



California Department of Housing and Community Development

Its Oversight of Housing Bond Funds
Remains Inconsistent

Report 2018-037

COMMITMENT
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September 20, 2018

2018-037

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 Health and Safety Code sections 53533 and 53545, the California State Auditor presents its fifth audit in a series concerning the Housing and Emergency Shelter Trust Fund Acts of 2002 and 2006. This report concludes that the California Department of Housing and Community Development's (HCD) oversight of housing bond funds remains inconsistent and that HCD has failed to follow through on half of our recommendations from previous reports. We found problems related to how HCD is monitoring some bond programs, whether its housing bond database can perform key functions, and how it is ensuring that it does not exceed administrative spending limits.

Although HCD generally performed adequate monitoring of the four loan-based multifamily housing programs we reviewed, it has inadequately monitored some of its grant programs. Specifically, we found continuing problems with HCD's oversight of two of its grant-based programs, totaling more than \$610 million of housing bond funds, which we also noted in our previous housing bond audit reports. For these two programs, HCD has failed to obtain half of the required performance reports detailing how the recipients are using the money to help target populations, and it also failed for one of those programs to perform on-site visits to verify whether those recipients, such as local governments, are providing assistance only to those who qualify.

In addition, despite years of continued development, HCD cannot effectively use its centralized database system to monitor program work for all of its housing bond programs, as intended. As a result, HCD management is limited in its ability to verify that staff are receiving and monitoring required reporting documents in certain programs and cannot always assure the public that the bond funds are reaching the recipients intended in state law.

Moreover, HCD risks exceeding some statutory administrative spending limits. According to HCD, it has exceeded the 5 percent statutory administrative spending limit for at least two of its programs and estimates it will exceed the limit in another before it can fully complete its monitoring obligations. By exceeding those limits, HCD could potentially violate state law and may be unable to monitor recipients as required. Further, HCD management lacks a long-term plan for addressing its administrative spending overages.

Respectfully submitted,



ELAINE M. HOWLE, CPA
California State Auditor

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SUMMARY

In 2002 and 2006, Californians voted to provide a total of nearly \$5 billion in bonds (housing bonds) for use in financing affordable housing. The California Department of Housing and Community Development (HCD) oversees the majority of housing bond programs for the State and is responsible for ensuring that target populations receive bond-funded housing. Since 2007 our office has performed five required audits, including this one, of HCD's housing bond program management. In each audit, we found similar problems related to HCD's monitoring of certain housing bond programs, particularly CalHome and Building Equity and Growth in Neighborhoods (BEGIN), both of which generally enable low-income and very low-income households to become or remain homeowners. We also identified concerns related to HCD's implementation of its housing bond database and its adherence to administrative spending limits. To ensure HCD addressed the problems we identified, we made a total of 28 recommendations in the first four reports, which HCD previously asserted that it implemented. However, during this review, we determined that HCD had not followed through on half of these recommendations. This report concludes the following:

HCD Continues to Monitor Its Housing Bond Programs Inconsistently

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The housing bond programs that HCD oversees generally award funds to recipients, such as local government agencies and nonprofits, that in turn use the funds to benefit target populations. To verify that these populations receive the intended benefits, HCD's policies require its staff to monitor the award recipients. However, we found significant differences between HCD's monitoring of its loan-based programs, which require recipients to pay back the funds, and its monitoring of its grant-based programs, which do not require the recipients to pay back the funds. Specifically, HCD has failed to perform critical steps when monitoring grant-based programs, including CalHome and BEGIN. It has not obtained required performance reports detailing how the recipients have used the funds to help target populations, nor has it performed on-site visits to verify whether recipients have provided assistance only to those who qualify.

HCD Is Unable to Fully Use Its Housing Bond Database, Impeding Its Ability to Ensure That Staff Adequately Monitor Award Recipients

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Although HCD has put into service a centralized database—the Consolidated Automated Program Enterprise System (CAPES)—it has not ensured the system has the necessary functionality for it to monitor its housing bond programs. As a result, HCD staff do not use CAPES to monitor CalHome or BEGIN. Because HCD staff

do not use CAPES consistently, HCD management is limited in its ability to verify that staff receive and monitor the reports that recipients must submit, and HCD therefore lacks assurance that the bond funds are reaching the target populations.

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HCD Risks Exceeding Some Statutory Administrative Spending Limits, Which Could Threaten Its Ability to Meet Its Monitoring Requirements

According to its tracking tool and its bond fiscal manager, HCD has exceeded the 5 percent statutory administrative spending limit for at least two of its programs, including BEGIN. HCD projects it will also exceed this limit for CalHome before it can complete its monitoring obligations. When it exceeds statutory spending limits, HCD is potentially violating state law and risks being unable to monitor recipients as required. Further, HCD management lacks a plan for addressing administrative spending overages.

Summary of Recommendations

Legislature

The Legislature should require HCD to annually report to it in detail on its monitoring of CalHome and BEGIN awards and to include performance metrics to demonstrate that recipients have issued loans to eligible homeowners.

The Legislature should require the Business, Consumer Services and Housing Agency to annually report to it on the status of HCD's implementation of our recommendations.

HCD

HCD should immediately obtain all required performance reports for its grant-based programs, including CalHome and BEGIN, and it should also develop a plan for performing on-site visits of the CalHome recipients.

HCD should determine CAPES's usability for the housing bond programs, decide based on that determination if management should enforce the use of the database by its staff, and develop a plan to address the feasibility of continuing to develop CAPES.

HCD should develop a long-term plan describing how it will address instances when it has exceeded its administrative spending limits and how it will avoid exceeding the limits of the additional programs in the most immediate danger of overage.

Agency Comments

The Business, Consumer Services and Housing Agency agreed with our recommendations and indicated that HCD has begun implementing them.

