Department of Housing and Community Development:

Awards of Housing Bond Funds Have Been Timely and Complied With the Law, but Monitoring of the Use of Funds Has Been Inconsistent

September 2007 Report 2007-037

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September 12, 2007 2007-037

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As required by the Housing and Safety Code, Division 31, sections 53533 and 53545, the Bureau of State Audits presents its audit report concerning the first audit in a series on the Housing and Emergency Shelter Trust Fund acts of 2002 and 2006.

This report concludes that the Department of Housing and Community Development (department) and the California Finance Housing Agency generally awarded funds in a timely manner and consistent with the law. However, we noted that the monitoring of awardees performed by the department is inconsistent. In addition, the department overrode controls over advances put in place for one of the programs tested. Further, for two of the programs we reviewed, the department had not established monitoring processes for the completion phase of its agreements with awardees. Strengthening its oversight in these areas would help the department ensure that awardees have used funds only for eligible costs and that their activities benefit only targeted populations.

Respectfully submitted,

Elaine M. Howle

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State Auditor

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Summary

Results in Brief

In November 2002 and 2006, California voters passed the Housing and Emergency Shelter Trust Fund acts to provide bonds (housing bonds) for use in financing affordable housing for low- to moderate-income Californians. The Department of Housing and Community Development (department) and the California Housing Finance Agency (Finance Agency) manage the programs funded by the housing bonds.

In awarding housing bond funds, the department and the Finance Agency generally have been timely and consistent with the law. Except for fiscal year 2002–03, the first year the housing bonds became available, the timing and amounts of awards have approximated or exceeded both entity's estimates. In addition, both the department and the Finance Agency established and adhered to policies intended to ensure that only eligible applicants receive awards. However, for one of the five programs we tested, the Emergency Housing and Assistance Program (Emergency Housing Program), the department could not document its use of rating and ranking tools for some of the awards we tested.

The department's monitoring of entities to whom it awarded funds (awardees) has been inconsistent. Although the department generally has controls in place over payments, it overrode those controls for the CalHome Program. The department allowed three of the 18 awardees tested, or 17 percent of our sample, to receive advances greater than the limit set in their standard agreements. Establishing limits on the amounts advanced to awardees helps ensure that projects are in fact progressing before all funds are disbursed and that the State maximizes interest earnings.

The department could strengthen its ongoing oversight of the developers, nonprofit organizations, local governments, and other entities (sponsors) receiving housing bond funds. For three of the five programs reviewed, the department's Multifamily Housing—General and Joe Serna Jr. Farmworker Housing—General programs and the Finance Agency's California Homebuyer's Downpayment Assistance Program, monitoring efforts are in place. However, the department does not currently have processes for conducting site visits of sponsors or otherwise verifying program compliance during the period following final payment of funds by the State for its Emergency Housing and CalHome programs. Thus, the department cannot always ensure that sponsors have used funds only for eligible costs or that their activities benefit only targeted populations.

Audit Highlights . . .

Our review revealed that for the Housing and Emergency Shelter Trust Fund Act of 2002 (Proposition 46):

- *Both the Department of Housing and Community Development (department) and California Housing Finance Agency (Finance Agency) generally awarded funds in a timely manner.*
- *Both the department and Finance Agency generally complied with legal requirements for making awards; however, the department could not provide its rating and ranking tools in some cases for its Emergency Housing and Assistance Program (Emergency Housing Program).*
- *Both the department and Finance Agency generally used appropriate monitoring procedures during the expenditure phase, but the department sometimes overrode controls concerning advance payments for the CalHome Program.*
- *The department does not exert adequate monitoring over the completion phase for two of its programs—Emergency Housing and CalHome.*

For one of the programs, the department states that it did not want to establish a costly and burdensome monitoring process and for the other that an administrative cost cap, staff inexperience, and a work backlog have limited monitoring activities. However, the department also indicates that in order to verify sponsor-provided information, it is in the process of testing monitoring procedures for the CalHome Program and designing a monitoring process for the Emergency Housing Program.

Recommendations

The department should implement record-keeping procedures for the Emergency Housing Program to ensure that applicants who receive awards have been properly evaluated.

The department should continue its efforts to consistently monitor sponsors' use of housing bond funds by doing the following:

- Consider eliminating its process of overriding restrictions on advances for the CalHome Program.
- Give high priority to finalizing and implementing monitoring procedures for the CalHome and Emergency Housing programs, which do not currently have such procedures in place.
- Review its other housing bond programs that were not specifically evaluated in this initial audit to ensure that monitoring procedures are in place and operating.

Agency Comments

The department generally agreed with our recommendations and indicated the steps it would take to implement them within the next six months.

Introduction

Background

For 20 years, voters and the Legislature have supported numerous efforts to aid low- to moderate-income and homeless populations in securing housing and shelter. In the late 1980s and early 1990s, voters approved the issuance of $600 million in general obligation bonds to fund state housing programs. After the last of those bond funds were spent, the Legislature typically appropriated less than $20 million annually from the State's General Fund for the programs. However, in fiscal year 2000–01, the Legislature appropriated more than $350 million from the General Fund for housing programs. In the last five years, the Legislature proposed and voters approved nearly $5 billion in Housing and Emergency Shelter Trust Fund Act bonds (housing bonds) to continue these efforts.

Housing and Emergency Shelter Trust Fund Act of 2002

In November 2002 California voters approved the Housing and Emergency Shelter Trust Fund Act of 2002 (Proposition 46), which provides $2.1 billion for the development of affordable rental housing, emergency shelters, and down payment assistance to low- to moderate-income home buyers. Proposition 46 currently funds 23 housing programs: 12 programs already established when the bonds were approved and 11 new programs, nine established in 2002 and two established in 2005. The new programs include funds for down payment assistance to low-income first-time home buyers and supportive housing aimed at reducing homelessness. Proposition 46 allocates specific amounts for the 23 programs, which are administered by either the Department of Housing and Community Development (department) or the California Housing Finance Agency (Finance Agency). Figure 1 on the following page shows Proposition 46 funding by four core program areas, which we categorize and describe in the text box, along with another core program area added by a later proposition. The Appendix provides details on each program within the core areas.

Many of the laws governing Proposition 46 programs also restrict administrative costs. These restrictions generally limit the amount of funding the department and the Finance Agency can use for administrative support costs to between 3 percent and 5 percent of program allocations.

Core Program Areas

Multifamily housing programs: Provide funding for constructing or renovating rental housing projects. They also fund supportive housing for disabled or homeless persons. Funding generally takes the form of low-interest loans to awardees to partially fund the cost of construction.

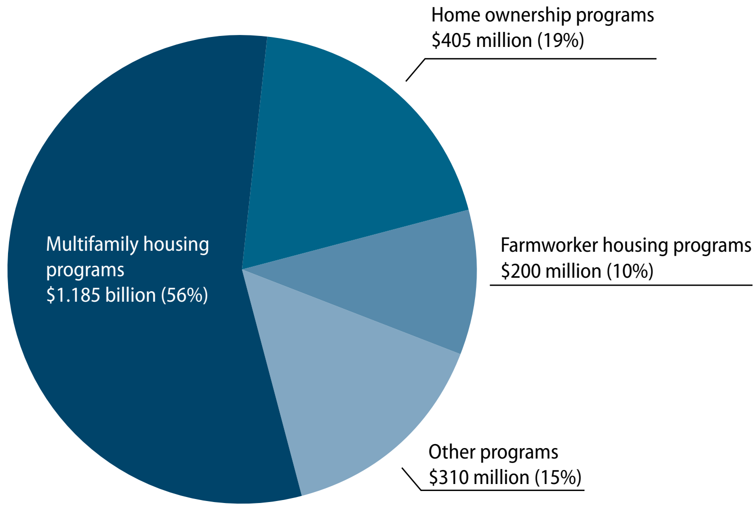
Home ownership programs: Encourage home ownership by offering low-interest loans or grants that help low- to moderate-income Californians meet down payment requirements.

Farmworker housing programs: Provide funding for the construction or rehabilitation of housing for agricultural employees and their families. Funds support both rental and owner-occupied housing.

