SECTION 3

IN THE HARDEST HIT FUND, TREASURY RECENTLY GAVE UP NEARLY 10 MILLION DOLLARS TO STATE AGENCIES AND INCREASED THE RISK OF FRAUD, WASTE AND ABUSE, RISKS THAT SHOULD BE MITIGATED

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Treasury took two recent actions in the Hardest Hit Fund (HHF) that impact taxpayers who fund TARP and increase the risk of fraud, waste, and abuse in HHF's blight demolition subprogram. First, on April 1, 2016, Treasury made the decision to give up its future right to recover nearly $10 million dollars that Treasury estimated to be returned to the Hardest Hit Fund.[1] These dollars are likely to be much higher given recent trends and new HHF programs that haven't yet gotten off the ground.[2] Second, Treasury recently increased TARP dollars paid per demolished house, and expanded the program to allow TARP dollars to pay for the demolition of larger apartment buildings with five or more apartments.[3] These changes increase the risk of fraud, waste, and abuse. These risks can, and should be, mitigated. SIGTARP is willing to work with Treasury to mitigate these risks. With $3 billion in TARP dollars remaining to be spent by state agencies in the Hardest Hit Fund, it is imperative that taxpayers and the program are protected from fraud, waste and abuse.[4] Finally, these changes were buried in contract amendments on Treasury's website.[5,i] Treasury should bring greater transparency when making significant changes to programs.

In April 2016, Treasury amended its contracts with state agencies to give up nearly $10 million, and possibly far more, that under the contract were to be returned to Treasury

The Hardest Hit Fund is a program where the majority of TARP dollars expended to assist a homeowner are recovered if the house is sold prior to either a three, five, or 10-year period (depending on the state).[ii] When a homeowner receives either HHF foreclosure assistance or when HHF funds are used to demolish a blighted house, there is a forgivable loan secured by a lien placed on the property. The homeowner does not have to repay the assistance back if they stay as the owner of their home for the applicable number of years.[i,6] The lien is an important protection against fraud, waste, and abuse. For example, the lien protects against a homeowner, buyer, or developer profiting off of the TARP assistance in a house flip.

In the past five years, state agencies have recovered $188 million from homeowners who received HHF assistance before selling their home or refinancing

i In some states, the lien is forgiven each year by a percentage. For example, in a state with a five-year lien, the amount of the lien would decrease by 20% of the TARP dollars received each year. In other states, the lien stays at the full value of TARP dollars received until the end of the period.
ii Three small HHF Programs modify homeowners' mortgages with a 30-year lien forgiveness period.

their mortgage with a new loan, a figure that is increasing each year.[7] Given its design of the program to include a lien, Treasury anticipated that dollars would be recovered from homeowners who sold their property or refinance their mortgage. In its contracts, Treasury provided that during the program these dollars would be recycled back into the program, and after the program closed, the money would be paid back to Treasury, reducing the burden on taxpayers for the cost of TARP.[iii]

In April, 2016, Treasury amended its contracts to delete the requirement that at the close of the program, state agencies remit homeowner recoveries to Treasury, meaning that state agencies can keep these recovered dollars. In a one-page internal Treasury memorandum, using data prior to April 2016, Treasury estimated recoveries of $347.2 million. Treasury estimated $337.6 million in recoveries prior to December 2021 (the program close) that would be recycled into the program. Treasury estimated $9.6 million in recovered dollars after the program closed. Treasury decided that allowing states to retain the $9.6 million in recoveries would alleviate an administrative burden on Treasury for administrative costs after the program closed.[8]

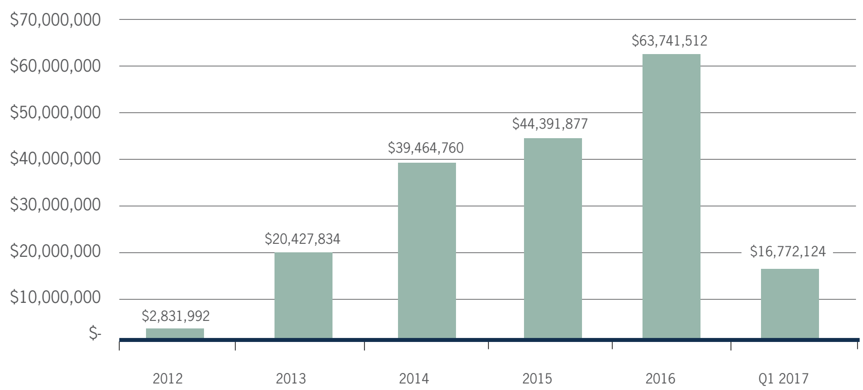
Treasury's decision to give up recoveries after the program closes did not protect taxpayers. First, the data Treasury analyzed to predict recovered dollars was dated, and has since significantly increased, and Treasury did not take into account how changes in the new round of $2 billion in funding could change recoveries. Second, Treasury did not account for the fact that certain states could have greater percentage of recoveries than others or that certain states would increase recoveries. Third, Treasury made no estimate of what post-program administrative costs would be, or took any action to mitigate post-program costs.