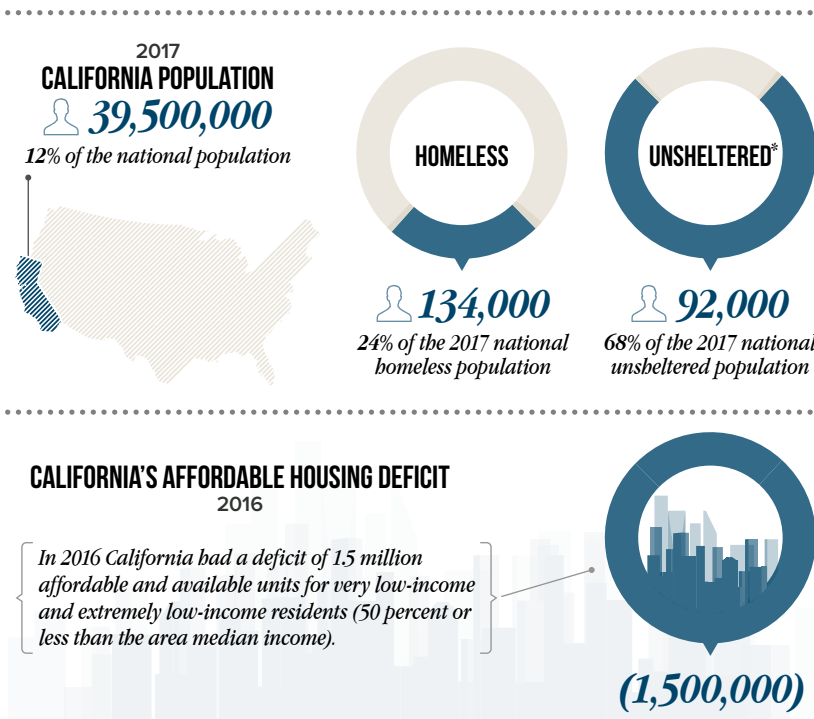
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INTRODUCTION

Background

The State’s housing goal is to provide a decent home and suitable living environment for every California household. California voters passed the Housing and Emergency Shelter Trust Fund Acts of 2002 and 2006 (Propositions 46 and 1C, respectively) to provide nearly \$5 billion in bonds (housing bonds) for use in financing affordable housing. The two propositions allocated funds to 29 different housing programs that the California Department of Housing and Community Development (HCD), the California Housing Finance Agency, and the California Pollution Control Financing Authority administer. These three housing bond administrators have awarded the majority of Propositions 46 and 1C funds to rehabilitate older buildings, construct new affordable housing units, and assist single families with the costs associated with homeownership, including down payment assistance and home rehabilitation. Currently, California continues to face an affordable housing shortage, as Figure 1 shows.

Figure 1
California Continues to Face Insufficient Affordable Housing



Source: Statistics from the National Low Income Housing Coalition, the U.S. Census Bureau, and the U.S. Department of Housing and Urban Development.

* Unsheltered: Homeless people whose primary nighttime location is a public or private place not ordinarily used as a regular sleeping accommodation (for example, the streets, vehicles, abandoned buildings, parks, or camping grounds).

HCD's Oversight of Housing Bond Programs

HCD's mission is to provide leadership, policies, and programs to preserve and expand safe and affordable housing opportunities and to promote strong communities for all Californians. As part of its mission, HCD administers 21 of the 29 housing bond programs. These programs award housing bond funds to recipients such as cities, nonprofit housing agencies, for-profit developers, housing development groups, and agricultural employees, with the type of recipient dependent upon the nature of the specific program. The housing bond programs are designed to help target populations afford housing in California. As Figure 2 describes, these populations include very low-income to moderate-income households, homeless, homeless youth, and agricultural workers.

HCD generally administers two types of programs: loan-based programs in which recipients pay back the funds, and grant-based programs, in which they do not. In loan-based programs, HCD receives principal and interest payments and fees for project monitoring, while it generally does not receive these payments for grant-based programs. Two of the programs HCD administers are CalHome and Building Equity and Growth in Neighborhoods (BEGIN)—grant-based programs that are earmarked to receive \$505 million and \$106 million, respectively, of the housing bond funds. These programs generally allow low-income and very low-income households to become first-time homebuyers or remain homeowners.

HCD's Monitoring of Program Allocations

HCD's role does not end once it provides awards. HCD is responsible for monitoring the award recipients' compliance with state law, regulations, and program requirements. It does so by ensuring that recipients continue to provide safe and affordable housing and that the homes its awards finance remain well maintained. HCD's monitoring of these housing bond programs is important given that they account for \$4.39 billion of the bond funds, as Figure 3 on page 8 shows.

HCD put the Consolidated Automated Program Enterprise System (CAPES) into service in 2007 to serve as its department-wide data collection and organization system to track awards and monitor housing loans and grants. However, as we discuss later in this report, not all HCD divisions use it to manage their work because the system does not yet have full functionality.

Figure 2
HCD’s Housing Bond Programs We Reviewed Are Intended to Help Target Populations Afford Housing



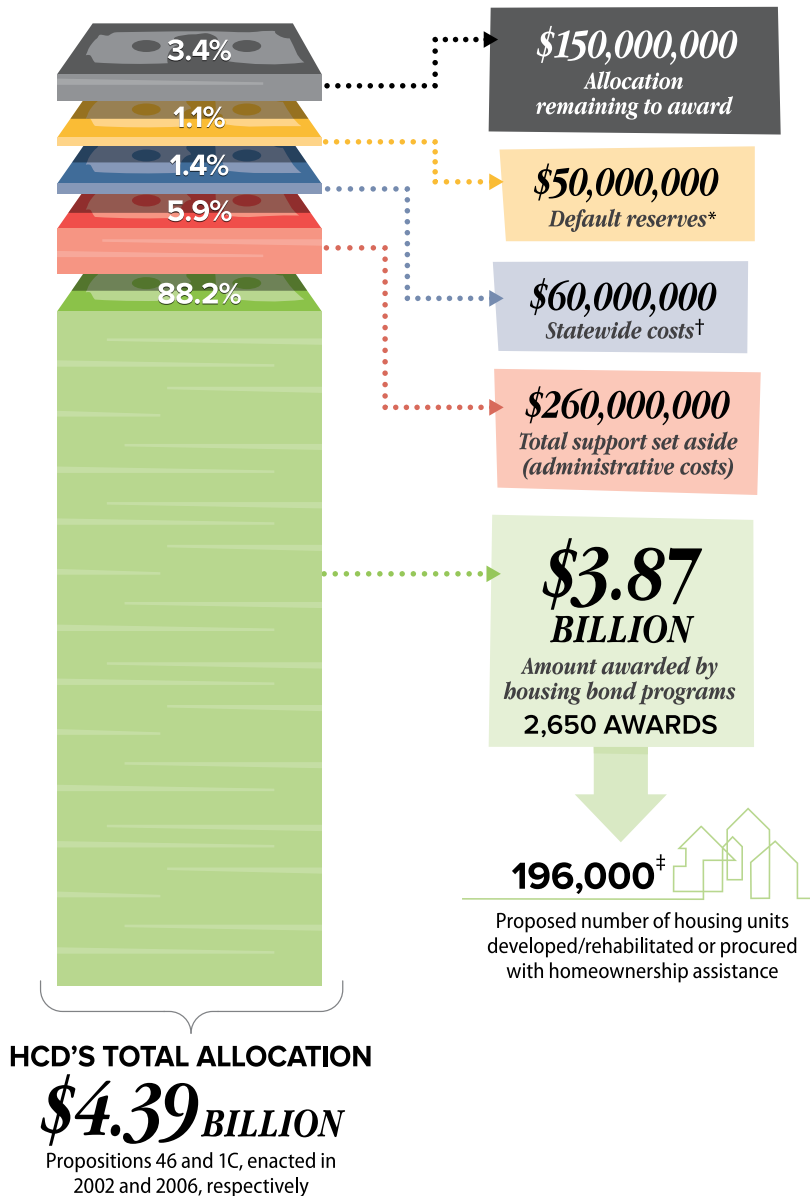
Source: Analysis of state law and regulations, HCD program guidelines, and funding levels for Propositions 46 and 1C as of December 31, 2017.

