
SECTION 3

**PROTECTING TAXPAYERS FROM
RISING BLIGHT DEMOLITION
COSTS IN TARP**

SIGTARP recently warned in a June 2016 audit that lax contracting requirements for the Hardest Hit Fund (HHF) created a risk that could lead to overcharging of TARP dollars, and fraud for the demolition of blighted houses.¹ TARP contracting has already improved as a result of Treasury implementing SIGTARP's two top recommendations in the June 2016 audit – to limit TARP dollars to only necessary and reasonable costs, and to require competition. SIGTARP estimates these recommendations will save taxpayers up to \$161 million in this more than \$800 million program.^{2*i*} In this report, we describe how the average cost of TARP-funded blight demolition has been on the rise in the two states where Treasury has committed \$619 million in TARP funds for demolition – Michigan and Ohio.³ In Michigan, which accounts for nearly half of all committed TARP dollars, the average cost of demolition paid with TARP dollars increased by 90% in less than three years from \$9,266 per house to \$17,643.⁴ In Ohio, the average cost of demolitions charged to TARP increased 62% over 2 ½ years (from \$9,293 per house to \$15,019).⁵ These increases in cost significantly impact federal taxpayers, as these two states account for a combined 76% of the \$811 million in TARP dollars for this program.⁶

It takes vigorous oversight to protect taxpayers from paying rising costs, and to protect against overcharging and fraud. Immediately after SIGTARP issued its June 2016 audit, the average cost of TARP-funded demolitions in Michigan stopped increasing, and immediately reversed course, decreasing by 38%, which has already saved taxpayers more than \$3.6 million in fiscal year 2017.ⁱⁱ Those cost savings should continue in future quarters and years as the program extends to fiscal year 2021. The decrease in costs after SIGTARP's audit highlights the power of SIGTARP's oversight to protect taxpayers and save federal dollars.

In addition to direct cost savings, one of SIGTARP's goals when publicly releasing an audit is to have a deterrent impact to prevent fraud and overcharging, which is critically important because TARP's Blight Elimination Program is in a ramp-up period. There are hundreds of millions of TARP dollars to be paid in the future in this HHF subprogram. Congress authorized an additional \$2 billion to the overall Hardest Hit Fund for 2016, some of which will go to blight demolition. Since the time of SIGTARP's June 2016 audit, the blight demolition program has grown by almost \$200 million, added another state, Mississippi, and extended for three additional years.⁷ Mississippi has not yet started demolitions. Alabama and Tennessee have only just started with three houses demolished each. Certain cities and counties in other states have not yet started demolitions.⁸

SIGTARP will be conducting oversight to determine why costs in Michigan and Ohio rose. It is not inevitable that taxpayers have to pay higher costs over time because in Indiana, the demolition costs have remained relatively constant.⁹ SIGTARP will continue to conduct vigorous oversight over this TARP program and these federal dollars. For example, in order to understand costs at a granular level,

ⁱ On March 24, 2017, South Carolina reduced its HHF funding allocated to blight demolition from \$35 million to \$30 million, bringing the total HHF allocation for HHF states for blight demolition programs to \$806 million. Data in this report is as of 12/31/2016 when the total HHF allocation to all HHF states for blight demolition programs was more than \$811 million.

ⁱⁱ With an average cost per house savings of \$3,543 (\$17,643 less \$14,100) for each of 1,020 houses demolished in the first and second quarter of fiscal year 2017, the cost savings are \$3,613,860.

SIGTARP recently announced an audit into demolition costs in Flint, Michigan, which is the second largest city receiving TARP dollars for demolitions.¹⁰

Treasury and state agencies can also conduct more vigorous oversight to mitigate the risk of overcharging and fraud, and that starts with implementing SIGTARP's existing recommendations in its June 2016 audit. Treasury took the first step in protecting taxpayers from overcharging and fraud by implementing two of SIGTARP's 18 recommendations in the audit to limit TARP dollars to only necessary and reasonable costs, and requiring competition. State agencies have been implementing the competition requirement, but more can be done as SIGTARP recommended specific controls to prevent unfair competitive practices. State agencies have focused less on implementing the requirement to limit TARP to "necessary and reasonable costs." SIGTARP has several recommendations designed to arm state agencies with knowledge about what costs are necessary and reasonable.

