



**Housing and Community Development Department
Affordable Housing Program
Inclusionary Housing and State Density Bonus Programs**

*Report on Internal Controls over Activities of the Inclusionary
Housing and State Density Bonus Programs and on Participant
Compliance with Restrictive Covenants*

October 9, 2006



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Introduction, Purpose and Scope

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Introduction

The County of Santa Barbara Housing and Community Development Department (hereafter "HCD") administers several programs that provide affordable housing options to eligible residents of Santa Barbara County. The Inclusionary Housing and the State Density Bonus Programs work together under the Affordable Housing Program (hereafter "the Program") to increase the supply of price restricted affordable units within County boundaries. The Program oversees homes developed for purchase and for rent. Since its inception, the Program has been administered by various County departments, eventually coming under the administration of HCD in 2003.

The County of Santa Barbara...administers several programs that provide affordable housing options to eligible residents.

Purpose and Scope

The purpose of our audit was to determine whether an adequate and effective system of control had been provided over key activities of the Program. Our examination focused exclusively on the affordable ownership activities of the Program. We did not review the system of controls over the affordable rental activities administered by the Program. We were concerned specifically with the following processes of the affordable ownership activities:

- Lottery and eligibility process
- Inventory control and unit tracking
- Restrictive covenant compliance monitoring and enforcement
- Refinancing and home equity monitoring
- General administrative functions

Our examination focused exclusively on the affordable ownership activities of the Program.

This is a final report. A preliminary report was issued on March 15, 2006 (hereafter "the preliminary report") to report the results of our test work as of that date. The final report includes findings and recommendations through October 9, 2006, including those identified in the preliminary report.

Our examination has included sufficient inquiries, observations, and tests of transactions to provide a basis for our conclusions and to enable us, where appropriate, to recommend changes to procedures to assist management in achieving its objectives.

We did not audit the Housing Finance Division and its associated programs. An examination is being conducted and the results will be addressed in a separate report.

Findings and Recommendations

I. Lottery and Eligibility Certification Processes

Summary

HCD conducts a computerized random ranking lottery to select the purchasers of its new affordable units. The adequate screening of each application is the key control in ensuring only qualified applicants are permitted to participate in the Program. HCD prepares a list of eligible applicants, from which a lottery is conducted. Eligible applicants must:

- Reside or be employed in Santa Barbara County
- Have a combined projected household income that is within the allowable range for the housing unit under consideration
- Not have a gift amount in excess of a pre-determined threshold
- Obtain a loan pre-qualification letter
- Agree to reside in the unit and not rent in whole or in part
- Not own assets that exceed ½ the purchase price of the unit
- Not have owned any residential property within the last three years, with limited exceptions
- Possess sufficient funds to pay the required 5% down payment
- Maintain a household size that is within the allowable range for the housing unit under consideration
- Be United States citizens or permanent residents

Prior to the purchase of an affordable unit, applicants selected in the lottery are subject to an extensive eligibility certification process to verify the accuracy of data submitted.

Finding: I-a

We noted several deficiencies and inefficiencies in the lottery and eligibility certification processes. We observed four lotteries and reviewed applications, certifications and rejections for two separate developments. Of the cases we reviewed, we noted significant weaknesses in the lottery and eligibility certification processes. The key areas of concern over the lottery process include:

- Onerous initial application
- 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

The adequate screening of each home buyer is the key control in ensuring only qualified applicants are permitted into the Program.

We noted several deficiencies and inefficiencies in the lottery and eligibility certification processes.