Administrative Spending

By statute, HCD can use up to 5 percent of the funds it appropriates to certain programs for administrative costs. These programs include CalHome and BEGIN. When these two programs award funds, HCD has 20-year monitoring agreements with the recipients. These grant-based programs do not receive fees from the recipients to help pay for administrative costs;

rather, state law authorizes HCD to use up to 5 percent of the program-specific housing bond funds for this purpose. These administrative costs include HCD's costs related to its program-related operational activities, including making awards and monitoring recipients to ensure that their use of awards complies with state law, regulation, and program guidelines.

Figure 3
HCD Awarded Almost All of Propositions 46 and 1C Housing Bond Funds to Create New Housing Units and Assist Individuals in Homeownership



Source: Analysis of state law and HCD's consolidated bond reports for Propositions 46 and 1C as of December 31, 2017.

* **Default reserves:** Amounts for unexpected costs incurred to protect the State's financial interest. HCD could eventually disburse those amounts.

† **Statewide costs:** Expenses, including costs to issue the bonds, incurred by the State Treasurer's Office, the State Controller's Office, and the Department of Finance (Finance).

‡ The definition of *housing unit* varies by program. For example, a housing unit can be a single-family home, a multibed apartment, one habitable room, or an incentive to build a housing unit.

Potential Future Housing Bonds

As the text box shows, California voters will decide in November 2018 whether to approve an additional \$3 billion in housing bonds, including \$2.85 billion for the housing programs that HCD currently oversees. The ballot measure would provide more money to many of the same programs that Propositions 46 and 1C funded. According to the senate bill that created this ballot measure, investment in existing and successful housing programs to expand the State’s housing stock should benefit California’s homeless population and low-income earners, as well as some of the State’s most vulnerable populations, such as foster and at-risk youth, persons with developmental and physical disabilities, farmworkers, the elderly, single parents with children, and survivors of domestic violence.

Multifamily Housing Program	\$1.5 Billion
CalHome Program	\$300 Million
Infill Incentive Grant Program	\$300 Million
Joe Serna, Jr., Farmworker Housing Grant Program	\$300 Million
Affordable Housing Innovation Program	\$300 Million
Transit-Oriented Development Implementation Program	\$150 Million

Source: Senate Bill 3 (Chapter 365, Statutes of 2017), Veterans and Affordable Housing Bond Act of 2018.

Recommendations From Our Previous Audits

As Table 1 on the following page illustrates, our office performed four previous audits of HCD’s administration of housing bond programs. We found that HCD failed to adequately monitor some of its housing bond programs, to fully implement its housing bond database, and to ensure that it did not exceed administrative spending limits. We made a total of 28 recommendations to HCD to address the problems we identified in those audits.

Table 1
HCD Has Long-standing Problems in Some Areas We Reviewed

Requirements Assessed for Selected Programs	AUDIT REPORT 2007-037, RELEASED SEPTEMBER 2007	AUDIT REPORT 2009-037, RELEASED NOVEMBER 2009	AUDIT REPORT 2012-037, RELEASED OCTOBER 2012	AUDIT REPORT 2014-037, RELEASED SEPTEMBER 2014
HCD generally awarded bond proceeds in a timely fashion	Yes	Yes	Yes	Yes
HCD generally awarded bond proceeds in a manner consistent with requirements	Yes	Yes	Yes	Somewhat
HCD generally ensured that awardees are using funds to benefit target populations (monitoring)	Somewhat	Somewhat	Somewhat	Somewhat
CAPEs can adequately perform key functions necessary for HCD to administer bond awards	No*	No	No	No
HCD estimates it will stay within administrative spending restrictions	Yes	Yes	No	No

Source: California State Auditor reports 2007-037, 2009-037, 2012-037, and 2014-037.

* The California State Auditor issued a letter in 2007 to the Business, Transportation and Housing Agency (in 2013 it became the California State Transportation Agency) identifying issues with CAPEs.

■ HCD generally met the requirements we reviewed.

■ HCD did not meet some of the requirements we reviewed.

■ HCD did not meet the requirements we reviewed.

HCD Continues to Monitor Its Housing Bond Programs Inconsistently

Key Points:

- For the past four years, HCD has inadequately monitored some of its grant-based programs, including CalHome and BEGIN. It did not obtain required performance reports or perform on-site visits.
- HCD has prioritized monitoring its loan-based programs over monitoring its grant-based programs.

HCD Inadequately Monitors Some of Its Grant-Based Programs

For this audit, we reviewed eight housing bond programs—totaling \$3.4 billion of the nearly \$4.4 billion in housing bond funds—and found that HCD adequately monitored four but did not adequately monitor the other four. Specifically, HCD generally provided adequate monitoring of its loan-based programs by performing on-site visits and reviewing required reports. However, it did not adequately monitor its grant-based programs, including CalHome and BEGIN. As a result, it cannot be certain that award recipients for these programs used the funds to assist target populations with homeownership or home rehabilitation.

We found that HCD generally adequately monitored the four loan-based multifamily housing programs we reviewed, which received \$1.7 billion of the housing bond funds. For its multifamily housing programs, HCD makes loans to recipients, such as sponsors with experience in owning and developing affordable rental housing, to build or rehabilitate apartment buildings with a certain number of the units designated for lower-income individuals and families. The rental rates for these units are set based on the income levels of the occupants, the unit types, and locations. HCD generally monitors these programs by performing on-site visits and collecting and reviewing required reports to ensure that the award recipients are upholding their 55-year commitment to designate specific units as low-income, that they are charging appropriate rents, and that only the target populations are residing in the designated units. The required performance reports that HCD collects and reviews include schedules of rental income that identify each tenant's income, which HCD can use to ensure that the recipients are renting the designated units only to those who qualify. We reviewed a total of \$49 million that the four multifamily housing bond programs—which include the general program and three related multifamily programs—awarded. As Table 2 on the following page shows, we found that HCD generally performed sufficient monitoring to ensure that qualified families and individuals occupied the designated units.

