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Secretary Jacob J. Lew
Office of the Secretary
U.S. Department of Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Alert Letter

Dear Secretary Lew:

I am issuing you this alert letter because an urgent matter has come to my attention that I believe requires immediate action. Specifically, I want to alert you to serious risk that TARP's Housing Finance Agency Innovation Fund for the Hardest Hit Housing Markets (the "Hardest Hit Fund" or "HHF") efforts to reduce blight in hard-hit states could be strategically misused to select lived-in residences for the purpose of HHF-reimbursed demolition. This would leave less TARP funds to demolish the abandoned properties Treasury intended, uproot people from their homes in poor neighborhoods, and in worst case scenarios, could open up TARP to manipulation, abuse, or criminal conduct.

My office has been conducting an audit to warn Treasury of risks that could undermine the success of HHF's efforts at blight elimination so that Treasury can take action to mitigate those risks and improve the likelihood of program success. We are in the process of finishing our field work and preparing a report on our findings. However, given the fast pace at which HHF demolitions are taking place in certain cities, I believe the potential risk is of such magnitude that I could not delay bringing it to your attention.

TARP has great potential to help heal the ills of vacant and abandoned properties in hard-hit cities, but only if this TARP program is not diverted from its intended purpose, and is protected against fraud, waste, and abuse. TARP's Hardest Hit Fund has a different purpose than other federally funded blight demolition — helping people stay in their homes by preventing foreclosures (as required by TARP law). A program designed to keep people in their homes should not be used to reimburse acquisition or demolition that uproot other people from their homes.

HHF is at risk if it is treated the same as the Housing and Urban Development's ("HUD") Neighborhood Stabilization Program ("NSP") or other blight elimination funding programs whose purposes include redevelopment of demolished vacant properties, and allow for the acquisition of occupied properties for demolition.[1] HHF has a different purpose, different intent, and different requirements.

Treasury intended that the HHF Blight Elimination Program prevent foreclosures by combatting the ills associated only with *vacant* and *abandoned* properties, rather than lived-in residences. Treasury Assistant Secretary for Domestic Finance, Mary Miller, at an August 26, 2013 news conference announcing the HHF Blight Elimination Program said, "Abandoned and blighted homes depress surrounding home values and strain community resources, but this innovative program will reduce foreclosures and revitalize neighborhoods."[2] Her Treasury press release that same day stated, "Neighborhoods across Michigan that have been struggling with the damaging effects caused by vacant and abandoned properties will soon see the benefit of these funds." She further added, "This program takes an innovative approach to reduce foreclosures and revitalize neighborhoods and communities, while also providing increasing local tax receipts and reducing the strain on municipal resources."[3] Treasury's Hardest Hit Fund then-Program Director addressed the intent of the HHF Blight Elimination Program in an October 2013 blog post stating, "Economic research indicates that the demolition of vacant and abandoned blighted properties followed by "greening" or redevelopment of the parcels increases surrounding home values when compared to taking no action. When home values improve, homeowners recover equity: these innovative programs will therefore reduce the likelihood of foreclosure for families living in hard-hit neighborhoods." [4]

At a summit on TARP housing programs in April 2014, you described traveling to Detroit and that you "witnessed firsthand how the Hardest Hit Fund is making a difference. For the first time under this program, workers were tearing down abandoned buildings to revitalize a community. The fact is a foreclosed sign in front of one home can pull down the value of every home around it. And an abandoned building can cause a once-stable neighborhood to slip into a downward spiral. On these blocks and in these neighborhoods, the Hardest Hit Fund is providing families with a second chance."[5]

The cities hard-hit by abandoned properties that are using TARP funds for demolition have larger economic redevelopment plans that TARP is not designed to address, even if those plans have the potential to reduce foreclosures. These cities contain vacant and abandoned properties

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[1] Unlike NSP, HHF is not a grant program and does not have the protections and requirements of federal grant regulations for including occupied homes in the program. For example, HUD's NSP allows for the acquisition of occupied property for demolition, but requires compliance with laws governing notices to occupants and relocation requirements. HUD's NSP toolkit provides, "If you decide to make an offer on an occupied property…," the Uniform Relocation Assistance and Real Property Acquisition Policies Act requires you to send a specific notice that informs people that are displaced that they may be eligible for relocation assistance, requires a URA-compliant appraisal if the value is greater than $25,000. HUD's NSP Toolkit also states, "When using NSP to acquire or renovate occupied properties, part of the required due diligence is to determine if the seller followed the new tenant protection laws." Treasury has no similar requirements or protections.