Ensuring protection from overcharging will require much stronger action by Treasury and state agencies, and SIGTARP previously recommended how they should take stronger action. SIGTARP recommended that Treasury require state agencies to conduct a rigorous analysis using best practices to determine the customary "necessary and reasonable costs" of demolition in each city, and subsequently benchmark claims against that analysis. Rather than require that state agencies perform the rigorous analysis and implement strong controls as recommended by SIGTARP, Treasury has left it to state agencies to ensure that TARP is limited to only those necessary and reasonable costs of demolition. SIGTARP's review found that the state agencies have not adopted the type of rigorous analysis or strong controls that SIGTARP recommended, keeping taxpayers exposed to the risk of overcharging and fraud.¹¹

BACKGROUND

In June 2016, SIGTARP reported finding that the Blight Elimination Program was significantly vulnerable to the substantial risk of overcharging that could lead to fraud, waste, or abuse, and that there were no requirements for competition.ⁱⁱⁱ SIGTARP found that Treasury had designed lax contracting that led to a risk of overcharging and lack of competition. As it relates to overcharging, rather than limit TARP dollars to the "necessary and reasonable costs" of demolition—the standard for federal contracts—Treasury allowed payments up to a worst-case scenario maximum allowable cost (\$15,000 to \$35,000 depending on the state). One Ohio official described the worst-case scenario to SIGTARP as a "hot house" filled with asbestos.¹²

SIGTARP reported finding in its audit that Treasury is leaving the decisions about what costs are necessary and reasonable to the recipients of Federal dollars. An official from Michigan's housing finance agency administering TARP

ⁱⁱⁱ SIGTARP, "Treasury's HHF Blight Elimination Program Lacks Important Federal Protections Against Fraud, Waste, and Abuse," June 16, 2016.

federal dollars told SIGTARP that the costs are “pretty much left up to the blight partner.”¹³

In July 2016, members of the House Committee on Oversight and Government Reform including Chairman Jason Chaffetz, Chairman of the Subcommittee Jim Jordan, Representative John J. Duncan, Jr, and Representative Mick Mulvaney, sent a letter to then-Treasury Secretary Lew citing SIGTARP’s audit findings, and their concerns. These members of Congress requested documents and information, including Treasury’s timeline for fully responding to SIGTARP’s recommendation.¹⁴

DEMOLITION COSTS PAID FOR WITH TARP DOLLARS ROSE SIGNIFICANTLY IN MICHIGAN AND OHIO

After analyzing data from TARP-funded demolitions in the three states that have spent the most TARP dollars (Michigan, Ohio, and Indiana), SIGTARP found that costs were on the rise prior to SIGTARP’s audit in Michigan and Ohio. These two states account for 76% of TARP funding for demolitions (\$619 million).¹⁵

Preventing fraud and seeking cost savings for the hundreds of millions of TARP dollars that will be paid in this program is one of SIGTARP’s highest priorities. SIGTARP has already released several audits on this program. SIGTARP’s June 2016 audit received considerable attention in the media, which can provide a deterrent impact on fraud.^{iv}

SIGTARP recommendations to Treasury to require state controls and analysis are particularly important because this TARP program is in a ramp up period. The largest states, Michigan and Ohio, which were recently allocated additional TARP dollars, can have the biggest dollar impact by implementing strong controls. Cities, counties, and states that have not yet started, or are just beginning TARP-funded demolitions, can implement strong controls from the start. Mississippi has not started demolitions, and Alabama and Tennessee have just started. South Carolina has only recently started demolitions, and the following South Carolina counties have not yet started demolitions (Allendale, Anderson, Charleston, Chester, Florence, Hampton, Horry, Kershaw, Lancaster, and Union). Some states have cities in that state that have not begun demolitions. For example in Illinois, the cities of Aurora, Chicago Heights, and Springfield have not yet begun demolitions. In Indiana, the following cities, towns or counties are authorized for TARP-funding, but have not started demolitions (Austin, Bicknell, Columbus, Delphi, Garrett, Muncie, Seymour, Vincennes, Washington, Pulaski, Vigo, Monroe, Noble/Kendallville, Brookville, Cambridge City, Daleville, Edwardsport, Hagerstown, Lagro, Oaktown, St. Joe, Walton).¹⁶

^{iv} This included the major media coverage in the states that were allocated the most TARP dollars for blight demolition – Michigan, Ohio, and Indiana. Media coverage included a local Detroit ABC news television station and The Associated Press story on SIGTARP’s audit, which ran in 29 outlets throughout the nation.