In contrast, we found continuing problems with HCD's oversight of two of its grant-based programs—CalHome and BEGIN. We also noted these problems in our 2009, 2012, and 2014 housing bond audit reports. These two programs—which total

Table 2
HCD's Monitoring Practices Raise Questions About Whether Bond Funds Benefited Target Populations
From 2014 Through March 2018

HOUSING BOND PROGRAM	ASSISTANCE TYPE	PROGRAM ALLOCATION TOTAL	AWARDS WE REVIEWED	TOTAL AWARDED FOR ITEMS WE REVIEWED	NUMBER OF REQUIRED REPORTS	NUMBER OF REQUIRED REPORTS RECEIVED	COMPLIANCE PERCENTAGE	DID HCD USE RISK ASSESSMENTS TO IDENTIFY SITES TO VISIT?	DID HCD PERFORM SITE VISITS?
Multifamily Housing Program—General	Loans	\$1,199,381,274	3	\$20,602,594	46	46	100%	Yes	Yes
Infill Incentive Grant (IIG) Program	Grants	790,000,000	3	44,929,120	<i>The IIG program does not have processes and procedures for monitoring.</i>				
CalHome Program	Grants*	505,471,081	5	5,250,000	57	30	53	No	No
Multifamily Housing Program—Supportive Housing Program	Loans	435,472,610	2	13,061,606	36	36	100	Yes	Yes
Joe Serna, Jr., Farmworker Housing Grant Program (farmworker housing program)—General	Grants and Loans	290,000,000	Multifamily 2	4,445,000	18	18	100	Yes	Yes
			Single-Family 1	1,500,000	<i>The farmworker housing program does not have effective processes and procedures to monitor grants made directly to farmworkers for homeownership assistance.</i>				
BEGIN Program	Grants	106,067,619	1	2,790,000	4	2	50	NA	NA
Multifamily Housing Program—Homeless Youth	Loans	39,733,906	2	9,390,138	19	16	84	Yes	Yes
Multifamily Housing Program—Governor's Homeless Initiative	Loans	38,336,950	1	6,404,461	17	17	100	Yes	Yes

Source: Analysis of HCD program guidelines, rules and regulations, program files, and staff interviews.

NA = Not applicable because on-site monitoring is generally not required for the BEGIN program after the standard agreement has expired.

* The CalHome program can also provide loans, but HCD primarily provided grants.

about \$505 million and \$106 million, respectively, of the housing bond funds—generally help moderate-income, lower-income, and very low-income households to become first-time homebuyers or to remain homeowners. Specifically, through these two programs, HCD provides grants to local government agencies and nonprofits that subsequently provide individual households with loans. Although the local government agencies and nonprofits do not pay back the funds to HCD, the individual households repay the principal and interest to the agencies and nonprofits. The agencies and nonprofits that participate in these two programs must deposit all repayments in an account known as a *reuse account* and use those funds only for program-eligible activities. However, HCD did not always perform the monitoring required to ensure that recipients used the funds to assist target populations with homeownership or home rehabilitation. We reviewed five CalHome awards, which totaled nearly \$5.3 million, and found that HCD did not collect or review all required reports, perform risk assessments, or conduct on-site visits. We also reviewed one BEGIN award of \$2.8 million and found similar problems related to the collection and review of required reports.

From 2014 through March 2018, HCD collected only 32 of 61 required reports—which detail how the award recipients used the money to provide mortgage or home rehabilitation assistance—for CalHome and BEGIN; thus, nearly half were missing. HCD’s CalHome regulations and BEGIN policies require recipients to submit certain reports to HCD quarterly and annually, as the text box shows. In one example, HCD did not collect or review 16 of the 18 required CalHome reports from 2014 through March 2018 for the city of Pico Rivera. In response to a recommendation from our 2014 audit report, HCD added a policy to the CalHome and BEGIN manuals stating that it would not process disbursements if recipients had any delinquent or missing required reports. However, in this instance, HCD violated its own policy. According to a staff member in the grant management section, high staff turnover resulted in contract responsibility moving from one staff member to another staff member. He stated that he did not begin monitoring Pico Rivera until January 2017, one month before it requested HCD to disburse funds. Although the staff member asserted that he reviewed Pico Rivera’s expenses to ensure that they were allowable and that he

CalHome and BEGIN Reporting Requirements

Quarterly Status Reports

1. Recipients must provide HCD with quarterly status reports no later than 30 days following the end of each calendar quarter during the term of the standard agreement, which expires 36 months from the award date.
2. The reports are to include a summary of program activities during the quarter, such as the number of units assisted, any planned activities for the next quarter, a financial summary including the original grant amount, all drawdowns, and the remaining balance.

Annual Status Reports

1. Recipients must provide reports to HCD annually, due no later than 30 days after June 30 during the term of the standard agreement, which expires 36 months from the award date.
2. The reports are to include the number of units assisted under the program requirements, a financial summary including the original grant amount, total funds drawn during the fiscal year, and the remaining balance.

Reuse Account Reports

1. Recipients must report annually on their reuse accounts for the length of the monitoring agreement, 17 years after the end of the standard agreement.
2. The reports are due no later than 30 days after June 30.
3. The reports must specify how the recipients are using loan repayments for CalHome and BEGIN activities.

Source: HCD’s CalHome regulations and desk manual and BEGIN operations handbook.

reconciled the award balance before approving the disbursement, HCD should have been monitoring the city's use of funds over the four-year period. Instead, HCD still disbursed more than \$850,000 to that city despite its missing reports.

When we asked a manager within the grant management section why HCD did not collect the required performance reports for the CalHome and BEGIN programs, he indicated that HCD management failed to ensure that staff knew their responsibilities. Specifically, HCD experienced significant turnover in program staff, which led to a lack of awareness of responsibilities and of expectations for properly monitoring program award recipients. He also indicated that staff did not receive proper training on the monitoring requirements when they assumed new program responsibilities. Further, he stated that monitoring grant programs has been a low priority for HCD. Consequently, the level of monitoring HCD provided to CalHome and BEGIN is inadequate given that these programs are responsible for over \$600 million in housing bond funds.