iii Treasury's 2010 contracts with state agencies provided that when a homeowner who had received TARP dollars in the Hardest Hit Fund sold their house prior to the expiration of the lien, the state agencies would recycle those dollars back into the program before the state agency submitted requests to Treasury for additional TARP dollars.

First, the data Treasury analyzed to predict recovered dollars was dated, and has since significantly increased as seen in Figure 3.1 below

FIGURE 3.1

TARP DOLLARS RECOVERED AND PUT BACK INTO THE HARDEST HIT FUND (AS OF MARCH 31, 2017)



Soiurce:SIGTARP analysis of Treasury provided Hardest Hit Fund Quarterly Financial Reports – obtained via data call from Treasury 7/7/2017

Whereas in 2014 recoveries were $39 million, increasing only slightly to $44 million in 2015, there were even greater recoveries of $63.7 million in 2016.[9] Recoveries in future years are likely to continue to increase. This is particularly true given the fact that HHF expanded with an additional $2 billion in 2016.

Treasury did not take into account how changes in the new round of funding would increase post-program recoveries

Under Treasury's estimation, 54% of all recoveries have already come back.[10] However, this was based on data before state agencies recently reopened programs or created new programs with the new 2016 funding of $2 billion. Estimating recoveries based on past programs does not take into account what could be greater recoveries in these new programs. For example, Treasury now allows TARP to pay up to $75,000 for the demolition of larger apartment buildings in Ohio, and could extend that to other states.[11] An investor in apartment buildings might be more willing to sell the property in future years after the program closed than a homeowner trying to stay in their neighborhood. In addition, some of the newly reopened or created programs have not yet begun providing assistance, or have provided only minimal assistance, which pushes back the timeline on recoveries.

Second, Treasury did not account for the fact that certain states could have greater percentage of recoveries than others or for recent increases in recoveries in certain states

Based on trends, recoveries vary by state. Overall, HHF recoveries in California, Oregon, Illinois, North Carolina, and Florida, account for about three quarters of the full $188 million recoveries as seen in Table 3.1.

TABLE 3.1

TARP DOLLARS RECOVERED AND PUT BACK INTO THE HARDEST HIT FUND
(AS OF MARCH 31, 2017)

State Agency	TARP Dollars Recovered - Program to Date	TARP Dollars Recovered - Past Year	Percentage of TARP Dollars Recovered in Past Year
California	$59,438,958	$19,626,683	33%
Oregon	$35,409,033	$6,948,054	20%
Illinois	$23,711,931	$6,221,268	49%
North Carolina	$14,989,622	$5,594,072	42%
Florida	$12,087,133	$2,962,052	46%
Michigan	$7,280529	$2,024,509	41%
Ohio	$4,970,781	$1,930,148	34%
New Jersey	$5,639,392	$1,426,203	34%
Kentucky	$3,369,158	$1,426,203	42%
Georgia	$3,31,991	$1,866,987	56%
Tennessee	$3,108,847	$1,425,347	46%
Arizona	$2,889,427	$1,273,759	44%
South Carolina	$2,767,338	$2,025,005	37%
Indiana	$2,085,519	$1,083,288	52%
Rhode Island	$1,619,582	$370,940	23%
Nevada	$1,442,335	$199,848	14%
Alabama	$986,279	$248,449	25%
Washington, D.C	$908,809	$175,107	19%
Mississippi	$582,413	$352,318	60%
Total	**$187,629,098**	**$66,358,290**	**35%**

Sources: SIGTARP analysis of Treasury DHardest Hit Fund Quarterly Financial Repors – obtained via data call from Treasury 7/7/2017.

Recoveries are increasing; with nearly 40% of all recoveries happening within the past year – even though HHF has existed since 2010. In some states, recoveries in the past year have significantly increased. This includes Mississippi, where 60% of the recoveries were in the last year, Georgia where 56% of recoveries were in the last year, and Indiana where 52% of recoveries would have been in the last year. These increases in recoveries would have been after Treasury conducted its estimate.[12] In the past quarter, there has already been more than $16 million in recoveries. See Table 3.2.