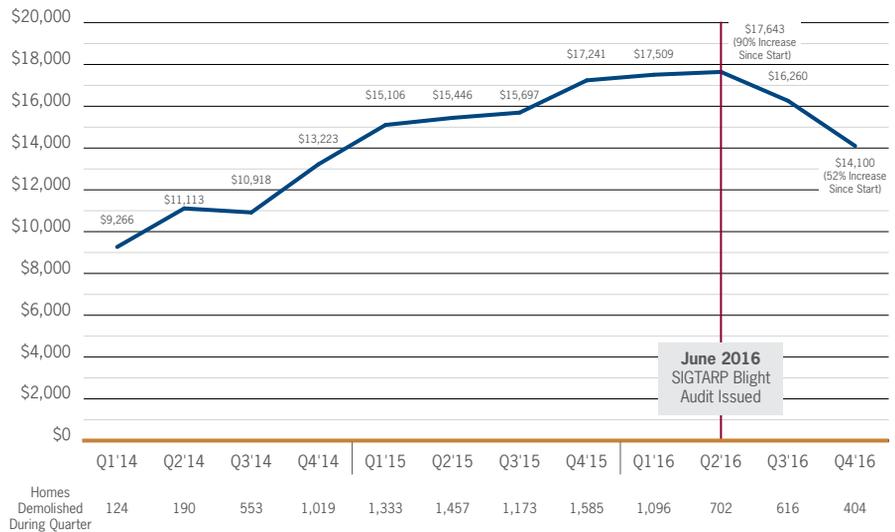
SIGTARP’s data analysis shows rising average costs in Michigan and Ohio, but not in Indiana. The following shows those trends in each state, as well as the largest city in Michigan and Ohio, in terms of TARP dollars.¹⁷

Demolition Costs Funded by TARP Rose 90% in Michigan, Which Accounts for Nearly Half of All TARP-Funded Demolitions, Then Decreased After SIGTARP’s Audit

Rising costs for HHF demolition in Michigan has the largest impact on taxpayers than in any other state because Michigan accounts for nearly half of all TARP dollars for demolition (\$381 million of \$811 million). Demolition costs paid by TARP in the state of Michigan rose 90% from an average cost of \$9,266 per house to \$17,643 per house, as seen in in Figure 3.1 below. This represents a total of \$142 million in TARP dollars spent through June 30, 2016.¹⁸

FIGURE 3.1

AVERAGE COST FOR \$158 MILLION IN TARP-FUNDED DEMOLITIONS (MICHIGAN), AS OF 12/31/2016



Source: SIGTARP analysis of Michigan HHF Blight Demolition data through 12/31/2016, obtained via Michigan State Housing Development Authority response to SIGTARP data call.

The timing of SIGTARP’s audit report directly correlates to a stop in rising costs and the start of decreasing costs. After SIGTARP’s report, the costs billed to TARP dropped by 38%, which has already saved taxpayers more than \$3.6 million in fiscal year 2017.^v Those cost savings should continue in future quarters and years as the program extends to fiscal year 2021. Even with this drop in costs, the average cost still remains 52% higher than two years prior. With Treasury committing to pay an additional \$222.7 million in TARP demolitions in Michigan, mitigating the risk

^v With an average cost per house savings of \$3,543 (\$17,643 less \$14,100) for each of 1,020 houses demolished in the first and second quarter of fiscal year 2017, the cost savings are \$3,613,860.

of fraud must remain a high priority for SIGTARP, Treasury, and the Michigan agency.¹⁹

TARP-Funded Demolition Costs Rose 57% in Detroit and Decreased After SIGTARP’s Audit

Detroit, Michigan is the city that receives the largest amount of TARP-funding for demolitions in the nation at \$130 million. In Detroit, the average cost of demolition per house rose 57%. The average cost of TARP-funded demolition in Detroit at the time of SIGTARP’s June 2016 audit was \$17,622, very close to the peak average for the entire state of Michigan, as shown in figure 3.2.

FIGURE 3.2

AVERAGE COST FOR \$103 MILLION IN TARP-FUNDED DEMOLITIONS (DETROIT, MI), AS OF 12/31/2016



Source: SIGTARP analysis of Michigan HHF Blight Demolition data through 12/31/2016, obtained via Michigan State Housing Development Authority response to SIGTARP data call.