HCD management failed to ensure that staff knew their responsibilities.

When HCD did collect required reports, it is unclear whether staff used them in their decision making, and its lax oversight may have prevented individuals and families in need from obtaining timely assistance. For example, HCD collected all 16 required performance reports for one CalHome award to the Coachella Valley Housing Coalition (coalition). However, HCD twice provided one-year extensions to the award's original term, which expired 36 months from the award date, even though the coalition repeatedly stated in its reports that it was still searching for recipients for the loans and had not yet issued any. Based on these reports, HCD should not have granted the extensions. Doing so could cause HCD to violate its regulations, which require that if it does not expend all awarded funds within 36 months, it must make those unused funds available for other program purposes.

When it granted the coalition's extensions, HCD prevented the funds in question from being available to other potential recipients, perhaps in a different region with greater and more immediate need. HCD eventually cancelled the full amount of the award, but only after it had extended the award contract for two years beyond the original term. Further, at the time it originally issued

the coalition's award, HCD reported that it had about 50 other applicants that had not received awards. If HCD allows recipients to keep funds rather than making loans, those funds are not available to help address California's housing needs. According to the CalHome program manager at that time, HCD often granted extensions when requested because of the limited CalHome funds left to award. Further, the manager explained that HCD wanted to allow recipients adequate time to use the funds. However, HCD violated its regulations when it did not expend the funds it awarded to the coalition within 36 months and instead granted extensions.

In addition to its failure to collect and review required reports, HCD's asset management compliance branch chief stated that HCD did not conduct any on-site monitoring or use its risk assessment tool to monitor CalHome awards from 2014 through March 2018. HCD's desk manual requires risk assessments to identify recipients for on-site visits. The risk assessment considers factors such as whether a recipient has requested an extension to the standard agreement or failed to submit performance reports, as well as the dollar amount of the award and the recipient's number of open awards. In response to a recommendation from our 2014 audit report, HCD updated its risk assessment tool and its CalHome desk manual to require its staff to conduct on-site visits based on the risk assessment tool. HCD designed its procedures for on-site visits to allow staff to evaluate whether the award recipient provided homeownership or home rehabilitation assistance to only qualifying individuals or families. However, HCD did not perform any on-site visits for CalHome awards from 2014 through March 2018, nor did it perform any risk assessments. Thus, it was unable to confirm whether recipients provided assistance only to those who qualified.

.....

**HCD did not conduct any on-site monitoring
or use its risk assessment tool to monitor
CalHome awards from 2014 through
March 2018.**

.....

The deputy director of HCD's division of financial assistance (financial assistance deputy director)—who oversees the housing bond programs—stated that after HCD updated its risk assessment tool in 2014, it did not follow through with implementing its stated processes to perform on-site monitoring of CalHome award recipients. Instead, it tasked CalHome staff and managers

with other priorities, such as reviewing the portfolio of awards to identify which awards it needed to cancel or extend. In response to our current audit, HCD completed risk assessments for active CalHome recipients in August 2018 and stated it would perform on-site monitoring starting in late August 2018. Even so, we are concerned that HCD will not follow through on its assertions given that we made similar recommendations in each of our 2009, 2012, and 2014 housing bond audit reports.

We also reviewed the IIG program and the farmworker housing program, with funding of \$790 million and \$290 million, respectively. The IIG program provides financial assistance for the infrastructure improvements necessary to facilitate new infill housing developments through affordability covenants, agreements that require that a certain number of units in these developments remain designated for low-income families and individuals for 55 years.¹ The farmworker housing program provides loans or grants for multifamily housing developments and for single-family homes. The single-family farmworker housing program provides grants directly to agricultural employees and their families for home-buying assistance, among other things. If the program awards a grant directly to a family, the family must own and occupy the home paid for by the grant. According to the program managers, HCD has not implemented formal or specific policies or procedures that require it to collect status reports or to perform on-site monitoring for either of these programs, nor has it developed effective processes to ensure that the award recipients or their renters are living in the homes as the programs require.

Although other HCD programs, such as the multifamily housing programs, or local jurisdictions may monitor IIG awards, HCD does not track this monitoring. According to the IIG program manager, although HCD relies on these other sources for providing monitoring such as on-site visits, it does not document whether visits occur, who performs them, or their outcomes. For example, IIG program staff do not obtain reports or other documentation to verify that multifamily housing programs or local jurisdictions have performed any on-site visits of award recipients. As a result, HCD is unable to ensure that the housing units developed through the IIG program are affordable and will continue to be so for the duration the program requires. In response to the concerns we identified, HCD's IIG manager acknowledged the need for HCD to develop procedures to monitor IIG award recipients and provided us with draft monitoring procedures in May 2018. Notwithstanding, the

¹ An infill housing development is a site that is at least 10 years old and is being redeveloped for urban uses.

draft monitoring procedures are inadequate because they do not describe how HCD will track awards monitored by other entities or those that do not fall under the oversight of another entity.

Although other HCD programs may monitor these awards, HCD does not track this monitoring.

Although HCD recently developed procedures to monitor whether only qualified farmworkers are occupying housing funded through the single-family farmworker housing program, these procedures are limited in their effectiveness. According to HCD's grant lien agreements for this program, the recipient must occupy the property and not rent, or otherwise lease, any part it. In 2018 HCD implemented an annual compliance letter process for this program requiring recipients to self-certify that they have homeowners insurance, that their property taxes are current, and that they have not added any additional debt to the title, among other items. However, according to the HCD homeowner portfolio manager, HCD does not request or obtain any supporting documentation, such as proof of insurance or a current utility bill, to verify the recipients' assertions on the form and demonstrate that they are occupying the homes in question. Further, the HCD homeowner portfolio manager asserted that as of April 2018, HCD had received only a 33 percent response rate to the 650 self-certification letters it had sent out, and it does not follow up on letters when the homeowners do not respond. As a result, it is difficult for HCD to determine the level of compliance with the program requirements. According to the homeowner portfolio manager, HCD does not have the staff and resources to follow up on the recipients who do not respond. In response to our audit, HCD did create policies for following up on these letters.

