



U. S. Department of Housing and Urban Development
Office of Inspector General
New York/New Jersey Office
26 Federal Plaza – Room 3430
New York, NY 10278-0068

MEMORANDUM NO. 2011-NY-1802

July 14, 2011

MEMORANDUM FOR: William T. O’Connell, Director, Community Planning and
Development Division, 2CD

FROM: *Edgar Moore*
Edgar Moore, Regional Inspector General for Audit, New York/New Jersey, 2AGA

SUBJECT: The City of Dunkirk, NY, Used Community Development Block Grant Recovery
Act Funding for an Ineligible Activity

INTRODUCTION

We conducted a review of the City of Dunkirk, NY (City), pertaining to its Community Development Block Grant (CDBG) funds received under the American Recovery and Reinvestment Act of 2009 (Recovery Act). We selected this auditee based on a congressional interest inquiry received by the Recovery Act Transparency and Accountability Board and forwarded to the U.S. Department of Housing and Urban Development’s (HUD) Office of Inspector General (OIG) in September 2010. The inquiry pertained to a concern that CDBG funds received under the Recovery Act (CDBG-R) may have been used to support an activity prohibited by Section 1604 of the Recovery Act. The primary objective of our review was to evaluate the validity of the congressional concern that the City used CDBG-R funds for an activity prohibited by the Recovery Act.

In accordance with HUD Handbook 2000.06, REV-3, within 60 days, please provide us, for each recommendation in this memorandum, a status report on (1) the corrective action taken, (2) the proposed corrective action and the date to be completed, or (3) why action is considered unnecessary. Additional status reports are required 90 days and 120 days after this memorandum is issued for any recommendation without a management decision. Also, please furnish us copies of any correspondence or directives issued because of this review.

The draft memorandum report was provided to City Officials on June 14, 2011, and City officials provided their written comments on July 6, 2011. City officials generally disagreed with our findings and recommendations. The complete text of the City officials’ response, along with our evaluation of that response, can be found in Appendix B of this memorandum.

Should you or your staff have any questions, please contact Joseph Vizer, Assistant Regional Inspector General for Audit, at (973) 776-7333.

METHODOLOGY AND SCOPE

To gain an understanding of the Recovery Act, we reviewed applicable laws, regulations, and HUD program requirements. In addition, we reviewed contracts, files, and records at the City and the Dunkirk Local Development Corporation (Corporation). We also conducted interviews with pertinent City and Corporation officials and reviewed disbursement records. We reviewed available files and records at the HUD Buffalo field office and conducted interviews with appropriate HUD personnel.

We performed our onsite work from October 2010 through February 2011 at the City and HUD offices. Our work was not conducted in accordance with generally accepted government auditing standards. The review was significantly limited in its scope, with the primary objective being to evaluate the validity of the congressional concern that the City used CDBG-R funds for an activity prohibited by the Recovery Act.

BACKGROUND

The Recovery Act became Public Law 111-5 on February 17, 2009. It established supplemental appropriations for job preservation and creation, infrastructure investment, energy efficiency and science, assistance to the unemployed, State and local fiscal stabilization for the fiscal year ending September 30, 2009, and other purposes. Authorized under Title XII of the Recovery Act, HUD allocated \$1 billion in CDBG funds to State and local governments to carry out, on an expedited basis, eligible activities under the CDBG program.

On August 10, 2009, HUD awarded \$153,520 in CDBG-R funding to the City. The City executed a subrecipient agreement in September 2009 with the Corporation, whereby the Corporation was to administer the CDBG-R funding and oversee a hotel water park project. The total water park project budget as stated was \$1.2 million, and the Corporation was going to use the Recovery Act funds to provide \$103,520 as a loan and \$50,000 as a grant to the hotel developer. The national objective of the project was job creation.

This review was initiated as a result of a congressional interest inquiry from the Recovery Accountability and Transparency Board. This board was created by the American Recovery and Reinvestment Act of 2009 and has the goals of providing transparency of Recovery-related funds and to prevent and detect fraud, waste and mismanagement. Earl E. Devaney was appointed by President Obama to serve as the chairman and 12 Inspectors General from various federal agencies serve with the chairman on the Board.

RESULTS OF REVIEW

The congressional concern that City officials used CDBG-R funds to support an activity prohibited by the Recovery Act was valid. The review disclosed that the City used at least some Recovery Act funding for water park costs at a local hotel. In addition, the initial focus of the whole Recovery Act project, including the national objective of job creation, was to complete a water park project. While HUD and the City took certain steps in an attempt to change the focus from a water park to general hotel renovations, a review of files and documents showed that the

project would not be eligible for Recovery Act funding. The following sections discuss the review results in greater detail.