Other programs: Provide funding for developing emergency shelters and transitional housing, incentives to cities and counties based on the number of new housing units approved, mortgage insurance for high-risk home buyers, and the capital and staffing needs of local government agencies responsible for enforcing housing codes.

Development programs: Promote developments like parks, water, sewage, transportation, and housing in existing urban areas and near public transportation. (This core program area applies only to funds available through the Housing and Emergency Shelter Trust Fund Act of 2006.)

Figure 1
Proposition 46 Funding Allocations by Core Program Area



Source: Health and Safety Code, Division 31, parts 2 and 3, and the Department of Housing and Community Development's *Cumulative Proposition 46 Bond Awards Report Through December 31, 2006*.

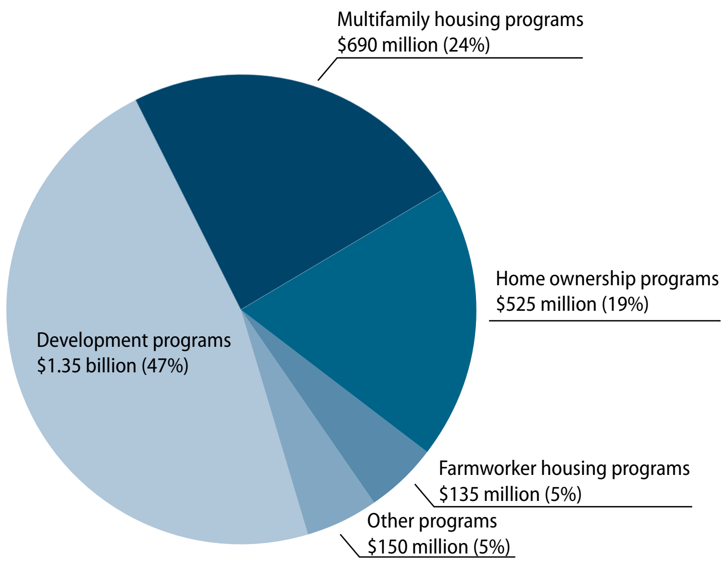
Note: The funding amounts shown include administrative costs. Proposition 46, the Housing and Emergency Shelter Trust Fund Act of 2002, requires that actual administrative costs be paid from the bond funds. In addition, for some programs, the law requires that funds not awarded within a certain time frame revert to other housing bond programs. The amounts shown represent funding available as of December 31, 2006, and may not agree with the original funding level for programs presented in the law.

Housing and Emergency Shelter Trust Fund Act of 2006

In November 2006 California voters approved the Housing and Emergency Shelter Trust Fund Act of 2006 (Proposition 1C). It provides nearly $2.9 billion to support the same core program areas as Proposition 46, plus a fifth core area of development programs, which focus on infrastructure (see text box on previous page).

Proposition 1C funds 14 housing programs, 10 of which existed prior to the passage of the proposition. Three of the four new programs established in 2006 support urban development and parks, while one is aimed at encouraging cost-saving approaches to create or preserve affordable housing. However, the Legislature did not originally clarify the specific uses of the funds for the new Affordable Housing Innovation Fund; Housing Urban-Suburban-and-Rural Parks Account; and Regional Planning, Housing, and Infill Incentive Account. As of early August 2007 the Legislature was considering several bills that would further define the use of these funds. Figure 2 shows Proposition 1C funding by core program area.

Figure 2
Proposition 1C Funding Allocations by Core Program Area



Source: Health and Safety Code, Division 31, parts 2 and 3.

Note: The amounts shown include administrative costs. Proposition 1C, the Housing and Emergency Shelter Trust Fund Act of 2006, requires that actual administrative costs be paid from the bond funds.

Department of Housing and Community Development

The department is the State's principal housing agency. Its mission is to provide leadership, policies, and programs to expand and preserve safe and affordable housing opportunities and promote strong communities. With more than 500 employees and a budget of about $654 million for fiscal year 2006–07, the department focuses its efforts through three major divisions—Financial Assistance, Housing Policy Development, and Codes and Standards—which account for most of the department's resources. The Financial Assistance Division (division) awards the grant and loan funds available from the housing bonds. The division also offers technical assistance, promotes economic development, and manages the department's portfolio of loans and grants.

Although final responsibility for managing housing bond funds rests with the department, and it makes all housing bond disbursements, it directly administers only 19 of the 28 housing bond programs. For the other nine programs, the department acts through another state agency responsible for day-to-day program management or the administering agency is not yet determined. As of early August 2007, the Legislature was considering bills to clarify which agency will manage two of the new programs funded by Proposition 1C. Further, the department says it is in the process of establishing an interagency agreement with the Department of Parks and Recreation to jointly administer one of the four new Proposition 1C programs: the Housing Urban-Suburban-and-Rural Parks program. The department also states that it is collaborating with the California Department of Transportation to set guidelines for the Transit-Oriented Development Implementation Program.

Awardees Consist of Two Groups

Sponsors: Local public entities, nonprofit corporations, joint ventures, partnerships, limited partnerships, trusts, corporations, cooperatives, or individuals qualified to own, construct, or rehabilitate housing developments.

Home buyers: Persons, generally purchasing homes for the first time and of low- to moderate-income, who receive assistance through housing bond programs.

Most programs operated directly by the department provide funding to sponsors (see text box) that construct or manage housing projects. In many cases, those sponsors in turn provide services to the beneficiaries targeted by the programs. Typically, housing bond funds only partially finance projects. As of December 31, 2006, the department reported leveraged private capital of more than $3.9 billion related to about $1.4 billion in awards for the housing bond programs it directly manages.

California Housing Finance Agency

As the State's affordable housing bank, the Finance Agency supports the needs of renters and first-time home buyers by offering financing and programs that create safe, decent, and affordable housing opportunities for individuals within specified income ranges. Under interagency agreements with the department, the Finance Agency directly manages seven Proposition 46 programs. In August 2007 the department executed another such agreement for two programs under Proposition 1C. In addition to the programs supported by the propositions, the Finance Agency provides loans to home buyers and sponsors of affordable rental housing through the sale of tax-exempt and taxable bonds unrelated to the housing bonds.

With more than 270 employees and a budget of about $37 million in fiscal year 2006–07, the Finance Agency addresses its mission through three types of programs: mortgage insurance programs, home ownership programs, and multifamily financing programs. Mortgage insurance programs aid first-time home buyers, low- to moderate-income borrowers, and individuals who may not qualify for traditional lending programs by providing primary mortgage insurance at favorable rates.

Home ownership programs aim to provide affordable housing opportunities by offering mortgages to first-time home buyers with very low to moderate incomes. Since 1975 the Finance Agency has helped more than 130,000 Californians purchase first homes by issuing a total of $12.1 billion in loans. The Finance Agency's current portfolio contains more than 37,600 home mortgage loans valued at a total of $4.2 billion. The Finance Agency does not lend money directly to borrowers. Rather, private lenders approved by the Finance Agency verify applicants' qualifications and offer mortgage loans. After the Finance Agency reviews closing documentation and ensures that certain requirements are met, it purchases the mortgage loans from the lenders and assumes responsibility for servicing the loans.

Finally, multifamily financing programs make loans to affordable housing sponsors for new construction and rehabilitation projects. The goal of these programs is to finance rental housing for very low- to moderate-income and special-needs households. Since its inception in 1975, the Finance Agency has made nearly $1.7 billion in loans for multifamily housing projects, financing 415 projects and providing more than 33,300 housing units.

Scope and Methodology

The California Health and Safety Code, sections 53533 and 53545, requires the Bureau of State Audits to conduct periodic audits of housing bond activities to ensure that housing bond proceeds are awarded in a manner that is timely and consistent with legal requirements and that awardees use the funds in compliance with the law.

To determine whether awards of housing bond funds were timely, we reviewed the propositions, prior audits, and other laws to clarify the definition of *timely*. We also interviewed department staff to understand the policies and procedures developed by the department to implement and report on program activities related to housing bonds, including awarding funds. Because the law does not define *timely*, we concluded that the department's estimated awards established in 2002 and the Finance Agency's estimated awards established in 2003 were the most appropriate criteria against which to compare actual awards. Using information from department and Finance Agency awards-tracking systems, we compared actual awards for each fiscal year from 2002–03 to 2006–07 with department and Finance Agency planned timetables for awarding funds.