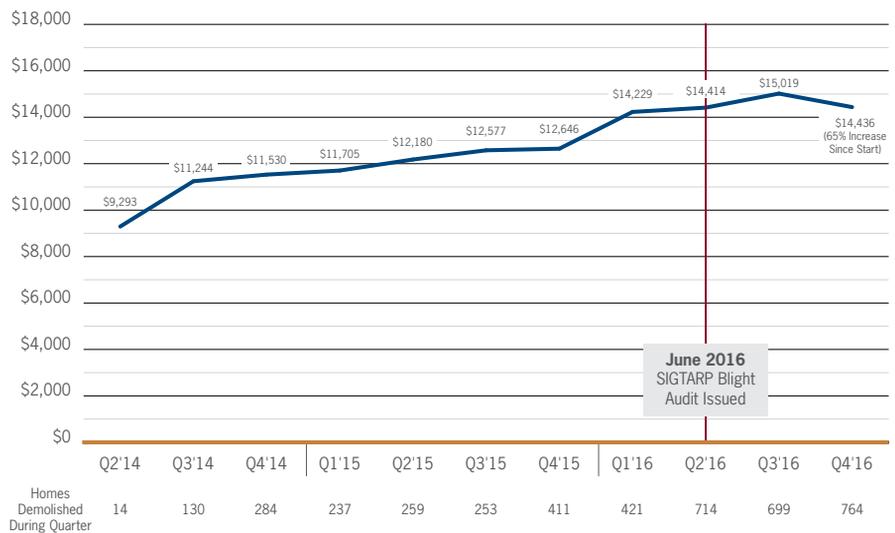
The data shows a direct correlation to the timing of SIGTARP’s June 2016 audit and the decrease in demolition costs. After SIGTARP issued its June 2016 audit, costs immediately dropped, and since then have dropped significantly. In addition, Treasury temporarily suspended all TARP dollars in Detroit for blight demolition in August 2016. With an additional \$67 million in TARP dollars committed to blight demolition in Detroit, cost savings to taxpayers is critical.²⁰

In Ohio, TARP-Funded Demolition Costs Remain On the Rise with a 62% Cost Increase

Like Michigan, the average cost of TARP-funded-demolition in Ohio has been steadily rising. Unlike Michigan, that rise in costs has not stopped. Ohio is the state with the second highest amount of federal TARP dollars committed by Treasury to blight demolition. Treasury committed \$238 million in TARP funds for demolition of abandoned houses in Ohio, which is 28% of the \$811 million program.²¹ Demolition costs for Ohio have risen over time, starting at \$9,293 per house in the quarter ending June 30, 2014 and rising to \$15,019 per house for the quarter ending on September 30, 2016, the latest data available. So far, \$57 million in TARP has been spent for demolitions in Ohio.²²

FIGURE 3.3

AVERAGE COST FOR \$57 MILLION IN TARP-FUNDED DEMOLITIONS (OHIO), AS OF 12/31/2016



Source: SIGTARP analysis of Ohio HHF Blight Demolition data through 12/31/2016, obtained via Ohio Housing Finance Agency response to SIGTARP data call.

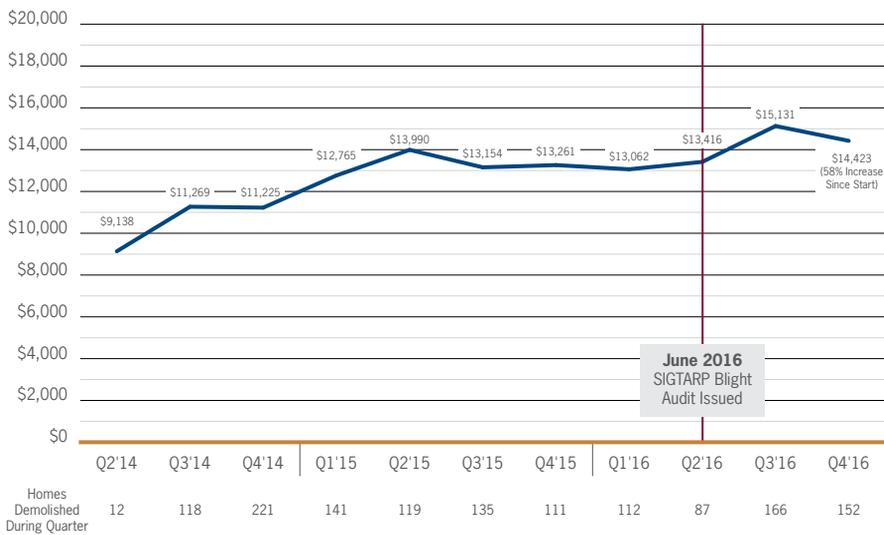
Demolition costs did not decrease in Ohio after SIGTARP's audit. In fact, the average cost continued to rise after the audit. The average cost of demolition rose by 62% in 2 ½ years and only slightly dropped this past quarter.²³ With Treasury committing an additional \$180 million in TARP dollars for demolitions in Ohio, mitigating the risk of fraud must remain a high priority for SIGTARP, Treasury, and the Ohio agency.²⁴