[2] Michigan Governor Snyder news release, "Snyder, MSHDA launch largest residential blight removal effort in state history," August 26, 2013.

[3] Treasury Press Release, "Remarks of Under Secretary for Domestic Finance Mary Miller at Event Hosted by the Michigan State Housing Development Authority (MSHDA)," August, 26, 2013.

[4] Treasury Press Release, "Treasury Provides New Quarterly Reporting on HHF," October 17, 2013.

[5] U.S. Department of Treasury Press Center, "Remarks by Secretary Lew at the Making Home Affordable Five-Year Anniversary Summit," June 26, 2014.

in numbers beyond what TARP will be able to fund, leaving no room for diversion of TARP to lived-in residences. For example, an Indiana housing finance agency ("HFA") official told SIGTARP, "At one point there were reports through RealtyTrac and others that the state of Indiana had the largest number of abandoned foreclosed homes, otherwise known as zombie homes, in the nation, at least on a per capita basis." In addition, the presence of private self-interests in the potential end use of the properties post-demolition heightens the risk of manipulation, abuse, and criminal conduct, requiring heightened oversight.

SIGTARP found that Indiana's HFA selected and approved lived-in homes on the desired relocation site of a car dealership in Evansville, Indiana, under the TARP program and used TARP funds to reimburse their demolition (but not acquisition) despite the presence of other abandoned properties in the city. Indiana's HFA knew that the city selected those properties for inclusion under TARP because they were on the desired relocation site of a car dealership – an area known as Area 55. Indiana's HFA approved the City of Evansville's strategic plan for TARP. Under "phase 1" of the city's strategy, a private, for-profit partner, JBell Properties, LLC ("JBell"), proposed to remove 45 buildings (29 claimed to be eligible for TARP), so it could construct a new home for its "client," "a commercial enterprise which is being displaced to make room for the new [Indiana University] Medical School."

Despite Treasury's contract with Indiana's HFA limiting the TARP program to the demolition of vacant, abandoned, and blighted properties, Indiana's HFA approved lived-in residences to be included in the TARP program. Indiana's HFA approved the city's strategic plan that included a site evaluation matrix, inspection report, and photographs of each property. The city's strategic plan submitted to and approved by Indiana's HFA includes inspection reports from May 2014 for the proposed properties. The inspection reports for many of the proposed properties — including for 18 of these properties that would later actually be demolished under HHF — lists the properties as "occupied and secure." In addition, photographs dated May 2014, submitted to and approved by Indiana's HFA showed that people lived in these residences as evidenced by children's bicycles, a baby stroller, a child's tree swing, barbeque grills, front porch chairs, wind chimes, decorations, and American flags.

There were also press reports that people lived in some of the homes selected. Early press reports stated that residents received eviction notices and that relocation of the car dealership would require rezoning the area from residential to commercial.[6] Although the TARP application strategic plan stated, "no one has voiced opposition to our project," public citizens raised concerns at a hearing on September 24, 2014, about the acquisition and demolition of homes people were living in to make way for the auto dealership, forcing people to relocate. The notice for the public hearing stated that the application for the HHF Blight Elimination Program was approved and that the city intended to acquire and demolish listed properties.[7] Senior officials from Indiana HFA attended the meeting. A television news story ran in which the Executive Director of the Department of Metropolitan Development, City of Evansville told the press, "It was a very blighted place and people needed to be relocated out of there. Those

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[6] *See* ABC Channel 14 News, "Proposed location for D. Patrick downtown dealership revealed," June 19, 2014, http://www.14news.com/story/25823021/proposed-location-for-dpatrick-downtown-dealership-revealed.