To assess whether the department and the Finance Agency awarded funds in compliance with applicable statutory requirements, we selected five programs with significant Proposition 46 awards and expenditures through December 31, 2006. We tested the Multifamily Housing Program—General, the Joe Serna Jr. Farmworker Housing Grant Program—General, the CalHome

Program, and the capital development portion of the Emergency Housing and Assistance Program managed by the department. We also tested the California Homebuyer's Downpayment Assistance Program administered by the Finance Agency. The five programs accounted for 73 percent of awards and expenditures as of December 31, 2006. We analyzed information from the award-tracking systems to ensure that the total of all awards granted by each program did not exceed the allocation established in the law. Further, based on our review of relevant laws and regulations, we identified key legal provisions that the programs must implement when awarding funds. We judgmentally selected 59 awards (10 percent) from all awards granted by the four department-administered programs and randomly selected 29 awards from about 17,000 awards granted under the Finance Agency-administered program. We then tested those awards to assess whether key legal provisions were met.

To determine whether awardees complied with applicable statutes, we reviewed program guidelines, policies, and procedures and interviewed officials to determine how awardees are monitored throughout the term of their agreements with the department or the Finance Agency. Using the award samples previously described, we assessed whether the department and the Finance Agency implemented processes that would allow them to ensure that awardees used housing bond funds in compliance with the law.

The U.S. Government Accountability Office whose standards we follow, requires us to assess the reliability of computer-processed data. We tested the data from three computer systems that the department and the Finance Agency use to track information on awards and expenditures. Based on our review, we found the data to be sufficiently reliable for the purposes of this audit. The department converted its awards-tracking system in May 2007. We did not test the data in the new system as the cut-off for our review was December 31, 2006. However, we noted that the department lacked sufficient internal controls over the system conversion and we will issue a separate management letter discussing this weakness.

Because Proposition 1C was approved by voters in November 2006 and the department made its first awards of funds derived from the proposition late in fiscal year 2006–07, we did not test the awarding or use of those funds. However, the five programs we tested under Proposition 46 will also receive Proposition 1C funds in the future. Therefore, to the extent the department's and the Finance Agency's processes for awarding bond funds and monitoring their use does not change, we tested the controls they have in place for awarding and monitoring the use of funds from both Proposition 46 and Proposition 1C.

Audit Results

Awards of Housing Bond Funds Were Timely

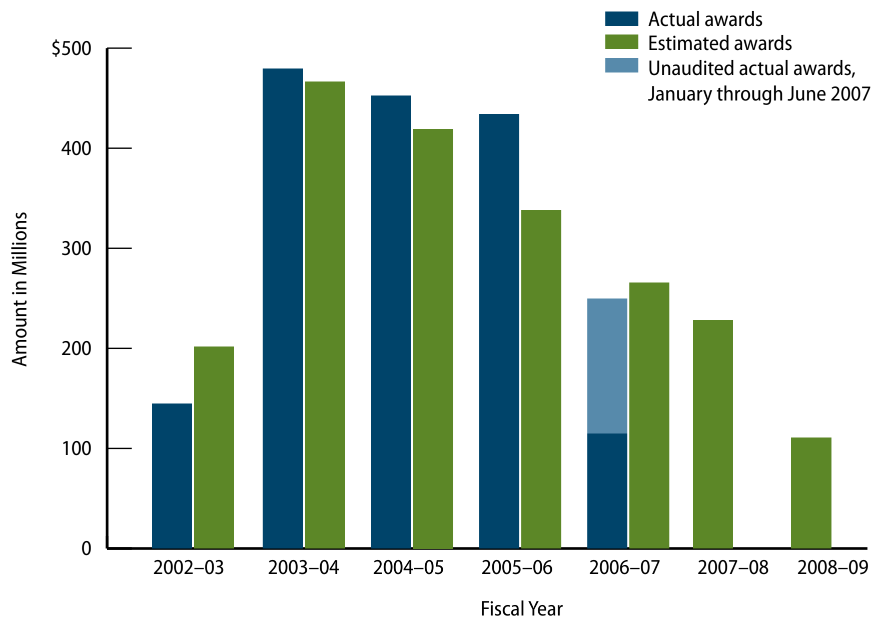
The Department of Housing and Community Development (department) and the California Housing Finance Agency (Finance Agency) have generally awarded funds from the 2002 Housing and Emergency Shelter Trust Fund Act bonds (housing bonds) in a timely manner. However, the department understated awarded funds by $50.5 million in its report titled *Cumulative Proposition 46 Bond Awards Through December 31, 2006* (bond awards report), which is available to the public. The department explained the reasons for excluding certain amounts and stated it would clearly note any exclusions in future reports.

In April 2002 the department prepared an estimated annual awards schedule (awards schedule) outlining, by fiscal year and program, the anticipated award of funds made available by the passage of the Housing and Emergency Shelter Trust Fund Act of 2002 (Proposition 46). Before voters approved the Proposition 46 bonds, the department undertook efforts to determine the needs of the prospective bond-related programs. That effort helped the department to develop regulations and guidelines, establish detailed timelines, and determine staffing needs. With the information it gained, the department prepared an awards schedule showing the total authorized funding, support costs, and estimated awards by program and fiscal year. The department estimated it would make Proposition 46 bond awards through fiscal year 2008–09. The department stated that it met with stakeholders to determine what level of funding they could handle on an annual basis. Based on the stakeholders' input, the department spread the awards over several years to ensure increased competition for the funds and thus higher-quality projects.

In 2003 the Finance Agency developed a business plan that included anticipated awards under its Proposition 46 programs. The plan outlined estimated awards covering the five-year period of fiscal years 2003–04 through 2007–08. The estimates shown in Figure 3 on the following page combine annual award estimates from the department's and the Finance Agency's plans.

The department and the Finance Agency have generally met and sometimes exceeded the goals specified in their awards schedules. As shown in Figure 3, for all complete fiscal years we audited except the initial year, actual awards exceeded estimated awards. In fiscal year 2002–03, actual awards fell below estimated awards by about $61 million.

Figure 3
Proposition 46 Estimated Awards Compared With Actual Awards as of December 31, 2006



Sources: Department of Housing and Community Development's Proposition 46 awards database and Housing Bonds of 2002 Estimated Annual Awards schedule; California Housing Finance Agency's awards database and *Five-Year Business Plan for Fiscal Years 2003–04 to 2007–08*.

Note: Proposition 46 is the Housing and Emergency Shelter Trust Fund Act of 2002.

Two factors explain most of the variance in fiscal year 2002–03. First, the Legislature did not appropriate any funds in this fiscal year for the Workforce Housing Rewards Program, which explains $33 million of the variance. Second, the department anticipated a higher demand for some programs than actually materialized. The department explained that after interest in the Emergency Housing and Assistance Program (Emergency Housing Program) fell short of expectations, it raised the funding limit per project with the aim of increasing interest in the program. The department also explained that when demand for the Multifamily Housing Program—Supportive Housing Projects fell short, it switched to an over-the-counter funding process allowing sponsors to apply any time they were ready rather than only on specified dates. The department says this has resulted in a steady flow of applications for that program. The second factor accounted for $18 million of the fiscal year 2002–03 shortfall.

From fiscal years 2003–04 through 2005–06, actual awards outstripped estimated awards in total by about $146 million, and actual awards each year exceeded $400 million. According to the department, it plans to award all Proposition 46 funds under its direct management by fiscal year 2007–08. The Finance Agency does not plan to award all Proposition 46 funds until fiscal year 2009–10. This is mainly because significant funds from its Mortgage Guaranty Insurance Program reverted,[1] and the Finance Agency did not receive legal authority to use these funds for the Residential Development Loan Program until September 2005. According to the Finance Agency's director of legislative affairs, the proponents of the Mortgage Guaranty Insurance Program expected market conditions to change, resulting in an increase in the need for lower cost mortgage insurance products for low- and moderate-income home buyers. However, the director stated that market conditions did not change as anticipated, and by mid-2004 private mortgage lenders and mortgage insurers introduced products that did not require mortgage insurance. As such, demand for Mortgage Guaranty Insurance Program products was not as great as originally anticipated, and the funds eventually reverted. In September 2005 the Legislature made the $75 million in remaining funds available to the Residential Development Loan Program.

