

## Housing and Community Development Management Responses to Audit Findings

(Please note that the summaries of the audit findings provided in this document are from Housing and Community Development. The full text of the audit findings are included in the Audit Report.)

### Lottery and Eligibility Certification Processes

{FINDING} I-a

- The key areas of concern over the lottery process include:
- Onerous application process.
  - Inconsistent application of lottery inclusion criteria.
  - Timing of lotteries.
  - Application fee processing.

The key areas of concern over the eligibility certification process include:

- Improper certification and rejection of applications.
- Lack of segregation of duties.
- Inconsistent application of policy waivers.
- Lack of management review.
- Poor documentation and retention practices.

**Response: Agree.** The audit team noted “commendable improvements” to these items identified in the preliminary audit report. Items noted as ongoing weaknesses are addressed in detail below.

- Although the audit team noted “commendable improvements” in file organization and completeness, management oversight and review, documentation practices, formation of a certification committee, and an abbreviated initial application, the team noted significant weaknesses in the lottery and eligibility certification processes as follows:

<ul style="list-style-type: none"> <li>• Inconsistent judgment applied to application criteria.</li> </ul>	<p><b>Response: Agree.</b> In order to apply program rules consistently, the organization has adopted a bifurcated application process. The first application process is concerned with eligibility to participate in the lottery ranking process. The second application process focuses on the income eligibility of potential buyers. The bifurcation of these two phases of the eligibility process enables management and staff to focus attention on the details of income eligibility.</p> <p>However, circumstances arise during the application process that require consideration on a case-by-case basis. In light of the County’s identified policy of providing affordable housing to all income levels, it is necessary to consider the totality of the circumstances when determining eligibility of</p>
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## Appendix A

	<p>an applicant. It is necessary to make decisions about applications based on the specific facts of an application, and the exercise of judgment is essential to effective administration of the affordable housing program. An administrative manual has been written to provide parameters for exercising discretion as needed. The administrative manual is designed to allow for revision as issues arise and management determines areas that require new policies or revision to existing policies. Finally, these policies can be reviewed for improvement opportunities with the process improvement team that continues to meet on “for sale” affordable unit issues.</p>
<ul style="list-style-type: none"> <li>• Lotteries held far in advance of development completion without recertification.</li> </ul>	<p><b>Response: Need more information.</b> Certification is generally performed at the time the property is available for sale. In the case of the Las Palmas Viejas project, a lottery was conducted in advance of construction. Eligible buyers are currently being re-certified in light of the long delay between lottery and property sale.</p> <p>In addition, certification is valid for a period of 90 days. This practice is consistent with program rules and the policy is documented in writing in the Buyer Information Package and the Housing Development Division’s Administrative Manual.</p>
<ul style="list-style-type: none"> <li>• Untimely deposit of application fees, improper return of non-refundable fees and failure to refund overpayment of fees.</li> </ul>	<p><b>Response: The comment is noted.</b> In light of the fact that the County’s non-refundable policy is clearly stated on the lottery application and in the Buyer Information Package, fees will be treated as non-refundable at all times. Management notes that the City of Santa Barbara does not charge a fee for certification. The County’s fee policy should be reviewed for consistency with program goals.</p>
<ul style="list-style-type: none"> <li>• Certification of incomplete applications.</li> </ul>	<p><b>Response: The respondent requires more detail to provide an educated response.</b> Files for older developments appear to be sparse in detail. However, the current process is vastly improved in terms of both the quantity and quality of documentation required. Certain documentary requirements are redundant. The documentation requirements for certification are currently under review for potential improvement through the identification of redundant and “no value added” documentary requirements.</p>
<ul style="list-style-type: none"> <li>• Lack of required disclosure of all sources of income, such as welfare payments and food stamps.</li> </ul>	<p><b>Response: Agree.</b> Current management has implemented several search tools in the certification process that will reduce the lack of disclosure noted in the audit report.</p>
<ul style="list-style-type: none"> <li>• Inconsistencies in determining income.</li> </ul>	<p><b>Response: Agree.</b> The department follows established HUD guidelines for the determination of income. Implementation of management review and certification committee review of files has reduced inconsistencies. Additional staffing and staff training is recommended to reduce calculation errors further.</p>