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Upon completion of our review, we alerted management to identified weaknesses in the lottery and eligibility certification processes. In response, management initiated changes to the processes. We traced five applications through the **new** process. We noted several areas of process improvement, as identified below:

- File organization and completeness
- Management oversight and review
- Documentation practices
- Formation of an eligibility committee
- Abbreviated initial application

Although there are commendable improvements in the process, there continue to be areas of deficiency as well as new weaknesses in the modified process. The weaknesses identified are as follows:

Continued weaknesses

- Inconsistent judgment applied to application criteria for inclusion or exclusion from the lottery
- Lotteries held far in advance of development completion, in some cases 12 or more months, without subsequent recertification process at time of purchase
- Untimely deposit of application fees, improper return of non-refundable fees and failure to refund overpayment of fees
- Certification of incomplete applications
- Lack of required disclosure of all sources of income, such as welfare payments and food stamps
- Inconsistencies in determining income
- Incomplete understanding of basic personal financial data by HCD personnel
- Ineffective procedures to verify prior property ownership, assets of the applicant(s), and US citizenship/permanent residency
- Inconsistent application of income category placement and of policy waivers for income thresholds
- Lack of segregation of duties between the advocacy role and the eligibility certification role

New weaknesses

- Improper income disclosures resulting from applicant confusion with the shortened initial lottery application
- Inadequate orientation of the eligibility committee members to the eligibility certification process and Program guidelines
- Failure by management and the committee to detect staff errors in all five applications reviewed

Recommendation

Based on the recommendations made in our preliminary report, HCD management is currently revising the lottery and eligibility certification processes. We noted numerous improvements in the processes and several added levels of

Although there are commendable improvements in the process, there continue to be areas of deficiency as well as new weaknesses in the modified process. Management has recognized the need to continually review improvements for effectiveness as articulated in their "Management Responses to Audit Findings."

Findings and Recommendations

oversight by management. Although we noted weaknesses in the committee review process, with continued Program education and experience, we believe the committee will function at the level expected and will provide valuable oversight of the eligibility process.

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We recommend management create and document clear procedures for the lottery and eligibility process. All stages of the process should be clearly stated through written internal procedures, applicant instructional materials should be produced, and orientation should be provided to the eligibility committee. In addition, we encourage management and the eligibility committee to access various information databases and employ checklists to verify eligibility criteria for every home buyer. Special scrutiny should be applied to all data submitted by each applicant.

II. Inventory Control

Summary

We conducted our examination based upon an estimated list of units compiled by the Specialty and Advanced Accounting Division of the Auditor-Controller's Office using HCD records, physical files, and recorded legal documents. This inventory listing identifies units sold through the Program and excludes affordable rental properties.

Finding: II-a

As reported in our preliminary report, HCD does not maintain an accurate inventory of all affordable units under its authority. We noted the following weaknesses in the inventory system:

- Omissions of recently constructed affordable units
- Exclusions of entire affordable developments
- Failure to track and record changes in ownership
- Inaccurate compilation of owner information, such as owner(s) names, purchase dates, recorded covenant numbers, and covenant expiration dates
- Improper inclusion of foreclosed or released units.

We identified 55 cases of inventory errors caused by these weaknesses. The lack of a complete inventory of units and an inventory tracking system limits management's ability to properly account for and safeguard County shared assets.

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Recommendation

Based on the recommendations made in our preliminary report, HCD management is constructing a comprehensive inventory tracking database. At the time of this report, the database was not ready for testing. As stated in the preliminary report, we recommend that HCD develop and implement formal policies and procedures to compile and maintain a complete and accurate inventory of affordable units. As new units are developed, they should be

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immediately accounted for by HCD. A frequent reconciliation of the inventory listing should be performed with exceptions resolved in a timely manner. Furthermore, supporting documentation should be maintained for each unit in a well organized manner. A clear audit trail of the creation, sale, and subsequent resale of each unit should be maintained.

Finding: II-b

Management has failed to maintain a complete and accurate listing of the number of affordable units released from the Program. During our examination, we reviewed 21 developments, consisting of 416 affordable units, and discovered that 27 have been released from the Program, as follows:

- 9 units lost to foreclosure
- 7 units released under expiring covenants (10 year terms)
- 7 units sold under equity share provisions of the covenants
- 4 units unknown status

Management is unaware of the total number of units released from the Program. Of the units management was able to identify, little or no documentation is maintained.

Recommendation

As previously recommended, management should establish a comprehensive inventory tracking system to aid in the monitoring of units in the Program. The identification and tracking of all affordable units will enable management to be alerted to the potential loss of a unit and the rights of the County with regard to that unit. To assist in the identification and tracking of affordable units, we recommend that management research properties in the County's Assessor Parcel System.