The increases in recoveries based off the older HHF programs, couple with new programs that have not yet started or only recently started, evidences that Treasury very likely gave up far more than $10 million.

Third, Treasury made no estimate of what post-program administrative costs would be, or took any action to mitigate those costs

Before giving up nearly $10 million in post-program recoveries for the sole purpose of offsetting administrative costs, Treasury conducted no estimate of post-program administrative costs. Treasury also took no action to mitigate these costs. Treasury stated that there would be administrative costs because "each of the 19 participating HFAs will need to maintain staff and other infrastructure to monitor and remit such recoveries to Treasury."[13] When the owner sells or refinances the property, the lienholder is contacted by the title company or seller, limiting the monitoring required. The state agency would then receive wired funds or a check, which they could use their existing staff to provide to Treasury. The only other step would be to release the lien, which generally uses a form template filed with the county. This would not seem to be a full time job for even one state employee post-program. Treasury could further mitigate administrative costs by working to understand each state agency's current process, and make sure that process is streamlined to minimize costs to TARP now and in the future. In addition, Treasury stated that its own Office of Financial Stability (OFS) would need to maintain staff and infrastructure to receive and process recoveries and monitor compliance. However, other Treasury staff such as in the Office of Domestic Finance (which is where OFS is housed), could receive the dollars and monitor compliance. As some weeks may not see any recoveries post-program, the amount of Treasury employee hours may not be onerous. However, the dollars recovered to Treasury sent back into the U.S. Treasury to reduce the cost of TARP to Federal taxpayers could be many more millions than what Treasury estimated, far exceeding administrative expenses.

Part of Treasury's analysis was a concern about asking state agencies to continue remitting recoveries to Treasury, while no longer paying for expenses with TARP dollars.[14] Treasury could mitigate this concern by allowing states to receive a portion of recoveries, such as 10%, to be put towards administrative expenses, rather than giving up 100% of recoveries.

TABLE 3.2

TARP DOLLARS RECOVERED IN QUARTER ENDED MARCH 31, 2017

State Agency	Administrative Expenses
California	$4,508,073
Oregon	$979,969
Illinois	$4,858,434
North Carolina	$1,385,279
Florida	$1,437,437
Michigan	$715,756
Ohio	$411,072
New Jersey	$258,610
Kentucky	$233,676
Georgia	$454,217
Tennessee	$392,500
Arizona	$323,284
South Carolina	$309,028
Indiana	$278,751
Rhode Island	$67,623
Nevada	$33,272
Alabama	$32,935
Washington, DC	$34,594
Mississippi	$56,616
Total	**$16,771,124**

Source: SIGTARP analysis of Treasury Hardest Hit Fund Quarterly Financial Reports – obtained via data call from Treasury 7/7/2017.

TABLE 3.3

TARP DOLLARS TO BE PAID PER DEMOLITION
Up to $15,000 in TARP $ Per House
Mississippi
Up to $25,000 in TARP $ Per House
Alabama
Indiana
Michigan*
Ohio (Single Family House)
Tennessee
Up to $35,000 in TARP $ Per House
Illinois
South Carolina*
Up to $75,000 in TARP $ Per Building
Ohio (Multi-Family Building)

Source: Treasury, Website, "Hardest Hit Fund - Current Program Documents", https://www.treasury.gov/initiatives/financial-stability/TARP-Programs/housing/Pages/Program-Documents.aspx, accessed 7/17/2017.
* Michigan and South Carolina dollars paid per demolition include single family properties with 1–4 units and multi-family properties with 4+ units but with the same cap as a single family home.

RECENT TREASURY CHANGES TO THE BLIGHT DEMOLITION PROGRAM IN THE HARDEST HIT FUND THAT INCREASE THE RISK OF FRAUD, WASTE, AND ABUSE

In April 2017, Treasury changed the blight demolition subprogram of the Hardest Hit Fund to permit TARP to pay for the demolition of larger apartment buildings with five or more units, and tripled the amount of TARP dollars per property from $15,000 to $75,000.[15] Treasury had been increasingly allowing TARP dollars to pay for the demolition of multifamily homes, but continued to limit TARP dollars to the same cap as a single family home as seen in Table 3.3 to the left.