During our review we noted that the department's bond awards report understated awards by $50.5 million. To notify the public of its progress in awarding Proposition 46 funds, the department prepares a bond awards report semiannually that it posts to its Web site. The December 31, 2006, report excluded $39.8 million in awards for the Joe Serna Jr. Farmworker Housing Grant Program (Farmworker Housing Program), and the CalHome Program. These excluded amounts related to projects originally funded by the State's General Fund that the Legislature switched to Proposition 46 funds in fiscal year 2003–04. In addition, the bond awards report excluded $10.7 million set aside for the renovation of state-owned facilities for migrant farmworkers. When asked why these projects funded by Proposition 46 were not included in the report, the department stated that it did not consider them new projects and believed that including them would mislead readers. Nevertheless, the department stated that it would disclose the exclusion of those funds in subsequent bond awards reports. Figure 3 includes the $50.5 million omitted from the bond awards report.

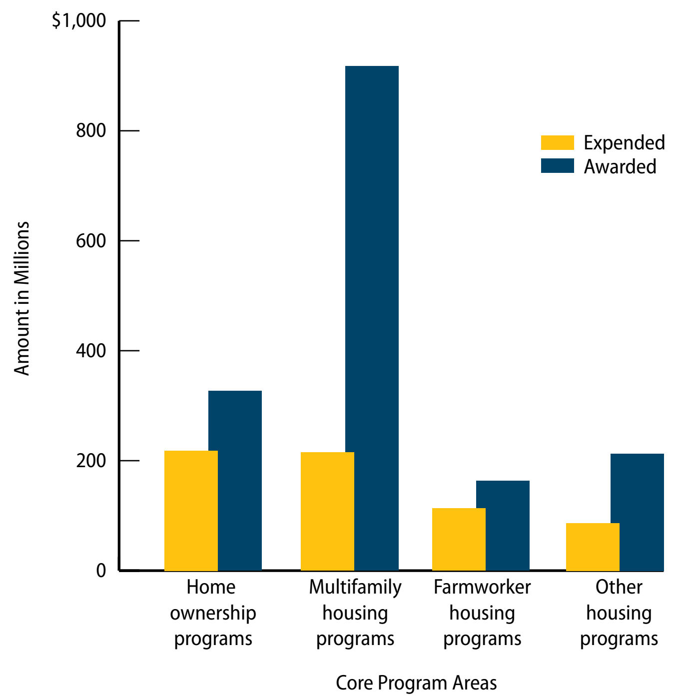
The department understated awards in the December 31, 2006, bond awards report, posted on its Web site by $50.5 million.

Compared to $1.6 billion in awards, the department only expended $632 million in payments to awardees under Proposition 46 as of December 31, 2006. The department disburses bond funds based on sponsors' requests for payment under the terms of their awards. The department also transfers bond funds to the Finance Agency based on funding requests related to the programs the Finance Agency manages. Figure 4 on the following page shows that the core area of home ownership programs has had the highest amount of expenditures. The figure also shows that the multifamily housing

[1] Reversions relate to the return of the unused portion of an appropriation once it has lapsed.

programs area, though second in total expenditures, has the lowest ratio of expenditures to awards. This is not surprising given that for programs under this core area, the department anticipates a two- to four-year lag between a sponsor's application and its loan closing, when the sponsor receives funds from the department.

Figure 4
Proposition 46 Awards Versus Expenditures as of December 31, 2006

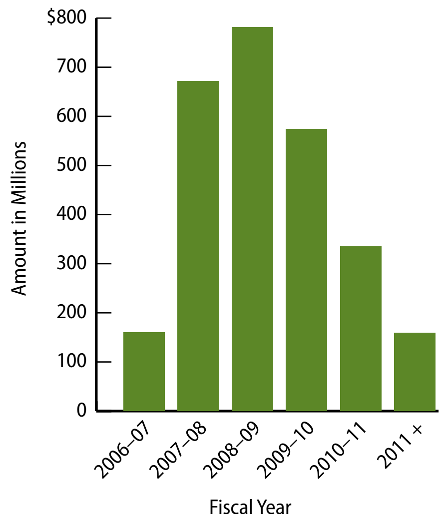


Sources: Department of Housing and Community Development's Proposition 46 awards database and Reconciliation of Controller's Appropriation Balances with Unexpended Balances as of December 31, 2006; California Housing Finance Agency's awards database.

Note: Proposition 46 is the Housing and Emergency Shelter Trust Fund Act of 2002.

Similar to planning activities for Proposition 46, for Proposition 1C the department and Finance Agency prepared estimated awards schedules in December 2006 and May 2007, respectively. As shown in Figure 5, these awards schedules estimate that more than half of awards will be made by the end of fiscal year 2008–09. The department stated that some of the estimated Proposition 1C awards are contingent on budget act authorizations. The largest award total is estimated for fiscal year 2008–09, when the department and Finance Agency plan for awards totaling $781 million, or 27 percent of all Proposition 1C funds.

Figure 5
Proposition 1C Estimated Awards by Fiscal Year



Source: Department of Housing and Community Development's Housing and Emergency Shelter Trust Fund Act of 2006 Award Schedule for 2006–07 through 2010–11; California Housing Finance Agency's *Five-Year Business Plan for Fiscal Years 2007–08 to 2011–12*.

Note: Proposition 1C is the Housing and Emergency Shelter Trust Fund Act of 2006.

In early summer 2007 the department announced the first awards of Proposition 1C funds totaling $166.2 million. The department stated that all these awards related to fiscal year 2006–07.

The Department and the Finance Agency Generally Complied With Legal Requirements When Awarding Housing Bond Funds

The department and the Finance Agency generally allocated and awarded housing bond funds for the intended programs, to the correct types of sponsors, and for the proper activities. For instance, the department verified for the CalHome Program that sponsors were either local governments or nonprofit organizations and ensured that proposed activities involved low-income homeowners seeking assistance in home rehabilitation projects or low-income first-time home buyers needing mortgage assistance. Likewise, for the Multifamily Housing Program, the department checked that sponsors had demonstrated the ability to complete affordable housing projects and that those projects included construction or rehabilitation of rental housing. Additionally, in determining the funds available for grants and loans, the department proportionally distributed statewide costs among the programs and appropriately earmarked funds for program administration. However, poor file management in the Emergency Housing Program made it impossible for us to verify if the department always used established selection criteria when awarding funds in fiscal years 2002–03 through 2004–05.

The department ensured that it did not exceed program allocations set in the law by periodically reviewing administrative costs and the amounts already awarded as loans and grants. The department prepared plans estimating the distribution of funds over a seven-year period for Proposition 46 funds and developed similar plans for Proposition 1C funds. Both plans include amounts set aside for administrative support costs. The department later refined its Proposition 46 plans to detail set-asides in three areas: statewide costs, administrative support costs, and default reserve costs (see text box). According to the department's most recent plans, it estimates using about $158.3 million (7.5 percent) for Proposition 46 set-asides and anticipates using $199.5 million (7 percent) for Proposition 1C set-asides. The set-aside costs reduce the total amount of funding available for grants and loans.

Types of Set-Aside Costs

Statewide costs: Expenses incurred by the State Treasurer's Office and the State Controller's Office, including bond issuance costs.

Administrative support costs: Costs associated with the administration and coordination of the housing bond programs.

Default reserve costs: Amounts for unexpected costs incurred to protect the State's security interest. The department will eventually disburse unused reserves on loans and grants.

The department and the Finance Agency award housing bond funds through program-specific application review and approval processes. At the end of the award phase, they each make a commitment to fund grants or loans. Generally, for the five programs we reviewed, the department and the Finance Agency established and adhered to processes for identifying eligible recipients and properly making awards. For example, for the CalHome and Emergency Housing programs, the department's eligibility determination included verifying nonprofit status and assessing prior experience with or capacity to perform program activities. Similarly, the California Homebuyer's Downpayment Assistance Program (Downpayment Assistance Program) managed by the Finance Agency ensured that awardees were first-time home buyers and that assistance was limited to 3 percent of the home purchase price, barring special circumstances.