In addition, a formal tracking procedure for units in development should be created to ensure all affordable units identified in the developer agreements are subsequently built.

The identification and tracking of all affordable units will enable management to be alerted to the potential loss of a unit and the rights of the County with regard to that unit.

The most significant disparities between covenants lie in the areas of rental, occupancy, transfers, resale, expiration, access to equity, and concurrent property ownership.

III. Restrictive Covenants

Summary

Each affordable unit owner is required to sign a restrictive covenant (hereafter referred to as the "covenant(s)") at the time of unit purchase. The content of the covenant varies significantly by development. While the intentions of the Program are identified through information packages, lottery listings and other publicly available documentation, we observed a lack of clear direction on the behalf of HCD, Planning and Development Department (hereafter "P&D"), and County Counsel to create restrictions in the covenants that coincide with the intentions of the Program. The most significant disparities between covenants lie in the areas of rental, occupancy, transfers, resale, expiration, access to equity, and concurrent property ownership. These significant variances create difficulties in

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the monitoring and enforcement process, confusion among Program participants, as well as the public perception of inequality.

Finding: III-a

During our examination, we identified several key issues with regards to inadequate and/or inconsistent restrictions on affordable property, as identified below:

- 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.
- 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.
- 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.
- 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.
- 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.
- 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.

A conflict exists between the public interest of achieving an increasing inventory of affordable units and the private interest of individual property rights.

Recommendation

Prior to the development of future restrictive covenants, we recommend that the HCD, County Counsel and the Board of Supervisors determine the overarching goals of the Program. A conflict exists between the public interest of achieving an increasing inventory of affordable units and the private interest of individual property rights. These differences should be evaluated and considered during

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the determination of the specific Program goals and objectives to create a Program that is fair to all involved parties.

A clear understanding of Program goals by the Departments and Board of Supervisors would help ensure that future restrictive covenants adequately protect those goals. It is essential that all future developments have covenants that are consistent in their restrictions and enforceability. In order to equalize existing covenants, management is developing a County ordinance governing all affordable units. The Program goals and objectives should be reflected in the ordinance.

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. Since home owners enjoy a lucrative share of the equity, the units are more likely to sell before the expiration of the covenant (10-30 years). HCD continues to execute equity share provisions, as evidenced by the Stonegate development approved by the Board of Supervisors in October 2006.

Recommendation

HCD management and County Counsel should establish standard covenant restrictions to meet the overall intention of the Program to provide affordable housing to the community on an ongoing basis. The shared equity provisions accelerate the reduction of affordable units in the County, as a whole. A policy prohibiting or significantly limiting the use of shared equity provisions in future restrictive covenants should be considered.

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. The first deed of trust position given to the primary mortgage lender provides an unintended incentive to unscrupulous lenders to extend excessive levels of secured debt to Program participants. High levels of home owner debt increases the risk of foreclosure and the lender's ability to obtain a highly valuable asset for a price well below market value. There is effectively no risk to the lender to extend significant amounts of secured debt to under qualified participants.

We found inconsistent application of the recent covenant requirement compelling home owners to record a Request for Notice of Default for all secured debt on the property. This document requires notice to be provided to the Program whenever the holder of a particular deed of trust declares a default or whenever the property is to be sold due to a default. We noted several cases where no request was recorded despite the restrictive covenant requiring notification. No system exists to ensure owners are properly recording the required document.

Although the County receives a portion of the appreciation on all equity share sales, the units are permanently released from the Program.

High levels of home owner debt increases the risk of foreclosure and the lender's ability to obtain a highly valuable asset for a price well below market value.

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Furthermore, we found management has no formal re-purchase program in place to address pending foreclosures. Management lacks a process for evaluating the costs and benefits of curing default on a superior mortgage or taking other action to prevent a foreclosure.