HCD Management Does Not Prioritize Monitoring Its Grant-Based Programs

HCD's lax monitoring of its grant-based programs may be due to its management's lack of emphasis on monitoring those programs. There is a stark difference between the thoroughness and level of documentation HCD staff use in monitoring its multifamily housing programs, which issue loans, and in monitoring its grant-based programs, such as CalHome and BEGIN. According to the asset management compliance branch chief, HCD invested

in resources and trainings for the multifamily housing programs because it believes these are the best programs to accomplish its mission of addressing California's housing issues. Further, with limited resources, HCD prioritized the multifamily housing programs as its core business. However, this does not absolve HCD of its responsibility to ensure that recipients of program grants use funds promptly and appropriately. Without adequate monitoring of its grant-based programs, HCD may prevent households that are in need from receiving the limited funds available.

Further, addressing these chronic monitoring issues is important because HCD could receive an additional \$900 million for the CalHome, IIG, and the farmworker housing programs under a new ballot measure going before voters in November 2018. Many of the problems we identified with CalHome have been ongoing for nearly a decade. Despite HCD's earlier assertions that it had implemented our recommendations to fix these problems, we found that it had not followed through on necessary changes. For example, we recommended to HCD in our 2009, 2012, and 2014 audit reports that it use a risk-based approach to identify potential recipients for on-site visits for CalHome. However, in our current audit, we found that nine years later, HCD still had not followed through on performing site visits or on using a risk-based approach to identify recipients to visit. Because HCD has failed to follow through on our recommendations and because it may receive significant additional funding for these programs, additional oversight of HCD is necessary.

Recommendations

Legislature

Given HCD's long-standing history of inadequate monitoring for some of its programs and the additional funds HCD could receive for CalHome under the November 2018 ballot measure, the Legislature should require HCD to disclose information about such monitoring in its annual report, which it should submit to the Assembly Committee on Housing and Community Development and the Senate Committee on Transportation and Housing. The report should identify all of the awards that HCD monitors for the CalHome and BEGIN programs and should include performance metrics such as the amount of funds awarded but not disbursed to recipients and therefore not issued to potential homeowners. The Legislature should also require HCD to disclose

in its annual report—at a minimum—the following information for all awards that HCD is responsible for monitoring in the CalHome and BEGIN programs:

- The amount of the original awards to recipients, the portions not yet disbursed to recipients, and an estimate of how many individuals could benefit from the remaining balance.
- Any extensions HCD granted to the standard agreement and the number of and reason for those extensions.
- The total balance of all recipients' CalHome and BEGIN reuse accounts, detailing the loan repayments recipients are required to reissue for program purposes and an estimate of how many households could benefit from the balance.
- A section describing HCD's monitoring efforts, including the collection of performance reports and the results of the risk assessments and on-site monitoring.

The Legislature should require the Business, Consumer Services and Housing Agency to monitor HCD's efforts and to submit a report annually to the Legislature demonstrating that HCD is continuing to implement our recommendations.

HCD

To ensure that it appropriately monitors CalHome as required by statute, regulation, and program guidelines, HCD should perform the following:

- By January 1, 2019, develop an annual plan for its CalHome on-site visits, which should be based on its risk assessments. The risk assessments should consider, among other things, which recipients have not submitted required performance reports.
- Perform the on-site visits it proposes in its annual plan.
- Immediately collect all required reports and follow up with recipients to obtain missing reports. Staff should withhold fund disbursements from recipients that have not submitted required reports. If the submitted reports reveal a problematic trend, such as a recipient not disbursing funds, HCD should take appropriate corrective action with the recipient.

- Immediately stop providing extensions to standard agreements to recipients if those extensions would cause HCD to not spend the full award within the 36-month term and therefore violate its regulations.

To ensure that HCD appropriately monitors BEGIN as required by statute, regulations, and program guidelines, HCD should immediately collect and review all required reports, and it should follow up with recipients to obtain any missing reports. If the reports reveal a problematic trend, such as a recipient not disbursing funds, HCD should take appropriate corrective action with the recipient.

To ensure that the IIG program award funds benefit the target population, HCD should develop and use a tool by December 1, 2018, to track which awards are monitored by local jurisdictions or by other HCD programs and which are not monitored at all. HCD should then immediately obtain monitoring reports from the local jurisdictions and other HCD programs to verify monitoring and review the results of such monitoring. HCD should follow up on any noted deficiencies. Further, HCD should, by January 1, 2019, develop a plan to perform on-site visits for those recipients that do not receive adequate monitoring from another source, and it should perform the planned on-site monitoring.

To ensure that single-family farmworker housing program recipients continue to qualify for housing, HCD should implement policies and procedures by December 1, 2018, to ensure that the information the recipients provide in the self-certification letters is accurate and complete by requiring that they include documentation as proof. HCD should also follow up to ensure that it receives responses to its annual compliance letters from all recipients.

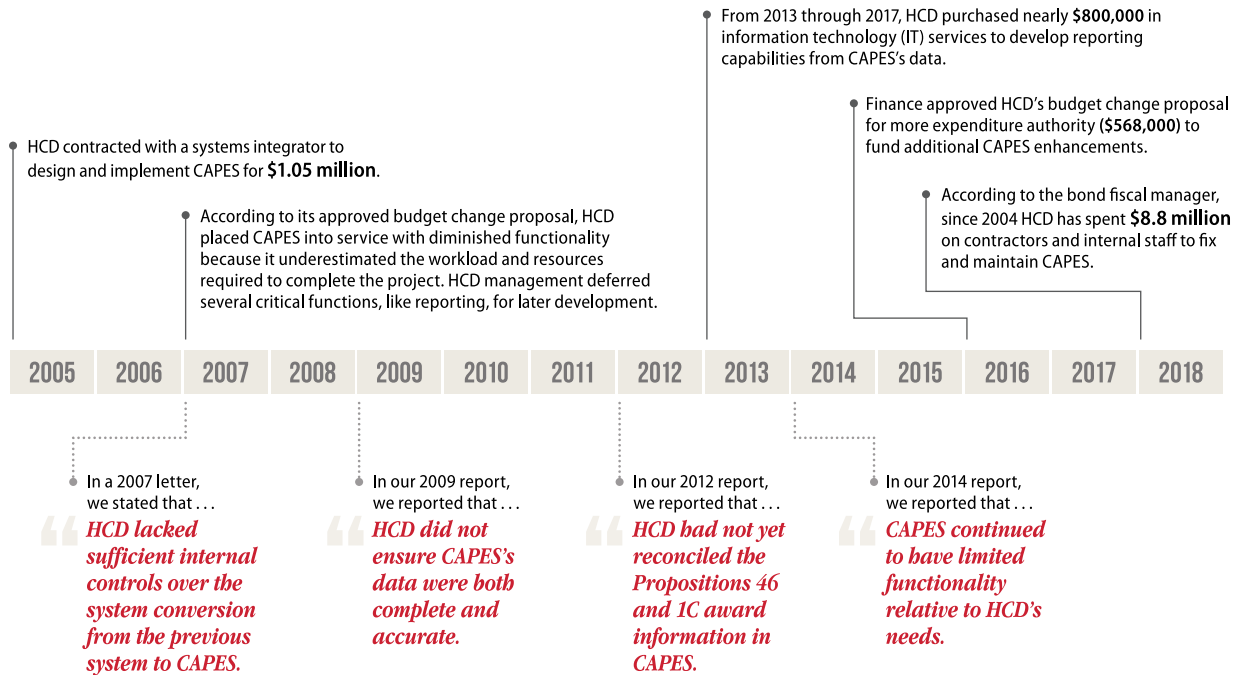
HCD Is Unable to Fully Use Its Housing Bond Database, Impeding Its Ability to Ensure That Staff Adequately Monitor Award Recipients