TARP-Funded Demolition Costs Rose 66% in Cleveland

More than a third of the state’s HHF demolitions occurred in Cleveland. The average cost of demolition has risen 66% from \$9,138 per house to \$15,131 in 2 ½ years.²⁵

FIGURE 3.4

AVERAGE COST FOR \$18 MILLION IN TARP-FUNDED DEMOLITIONS (CLEVELAND, OH), AS OF 12/31/2016



Source: SIGTARP analysis of Ohio HHF Blight Demolition data through 12/31/2016, obtained via Ohio Housing Finance Agency response to SIGTARP data call.

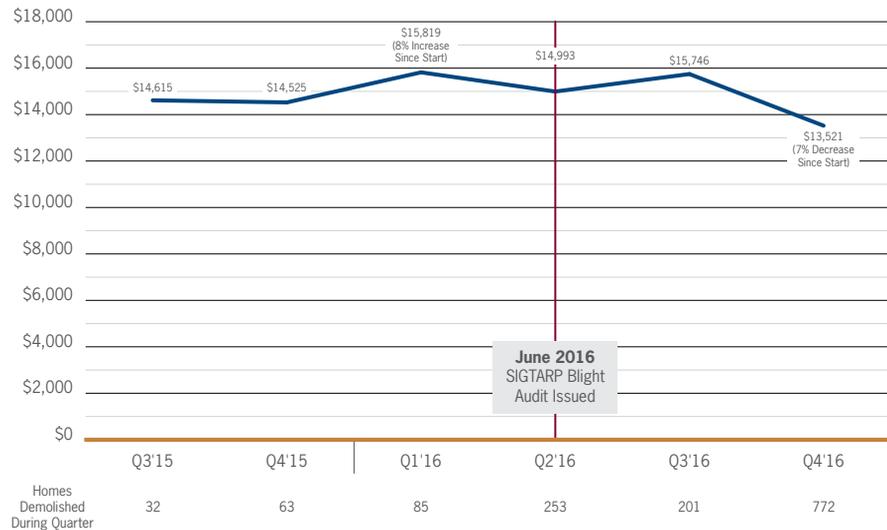
Treasury has already spent \$18 million in TARP in Cleveland.²⁶ There is another \$34 million in TARP dollars planned for demolitions in Cleveland and the surrounding areas.²⁷

TARP-Funded Demolition Costs in Indiana have Stayed Relatively Constant

In Indiana, where Treasury has committed \$75 million in TARP dollars for demolition, costs have remained relatively constant for the \$20 million in TARP funds spent.²⁸

FIGURE 3.5

AVERAGE COST FOR \$20 MILLION IN TARP-FUNDED DEMOLITIONS (INDIANA), AS OF 12/31/2016



Source: SIGTARP analysis of Indiana HHF Blight Demolition data through 12/31/2016, obtained via Indiana Housing and Community Development Authority response to SIGTARP data call.

The fact that costs have not increased in Indiana shows that rising costs are not an inevitable consequence that Treasury (and taxpayers) have to accept.

MITIGATING THE RISK OF OVERCHARGING AND FRAUD REQUIRES STRONG OVERSIGHT

The question of why costs are rising in Michigan and Ohio is one that SIGTARP will be conducting oversight to answer. Even if there may be explanations for certain rising costs, that does not necessarily mean that federal taxpayers have to pay for it with TARP dollars. In order to understand demolition costs at a more granular level, SIGTARP recently announced an audit of demolition costs in Flint, Michigan, the second largest city in TARP blight demolition funding.²⁹

Treasury and state agencies can also conduct more vigorous oversight to mitigate the risk of overcharging and fraud, and that starts with implementing SIGTARP's existing recommendations in its June 2016 audit. Treasury took the

first step in protecting taxpayers from overcharging and fraud by implementing SIGTARP's recommendation to limit TARP dollars to only necessary and reasonable costs, but ensuring that protection will require much stronger action by the state agencies.