The department also implemented competitive application processes for programs required to have them. For example, the Multifamily Housing Program issues notices of funding availability (notices) as an open call for applications. Following the competitive process detailed in the notices, the department evaluates applicants' ability to proceed with the acquisition, construction, or rehabilitation of proposed projects and then ranks the applicants. We found that for this program the department ranked applicants according to scores, from highest to lowest; eliminated any that did not meet minimum requirements; and awarded funds in rank order until the money was exhausted.

Although the department has award procedures for the Emergency Housing Program similar to those of the Multifamily Housing Program, it has not recently employed competitive selection because demand for funding has not met or exceeded offered funding since the establishment of Proposition 46. However, inadequate record keeping made it impossible to verify that program staff always assessed submissions according to criteria for applicant capability as set forth in the program notices. These criteria include minimum standards. For seven of the 19 Emergency Housing Program awards we reviewed (37 percent), the department could not provide the ranking and rating tools or project reports that it uses to document its assessment of applicants. After we completed our fieldwork, the department provided us with rating and ranking tools for four of the seven awards. If the department does not thoroughly assess applicants, it may award funds to sponsors that are not capable of undertaking or completing projects. According to the Emergency Housing Program manager, high turnover in program manager and staff positions and the lack of policies and procedures regarding file management have made it difficult to maintain files in good order. He further said that the program is developing new policies and procedures regarding file management and intends to implement them soon for future awards. However, he did not commit to applying these procedures to current awards.

Inconsistent Monitoring Efforts Limited the Department's Ability to Ensure the Proper Use of Funds

The department has not consistently established or followed procedures for monitoring sponsors' use of funds and ensuring that occupants of bond-funded housing meet eligibility requirements for two of the four housing bond programs under its administration that we reviewed. As a result, it could not ensure that sponsors for the CalHome and Emergency Housing programs used funds in accordance with grant requirements or that the programs only benefited targeted populations. The department, however, has monitoring processes in place for the Multifamily Housing and Farmworker Housing programs. In addition, because of the nature of real estate transactions, the Finance Agency can ensure that borrowers continue to use Downpayment Assistance Program funds appropriately.

Regardless of the type of housing assistance provided by bond-supported programs, monitoring comprises two phases: expenditure and completion (see text box).

Phases of Monitoring for Housing Bond Programs

Expenditure phase: Period from award commitment to final state payment to awardee.

Completion phase: Period from final state payment to fulfillment of all contract requirements by awardee.

The Department and the Finance Agency Generally Undertake Appropriate Monitoring Procedures During the Expenditure Phase

For the expenditure phase, the department and the Finance Agency have processes in place to ensure that sponsors and borrowers meet legal requirements. For example, before closing a loan, the department requires the sponsor of a Multifamily Housing Program project to submit a management plan and an initial operating budget for approval. We found that the department had approved management plans and obtained operating budgets for all the projects in our sample that had closed loans.

The length of the expenditure phase varies widely among programs, depending on the type of assistance provided. For example, the expenditure phase lasts an average of one and a half months for the Downpayment Assistance Program, but it can continue for more than three years for construction projects under the Multifamily Housing and Farmworker Housing programs. This phase begins when the department or the Finance Agency commits to provide funding and ends when an awardee has received all funds earmarked for an approved loan or grant. The purpose of monitoring during this phase is to ensure that sponsors exhibit reasonable progress in meeting their goals and that the department only reimburses sponsors for allowed costs. For some programs we reviewed, verification that sponsors met program criteria was performed through document reviews. For example, both the Emergency Housing and Farmworker Housing programs require remittance of receipts or invoices and architectural certifications to show evidence of work completed and to document costs requested for reimbursement. We found that the department received supporting documents before it disbursed funds to Emergency Housing and Farmworker Housing sponsors in our samples that had requested fund distributions.

The purpose of monitoring during the expenditure phase is to ensure that sponsors exhibit reasonable progress in meeting their goals and that the department only reimburses sponsors for allowed costs.

The Finance Agency uses approved lenders to qualify applicants for its Downpayment Assistance Program. After the approved lender closes the loan, the Finance Agency verifies that certain conditions are met before purchasing and assuming responsibility for servicing the loan. We found that Downpayment Assistance Program loans we reviewed met all significant awarding conditions.

Because the CalHome Program awards funds to sponsors who in turn provide loans to qualified home buyers, its standard agreement allows a sponsor a 25 percent advance of awarded funds. The standard agreement states that after the sponsor submits supporting documents for two-thirds of an advance, the sponsor can receive an additional 25 percent advance. This policy limits the State's risk by requiring sponsors, on an incremental basis, to certify that they are using bond proceeds for allowed purposes.

This policy also helps to maximize the State's interest earnings by retaining funds at the state level. However, we found that for three of the 18 awards tested, 17 percent of our sample, sponsors received advances exceeding 25 percent. Had the department retained the funds advanced over the 25 percent threshold for the three awards, we estimate it could have earned $42,000 in interest through July 2007 based on the effective yield of the State Treasurer's Office pooled money account.

For three of the 18 CalHome Program awards tested, sponsors received advances exceeding the 25 percent limit set in their standard agreements.

Two examples highlight our concern with the department's override of its policy on advances. In February 2007 the department authorized a 100 percent advance of an award on the last day funds were available for disbursement under an agreement nearly three years old. The department approved the request based only on a list of potential home buyers. However, as of August 10, 2007, the sponsor had submitted documentation to the department supporting the expenditure of only 7.5 percent of the advanced funds. In another case, the department authorized a 50 percent advance in March 2006 based on correspondence from the sponsor that did not list loans that would be funded by the advance. However, as of August 10, 2007, the department had no documents on file supporting expenditure of those funds. When we asked about its policy regarding advances, the department's Home and Homeownership section chief said that it is permissible to be more flexible than the standard agreement as long as there is no conflict with laws or regulations. Nevertheless, the facts in each case lead us to question the wisdom of the department's overriding what appears to be a reasonable policy to ensure the delivery of services close to the time of payment and to maximize the State's interest earnings.

For Two Programs, the Department Does Not Have Adequate Monitoring Processes for the Completion Phase

Of the five programs we reviewed—Downpayment Assistance, Farmworker Housing, and Multifamily Housing—had processes in place to adequately ensure compliance during the completion phase. The two remaining programs the department administers—CalHome and Emergency Housing—had weak or nonexistent monitoring during the completion phase. Consequently, the department cannot always be certain that sponsors are using bond funds to help intended beneficiaries, such as low- to moderate-income home buyers or homeless individuals.

Monitoring during the completion phase, which extends from when the department has finished disbursing funds for a loan or grant to the end of contractual requirements, varies greatly depending on the type of housing assistance. For the Emergency Housing Program, the completion phase is less than five years for small rehabilitation loans. By contrast, for the Multifamily Housing and Farmworker Housing programs, the completion phase can last up to 55 years.

For the Multifamily Housing and Farmworker Housing programs, the department assigned responsibility for monitoring compliance with contract terms to the Asset Management and Compliance Section under its Division of Financial Assistance. A primary goal of completion phase monitoring is ensuring that occupants of housing bond-funded projects meet eligibility requirements, which are typically tied to income but in the case of the Farmworker Housing Program depend on occupation. Because the expenditure phase for these programs can last more than three years, only a few of the projects we tested had received full funding and had moved into the completion phase. Although none of our selections had received a site visit, we found that the centralized monitoring group had scheduled a site visit for one of the closed projects and that the other two projects were well within the three-year window for site monitoring.

Because of the nature of real estate transactions and the design of their loan programs, the Finance Agency does not actively monitor borrowers during the completion phase. However, as the holder of liens secured by deeds of trust, the Finance Agency receives notification of events triggering a loss of eligibility and the need for loan repayment. For instance, loans from the Downpayment Assistance Program are subordinate to other mortgages; therefore, repayment to the Finance Agency is due if any primary mortgage is paid, refinanced, or assumed. Further, the Finance Agency has processes for following up on other situations that could lead to requiring repayment, such as a change in the borrower's address. For our test items, we found that the Finance Agency was repaid whenever a triggering event occurred.