Key Point:

- Despite years of continued development, HCD cannot effectively use CAPES to monitor program work for all of its housing bond programs. Some programs do not enter data into CAPES, and HCD continues to have incomplete and inaccurate data for its other housing bond programs, further complicating its required monitoring of funds and outcomes.

Although CAPES has been in service since 2007, HCD still cannot fully use the system for its intended purposes. As Figure 4 on the following page shows, HCD's implementation and continued development of CAPES has cost millions of dollars over almost 13 years. One of CAPES's objectives was to provide HCD with centralized and accurate management reporting that tracked, for example, employee workload and monitoring progress. However, HCD initially put CAPES into service in 2007 with reduced functional capabilities relative to the system's initial objectives, including a lack of reporting ability, because it underestimated the workload and resources required to complete the system. In 2018 HCD is still working on CAPES to achieve the desired functionality. According to the financial assistance deputy director, CAPES has improved in both functionality and usability since 2007, but HCD still cannot effectively use it to track and monitor program work for all housing bond programs. Although CAPES does not currently provide the level of functionality that HCD needs, the system does have basic capacity for collecting some data, such as the dates HCD receives reports for the CalHome program. Nonetheless, our review found that HCD staff have not used CAPES for this basic purpose.

According to the financial assistance deputy director, HCD management has not formally directed all HCD staff and programs to use CAPES because of its limited functionality; instead, it allows each program to determine what data tools to use. For example, we found that HCD's multifamily housing programs have used CAPES to track their long-term monitoring activities but that its CalHome and BEGIN programs have not. Instead, staff in the CalHome program have inconsistently used spreadsheets to track monitoring. If HCD's programs consistently used CAPES for basic data collection, HCD management could run reports from the system to assess whether staff collect and review the required reports for monitoring. However, when staff do not consistently use the system for monitoring all awards, HCD cannot use CAPES to produce meaningful reports. The financial assistance deputy director asserted that she plans to start using reports to the extent that CAPES can generate them for administrative purposes by December 2018, with the expectation of holding management accountable for completing program monitoring requirements.

Figure 4**HCD's Attempts to Implement a Central Housing Bond Database Have Been Costly and Mired in Technical Challenges**

Source: Analysis of HCD's contracts and internal system cost information and California State Auditor reports 2007-037, 2009-037, 2012-037, and 2014-037.

We are concerned that if voters approve the additional \$3 billion for housing programs, HCD could be unprepared to effectively monitor certain programs' recipients. Our previous four audits, beginning in 2007, noted a number of problems with CAPES, including that HCD has not ensured that it contains complete and accurate data. Figure 4 shows some of the issues we identified related to CAPES during these audits. For example, in our 2014 report, we noted that HCD lacked an effective system for its program managers to use to track each aspect of their programs and that some staff relied on informal methods, like electronic spreadsheets. When we asked why HCD has not addressed these issues, the financial assistance deputy director stated that although HCD has completed several of its software enhancements for CAPES, it has a backlog of additional enhancements to make and limited staff to make them. Further, HCD has diverted resources to implement FI\$Cal—the State's new single financial management system. However, as we discuss in the previous section, HCD has not adequately monitored some of its housing bond programs, including failing to collect required reports that demonstrate whether recipients are providing housing to target populations. If HCD wants to use CAPES as a tool to effectively monitor its housing bond programs, it needs to address CAPES's deficiencies and direct all staff to use the system.

Recommendations

HCD

To ensure that it maximizes the benefit of the funds it has invested in CAPES's development and to support its ongoing efforts to improve CAPES's usability, HCD should do the following by January 1, 2019:

- Perform an assessment of those programs that do not fully use CAPES.
- Determine to what extent the programs could be using CAPES at its current level of development to capture information.
- Formally direct staff working on those programs to enter data into CAPES and then use those data to manage the contracts and staff workloads associated with the programs.
- Develop a remediation plan to augment CAPES in the specific ways required by any HCD programs that are currently unable to use the system for their operational needs. Concurrent with the remediation plan, HCD should develop realistic project management plans, including project milestones, for completing the necessary system upgrades.
- Develop a documented process to ensure that all data in CAPES are accurate and complete. This process should include all phases of contract management, including monitoring. HCD should implement a routine periodic review of this process and update the process as necessary.

In conjunction with the planning efforts outlined above and to ensure that it can most efficiently manage its limited resources related to IT, HCD should develop a cost-benefit analysis by March 1, 2019, that addresses the costs of continuing to maintain and enhance CAPES in the long term versus the acquisition and maintenance costs of an off-the-shelf database product. At a minimum, it should include the following:

- All costs associated with CAPES's enhancement, support, and future maintenance.
- A documented methodology, including all assumptions, and thorough documentation of the sources for the underlying data.

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HCD Risks Exceeding Some Statutory Administrative Spending Limits, Which Could Threaten Its Ability to Meet Its Monitoring Requirements

Key Point:

- HCD's projections indicate that it risks exceeding the statutory administrative spending restrictions for some housing bond programs before it completes its obligations for long-term monitoring. HCD management lacks a long-term plan for avoiding such administrative spending overages.