As SIGTARP reported in its June 2016 audit, because of the heavy reliance on those receiving the TARP dollars, neither Treasury nor the state agencies administering the TARP dollars are armed with the knowledge to understand and question the rising costs in Michigan and Ohio. SIGTARP made two recommendations in June that Treasury has not implemented that propose a rigorous analysis and strong controls. SIGTARP recommended that Treasury require state agencies to conduct a rigorous analysis for each city to determine the customary necessary and reasonable costs. SIGTARP recommends that the state agencies conduct this analysis by layering three best practices: independent experts, third party fair market value quotes, and current and historical cost information. Second, once the state agency has their own analysis of that city's customary necessary and reasonable costs, as a strong control, Treasury should require them to benchmark all claims against it, and require substantial, written justification for any costs in excess of the customary cost in that city.³⁰

Rather than require that state agencies perform the rigorous analysis and implement strong controls as recommended by SIGTARP, Treasury made a general requirement that state agencies are responsible for ensuring compliance with the new limitation to only reimburse necessary and reasonable costs.³¹ It should be remembered that state housing finance agencies were not in the business of administering demolition programs.

SIGTARP reviewed the new changes by the state agencies provided to SIGTARP, 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.

- South Carolina state agency: *"Costs do not exceed 10% of the approved cost estimate. Costs for asbestos abatement should typically be estimated between \$3 and \$4 per sq. ft. Costs for demolition and site restoration should typically be estimated between \$4 and \$5 per sq. ft." The state agency also requires a broker opinion of value or appraisal for acquisition costs, limits attorney's fees for acquiring property to \$600, limits title search and exam to \$350, and limits the maximum for quieting title to \$3,000. This is the only state agency to conduct their own analysis of necessary and reasonable costs, and they should be recognized as such. As SIGTARP recommended, the state agency analysis should be done at the city level where costs can vary widely.*

In contrast:

- Michigan state agency: *Agency staff will analyze "demolition costs based on size of structure and reasonableness compared to other work being done in each city and areas of the state." This is better than the lax controls before, and is*

focused on costs in each city. However, this methodology still relies too heavily on contractors submitting invoices. If the state agency staff compared a claim for \$17,000 in May 2016, just before SIGTARP's audit, it would have looked reasonable and necessary at that time, without the staff realizing that these costs had increased by 90% over the prior three years.

- Ohio state agency: The state agency did not change its program guidelines to ensure that TARP is only used to pay necessary and reasonable costs. Existing guidelines use general maximum allowable expenses for the entire state which do not provide guidance or controls to agency staff to find the necessary and reasonable costs, and do not allow for differing costs in each city.
- Indiana state agency: *Funding limited to \$15,000 if the house was without a basement or \$25,000 with a basement. The state agency created an "allowable expense chart" stating which categories of expenses will be paid.* The basement difference in costs is a good start, but still relies too heavily on maximum allowable caps, rather than an analysis of customary "reasonable and necessary costs." Also, the caps are at a state level, not allowing for differing costs in each city. This does not give sufficient controls or guidance to the state agency staff when reviewing claims.
- Tennessee state agency: *"All invoices submitted for payment through the BEP will be reviewed by THDA prior to disbursement. THDA, at its sole discretion, will determine if the charges are both necessary and reasonable."* This provides no control, direction or guidance to the staff reviewing claims.
- Illinois state agency: *The state agency shall ensure that all expenditures are reasonable as determined in its sole discretion.* This provides no control, direction or guidance to the staff reviewing claims.
- Alabama state agency: The state agency did not change its program guidelines to ensure that TARP only pays necessary and reasonable costs.
- Mississippi state agency: As the newest state, Mississippi is still working on their guidelines.³²

Federal taxpayers deserve the same strong controls for TARP-funded demolitions regardless of the state where demolitions occur. SIGTARP's recommended methodology is rigorous while allowing for local conditions. In order to protect taxpayers, state agencies must be better informed about what costs are customarily necessary and reasonable for demolitions in each city, rather than relying on a review of invoices post-demolition, with nothing to benchmark those invoices against.

The rising cost of blight elimination raises concerns that require additional oversight to protect TARP dollars. Already, SIGTARP's audit has stopped rising costs in Michigan, and costs have dropped since the audit, representing a savings to taxpayers of \$3.6 million.³³ However, costs are still higher in Michigan and Ohio.³⁴ By adopting SIGTARP's recommendation to limit TARP to necessary and reasonable costs, rather than a maximum allowable cap, Treasury took the first step in protecting taxpayers. However, that step should be executed consistently through the state agencies, by requiring rigorous analysis and controls. For its

part, SIGTARP will continue with its vigorous oversight. SIGTARP will continue to track and report on rising costs in TARP, and work with Treasury through recommendations designed to save taxpayers federal dollars and prevent fraud.