The department had not verified sponsors' claims related to loans to eligible borrowers for 17 of the 18 CalHome Program awards we tested, whether through site visits or by reviewing original documentation, even though the sponsors had received all funds.

The lack of established monitoring plans for the completion phase of both the CalHome and Emergency Housing programs is surprising because both programs have existed for more than seven years. As of December 31, 2006, the department had awarded a total of $96.4 million in Proposition 46 funds to 171 sponsors through the CalHome Program and $127.8 million to 190 sponsors through the Emergency Housing Program. During the expenditure phase, the CalHome Program receives certifications from sponsors claiming to have made loans to eligible borrowers. However, we found that for 17 of the 18 CalHome Program awards we tested, the department had not verified any of the information provided whether through site visits or by reviewing original documentation, even though the sponsors had received all funds. For the remaining award, the sponsor had not yet received any funds. As a result, the department cannot be certain that sponsors complied with housing bond requirements related to occupants' income limits or their status as first-time home buyers.

Similarly, for the Emergency Housing Program, we found that the department had not performed site visits to verify sponsor activities for any of the awards we tested that were in the completion phase. Moreover, the program manager said that the program has not performed any site visits since 2005 and even then it did not have formal policies and procedures governing the purpose and documentation requirements for site visits. Without monitoring processes for verifying compliance, the department cannot ensure that sponsors use funds in accordance with housing bond requirements or that the program benefits the intended populations.

For the Emergency Housing Program, the department had not performed site visits to verify sponsor activities for any of the awards we tested that were in the completion phase.

When we inquired about the lack of a completion-phase monitoring process, the department explained that it did not want to establish a costly and burdensome monitoring process for the CalHome Program. Nonetheless, the department says it is currently piloting a monitoring process for this program that proposes to verify individual files at the sponsor's location to substantiate information related to income or first-time home buyer status. The department stated that it began this process in July 2007 and that in December 2007 it will assess the level of ongoing monitoring needed. Additionally, the department stated that the Emergency Housing Program does not have the resources necessary to perform monitoring because of the program's 4 percent cap on administrative expenses and that it has been further limited by staff inexperience and a backlog of loan closings. The department, however, indicated that it plans to build a monitoring system to ensure that projects continue to serve as homeless shelters for the duration of their loan terms.

The department stated that program managers provide briefings to executive staff concerning program outcomes, including the monitoring of awardees. However, because two of the four department-administered programs we reviewed had no monitoring processes in place to verify awardees' use of funds during the completion phase, it appears that follow-up on the implementation of monitoring processes is weak. Thus, other housing bond programs the department administers that we did not specifically review in this audit may have similar problems. Without adequate monitoring, the department cannot be sure that funds provided under the core program areas it directly administers are benefiting the intended beneficiaries of the housing bonds.

Recommendations

The department should implement record-keeping procedures for the Emergency Housing Program to ensure that applicants who receive awards have been properly evaluated.

The department should continue its efforts to consistently monitor sponsors' use of housing bond funds by doing the following:

- Consider eliminating its process of overriding restrictions on advances for the CalHome Program.
- Give high priority to finalizing and implementing monitoring procedures for the CalHome and Emergency Housing programs, which do not currently have such procedures in place.
- Review its other housing bond programs that were not specifically evaluated in this initial audit to ensure that monitoring procedures are in place and operating.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. We limited our review to those areas specified in the audit scope section of the report.

Respectfully submitted,

Elaine M. Howle

ELAINE M. HOWLE
State Auditor

Date: September 12, 2007

Staff: Jim Sandberg-Larsen, CPA, CPFO, Project Manager
Mary Camacho, CPA
Angela Dickison
Melissa Arzaga Roye, MPP

Appendix

PROGRAMS FUNDED BY THE HOUSING AND EMERGENCY SHELTER TRUST FUND ACTS OF 2002 AND 2006

Table A on the following pages presents key details of programs funded by the Housing and Emergency Shelter Trust Fund Act of 2002 (Proposition 46) and the Housing and Emergency Shelter Trust Fund Act of 2006 (Proposition 1C). The programs are categorized into five core program areas: multifamily housing programs, home ownership programs, farmworker housing programs, development programs, and other programs. For each program, the table lists the year it was established, a brief description, and the program's allocation under each proposition as of December 31, 2006; the agency directly managing the program is also indicated.

The Department of Housing and Community Development (department) is responsible for managing all Proposition 46 funds; however, it directly administers 16 of the 23 programs, and the California Housing Finance Agency (Finance Agency) manages the other seven programs. For the 14 Proposition 1C programs, the department is responsible for directly managing 10 programs, and the Finance Agency manages two; the Legislature still needs to clarify the managing agency for the two remaining Proposition 1C programs.

Table A

Key Details for Programs Funded by the Housing and Emergency Shelter Trust Fund Acts of 2002 and 2006

PROGRAM	YEAR PROGRAM ESTABLISHED	DESCRIPTION	PROPOSITION 46* FUNDING ALLOCATION	PROPOSITION 1C† FUNDING ALLOCATION
Multifamily Housing Programs				
Downtown Rebound Program	2000	Loans and/or grants for rental housing development projects located within one-quarter mile of an existing or planned major transit node. Funding priority is given to projects developed within walking distance of schools; major employment centers; or public amenities, including shopping, parks, and major entertainment venues.	$15,000,000	
Exterior Accessibility Grants for Renters Program	2002	Grants for exterior modifications to rental housing to accommodate low-income renters with disabilities.	5,000,000	
Local Housing Trust Fund Matching Grant Program	2002	Matching grants to local housing trust funds that provide loans for the construction of rental housing projects or units within rental housing projects, for very low-income persons and families earning less than 60 percent of the area median income.	25,000,000	
Multifamily Housing Program—General	1999	Deferred payment loans for the development and construction of new, and the rehabilitation or acquisition and rehabilitation of existing, transitional, or rental housing developments.	805,000,000	$345,000,000
Multifamily Housing Program—Governor's Homeless Initiative	2005	Interagency effort among the Department of Housing and Community Development, California Housing Finance Agency, and Department of Mental Health aimed at reducing the number of persons with severe mental illness who are chronically homeless by developing permanent supportive housing.	40,000,000	
Multifamily Housing Program—Homeless Youth	2002	Loans to facilitate and support the development and operation of housing for homeless youth.		50,000,000
Multifamily Housing Program—Nonresidential Space for Supportive Services	2002	Grants for nonresidential space for supportive services providing job training, health services, and child care within or immediately proximate to projects funded by other multifamily housing programs.	20,000,000	
Multifamily Housing Program—Supportive Housing Projects	2002	Loans for supportive housing for individuals and households moving from emergency shelters or transitional housing or those at risk of homelessness. Loans are used for rental units linked to supportive services where occupancy is restricted to households that include a disabled adult and that are homeless or at risk of homelessness.	195,000,000	195,000,000
Preservation Opportunity Program	2002	Loans for at-risk units that will likely convert to market-rate housing.	5,000,000	
Residential Development Loan Program	2005	Low-interest loans to housing sponsors for site acquisition and predevelopment expenses related to affordable in-fill owner-occupied housing developments.	75,000,000	100,000,000
Subtotals			**$1,185,000,000**	**$690,000,000**

Agency directly managing program:
- Department of Housing and Community Development
- California Housing Finance Agency