[7] *See* City of Evansville, "Blight Elimination Program--Notice of Successful Application and Hearing," August 22, 2014, http://www.evansville.in.gov/modules/showdocument.aspx?documentid=16105.

properties need to be demolished."[8] A press article quotes one former Vanderburgh County Commissioner as saying, "My problem is that the city will be using this money to demolish properties that were being lived in. Families were living there. More than 25 percent of the funds will be used to wipe a neighborhood off the face of the earth."[9] The former County Commissioner told the television news station that 25 of the properties were located on two streets, adding, "That doesn't stabilize a neighborhood. That demolishes a neighborhood. It's gone. And then the future purpose of the land is a commercial enterprise. I'm saying that this money is not supposed to be used in that way."[10]

Two days after the public hearing, the city sent a letter to Indiana's HFA stating that Indiana University had selected a site for its medical school that was the current home of the downtown D-Patrick Ford dealership. The city said in the letter that the dealership identified Area 55 as a relocation option. The city said in the letter that JBell held title to 26 properties and intended to acquire the remaining properties, and then a new blight partner, New Odyssey Investments, LLC ("New Odyssey"), would acquire them from JBell. Once cleared of structures, New Odyssey would develop the vacant land into the new home of D-Patrick Ford dealership. It described that 27 of the properties "have recently served as rental units."

All of the properties were then acquired for the purpose of demolition. On October 15, 2014, 45 parcels were combined into one single parcel, and sold to New Odyssey for over $2.4 million. Two days later, Indiana's HFA approved New Odyssey as a substitute partner for JBell under TARP's Blight Elimination Program.

Indiana's HFA approved 24 of the Area 55 properties as qualifying for the HHF Blight Elimination Program. In the letter of approval, the Director of the Blight Elimination Program for Indiana's HFA thanked the city's Department of Metropolitan Development for multiple emails, calls, and meetings concerning the Area 55 properties, saying that the HFA "now has a thorough understanding of what led Evansville to include the Area 55 properties in its BEP application." The Director continued in the letter saying that the HFA had agreed with the city department "that no Blight Elimination program acquisition funds may be used for the Area 55 properties. No acquisition claims will be made, if made, none shall be honored."

On November 3, 2014, the city asked Indiana's HFA to substitute properties from "the BEP grant," after five property owners redeemed their properties at a tax foreclosure preventing the city from acquiring title, and one owner picked up the house and moved it to another lot.[11] The letter from the Executive Director of the City's Department of Metropolitan Development to

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[8] *See* TriState Home Page.com, "DMD responds to concerns over properties selected for demolition," September 11, 2014, http://www.tristatehomepage.com/news/dmd-responds-to-concerns-over-properties-selected-for-demolition.

[9] *See* Jessie Higgins, "City, state meets with community over use of Hardest Hit Fund grant," Evansville Courier & Press, September 25, 2014.

[10] *See* TriState Home Page.com, "DMD responds to concerns over properties selected for demolition," September 11, 2014, http://www.tristatehomepage.com/news/dmd-responds-to-concerns-over-properties-selected-for-demolition.

[11] The city said in its letter, "First there were five properties that were redeemed from the tax sale which means we can't acquire title that would allow us to raze them with this program." The city also said that one owner moved the house.

Indiana's HFA states, "In order to keep the D-Patrick move to Area 55 on schedule we are requesting that all 24 properties in Area 55 be included in the Compliance Package. This will allow construction to begin in time for the work to be completed by the date needed to vacate their downtown location. This will also allow the Indiana University Medical School work to begin as scheduled. Attached is the list of properties." Indiana's HFA responded by letter approving the request to place all 24 Area 55 properties "in the compliance/sample demolition group," and said that Indiana's HFA will have an inspector on site for the first Area 55 demolition. Demolitions began the day after Christmas 2014, and continued through January 31, 2015. Indiana's HFA approved $293,073 in TARP reimbursement for the demolition of 24 homes in Area 55 – $246,490 of that amount was for the demolition of the 18 residences that were lived-in at the time they were approved for the program.

Indiana's HFA allowed TARP's Hardest Hit Fund to be used as part of a plan that selected and approved lived-in homes for demolition under HHF, which would require evicting or otherwise uprooting people from their homes.[12] This was not the intent of HHF. Indiana's HFA may be following a strategy that might be permissible under HUD's NSP program, but unlike TARP, HUD's program imposes substantial legal requirements and protections on the acquisition of occupied properties. This puts TARP at great risk of abuse. If a lived-in residence is selected and the residents uprooted as part of a demolition strategy that is funded by TARP, the fact that other funds are actually used for the acquisition does not change the fact that lived-in homes were knowingly selected and targeted for demolition in connection with TARP's HHF program. Allowing TARP to reimburse the costs of demolishing homes that were recently lived-in, but that were targeted for removal in furtherance of a desired end-use, leaves this program at great risk of abuse, and leaves fewer TARP dollars available to address existing zombie properties in these cities.