Treasury expanded use of TARP to larger apartment buildings despite not implementing 18 of SIGTARP's recommendations to implement standard federal contracting rules to protect against fraud, overcharging, bid rigging, and other closed-door practices

Treasury's change increases the risk of fraud, waste, and abuse, risk that should be mitigated. SIGTARP has already recommended that Treasury mitigate risk in its June 2016 audit. In that audit, SIGTARP warned that the blight demolition program is significantly vulnerable to fraud, bid rigging, other closed door contract awards, and overcharging. SIGTARP found there are no federal competition requirements or limitations that federal funds only pay for costs that are necessary and reasonable. SIGTARP reported that most state agencies also have no competition requirements and no state agency has requirements that demolition costs be limited to necessary and reasonable costs.[16] There are more than 400 local partners and their subcontractors receiving these Federal dollars without those protections.[17] SIGTARP recommended that these vulnerabilities be reduced by requiring full and open competition and specific requirements to ensure full and open competition.[18]

In December 2016, Treasury implemented only two of SIGTARP's 20 recommendations, by requiring state agencies to implement controls for only the very basic requirements to require full and open competition and limit TARP reimbursement to necessary and reasonable costs. SIGTARP recently reported in April 2017, that SIGTARP reviewed new changes by the state agencies after SIGTARP's audit report, and found significant inconsistencies, and that other than one state agency in South Carolina, the state agencies have not implemented the type of rigorous analysis or strong controls that SIGTARP recommended, leaving taxpayers exposed to the risk of overcharging and fraud.[19] SIGTARP's other 18 recommendations in that audit that have not been implemented are to put in place standard federal competition and antifraud rules that apply to federal grants, such as for demolition in HUD programs. These standard federal rules are designed to 1) arm state agencies with knowledge of what demolition costs are necessary and reasonable, use that as a benchmark for claims for TARP funds; 2) ensure full and open competition, through specific competition requirements; and 3) prevent bid-rigging, contract steering and other closed door contracting processes. Without the implementation of these recommendations, taxpayers are at risk.

However, without fully implementing SIGTARP's recommendations to protect taxpayers, Treasury has allowed for the expansion of the blight demolition program to use HHF dollars to demolish large apartment buildings rather than single family homes, and tripling the amount of TARP dollars per property. This increases the risk to taxpayers.

Treasury did not identify and mitigate risk in this expanded use of TARP dollars, but should do so now

The use of TARP dollars to demolish larger apartment building poses new risks of fraud, waste, and abuse that Treasury should have analyzed and taken steps to mitigate. In April 2015, SIGTARP issued an audit report finding, "Treasury has not taken a risk-based approach to identify and mitigate risks that could form barriers to the most effective use of TARP funds for demolition activity or could lead to fraud, waste, and abuse." Treasury continued that same pattern.[iv]

SIGTARP asked Treasury for any analysis performed by Treasury that would support the changes approved to blight demolition programs. Treasury only provided a 2013 analysis that was used to create the blight demolition program.[20] Treasury has provided SIGTARP with no analysis of the risks associated with using TARP to pay for demolishing larger apartment buildings.[v] SIGTARP can provide Treasury recommendations to mitigate risk.

Using TARP to demolish larger apartment buildings poses increased risk of fraud and other crime that can, and should be, mitigated by Treasury

The demolition of larger apartment buildings poses different and increased risk of fraud, waste, and abuse than demolishing a single family home. For example,

Risk of Developer Fraud: A large vacant lot in an area with large apartment buildings would often be considered attractive by a developer. However, the use of federal dollars to make that lot vacant through federally-funded demolition brings risk of developer fraud in the acquisition of the lot. There is a risk of collusion with a developer and existing property owner. There is also the risk of corruption with city or county officials in the award of contracts or rezoning for commercial use, in kick-back schemes or quid-pro quo arrangements.

Risk of Unfair Competition such as Bid-Rigging or Collusion: There will be a limited pool of demolition companies with capacity to demolish larger apartments or housing complexes. Local contractors may not have the capacity to bid, opening it up

iv See SIGTARP, "Treasury Should Do Much More to Increase the Effectiveness of the TARP Hardest Hit Fund Blight Elimination Program," April 21, 2015.

v Even Treasury's 2013 analysis only focuses on how the demolition of residential houses will increase home values within a 200-foot radius. Treasury apparently has no analysis of the increase in home values or stabilizing neighborhoods around large apartment buildings, which is required to use TARP dollars.

to out-of-state contractors. Larger contracts, more Federal money and a smaller competitive pool, increase the risk of criminal unfair competition.