PROGRAM	YEAR PROGRAM ESTABLISHED	DESCRIPTION	PROPOSITION 46* FUNDING ALLOCATION	PROPOSITION 1C† FUNDING ALLOCATION
Home Ownership Programs				
Building Equity and Growth in Neighborhoods Program	2002	Grants to cities, counties, or cities and counties to be used for down payment assistance to first-time low- to moderate-income home buyers purchasing newly constructed homes within a Building Equity and Growth in Neighborhoods project.	$75,000,000	$125,000,000
CalHome Program	2000	Grants and loans to private nonprofit and local government agencies that aid households with low and very low incomes. Grants are used for first-time home buyer down payment assistance, home rehabilitation, home buyer counseling, self-help mortgage assistance, or technical assistance for self-help home ownership.	115,000,000	290,000,000
California Self-Help Housing Program	1978	Grants to public entities and private nonprofit corporations to provide assistance to persons and families of low to moderate income who are owner-builders or self-help rehabilitators.	10,000,000	10,000,000
California Homebuyer's Downpayment Assistance Program	2000	Down payment assistance, including deferred-payment low-interest loans to reduce principal and interest payments and make financing affordable for first-time low- to moderate-income home buyers.	121,032,007	100,000,000
Extra Credit Teacher Home Purchase Program	2000	Provides federal mortgage credit certificates and reduced-interest loans funded by mortgage revenue bonds to eligible teachers, principals, vice principals, assistant principals, and classified employees who agree to teach or provide administration or service in high-priority schools.	25,000,000	
Homebuyer Downpayment Assistance Program—School Facility Fee	2002	Assistance to qualified first-time home buyers in the form of a partial or full rebate of the school facility fees on affordable housing.	50,000,000	
Homeownership in Revitalization Areas Program	2002	Down payment assistance to low-income first-time home buyers who are purchasing a residence in a community revitalization area as documented by a nonprofit organization. Down payment assistance may include loans to provide deferred-payment subordinate loans to borrowers to be used for down payments or closing costs, totaling up to 6 percent of a home's purchase price.	9,300,000	
Subtotals			**$405,332,007**	**$525,000,000**
Farmworker Housing Programs‡				
Joe Serna Jr. Farmworker Housing Grant Program—General	1977	Grants and loans for construction or rehabilitation of housing for agricultural employees and their families. Also includes loans and grants for the acquisition of manufactured housing as part of a program to address and remedy the impacts of current and potential displacement of farmworker families from existing housing.	$155,000,000	$135,000,000
Joe Serna Jr. Farmworker Housing Grant Program—Migrant Housing	2001	Projects that serve migratory agricultural workers, including grant funds reserved for development of housing for migrant farmworkers.	25,000,000	
Joe Serna Jr. Farmworker Housing Grant Program—Wellness Program	2000	Health services to achieve the goal of advancing comprehensive strategies for improving the health status of agricultural workers and their families.	20,000,000	
Subtotals			**$200,000,000**	**$135,000,000**

continued on the next page

PROGRAM	YEAR PROGRAM ESTABLISHED	DESCRIPTION	PROPOSITION 46* FUNDING ALLOCATION	PROPOSITION 1C† FUNDING ALLOCATION
Development Programs				
Housing Urban-Suburban-and-Rural Parks Account (managing agency still to be determined)	2006	Grants for housing-related parks in urban, suburban, and rural areas.		$200,000,000
Regional Planning, Housing, and Infill Incentive Account (managing agency still to be determined)	2006	Grants for capital outlay related to in-fill housing development and other related in-fill development.		850,000,000
Transit-Oriented Development Implementation Program	2006	Provide assistance to cities, counties, cities and counties, transit agencies, and developers to establish higher density uses within close proximity to transit stations.		300,000,000
Subtotal				$1,350,000,000
Other Programs				
Affordable Housing Innovation Fund	2006	Grants and loans to entities that develop, own, invest in, or make loans for affordable housing. Also used to create pilot programs to demonstrate innovative cost-saving approaches to creating or preserving affordable housing.		$100,000,000
Code Enforcement Incentive Program	2000	Grants for capital expenditures dedicated to local building code enforcement and compliance efforts.	$5,000,000	
Emergency Housing and Assistance Program	1993	Capital development grants for programs such as acquisition, leasing, construction, or rehabilitation of sites for emergency shelter and transitional housing for homeless persons.	195,000,000	50,000,000
Workforce Housing Rewards Program	2002	Capital grants to provide local assistance for the construction or acquisition of capital assets for cities, counties, and cities and counties that provide land use approval to affordable housing developments.	100,000,000	
Mortgage Guaranty Insurance Program	1993	Bond and loan insurance to facilitate financing for low- to moderate-income housing by reducing risk to the lender.	9,667,993	
Subtotals			**$309,667,993**	**$150,000,000**
Totals			**$2,100,000,000**	**$2,850,000,000**

Source: Health and Safety Code, Division 31, parts 2 and 3, and the Department of Housing and Community Development's *Cumulative Proposition 46 Bond Awards Through December 31, 2006*.

Note: The funding amounts shown include administrative costs. Both propositions require that actual administrative costs be paid from bond funds. In addition, for some programs, the law requires that funds not awarded within a certain time frame revert to other housing bond programs.

The amounts shown in the funding columns represent funding available to the programs at December 31, 2006, and as a result may not agree to the original funding level for the programs presented in the law. The following programs received additional allocations due to funds that reverted from other programs:

California Homebuyer's Downpayment Assistance Program	$3.5 million
Downtown Rebound Program	$15 million
Multifamily Housing Program—Governor's Homeless Initiative	$40 million
Multifamily Housing Program—General	$5 million
Residential Development Loan Program	$75 million

* Housing and Emergency Shelter Trust Fund Act of 2002.

† Housing and Emergency Shelter Trust Fund Act of 2006.

‡ Proposition 1C allows the department to use the Joe Serna Jr. Farmworker Housing Grant Program funds on any of the Joe Serna programs; however, the Department of Housing and Community Development has chosen to use the funds for the general program exclusively.

(Agency response provided as text only.)

Business, Transportation and Housing Agency
980 9th Street, Suite 2450
Sacramento, CA 95814-2719

August 30, 2007

Elaine M. Howle, State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Dear Ms. Howle:

Attached are responses from the Department of Housing and Community Development (Department) and the California Housing and Finance Agency (Finance Agency) to your draft audit report, *Department of Housing and Community Development: Awards of Housing Bond Funds Have Been Timely and Complied With the Law, But Monitoring of the Use of Funds Has Been Inconsistent* (#2007-037). Thank you for allowing the Department, the Finance Agency, and the Business, Transportation and Housing Agency the opportunity to respond to the report.

We appreciate your acknowledgement that the Department and Finance Agency awarded housing bond funds timely and that they generally complied with legal requirements when awarding housing bond funds. Moreover, we are pleased that you found no issues with the manner in which the Finance Agency administers Proposition 46 funds.

As noted in its response, the Department has already begun to make improvements in processes and/or procedures for which you expressed concern. Your report mentions the monitoring in the CalHome Program that the Department started last month. In addition, the Department has developed draft procedures for record filing and maintenance for the Emergency Housing and Assistance Program (EHAP) and expects to finalize them within two months. Further, a long-term, on-site monitoring procedure for the EHAP is under development and the Department plans to review, document, and identify any necessary process improvements in its monitoring procedures for programs not included in your audit. The Department anticipates completing all corrective action within six months. Specifics of its complete action plan are in its attached letter.

If you need additional information regarding this response, please do not hesitate to contact me, or Michael Tritz, Deputy Secretary for Audits and Performance Improvement at the Business, Transportation and Housing Agency, at (916) 324 7517.

Sincerely,

(Signed by: M. M. Berte for)

DALE E. BONNER
Secretary

Attachment

Department of Housing and Community Development
Office of the Director
1800 Third Street, Room 450
Sacramento, CA 95811

August 28, 2007

Dale E. Bonner, Secretary
Business, Transportation and Housing Agency
980 Ninth Street, Suite 2450
Sacramento, CA 95814

Dear Secretary Bonner:

The Department of Housing and Community Development (Department) was pleased to assist the Bureau of State Audits (Bureau) in its first review of the Proposition 46 and Proposition 1C housing bond programs. The Department is also pleased that the Bureau has recognized the Department's successful efforts in promptly awarding housing bond funds, in-progress loan and grant accountability measures and effective post-completion monitoring procedures for loans and grants with long-term affordability requirements. Finally, the Department appreciates the Bureau's careful review and welcomes the opportunity to make improvements. All improvements are well underway and will be completed before the Department submits the six-month progress report related to this audit.

The Department's View and Corrective Action Plans in response to conditions and recommendations included in the Bureau's August 24, 2007, draft audit report are as follows:

1. The Bureau of State Audits recommended as follows:

The department should implement record-keeping procedures for the Emergency Housing Program to ensure that applicants that receive awards have been properly evaluated.