<ul style="list-style-type: none"> <li>• Incomplete understanding of basic personal financial data by HCD personnel.</li> </ul>	<p><b>Response: Agree.</b> Current management has implemented an administrative manual and is developing staff training to address this issue.</p>
<ul style="list-style-type: none"> <li>• Ineffective procedures to verify prior property ownership, assets of the applicant(s), and US citizenship/permanent residency.</li> </ul>	<p><b>Response: Agree, in part.</b> In response to the preliminary audit, several process improvements have been implemented that address this finding. Staff is now required to run several property and asset checks using generally accepted search products and Santa Barbara County Recorder records to investigate property ownership, assets, credit, and citizenship/residency.</p>
<ul style="list-style-type: none"> <li>• Inconsistent application of income category placement and of policy waivers for income thresholds.</li> </ul>	<p><b>Response: This will be reviewed with staff to ensure consistent application of program rules.</b></p>
<ul style="list-style-type: none"> <li>• Improper income disclosures resulting from applicant confusion with the shortened initial lottery application.</li> </ul>	<p><b>Response: The form was designed with the help of Auditor-Controller staff.</b> Although it is relatively simple and straightforward, the form is not producing the results that were anticipated. The form will need to be reviewed as part of the Plan-Do-Check-Act cycle of process improvement to improve quality.</p>
<ul style="list-style-type: none"> <li>• Inadequate orientation of the eligibility committee members to the eligibility certification process and program guidelines.</li> </ul>	<p><b>Response: Agree.</b> The certification committee has been implemented in response to preliminary audit findings that the program suffered from internal control weaknesses. The certification committee will need to be reviewed as part of the Plan-Do-Check-Act cycle of process improvement to improve quality.</p>
<ul style="list-style-type: none"> <li>• Failure by management and the committee to detect staff errors in all five applications reviewed.</li> </ul>	<p><b>Response: Agree in part, and disagree in part.</b> Although we disagree that all five files contain errors, we agree that additional written documentation would allow for easier independent review of files and reconciliation of eligibility determinations. As a result of the audit report’s finding, written documentation for any exception to required documentation must be noted in the applicant’s file and initialed by the reviewing manager. An additional review of the files by the audit team may be warranted to review noted “errors” that were not found by management after the second review of the five certification files.</p>

**Inventory Control**

Finding II-a

- HCD does not maintain an accurate inventory of all affordable units under its authority:

**Response: Agree.** A comprehensive database is currently in development that will allow tracking of affordable unit inventory with increased reliability.

Finding II-b

- Management has failed to maintain a complete and accurate listing of the number of affordable units released from the program.

**Response: Agree.** The IHP database will track all units, including new units entering the system and units released from restriction.

## **Restrictive Covenants**

Finding III-a

- During examination, we identified several key issues with regards to inadequate and/or inconsistent restrictions on affordable property.

Rental restrictions prohibit Program participants from earning income on affordable units. We noted cases of home owners earning income from partial rentals; including “exchange student” programs. Rental income policies should be expanded to prohibit partial rentals.

**Response: Agree in part.** County Counsel has indicated that a partial rental restriction is unconstitutional and has advised the Board of Supervisors of this opinion. In addition, numerous covenants do not contain any provision prohibiting partial rental. County Counsel has opined that the County is legally barred from implementing such a restriction by ordinance as it would represent a possible impairment of contracts.

- The current occupancy requirement of 10 months per year allows significant latitude in owner occupancy. A year-round requirement will simplify enforcement and help to eliminate partial year occupancy.

**Response: Agree.** The 10-month occupancy requirement has been eliminated from the covenants. Additionally, the owner occupancy ordinance does not contain reference to a 10-month occupancy requirement.

- Restrictions over deed transfers and additions to title are ambiguous. Affordable units should stay deeded with the originally qualified owner(s) with exceptions for subsequent marriage and divorce. Clear rules for prohibitions against transfer to trusts or other non-person entities should be developed and documented. Transfers to non-spouse family members or friends should be prohibited.

**Response: Agree in part.** These issues are under review for inclusion in the administrative manual. However, there are significant policy considerations that will require approval by the Board of Supervisors. Refer to Comprehensive Planning.

- There is a significant disparity between covenant expiration terms and equity share provisions. Expiration terms range from 10 years to 45 years with term reset provisions in a limited number of cases. Several of the covenants provide for equity share upon sale of unit prior to covenant expiration. Expiration terms, term reset provisions, and equity share provisions should be standardized for future covenants.