The current practice of Indiana's HFA creates an unacceptable risk that TARP could be diverted from its intended target of "zombie" vacant and abandoned eyesore properties that drag neighborhoods down and cause foreclosures. When Indiana's HFA approved the City of Evansville's strategic plan, it knew that the properties in Area 55 were lived-in, but still selected and approved them to be included in the TARP program. Indiana's HFA appears to be relying on the fact that acquisition costs were not paid for with TARP funds. However, if a home was not abandoned, reimbursement of the land bank or program partner for the costs associated with that demolition is beside the point – these properties should not have been part of HHF. Because the HHF Blight Elimination Program is essentially a reimbursement program, in which the actual disbursement of TARP funds by the HFA is made only after a property has been demolished, the crucial decision of eligibility by a state HFA must be made when a property is included within a TARP applicant's strategic plan, and certainly before demolition.

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[12] It was also reported that in September 2015, the auto dealership moved hundreds of cars to the new location where the homes were demolished. *See* ABC Channel 14 News, "Evansville dealership moves cars and makes room for IU medical center," September 5, 2015, http://www.14news.com/story/29967804/evansville-dealership-moves-cars-and-makes-room-for-iu-medical-center.

State HFAs should ensure TARP's limitations to vacant and abandoned properties are addressed in the strategic plans and selection of demolition sites. Once the state HFA approves the strategic plan, the process is underway. The city/land bank/non-profit/for-profit partner has an expectation that those demolitions are taking place under a TARP program, and will be reimbursed by TARP if the partner submits the correct paperwork. A state HFA's approval of a strategic plan under TARP also creates a public perception. For example, the public notice related to the acquisition and demolition of the homes on the desired site of the car dealership, said that the application for the HHF Blight Elimination Program was approved, and then said the City intended to acquire and demolish the list of residences that followed.

The state HFAs should also ensure that they do not unknowingly approve lived-in residences for TARP by conducting due diligence to ensure that the properties selected are vacant and abandoned. This is particularly true if the blight partner has not yet acquired the property or only recently acquired the property. The state HFA should make a site visit prior to approving the strategy. There are also databases that state HFAs could use. For example, the U.S. Postal Service maintains databases of vacant and abandoned properties. Valassis Marketing Services that distributes Red Plum coupon books to homes nationwide collected an extensive database of vacant addresses, which it has already made available to one state HFA. Cities and counties maintain a list of condemned properties as well as properties whose utilities have been disconnected.

TARP housing programs should not be seen by anyone as an opportunity to profit from TARP-funded reimbursement by targeting lived-in homes for acquisition and demolition. In addition, whenever self-interested parties seek to use Federal TARP funds in connection with land use planning, acquisition, and redevelopment activities, there is a heightened importance of active and effective oversight. In the worst cases, there is the risk of manipulation and/or abuse (which may not be illegal) or criminal conduct. However, even short of that worst case scenario, if actions are taken as part of a plan related to TARP to make lived-in homes vacant, even for a handful of properties, TARP has been misused and TARP funds have been diverted from the intended purpose. This diversion leaves fewer TARP funds for where there is a real need — zombie properties — those vacant and abandoned eye-sore properties that drag down neighborhoods and lead to foreclosures.

SIGTARP Recommendations

Treasury should immediately direct state housing finance agencies that they should not allow the Hardest Hit Fund to be used strategically to select lived-in residences for demolition, and should instead be used solely to select zombie properties for demolition. Treasury should take all oversight action necessary to ensure that the Hardest Hit Fund is not used for lived-in residences, including requiring state housing finance agencies to adopt and implement effective due diligence and other controls and procedures to ensure the properties selected are zombie properties. Treasury should claw back all Hardest Hit Fund monies used for lived-in residences that were selected for the blight elimination program, including TARP payments of $246,490 for

18 lived-in residences in the neighborhood of Area 55, in Evansville, Indiana, and recycle those funds to demolish abandoned zombie properties. I am available to discuss this important concern with you further at your convenience.

Sincerely,

/Signed/

Christy Goldsmith Romero
Special Inspector General