Department's View and Corrective Action Plan

Draft standardized record filing and maintenance procedures for the Emergency Housing and Assistance Program-Capital Development (EHAP-CD) have been developed and will be finalized by the end of October 2007. The procedures will include guidance regarding the location of temporary working files and permanent files. An *EHAP-CD Contract File Stacking Order,* now in draft form, will be included as part of the file and will include placing the threshold criteria score sheet used for rating and ranking in a prominent location in each file. Procedures will also require the use of checkout cards for all files and staff training on proper maintenance of the files. New procedures will apply to the most recent awards as well as future awards. In addition, following the implementation of new procedures, staff will undertake a complete review of the older EHAP-CD bond-funded files to ensure that all files are complete and uniformly organized. This effort will be completed by February 2008.

2. The Bureau of State Audits recommended as follows:

The department should continue its efforts to consistently monitor sponsors' use of housing bond funds by doing the following:

- Consider eliminating its process of overriding restrictions on advances for the CalHome Program.

Dale E. Bonner, Secretary
Page 2

- Give high priority to finalizing and implementing monitoring procedures for the CalHome and Emergency Housing programs, which do not currently have such procedures in place.
- Review its other housing bond programs that were not specifically evaluated in this initial audit to ensure that monitoring procedures are in place and operating.

Department's View and Corrective Action Plan

CalHome Advance Process Improvements

The 25 percent limitation on advancing cash to sponsors was established as a guideline in the standard agreement to aid the Department and local jurisdictions in planning for disbursements. It was not intended to limit the pace at which grantees could offer loans to eligible borrowers or disburse funds to them when needed to purchase a home. Where local jurisdictions are short of internal funds to make loans and are experiencing high demands for home loans, CalHome should continue to provide an adequate advance so the jurisdiction can assist first-time, lower-income homebuyers to complete home purchases. The Department has found that, in some cases, 25 percent is not sufficient to provide cash flow to support the rate at which loans are being made. In these cases, a hard and fast limitation on advances could result in missed home purchase opportunities.

Rather than eliminating the option of overriding the 25 percent advance limitation altogether, the Department intends to establish clear procedures to guide staff in evaluating circumstances in which an advance above the 25 percent limitation may be appropriate as well as documenting the justification received. The cash advance process is being reviewed and written procedures will be developed by the end of October 2007. Procedures will ensure that exceptions are allowed only after there is clear documentation that the contractor has a proven history of making loans on a timely basis (using the Borrower Summaries which are submitted when actual loans have been made) and it is also determined that the amount requested is reasonable in consideration of the anticipated loan closing schedule. In all cases where advances have been provided, staff will evaluate actual performance, as measured by receipt of Borrower Summaries, at 60-day intervals following the advance. Staff will be trained on these procedures, and documentation will be maintained in each file.

CalHome and EHAP-CD Monitoring

CalHome Monitoring: As the audit recognizes, HCD generally undertakes appropriate monitoring procedures during the expenditure phase. This is also the case for CalHome. The Recipient is required to submit Program Guidelines, a Loan Servicing Plan, a Reuse Account Plan, CalHome Loan Documents (note and deed of trust) and, if a first-time homebuyer, Homebuyer Education Plan. These plans are reviewed by Department staff prior to any release of funds to make sure they are in compliance with CalHome regulations.

When funds are requested, monitoring is performed using the Borrower Summary form to ensure household income remains at 80 percent or below of the area median income for the number of members in the household. The sales price is reviewed, and staff ensures that CalHome is used for gap financing. The loan closing date is checked to ensure that work was not performed before the Standard Agreement is executed. Quarterly and annual reports from recipients to verify the balance of the recipients' grants are compared to Department balances as well as the units that have been purchased or rehabilitated. The Department tracks the reuse account balances as well as the number of units the reuse account has helped.

Dale E. Bonner, Secretary
Page 3

While CalHome was designed to require minimal longer-term monitoring, the Department was in the process of developing an on-site monitoring component during the course of the audit. The process includes a monitoring checklist to document compliance with housing bond requirements, including those that ensure the program benefits the intended population. A risk assessment procedure will help focus site reviews where most needed. The pilot effort began in July 2007. Results will be evaluated in December and procedures finalized by the end of January 2008.

EHAP-CD Monitoring: As with CalHome, in-progress monitoring during and at completion of the construction phase is in place for EHAP-CD. The Department receives and reviews documents before funds are disbursed that show evidence of work completed. In addition to the existing review of semi-annual reports, and monitoring visits that may occur during project development on an "as needed" basis, the Department is developing an on-site monitoring procedure for EHAP-CD during the 5- to 10-year period projects remain in operation. This procedure will be implemented no later than January 2008. Resources for this effort are limited due to the statutory cap on administrative expenditures. However, long-term on-site monitoring will be performed on a reasonable sample of projects, predicated on risk factors which will include: the borrowers' records of compliance in providing required semi-annual reports; the content of those reports; the value, nature and term of the loans provided; oversight provided by designated local boards, and other potential risk indicators. Monitoring will focus on the sponsor's use of funds in accordance with housing bond requirements with particular attention to ensuring the sponsor's projects are benefiting the intended population(s) and complying with fair housing laws. The EHAP-CD annual work plan requires the application and award process to be completed from January through June, so on-site monitoring will be conducted July through December of each year.

Review of Monitoring Procedures for Bond Programs Not Included in the Initial Audit

The Department welcomes the opportunity to identify additional improvements to its monitoring efforts and will immediately begin its review of the programs not included in this audit.

In establishing appropriate in-progress and long-term accountability and monitoring processes for the bond programs, the Department established the strongest processes for those loan and grant programs that make the largest awards and those which require the grantee or borrower (sponsor) to comply with conditions and provide continuing public benefits over the longest terms. These include the Multifamily Housing Program and its related rental housing programs as well as the Joe Serna Jr. Farmworker Housing Grant Program. For these programs, the goal of the monitoring process is to protect the state's significant investment, ensure the physical and fiscal stability of funded projects and ensure that the public benefit is preserved and available to residents over time. The Department is confident that, with the two exceptions noted above, its monitoring processes for other programs are appropriate for the varying types of programs and projects funded and the amount of funds invested. Nonetheless, the Department welcomes the opportunity to review the status of the other housing bond programs to document the status of its monitoring procedures and identify any necessary process improvements. The Department will report back on the results of this review, as well as any corrective measures initiated in the six-month progress report related to this audit.

Thank you for your careful review. Should you or your staff have any questions, please do not hesitate to contact me at 445-4775.

Sincerely,

(Signed by: Lynn L. Jacobs)

Lynn L. Jacobs
Director

California Housing Finance Agency
P.O. Box 4034
Sacramento, CA 95812

August 28, 2007

Mr. Dale Bonner, Secretary
Business Transportation & Housing Agency
980 9th Street, Suite 2450
Sacramento, CA 95814-2719

Re: CALIFORNIA HOUSING FINANCE AGENCY AUDIT OF PROP 46 FUNDS

Dear Secretary Bonner:

The Bureau of State Audits (BSA) has completed its review of the Housing and Emergency Shelter Trust Fund Acts of 2002 (Proposition 46 funds). The California Housing Finance Agency (CalHFA) is pleased to report that there were no findings or concerns related to the funds administered by CalHFA.

CalHFA employees are extremely dedicated to ensuring these funds are used as efficiently and effectively as possible. We have such a wonderful mission, and having these funds available has allowed us to maximize other resources and truly make homeownership a reality for a number of California families.

We wish to thank the BSA for its diligence and thoroughness in completing this audit, in particular, Jim Sandberg-Larsen, Mary Camacho, Melissa Roye and Angela Dickison were not only courteous, but professional and efficient in handling their audit responsibilities. I look forward to continuing our successful participation in these programs. Please contact me at (916) 324-4638 if there are questions regarding this audit.

Sincerely,

(Signed by: Theresa A. Parker)

Theresa A. Parker
Executive Director

cc: Members of the Legislature
Office of the Lieutenant Governor
Milton Marks Commission on California State Government Organization and Economy
Department of Finance
Attorney General
State Controller
State Treasurer
Legislative Analyst
Senate Office of Research
California Research Bureau
Capitol Press