1. *The City Applied for and Processed Recovery Act Funding for an Indoor Water Park*

City officials applied for and HUD processed a water park and splash water type project prohibited by Section 1604 of the Recovery Act. A review of City and HUD records showed that the project was intended to be a water park from inception.

In January 2009, the developer applied to the Corporation, a subrecipient of the City, for funding. The project application was for a \$1.2 million water park at the local Clarion Hotel. The contractor was listed as “Splash Makers,” and the applicant referred to the project as “Aqua City.” The application initially stated that 20 jobs would be created as a result of the project. In April 2009, Corporation officials approved the loan request from the local hotel for \$125,000 to pay for the water park. The Corporation’s board minutes stated that the hotel owners were looking for a loan to construct a water park inside the hotel and looking for a Corporation loan to pay for the water park.

In June 2009, City officials submitted an action plan amendment to HUD for the Recovery Act funding amount of \$153,250. The activity description was for Recovery Act funding to be used for an indoor water park at a local hotel. The amended plan provided that the Corporation would use the \$153,250 in funding toward the total water park costs of \$1.2 million. Thus, the job creation was to come from the water park.

In August of 2009, Corporation officials informed the developer (loan recipient) that, “upon discussing your program with HUD representatives, it was determined that eligible expenses would include physical improvements to the hotel building and new mechanical systems.” Funds may not be used to purchase pool or water park fixtures as these uses are prohibited by the Recovery Act.

However, in January 2010, the loan commitment and acceptance was executed between the Corporation and S & K Hospitality for \$175,000. The stated purpose was “financing for machinery and equipment to be purchased in connection with borrower’s water park facility renovation.” Additional provisions included that \$50,000 of the loan would be forgiven if the borrower completed the proposed water park facility and renovations in a timely manner in accordance with plans and specifications and not less than five jobs (permanent full-time equivalent) were created in connection with the water park facility.

Federal regulations prohibit using Recovery Act funds in support of any swimming pool or similar type projects. Federal Register, Vol. 74, No. 56, dated March 25, 2009, entitled “Presidential Documents,” provides, in part, “Funds under the Recovery Act shall not be committed, obligated, or expended by any executive department or agency, and shall not be used by any State or local governmental or private grantee or awardee, to support projects of the type described in section 1604 of Division A of the Recovery Act, which states that ‘none of the funds appropriated or otherwise made available in this Act may be used by any State or local government, or any private entity, for any casino, or other gambling establishment, aquarium, zoo, golf course, or swimming pool.’”

The section goes on to provide, “In exercising their available discretion to commit, obligate, or expend funds under the Recovery Act for grants and other forms of Federal financial assistance, executive departments and agencies, to the extent permitted by law, shall not approve or otherwise support funding for projects that are similar to those described in section 1604 of Division A of the Recovery Act.”

As discussed above, the project would violate Section 1604, since it was approved by HUD and processed by the City based upon a \$1.2 million budget for a water park project, including expansion of a pool area, with a total of \$153,250 in Recovery Act funding to be provided.

2. HUD and the City Made Project Changes in an Attempt To Make the Project Eligible

The initial application for Recovery Act funding was submitted to HUD on June 4, 2009, and dated May 23, 2009. The submission described the project clearly as an “indoor water park,” and no other hotel renovation or specific use of funds was mentioned.

According to City officials, HUD officials then instructed them to “amend” this filing. City officials submitted an amendment on June 10, 2009. The project was still referred to as a water park; however, the spreadsheet stated that the pool to be used for this project was an existing piece of infrastructure and would not be constructed but the existing fitness center area would be remodeled. HUD funding was specifically to be targeted toward infrastructure improvements including but not limited to HVAC (heating, ventilation, and air conditioning) and dehumidification equipment and atrium construction.

HUD officials indicated that when they instructed City officials to amend its filing they were trying to get the City to not use Recovery Act funds for an ineligible activity and since City officials represented that they were changing the wording to show that the Recovery Act portion of the project would be used for such costs as HVAC, hotel renovations, etc., HUD officials believed that this measure would make the project eligible for Recovery Act funding, and they approved the project. However, using Recovery Act funds on pool-like projects or supporting such projects is prohibited.

HUD officials informed the City that FederalReporting.gov indicated that CDBG-R funds were going toward the creation of a water park within Dunkirk’s waterfront district. In October 2010, HUD officials instructed the City to update and revise the description of the Recovery Act activity on “FederalReporting.gov.” FederalReporting.gov is the central government-wide data collection system for Federal Agencies and recipients of Federal Awards under Section 1512 of the Recovery Act. Federal Agencies, recipients and sub recipients are required to fulfill their reporting obligations by submitting data to FederalReporting.com on a quarterly basis for grants, loans and federally awarded contracts under the Recovery Act.

