developers used program funds for eligible acquisition and rehabilitation costs. The audit scope did not include tenant or homeowner eligibility and occupancy.”

As described in the audit report, in order to accomplish the HUD OIG audit objectives, our audit staff reviewed the following items:

- applicable HUD requirements;
- relevant background information related to the City and its NSP2 grant;
- the City’s policies and procedures for administering NSP2;
- samples of the City’s records pertaining to property acquisition, rehabilitations, and expenditures and disbursements; and
- samples of escrow files.

In addition, the audit staff also conducted the following actions:

- visited a sample of properties purchased and rehabilitated under NSP2 and
- interviewed HUD staff, City staff, developers, and real estate agents, as appropriate.

As clarification, in the first step of our process, the survey phase, our staff reviewed a nonstatistical survey sample from a universe of 66 properties with more than \$10.3 million in

NSP2 funds drawn down and attributed to four activities as of March 31, 2011. The survey sample totaled more than \$5 million for 12 property acquisitions and 8 rehabilitations. In addition, during the audit phase of the process, we expanded the nonstatistical sample to include an additional 22 property acquisitions with purchase prices that totaled more than \$2.1 million and 19 property rehabilitations with rehabilitation budgets that totaled more than \$1.2 million (see appendix E in the audit report for a summary of property information).

As you know, any material violations of HUD regulations or City procedures would be cited as a finding or concern in the audit report. The audit revealed three separate findings in the audit report, in summary, these findings were:

- Finding 1: The City approved ineligible and unsupported costs during rehabilitation that resulted in the overpayment of \$56,130 of NSP expenditures
- Finding 2: One NSP2 developer and a City Council member violated the conflict of interest requirements in an NSP2 property purchase transaction. The amount of this violation was \$62,500.
- Finding 3: The City approved ineligible real estate commissions, in the amount of \$51,936.

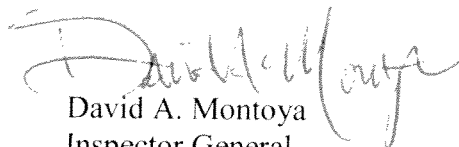
The audit report also notes that the audit “determined that the following internal controls were relevant to our audit objective:

- policies and procedures implemented to reasonably ensure that program activities comply with applicable laws and regulations.
- policies and procedures implemented to reasonably ensure that program funds are used for eligible activities.”

In closing, it is important to note that based on our sampling of files and transactions the three findings called out in the OIG audit report were the only material violations found during our audit.

I hope this letter helps to clarify the scope of the OIG audit and the information reviewed by our audit staff.

Sincerely,


David A. Montoya
Inspector General