**Response: Agree.** Covenant terms are set forth in the Housing Element and applied to developments as a condition of approval by the Planning Commission and Board of Supervisors. Although the existing terms of covenants are not within the department's control to modify, future covenants can be evaluated for consistency with program goals by the County Executive Office to provide recommendations to the Board of Supervisors.

- A small minority of the existing covenants address refinancing of the primary mortgage debt on the property or execution of subordinated home equity loans. Future restrictive covenants should determine clear rules on refinancing and subordinated loans.

**Response: Agree.** These issues are under review for inclusion in the administrative manual. However, there are significant policy considerations that will require approval by the Board of Supervisors. Future covenants can be evaluated for consistency with program goals by the County Executive Office to provide recommendations to the Board of Supervisors. Refer to County Counsel and Comprehensive Planning.

- Current restrictive covenants vary on whether Program participants may concurrently own additional real property. Similar to rental income generated from affordable units, concurrent ownership of additional real property by affordable unit home owners creates inequities in the Program. Certain Program participants have used their affordable units as an income source or asset base. Restrictions against concurrent real property ownership are necessary to prevent Program participants from using County shared assets as an income source. A policy regarding inherited property should be separately addressed.

**Response: Agree.** These issues are under review for inclusion in the administrative manual. However, there are significant policy considerations that will require approval by the Board of Supervisors. Future covenants can be evaluated for consistency with program goals by the County Executive Office to provide recommendations to the Board of Supervisors. Refer to County Counsel and Comprehensive Planning.

- A clear understanding of Program goals by the Departments and Board of Supervisors would help ensure that future restrictive covenants adequately protect those goals.

**Response: Agree.** The Housing Element was adopted by the Board of Supervisors and clearly states the Inclusionary Housing Program's goal "to increase the supply of price restricted affordable housing." Comprehensive Planning is in the process of rolling out a Housing Element training among affected departments that would resolve any informational issues. In addition, the Board has approved the formation of a Stakeholders Advisory Group to evaluate the Inclusionary Housing Program and Program alternatives in order to provide Program recommendations to the Board of Supervisors.

#### Finding III-b

- There are a number of covenants that include an equity share provision whereby the home owner may sell the unit, at any time, at fair market value and share in the appreciation with the County. Although the County receives a portion of the appreciation on all equity share sales, the units are permanently released from the Program.

**Response: Agree.** It should be noted that covenant terms are set forth in the Housing Element and applied to developments as a condition of approval by the Planning Commission and Board of Supervisors. Future covenants can be evaluated for consistency with program goals

by the County Executive Office to provide recommendations to the Board of Supervisors. Refer to County Counsel and Comprehensive Planning.

Finding III-c

- Management has failed to develop policies addressing the risk of foreclosure upon affordable units. Once a unit is foreclosed upon, the lender resells the unit at market value to the general public, resulting in the loss of an affordable unit to the Program.

**Response: Agree.** Current management is in the process of recording a Notice of Default for every “for sale” affordable unit. This will provide notice to the County in the event of a default and possible foreclosure sale, and allow County Counsel to defend the applicable affordability restrictions. Refer to County Counsel.

Finding III-d

- Management does not have a policy on mortgage loan refinancing and home equity loans. A limited number of developments have restrictive covenants limiting refinancing and home equity loans; however, the majority of covenants do not address the issue.

**Response: Agree.** The administrative manual contains current management policy on refinancings and home equity loans.

Finding III-e

- We tested a randomly selected sample of 30 affordable unit home owners for net cash out refinancing or separate home equity loans. We noted 12 of the 30 owners sampled have executed one or more equity transactions in excess of their original mortgage amounts, the majority of which occurred in the past 6 years. The total monetary value of the equity transactions in excess of original financing was approximately \$1.5 million for the 12 owners. There is no evidence of HCD management approval of any of these transactions.

**Response: Agree.** Historically, the program has lacked a written policy for reviewing and approving refinancings. The administrative manual now provides a written refinancing policy. As additional issues arise, the rules for approving requests for refinancing will be reviewed by the process improvement team to evaluate the current policy for sufficiency.

## **Covenant Compliance: Occupancy and Rental**

Finding IV-a

- We discovered various types of restrictive covenant violations by Program participants.

**Response: Agree.** To address violations of the program’s owner occupancy requirement, an ordinance has been presented to the Board of Supervisors. The second reading of the ordinance is scheduled to take place on January 9. It will become effective on February 8. In addition, management continues to work toward enforcement of the owner occupancy requirement applicable to all restricted “for sale” affordable units. Partial rental of a unit, however, is not an enforceable restriction as indicated by County Counsel.