City officials then changed the entry for FederalReporting.gov to state that the CDBG-R grant was going toward hotel improvements at the Clarion Hotel along Dunkirk’s waterfront. However, this measure did not effectively mitigate the fact that the project was for a water park/pool. Further, the loan commitments executed by City officials contradicted the

information in FederalReporting.gov as the loan commitment provided for the job creation to come from the water park, not the hotel renovation.

3. *The City Made Recovery Act Reimbursements for Water Park Cost Expenditures and Other Unsupported Costs*

City officials acknowledged that some of the Recovery Act funds were used for architect and engineering fees for the construction of the water park.

The Corporation made the following disbursements regarding the waterpark project:

<u>Date</u>	<u>Payee</u>	<u>Amount</u>	<u>Purpose/support</u>
6/8/09	Splashmakers, LLC	\$ 27,400	Waterpark design fees
9/21/09	S & K Hospitality, LLC	\$ 50,000	Loan proceeds (not supported)
12/3/09	S & K Hospitality, LLC	\$ 50,000	Loan proceeds (not supported)
12/21/10	Clarion Hotel	<u>\$ 31,134</u>	Windows and commercial washing machine
Total disbursed by Corporation to date		<u>\$158,534</u>	

The \$27,400 was disbursed directly to a vendor on behalf of the hotel and was for water park costs. The two \$50,000 checks were disbursed directly to the developer/hotel, and it was not evident what the developer used the \$100,000 for once it received the funds. However, Corporation files contained additional invoices from Splashmakers, LLC, that may have been paid directly by the developer.

After the 2009 funds shown above were disbursed by the Corporation, the City drew down Recovery Act funds to reimburse the Corporation for the \$127,400 in costs incurred up to that time. Specifically, the City only drew down \$103,520 in Recovery Act funds and disbursed the funds to the Corporation in January 2010. In December 2010, the City drew down another \$31,134 that was supported by invoices. Recovery Act funding used to date, therefore, is \$134,654 (the \$103,520 in January 2010 and the \$31,134 in December 2010).

Based on the above, \$100,000 of the Recovery Act funds were not properly supported regarding their final use. In addition, it is clear that some of the Recovery Act funds were used to reimburse the Corporation for water park design costs.

CONCLUSION

Given the facts and details discussed above in this memorandum, the City's water park Recovery Act project was an activity prohibited under Section 1604 of the Recovery Act. Federal funding expended to date of \$134,654 was, therefore, ineligible for inclusion under CDBG-R. Accordingly, the remaining \$18,866 of the total \$153,520 in CDBG-R grant funding to the City should be reprogrammed to another eligible activity, representing funds that should be put to better use. The ineligible costs occurred because City officials were either not aware of or misinterpreted the restrictions on the use of CDBG-R funds and did not have adequate controls to ensure that CDBG-R costs incurred were for eligible activities and supported by adequate documentation.

Discussion with the Office of Block Grant Assistance Director for Entitlement Communities in HUD headquarters revealed that if any of the Recovery Act funds were used for water park costs, the project was not eligible for Recovery Act funding due to the Section 1604 prohibitions. The Director for Entitlement Communities indicated that City officials should repay the ineligible costs to the CDBG-R program line of credit so that these funds can be used for a project that would be allowable under the Recovery Act.

The Federal Register¹ provides that all CDBG-R grantees must expend their entire allocation of CDBG-R funds by September 30, 2012. HUD guidance provides a milestone that HUD must ensure that CDBG-R grantees obligate 100 percent by the end of FY 2011 (September 30, 2011).²

RECOMMENDATIONS

We recommend that the Director of HUD's Buffalo Community Planning and Development Division instruct City officials to

- 1A. Reimburse the CDBG-R program line of credit the \$134,654 expended on ineligible Recovery Act costs from non-Federal funds.
- 1B. Reprogram the remaining \$18,866 in CDBG-R funding to other eligible activities and do not allow City officials to use Recovery Act funds to support the water park project.
- 1C. Submit a plan to use the \$153,520 in funds for a project that is eligible under the Recovery Act.

¹ Federal Register Vol. 74, No. 89, dated May 11, 2009, [Docket No. FR-5309-N-01] Notice of Program Requirements for Community Development Block Grant Program Funding Under the American Recovery and Reinvestment Act of 2009.

² American Recovery and Reinvestment Act of 2009, Department of Housing and Urban Development, Program Level Plan, Community Development Block Grant (CDBG) Entitlement Grants, which is available at www.recovery.gov.

We further recommend that the Director of HUD's Buffalo Community Planning and Development Division

- 1D Provide guidance on the allowable activities for CDBG-R funds and direct City officials to establish controls to ensure that all CDBG-R costs are only incurred for eligible activities that are supported by appropriate documentation.