Recommendation

We recommend management execute and record a “performance deed of trust” for future sales of affordable homes. We noted during our examination that buyers, lenders, and realtors often disregard clearly labeled resale restrictions recorded against a property. Therefore, a recorded resale restriction, as currently used by the Program, does not ensure the Program will be notified by a title company when the property is sold or title is transferred. The Program’s restrictions can best be enforced if they are incorporated into a deed of trust which has a high level of familiarity amongst lenders, title companies, and realtors. All holders of subordinate deeds of trust are notified of an owner default, prior to the sale of the property at a trustee’s sale. This gives the Program opportunity to cure the default, or to exercise its option to purchase. This document also normally ensures the title company will notify all holders of deeds of trust when property is being sold through a purchase agreement.

A recorded resale restriction does not ensure the Program will be notified by a title company when the property is sold or title is transferred.

We further recommend the consistent use of Requests for Notice of Default. A notice is required for each deed of trust against the property. The notice should be recorded by the escrow company at the time of the initial sale and at the time of subsequent secondary loans. The recording of such important legal documents should not be left to the home buyer. Management is encouraged to review all Program units to determine where notices need to be recorded.

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.

Our test work revealed that actual refinancing and home equity loans exist at a significant rate among Program participants (refer to the subsequent finding). Due to poor communication within HCD, the immediate past department head was unaware of the numerous requests made by home owners for permission to refinance or execute home equity loans.

Recommendation

We recommend management create policies regarding mortgage loan refinancing and home equity loans and to incorporate the policies into restrictive covenants. Management must consider the risks associated with permitting changes in loans on affordable properties. Borrowing limits based on resale price restrictions, affordability (housing cost to income ratio) standards, and loan purpose are key elements in the policy decision process. Over-encumbered properties are at higher risk of default; and, therefore, subject to eventual loss of the affordable unit to the primary lender. Additionally, community perception of

Borrowing limits based on resale price restrictions, affordability standards, and loan purpose are key elements in the policy decision process.

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the Program is adversely affected when home owners are successful at drawing large sums of cash beyond the affordable resale price of the unit.

It is essential that HCD personnel educate home owners on the policy to help deter future violations. Mechanisms to identify the occurrence of an equity loan or refinancing should be developed. Home owner education of the policy is needed. Not all attempts to refinance an existing mortgage or execute a home equity loan can be detected. However, home owner education, properly recorded deed restrictions via “performance deeds of trust”, and mutual understanding with commonly used lenders, realtors and title companies will significantly reduce the number of violations.

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.

12 of the 30 owners sampled have executed one or more equity transactions in excess of their original mortgage amounts.

Recommendation

To prevent further cases of unapproved equity loans against affordable units, management must develop policies and mechanisms recommended in prior findings.

IV. Covenant Compliance: Occupancy and Rental

Summary

A covenant is executed by each home buyer of an affordable unit. The restrictions principally limit the resale price of an affordable home, set income thresholds for future buyers, require owner occupancy, and prohibit rental of the units. The covenants vary by development, but the intent is consistent to ensure the units remain affordable for a pre-determined amount of time.

The Specialty and Advanced Accounting Division of the Auditor-Controller’s Office assisted HCD in compiling an estimated list of 395 affordable housing units. Subsequent to our preliminary report, the discovery of multiple inventory errors, covenant expirations, and sales resulted in a revised inventory of 389 units. The inventory of 389 excludes recently constructed affordable housing units. Each unit was tested for owner occupancy and rental covenant compliance.

The covenant restrictions principally limit the resale price of an affordable home, set income thresholds for future buyers, require owner occupancy, and prohibit rental of the units.

Finding: IV-a

We discovered various types of restrictive covenant violations by Program participants. These violations are separately reported below:

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Owner Occupancy and Rental

We identified a significant number of violations or suspected violations by affordable unit owners with the occupancy and rentals clauses of the covenants. Of the 389 home owners tested, we have concluded the following:

We identified a significant number of violations or suspected violations by affordable unit owners with the occupancy and rental clauses of the covenants.

