

Testimony before the U.S. House of Representatives  
Committee on Financial Services  
Subcommittees on Insurance, Housing and Community Opportunity  
and Oversight and Investigations

**“Fraud in the HUD HOME Program”**



Testimony of  
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U.S. Department of Housing and Urban Development

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Room 2128 Rayburn House Office Building

Chairman Neugebauer and Chairwoman Biggert, Ranking Members Capuano and Guttierrez, and Members of the Subcommittees, I am John McCarty, Acting Deputy Inspector General at the U.S. Department of Housing and Urban Development's (HUD) Office of Inspector General (OIG). I thank you for the opportunity to discuss oversight of HUD's HOME program. Today, I will discuss this issue from the perspective of an investigations manager with 37 years of law enforcement experience, including over ten years with HUD OIG. My testimony on our investigative work builds upon prior OIG testimony in June of this year which related to audit findings, internal controls and administration of the HOME program.

### **Background**

OIG's mission is to provide independent and objective reports to the Secretary and the Congress for the purpose of bringing about positive change in the integrity, efficiency, and effectiveness of HUD programs.

In order to put the program in perspective, I will briefly go over some of the general facts which were outlined in the earlier testimony. HOME is the largest federal block grant dispersed to state and local governments designed to create affordable housing for low-income households. During fiscal year 2011, HUD dispersed approximately \$1.8 billion HOME funds to the states and hundreds of localities nationwide based on formula grants. The program was designed to reinforce several important held values and principles of community development:

- HOME's flexibility enables people and communities to design and implement strategies tailored to their own needs and priorities.
- HOME's emphasis on consolidated planning expands and strengthens partnerships among all levels of government and the private sector in the development of affordable housing.
- HOME's technical assistance activities and set-aside for qualified community-based nonprofit housing groups builds the capacity of these partners.

The HOME program is authorized under Title II of the Cranston-Gonzalez National Affordable Housing Act, as amended. Program regulations are found at 24 CFR Part 92. HOME provides formula grants to states and localities that communities often use, in partnership with local nonprofit groups, to fund a wide range of projects that build, buy, and rehabilitate affordable housing for rent or homeownership, or to provide direct rental assistance to low-income people. HOME funds are allocated by formula to Participating Jurisdictions. Participating Jurisdictions are state and local governments (including consortia) that receive funds to operate the program. The formula is based, in part, on factors including age of units, substandard occupied units, number of families below the poverty rate, and population in accordance with the most recent Census data.

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HOME addresses a need for affordable housing in our country; a need that is increasing in the wake of the housing and economic downturn and rise in unemployment. However, OIG's Office of Audit has expressed for many years concerns about the controls, monitoring and information systems related to the HOME program.

While my experience is in the investigative and management aspects of OIG operations, I mention our audit work because it provides background on OIG's long standing concerns about some aspects of the HOME program. As my colleague, James Heist, testified this past June in his capacity as Assistant Inspector General for Audit, over the past five years, the OIG has conducted more than 60 audits of HUD's HOME program. At least twelve of these audits were conducted by the OIG at the request of the Department to address concerns that they had and wanted us to review

Our audits primarily focused on high risk or egregious actions within the HOME program. Some of the most common findings of these OIG audits involve concerns about lack of adequate controls, subrecipient activities, recapture provisions, over-reporting of program accomplishments, accounting issues and ineligible activities. There are many HOME programs that operate efficiently. In these audits, however, there is a pattern of non-achievement of some of the HOME objectives to provide affordable housing or to meet local building code requirements for actual housing rehabilitation work. As it pertains to our Office of Audit's accounting concerns previously cited in earlier testimony, that matter remains open and the OIG has asked the General Accountability Office (GAO) to opine. The OIG Office of Audit continues to work with the GAO on the resolution of this important issue.

The HOME program appropriation has been funded at almost \$2 billion annually over the last several years. Since October of 2008, we have opened 51 investigations of allegations of HOME fraud and convicted 21 individuals of fraudulent activity. Thirty-four of these investigations remain open. Over the last several years, our Office of Investigation has focused on a number of HUD grant programs resulting in criminal investigations. We have investigated and prosecuted criminal activity in HUD Community Program Development grants. We are diligently watching the delivery of those funds through the grantee process. Due to the pernicious effect and impact of HOME fraud in local communities, we expend time and resources to make sure that those instances of criminal behavior are aggressively pursued.

### **Monitoring**

OIG has also expressed a long standing concern about monitoring in the HOME program. For the past three years, there were approximately 650 Participating Jurisdictions receiving HOME funds. Those Participating Jurisdictions distributed the HOME funds to many thousands of sub-grantees. HUD focuses its monitoring at the grantee level through its 42 local field offices which is a large responsibility. Grantees in turn are responsible for monitoring their sub-grantees. Our

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Office of Audit has found that, in some instances, no monitoring is occurring, particularly at the subrecipient level.

On the investigative side, some of those who have been caught perpetrating HOME fraud have confessed that they were well aware of the at times minimal monitoring and oversight and have indicated that due to this, they were able to take advantage of the program for personal enrichment. Indeed, some defendants have stated that when monitoring was conducted, the defendants were able to hand pick which projects would be inspected. This allowed the defendants to steer oversight entities toward projects which were completed in accordance with policies rather than have an opportunity to expose wrongdoing in certain other HOME projects. In other cases, defendants have stated that they were able to use the Integrated Disbursement and Information System (IDIS) to indicate that projects were completed in order to take the final draw down funds for projects which were not in fact completed. Defendants indicated that they were able to easily do this because monitoring of transaction was limited.