- Current program rules prohibit prior improved residential property ownership for the 3 years prior to application for a unit subject to four exceptions outlined in the Income Certification Application.

The issue of subsequent property ownership is currently under review. There are significant legal and administrative issues raised by the proposal to prohibit subsequent property ownership.

The issue of deed modifications has been addressed in two ways. First, the annual survey includes a section regarding title transfers and refinancings. Second, the Recorder's Official Documents can now be accessed via staff desktop in order to facilitate document searches for each property. Non-approved transfers will be handled according to the terms of the covenant applicable to the subject property.

## **Compliance Monitoring and Enforcement Program**

### Finding V-a

- As reported in our preliminary report, HCD has an ineffective compliance monitoring and enforcement program. A database of each covenant and related restrictions does not exist.

**Response: Agree.** A comprehensive database is currently in development that will allow tracking of affordable unit inventory with increased reliability. In addition, the database will allow retention of scanned documents including covenants for easy access and determination of applicable restrictions.

### Finding V-b

- HCD management slowed or terminated enforcement efforts in response to violation enforcement uncertainty raised by County Counsel.

**Response: Agree.** Lack of consistent covenants among developments presents a significant enforcement challenge. In cases where a covenant contains no provision, County Counsel has indicated that there is no enforcement authority. In order to resolve this issue, HCD has developed a checklist of developments and applicable restrictions for easy reference by staff. In addition, HCD is undertaking a letter campaign to educate property owners about restrictions that are applicable to individual units. Restrictions must be determined by reviewing the covenant that is applicable to a specific unit. Finally, establishment of the Violations Committee that includes County Counsel as a committee member will provide additional review and support to HCD in an effort to enforce covenant provisions.

### Finding V-c

- The home buyer advocacy role and the enforcement role are performed by the same individual. A conflict of interest is created by this individual fulfilling two roles.

**Response: Agree.** Current staffing levels provide one staff member to perform all functions of the Housing Development Division. Additional staff is required to separate these roles.

### Finding V-d

- The lack of an adequate monitoring and enforcement program has created an adverse compliance environment.

**Response: Agree.** Current management has implemented an annual survey program for all “for sale” affordable units and is in the process of notifying all homeowners of the annual survey process including mandatory participation by affordable unit owners.

## **Data Gathering and Documentation Retention**

- Management has failed to implement document retention practices.

**Response: Agree.** Under current management, a formal file retention policy has been implemented. Lottery application files are retained for 5 years. Homeowner files for each property are maintained for the term of the covenant. In addition, the database will allow retention of scanned documents and eliminate the need for storage of bulky paper files.

## **Program Policies and Procedures**

Finding VII-a

- Program and administrative policies and procedures are outdated and insufficient. We noted limited written policies and procedures with regard to the lottery and eligibility certification processes, the unit inventory control process, and the restrictive covenant monitoring and enforcement process.

**Response: Agree.** Current management has implemented an administrative manual and is developing staff training to address this issue. In addition, policies and procedures will continue to be reviewed by the process improvement team to identify opportunities for improvement.

## **Building Code and Public Health Complaints**

Finding VIII-a

- We received various complaints by Program participants and neighbors of affordable units regarding perceived building code and public health violations.

**Response: Agree.** The Violations Committee has recommended that staff refer callers with these issues to Zoning Enforcement and law enforcement for appropriate handling of non-covenant related concerns. This policy has been implemented, and the referrals are being made as indicated.



*A final note:* We appreciate the resources that the Auditor-Controller's Office has dedicated to undertaking this audit of the County's "for sale" affordable housing units. We welcome the input and recommendations of the Auditor's staff and have used the audit report as a basis for identifying program weaknesses. In light of the nature and extent of errors that HCD staff continues to find with recorded documents and past practices, the ability to improve the program's processes has been greatly facilitated by the audit findings and recommendations. Extensive and repetitive administrative errors clearly highlight the need for additional Housing Development staff, as these errors generate a significantly increased administrative burden for Housing Development both in ongoing program operations and identification and correction of past administrative errors.

Current management is committed to ensuring property owner compliance with covenant restrictions. While a 25% non-compliance rate is unacceptable, it is important to note that this figure suggests at least 75% of property owners are in compliance with the restrictions of their covenants and are receiving the intended benefits of the County's affordable housing programs.