- 19 cases of *verified* non-occupancy, comprised of the following:
 - 6 rentals
 - 4 vacancies
 - 4 occupied by relatives
 - 2 occupied by one owner of a joint tenancy
 - 3 unoccupied by original loan guarantors
- 26 cases of *suspected* non-occupancy, based on the following factors:
 - Failure to respond to repeated information requests
 - Submission of conflicting evidence of occupancy
 - Absent at multiple site visits
- 10 cases of *verified* partial rental of units. Restrictions against partial rentals vary by covenant.

Additional Property Prior to Purchase

Program rules prohibit ownership of any real property (e.g. land, rental properties, timeshares, etc.) at the time of an affordable unit purchase. Additionally, subsequent to May 2001, applicants were prohibited from owning real property in the three years preceding the purchase of an affordable unit. During our examination, we identified the following:

We identified 10 verified cases of additional real property owned at the time of the affordable unit purchase.

- 10 *verified* cases of additional real property owned at the time of the affordable unit purchase
- 4 *suspected* cases of additional real property owned at the time of the affordable unit purchase
- 2 *verified* cases of additional real property owned in the 3 years preceding the affordable unit purchase
- 1 *suspected* case of additional real property owned in the 3 years preceding the affordable unit purchase

Additional Property Subsequent to Purchase

During our examination, we noted numerous cases of home owners purchasing additional property after acquiring the affordable units. As the covenants do not specifically prohibit the purchase of additional properties, the acquisition of additional property has proliferated in the Program. We noted the following cases in our examination:

- 30 *verified* cases of one real property purchase subsequent to the affordable unit purchase
- 6 *verified* cases of multiple real property purchases subsequent to the affordable unit purchase

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- 14 *suspected* cases of one or more real property purchases subsequent to the affordable unit purchase

Deed Modifications

HCD has not developed a process to monitor affordable unit deed modifications. During our examination, we noted multiple occasions of non-spouses added to the property deed, deed transfers to non-person entities (i.e. trust, LLP, LLC), and deed transfers to non-spouses without HCD approval. Program guidelines require owners to obtain explicit HCD authorization prior to modifying or transferring the deed of an affordable unit. All original affordable unit purchases and deed transfers require income certification and approval by HCD, excluding spousal transfers.

We noted multiple occasions of non-spouses added to the property deed, deed transfers to non-person entities, and deed transfers to non-spouses without HCD approval.

During our examination, we discovered the following deed violations:

- 11 *verified* cases of non-spouse individuals added to the deed
- 20 *verified* cases of deed transfer to a non-person entity
- 3 *verified* cases of deed title transferred to a non-spouse without HCD approval
- 3 *verified* cases of ex-spouse remaining on the deed
- 1 *verified* case of a deceased individual remaining on the deed

V. Compliance Monitoring and Enforcement Program

Summary

Program participants are subject to the County's compliance monitoring and enforcements efforts. It is at the discretion of HCD to determine the procedures necessary to verify home buyer compliance with the occupancy and rental clauses in the covenants and to pursue violations.

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. HCD relies on disorganized paper files and memory to track these complex and varied documents. We noted a complete lack of compliance monitoring efforts conducted by the predecessor department responsible for administering the Program. We noted one effort (in 2004) by HCD to test compliance with occupancy and rental clauses in the resale restrictive covenants. Management performed limited follow-up on the violations discovered during the 2004 survey and on other complaints filed by the public. The absence of a compliance monitoring and enforcement program increases the risk of owner violations of the restrictions placed on their property.

The absence of a compliance monitoring and enforcement program increases the risk of owner violations.

Recommendation

HCD management is working to develop a comprehensive restrictive covenant compliance monitoring and enforcement program. As of the date of this report, that program has not been fully implemented.

Findings and Recommendations

A complete database of all restrictions in each unique covenant should be developed and maintained to provide quick access to the information by all interested parties. We further recommend the updated monitoring and enforcement efforts include annual questionnaires of each home owner, random on-site home visits, public record searches, and inquiry of interested parties (home owner associations, neighbors, etc.). All identified violations must be pursued in a timely fashion and resolved in a manner consistent with the intent of the County's affordable housing objectives. The program should be formally documented with approved policies and practices. An annual compliance report to the Board of Supervisors is recommended.