One aspect of monitoring which HUD may want to consider is the use of independent third party monitors in the HOME program. HUD has used this concept in monitoring reconstruction grants (also Community Program Development grants) in New York after the destruction of September 11, 2001. Additionally, this concept was used in the Gulf States with five housing authorities for monitoring disaster recovery grants in the aftermath of Hurricane Katrina. The use of the third party monitors could be incorporated into the administrative fees to manage the HOME program, or as part of the underwriting process for project implementation.

As an OIG investigator, assessing some of the ways that HOME participants structure their operations, I believe that having the same individual design, implement, manage or draw down funds may not be a sound risk or fraud prevention strategy.

### **Information System Issues**

IDIS is used by more than 1,200 HUD grantees, including urban counties and states, to report projects and activities, draw down program funds, and report on accomplishments. IDIS has more than 15,000 individual grantee users, as well as several hundred HUD headquarters and field office users. HUD also uses the information system to generate reports used within and outside HUD, including the by public, participating jurisdictions, and the Congress.

Our Office of Audit has found that grantees and sub-grantees are able to update, change, cancel, re-open and increase or decrease project funding without review by the Department. Grantees and sub-grantees also self-report the number of families housed by their projects without verification by HUD. Grantees can also move HOME funds around from project to project and year to year. This level of control over the IDIS system can enable those intent on defrauding to hide their fraudulent activities.

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We believe that HUD's information systems used to administer the HOME program are incapable of producing complete and reconcilable audit trails throughout the entire grant life cycle and are unable to produce reports which would facilitate timely identification of fraud, waste and abuse in the programs. As stated in previous testimony, the OIG has concerns about the data integrity in the IDIS system and the impact that it has on HUD's overall financial statements. We believe with a more robust, up to date information system, the Department would be able to better monitor the HOME program. Further, the fact that grantees can draw down funds from the system without HUD approval can easily facilitate fraudulent transactions, as there is no check and balance provision.

### **Highlights from HOME Investigations**

Our investigative work reflects that fraud perpetrated on the HOME program, similar to other grant fraud, is sometimes facilitated through opportunity, desperation, and greed. Defendants may be motivated by ease of access to the funds and by their ability to deceive program oversight by manipulating the grant procedures. Subjects of our investigations have included Executive Directors of Community Development Departments and non-profit entities, elected officials, construction company employees, contractors, developers, and investment companies.

Our HOME program cases generally involve fraud schemes associated with embezzlement of funds, bribery, theft, false billing and kickbacks. Often, our cases are referred to us from confidential informants, who are involved with the grant and contract processes and, on occasion, by the Department, our Office of Audit, the press and the grantees themselves.

The impact on local jurisdictions, who are victims of HOME fraud, can be significant in terms of the political scandal it sometimes generates and the loss of limited rehabilitation funds to the local community. It is clear that the penalties received by these wrongdoers represent the seriousness with which these cases are prosecuted.

### **Law Enforcement Partnerships**

The Office of Investigations works closely with our many law enforcement partners in most of our cases, including investigations involving the HOME program. Our relationships with state and local law enforcement entities, the FBI, the IRS and other federal agencies, in many instances, assist in the initiation of these cases, as well as help to leverage tight investigative resources. Many of our HOME cases originate based on information received from confidential informants. Often these are contractors or developers who feel that they should have gotten contracts received by others, or who come forward to reveal bid-rigging or kickbacks schemes. Typical charges in HOME cases involve conspiracy, bribery, tax violation, wire and mail fraud, embezzlement, money laundering, false statements, program fraud and theft of government funds.

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### **Same Players**

Because of the emphasis on local control of HOME funds, we find that some of the same entities are annual recipients of HOME funds and can be for many years. Having the same players receive HOME funds from year to year is a double-edged sword. On the one hand, the recipients can be knowledgeable about how the program works. On the other, they can also exploit and manipulate the program since they may be aware of the weaknesses in the controls and potential limited oversight, as some HOME defendants have pointed out. Additionally, because the program is formula-based, recipients know that they will receive funding year after year and may face limited monitoring. We are aware that the Department is promulgating regulations to address some of the deficiencies in the HOME program and we understand that monitoring is one of the issues contained in the proposed regulations. In other cases, developers or non-profits lack the experience and capacity to handle HOME project development. This has caused, in some instances, floundering and failing projects, and can also make the program vulnerable for fraudulent activities.

### **Enforcement Actions Available to HUD**

In addition to the legal authority to recapture misspent HOME funds, HUD also has the ability to refer program violators to its Departmental Enforcement Center, the (DEC), as well as to the OIG, for possible civil, criminal or administrative sanctions. Some of the potential penalties for misusing HOME funds include sanctions provided in the False Claims Act and the Program Fraud Civil Remedies Act, suspensions, debarments, and criminal penalties. Our investigative and audit work has shown that we use all of these statutes to address violators.

We maintain a well-established rapport with the Departmental Enforcement Center, and work closely with it to facilitate timely and thorough referrals for administrative action to mitigate further wrongful use of program dollars.

We feel that removing bad actors from participating in the HOME and other government programs is imperative to protecting important tax payer dollars. It also sends a strong message to others in the industry that this type of fraudulent activity will not be tolerated and that the OIG and the Department will take advantage of all possible remedies.

### **Conclusion**

OIG believes that the HOME program is important program in providing affordable housing to low income Americans. Given the current economic and housing crisis in our county, the need for affordable housing may never have been greater than in these tumultuous times. With this crisis unfortunately comes opportunity for fraud to compete against successful examples of

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HOME funds used for their intended purpose. Since our investigative work focuses on areas of high risk and egregious actions in the program, our cases highlight areas where improvements need to be made especially in the area of monitoring. OIG believes that increased monitoring would have a deterrent effect on fraud in HUD's HOME program. We look forward to working with the Department and the Congress in addressing ways to improve the effectiveness of this vital program.