Risk of Fraud: The risk of overcharging and contract fraud grows exponentially as the amount of TARP dollars grows. Larger monetary contracts bring greater opportunity for fraud. This type of fraud involving larger properties has already taken place in other blight demolition programs, like the Department of Housing and Urban Development's ("HUD") Neighborhood Stabilization Program ("NSP"), a pattern that could be repeated in HHF. For example, HUD was the victim of fraud involving contract steering with respect to the demolition of a larger commercial property. In 2012, the supervisor of a town in the Detroit suburbs was sentenced to three years in prison for accepting bribes from a company seeking to receive NSP funds for demolition and asbestos abatement of an abandoned theater. The township supervisor attempted to steer the contract to the company providing the bribe. After unsuccessfully attempting to steer the contract, the township supervisor asked the winning bidder to provide him with cash payments in exchange for the supervisor's approval of a change order that fraudulently inflated the cost for the asbestos abatement.[21]

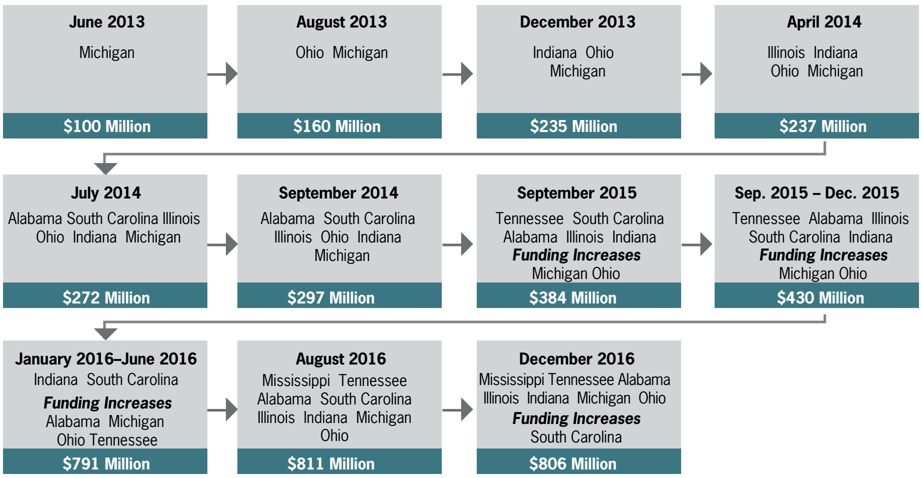
In another example, in 2017, an Indiana building commissioner was indicted for corruption. He is charged with using sham bidding practices and submitting fraudulent invoices to steer work to his companies and then bill the city for work that was either performed at inflated prices or for work that was never performed.[22]

While these types of fraud can exist in any contract award, the stakes increase as the dollar amount of the contract increases. These cases are just some basic examples of the type of fraud, waste, and abuse associated with expending blight demolition programs to larger demolition projects. These are the types of risk that Treasury should analyze.

The extent of this increased risk grows each time Treasury expands the program. Although right now, Treasury has only approved the demolition of large apartment buildings for one state, Treasury has historically expanded the blight demolition program, as shown in Figure 3.2.

FIGURE 3.2

INCREASE OF TARP DOLLARS



Sources: Treasury, Website, "Hardest Hit Fund - Current Program Documents", https://www.treasury.gov/initiatives/financial-stability/TARP-Programs/housing/Pages/Program-Documents.aspx, accessed 7/17/2017; Treasury, Website, "Hardest Hit Fund - Additional Program Information", https://www.treasury.gov/initiatives/financial-stability/TARP-Programs/housing/hhf/Pages/Archival-information.aspx?Program=Hardest+Hit+Fund, accessed 7/17/2017

Treasury should take steps to mitigate the increased risk of fraud, waste and abuse with demolition of the larger apartment buildings and/or housing complexes. At a minimum, Treasury should implement the remaining 18 SIGTARP recommendations in the June 2016 audit designed to prevent fraud, waste, abuse, and overcharging, and follow up on ensuring that state agencies implement rigorous analysis and controls. However, those recommendations were the basic recommendations related to smaller residential houses, not large apartment complexes. Treasury will need to conduct an analysis of risks and take steps to mitigate those risks. SIGTARP is willing to work with Treasury to develop a series of recommendations for controls and processes that mitigate risk to taxpayers.

Treasury Should Engage in Greater Transparency When Making Significant Program Changes

Finally, each of these program changes were buried in contract amendments posted on Treasury's website, despite the fact that they have real and significant consequences for taxpayers.[23] Whenever Treasury made changes to the HAMP program, they issued a release, but not so in HHF. This limits oversight and transparency, and should be remedied. Significant program changes require transparency to protect taxpayers.