Finding: V-b

HCD management slowed or terminated enforcement efforts in response to violation enforcement uncertainty raised by County Counsel. County Counsel questioned violation enforcement of certain covenant restrictions in cases where covenants are either contradictory to the intention of the Program or silent to the compliance elements inherent to an affordable housing program. We observed continued frustration by HCD personnel, including the immediate past department head, with a perceived inability to enforce the rules of the Program. Employee morale is suffering from lack of management direction and confusion of the intent of the Program. Inconsistency in covenants and resistance by County Counsel and HCD management to enforce covenants has resulted in increased violations and the ability for certain violations to continue.

Recommendation

We recommend HCD management join with County Counsel to determine a method to equalize all covenants in the Program. Agreement as to the goals of the Program between both departments is needed to ensure aggressive enforcement of the rules and restrictions.

Additionally, a policy to pursue criminal charges for allegations of possible criminal conduct in the Program should be developed with the assistance of the County District Attorney. We noted investigation of three cases of suspected criminal conduct by the District Attorney. Although no charges were brought against the individuals investigated, the District Attorney has indicated, in his report, that key improvements to the covenants and associated Program guidelines are needed to facilitate future enforcement of violations of criminal law.

Finding: V-c

The home buyer advocacy role and the enforcement role are performed by the same individual. A conflict of interests is created by this individual fulfilling two roles. The desire to assist participants in achieving home ownership and financial security can hinder the enforcement of rules and regulations by the same individual.

Inconsistency in covenants and resistance by county Counsel and HCD management to enforce covenants has resulted in increased violations.

Findings and Recommendations

Recommendation

Segregation of duties between the home buyer advocacy role and the monitoring and enforcement role should be achieved. The Program requires independence between the roles to ensure personal opinions do not interfere in achieving proper monitoring and enforcement of all Program rules and restrictions.

Finding: V-d

The lack of an adequate monitoring and enforcement program has created an adverse compliance environment. We experienced a high rate of non-cooperation by Program participants during the audit process. A lack of annual required reporting of compliance with restrictive covenants by Program participants has led many to question the County's authority to verify on-going compliance.

This lack of cooperation by Program participants is evidenced by a 33% non-response rate to original audit inquiries. The non-responsive participants required extensive procedures and County resources to verify compliance.

Recommendation

Management should implement periodic self-reporting requirements to foster an environment of cooperation and compliance. In addition, we recommend that HCD management notify all Program participants of their obligation to respond to HCD and County inquiries regarding Program compliance.

VI. Data Gathering and Document Retention

Finding: VI-a

Management has failed to implement formal data gathering and document retention policies. We noted numerous inconsistencies in how information is gathered, documented and retained. Disorderly filing methods have resulted in delayed document retrieval and the inability to locate important Program documents. We noted several cases where key documents, such as applications and income certification documentation, could not be located. In addition, Program information obtained via verbal communication was often inadequately documented in Program files or excluded in its entirety. We noted a tendency by staff to rely on personal memory as a means of data retention.

Recommendation

Accurate and complete Program files are essential to management's ability to properly administer and monitor the Program. We recommend management develop comprehensive data gathering and retention policies and practices. The policies should address proper documentation of verbal communications. Management should encourage a culture of accountability and communication. Emphasis should be placed on the importance of organization and accurate and thorough documentation practices during initial staff training as well as at the initiation of each new affordable housing development.

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

Accurate and complete program files are essential to management's ability to properly administer and monitor the Program.

Findings and Recommendations

We recognize the difficulties caused by the transfer of incomplete data from the predecessor department administering the Program. We encourage efforts by management to sort, organize, and catalog all transferred data. Proper cataloging of data will enable management to identify and pursue missing documents in order to compile complete historical Program records.

VII. 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. The most recent Program manual was developed by the predecessor department and implemented in February 2001. Management has continued to operate under this manual regardless of the limited policies and procedures developed for vital components of the Program.