APPENDIXES

Appendix A

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

<u>Recommendation number</u>	<u>Ineligible 1/</u>	<u>Funds to be put to better use 2/</u>
1A	\$134,654	
1B		\$18,866

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 policies or regulations.

2/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an OIG recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. In this case, if the City implements our recommendations, the \$18,866 in unexpended funds can be used for other activities that are eligible under the terms and conditions of the Recovery Act.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION



CITY OF DUNKIRK A Chadwick Bay Community

Office of the Mayor
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July 6, 2011

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26 Federal Plaza, Room 3430
New York, NY 10278-0068

To Whom It May Concern:

RE: City of Dunkirk Response to OIG Audit Report

Comment 1

The City of Dunkirk processed, committed and obligated its Recovery Act CDBG Funding under the direction and with the counsel of the Department of Housing and Urban Development (HUD) Buffalo office. The project was vetted by HUD staff and determined that since the swimming pool was an existing amenity to the hotel and was not being expanded that the project was eligible for funding. It was only after receiving this advice from HUD Buffalo that this project was selected as the City had several other potential projects to be funded in place of this project. The City respectfully disagrees with the Office of Inspector General's (OIG) blanket conclusion statement that the "City officials were either not aware of or misinterpreted the restrictions on the use of CDBG-R funds" as the City maintains that it exceeded its reasonably required due diligence by vetting the project in its entirety and without hiding its ultimate deliverable to the HUD Buffalo office. The City, as do many small municipalities, relies heavily on its duly assigned representatives from HUD for advice and guidance and maintains that HUD should be accountable for its decisions and recommendations.

Comment 2

Further the City of Dunkirk maintains that although that according to the OIG's results the original project was not an eligible use of funding, as the project has evolved so that nearly all funds expended are eligible expenditures. The Clarion Hotel upon submission of this project for approval has been required to completely renovate the hotel by their franchiser in order to keep their franchise designation. These additional expenses have forced the owners to indefinitely delay and cancel any water park plans and dedicate any and all available capital into making the required improvements in an effort to retain their franchise and keep the hotel operational. As such the City of Dunkirk maintains that the project would be eligible as a job retention activity with minor modifications to account for the initial design reimbursements.

Comment 3

Finally the City of Dunkirk maintains that the both the HUD guidance and OIG's findings represent that the CDBG-R funding cannot be used to create a swimming pool or similar attraction and as written leave a tremendous "gray" area for these types of reviews. It is our position the current guidance lacks clear definition as evidenced by the vastly different guidance that the City has received from HUD Buffalo at the time of application and the OIG's office during this audit. Further the City maintains that HUD lacked the proper system to evaluate these projects as they were submitted and was driven by a series of deadlines and not by quality control and ultimately HUD should honor the advice of its staff and field office.

Thank you for your time and prompt attention to this matter, as Mayor of the City of Dunkirk, I would like to say that your onsite staff worked with nothing but the utmost dignity and respect toward our City and staff and truly appreciate their professionalism throughout this process

Sincerely,

A handwritten signature in blue ink, appearing to read "Richard L. Frey".

Richard L. Frey
Mayor

AN EQUAL OPPORTUNITY EMPLOYER

OIG Evaluation of Auditee Comments

- Comment 1 Federal regulations prohibit using Recovery Act funds in support of any swimming pool or similar type project. Federal regulations provide that federal agencies shall not approve or otherwise support use of Recovery Act funding for projects involving swimming pools and other recreational type projects. As a result any funds committed for these types of activities will be considered ineligible.
- Comment 2 A total of \$27,400 was expended for design costs related to a water park (which is clearly not eligible) and the remaining costs and funds drawn down were not supported. As part of the audit resolution process HUD officials should obtain additional documentation from the City regarding the unsupported costs charged and determine if the revised hotel renovation would be an eligible activity if the water park project had been eliminated from the scope of work. All ineligible costs should be repaid to the CDBG-R line of credit and the funds should be used for an eligible Recovery Act project within the applicable time limits.
- Comment 3 As mentioned in the report Federal regulations at Section 1604 of the Recovery Act is clear in prohibiting CDBG-R funds from being used for any casino or other gambling establishment, aquarium, zoo, golf course, or swimming pool. In addition, Federal agencies are prohibited from approving or supporting funding for swimming pools and other recreational type projects. Further, in doing so the Notice of Program Requirements for Community Development Block Grant Program Funding under the American Recovery and Reinvestment Act of 2009, Part IIC provides in part, that HUD will interpret the definitions of these terms broadly. Therefore, any such activity is ineligible.