Management has implemented some new practices; however, a comprehensive collection of current procedures is not maintained in written form and the practices are applied inconsistently. Management has failed to provide clear Program parameters, including the purpose, limitations, and rules of the Program. This lack of a written, comprehensive Program manual has created an environment of confusion among department personnel. We noted that practices are often performed by staff based on undocumented understandings of processes. This has led to Program exceptions being processed using inconsistent judgment and varying levels of scrutiny. Management has provided no direction regarding exception processing and the level of judgment permitted in the Program. Unclear boundaries over exception processing provides a high level of risk that ineligible applicants will be included in the Program or eligible applicants will be excluded from the Program.

The inherent risk that exists in an affordable housing program requires constant oversight and guidance by HCD management.

Recommendation

We recommend management develop and implement a clear and concise Program manual to address all administrative and Program issues. The manual should identify proper policies and procedures for every component of the Program and provide Program boundaries to be followed by all employees. The inherent risk that exists in an affordable housing program requires constant oversight and guidance by HCD management. Management policy should not be left to the discretion of staff personnel. The manual should be periodically reviewed and updated to ensure all issues are addressed in a timely manner.

We further recommend that written procedures be developed to assist in the implementation and enforcement of management determined policies. Written procedures are a hallmark of an efficient and effective internal control framework. In the absence of written practices, personal judgment and inconsistent handling of processes may occur.

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Board of Supervisors guidance may be necessary for highly sensitive and complex policy decisions. Key matters such as: authority to draw cash on equity, occupancy and rental covenant restrictions for new and existing developments, and repurchase of units subject to foreclosure are examples of issues requiring senior management direction.

VIII. 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. Although none of the claims were investigated during the course of our audit, the clear dissatisfaction expressed by participants and community members suggests that a pattern of abuse may exist. We heard complaints related to excessive numbers of individuals living in small quarters, individuals living in garages, and general lack of common maintenance of the properties. Complaints of building code and public health violations are sometimes warnings of other violations occurring in the unit, such as rental and owner non-occupancy.

Recommendation

We encourage management to develop a system to track and investigate complaints. Policy on how allegations are escalated to the proper County departments is needed. Prompt response to complaints and enforcement of violations will help build a perception of proactive management.

Conclusion

Housing and Community Development

The Housing and Community Development Department, through its Housing Development Division, is responsible for oversight of the Program. The Program works to increase and maintain the inventory of affordable homes within the unincorporated areas of the County.

In February 2006, we commenced with our examination of the home buyer components of the Program. The examination was designed to determine whether an adequate and effective system of control had been provided over the affordable ownership activities of the Program. In addition, special work was conducted to determine compliance by all known participants with applicable Program rules and covenants. We did not review the affordable rental activities of the Program, and accordingly, we do not express an opinion on those activities. Our examination has included sufficient inquiries, observations, and tests of transactions to provide a basis for our conclusions.

This is a final report on our examination as of October 9, 2006. This report was preceded by a preliminary report on findings dated March 15, 2006. This report incorporates the findings from the preliminary report. This report is not intended to be a comprehensive assessment of the HCD Inclusionary Housing and State Density Bonus Programs. Our examination was limited exclusively to the affordable ownership activities of the Program.

In our opinion, the system of control provided over the affordable ownership activities of the Program is inadequate. Significant weaknesses exist in every key control point. We noted a consistent lack of management oversight, poor practices in selecting and determining eligibility for participation in the Program, ineffective restrictive covenants and related legal actions to secure County rights on the properties, ineffective monitoring and enforcement of participant compliance with Program restrictions, and poor administrative support functions.

The lack of strong internal controls has led to inconsistencies in Program administration, inequalities in benefits, and undetected violations of guidelines by Program participants. Management has not developed specific Program goals; therefore, adequate policies and procedures guiding operations do not exist.

We acknowledge the efforts made by management to assemble a task force to address the weaknesses in the Program and to create improved processes. We are hopeful the task force will lead the effort to focus on determining the overarching goals of the Program which will drive the design of the internal control framework and the associated processes necessary to reach the goals.

We sincerely appreciate the efforts by HCD staff and management in assisting in our examination.

Respectfully submitted,

Robert W. Geis, CPA
Auditor-Controller