As we discuss in the Introduction, state law imposes administrative spending limits of 5 percent on certain housing bond programs. According to its administrative cost-tracking tool and its bond fiscal manager, HCD has exceeded these administrative spending limits for at least two of its programs: BEGIN and the Code Enforcement Incentive Program. In addition, HCD projects that it will exceed the required 5 percent limit for CalHome before it can complete its monitoring obligations. HCD currently estimates that performing administrative activities, such as monitoring, will ultimately cause it to spend 6 percent of the almost \$630 million allocated to the three programs—or nearly \$6.5 million over the limit. Not only could HCD potentially violate state law by exceeding the administrative cost limits, it also risks not being able to monitor recipients as required, the consequences of which we discussed in the first section of this report. Nonetheless, HCD has not taken steps to avoid these outcomes. Specifically, HCD had already projected it would exceed the administrative costs limit for one of those programs, when we performed our 2012 and 2014 housing bond audits, but it did not take sufficient action to address the impending problem.

HCD continues to lack an effective mechanism to prevent it from exceeding statutory spending limits. In our 2014 housing bond audit, we reported that HCD did not have sufficient policies to ensure that it does not exceed these limits. Although HCD developed a policy to address this finding that includes an annual management review of administrative cost information, it still does not have a control in place to prevent it from spending funds on administrative activities that it could otherwise award to recipients. Instead, the policy states that HCD will annually review a summary report, which is a reactive approach rather than a preventive one. The policy essentially establishes a process for HCD to monitor how much it has spent over the administrative cap, but it does not provide a mechanism to prevent HCD from exceeding that limit. According to HCD's deputy director of administration, HCD has demonstrated its effectiveness in mitigating the risk of overspending as HCD has exceeded the administrative limit on only four occasions while administering the propositions 1C and 46 bond funds and programs. Nevertheless, HCD has not effectively mitigated the risk of overspending, as those four occasions demonstrated.

Further, HCD may have engaged in inappropriate practices when it faced deficiencies in administrative funding. Because HCD estimates it has exceeded or will exceed its allowable administrative cost limits for CalHome and BEGIN, it may be unable to complete its long-term monitoring obligations. According to HCD's 2016–17 Bond Baseline Adjustment Report, HCD has resolved this issue by using CalHome funds to pay for the remaining 20-year monitoring costs for the BEGIN contracts. Yet, HCD could not identify the legal authority that allows it to use CalHome funds to monitor BEGIN. In addition, HCD should have been more efficient in operating its programs and used a risk-based approach for monitoring, as we have recommended, thus increasing the possibility that it could monitor both programs for the required period using the programs' own funds. In fact, the Legislative Analyst's Office opined that 5 percent for administrative costs is a reasonable target for each housing bond program. HCD could lack the statutory authority to continue to administer a given program when it reaches the limit on administrative spending and therefore may need to cease its monitoring activities for that program. If this occurs, HCD may be unable to ensure that recipients use program funds for appropriate purposes.

.....

HCD may have engaged in inappropriate practices when it faced deficiencies in administrative funding.

.....

Furthermore, HCD may be imprudently retaining more funds for administrative purposes than warranted. When the housing bonds provide funds to some programs, HCD sets aside 5 percent for its administrative costs, which includes making the awards and monitoring the recipients. However, according to HCD documents, when HCD does not disburse all funds to a recipient and it subsequently awards those funds to another recipient, HCD retains 5 percent from the original award and 5 percent from the subsequent award for its administrative costs. We believe that it is unnecessary for HCD to retain the full 5 percent for administering the original award because its only costs should have been for making the award and for any limited monitoring it performed.

HCD management also lacks a long-term plan for addressing administrative spending overages. According to the deputy director of administration, HCD management meets annually with its bond fiscal manager to discuss administrative costs,

staffing needs, and available resources for the current fiscal year. However, HCD management does not review the bond fiscal manager's administrative cost projections, nor does it document its discussions of the long-term effects of exceeding the spending limits. The deputy director of administration indicated that HCD is developing plans to either increase program efficiencies or reduce staffing levels to stay within the 5 percent administrative spending limit. However, until it does so, HCD cannot be certain that it is prepared to use its limited resources to more efficiently monitor programs or that it has addressed the risk of having to cease administering a program.

HCD's ability to efficiently monitor its programs is additionally limited by the fact that its administrative cost-tracking tool lacks a clear methodology for its calculations and does not contain documented support for the underlying data that HCD uses to create its administrative cost estimates. The deputy director of administration asserted that the tool uses data from its accounting system and that HCD reconciles to the accounting system semiannually; however, it does not record in the tool either the source of the data or the results of any reconciliation. Because the administrative cost-tracking tool is the sole method HCD uses to track its administrative spending, HCD staff should establish a clear methodology for its calculations with documented support and provide it to management for review.

Recommendations

HCD

To ensure that it is able to meet its administrative monitoring obligations and that it uses housing bond funds in compliance with state law, regulations, and program guidelines, HCD should develop a long-term plan by January 1, 2019, for how it will avoid exceeding the administrative cost limits of those programs in the most immediate danger of overage and for how it will address instances when it has exceeded administrative cost limits. The plan should identify the programs at risk of exceeding the limit; the actions HCD will take for each program to gain efficiencies; its plan for moving staff between programs; a request for more money or legislative changes such as modifying the statutory limit on administrative spending, if necessary; and an evaluation of the consequences of not fulfilling its monitoring obligations.

To ensure that it complies with state law, prudently uses administrative funding, and promotes transparency, HCD should do the following:

- Obtain a legal opinion on whether it can use CalHome funding to monitor BEGIN awards. If it cannot, it should cease doing so.
- Calculate and retain only funds equal to its actual administrative costs in instances when it does not disburse awarded funds to a recipient and subsequently grants the funds to another recipient.

To ensure that it does not exceed administrative cost restrictions and that it maximizes the funds intended to address target populations' housing needs, HCD should estimate when it will run out of administrative funds for any specific program, document its projection methodology, and provide underlying data and support for its estimates. The projections should include, but not be limited to, actual staff time spent on the program, the number of awards being monitored, and the length of monitoring. Staff should provide these projections and methodologies to management for review and approval by December 1, 2018, and then at least biannually thereafter.

SCOPE AND METHODOLOGY

The Health and Safety Code requires the California State Auditor (State Auditor) to conduct periodic audits of housing bond activities to ensure that agencies that administer housing bond programs have awarded proceeds in a timely manner that is consistent with legal requirements and that recipients have used the funds in compliance with the law. Table 3 lists the audit objectives and the methods we used to address them. The State Auditor previously issued audit reports on this subject in September 2007, November 2009, October 2012, and September 2014.

Table 3
Audit Objectives and the Methods Used to Address Them

AUDIT OBJECTIVE	METHOD
1 Determine whether awards of housing bond funds were timely.	In our 2014 housing bond audit, we determined that HCD had awarded nearly all funds available and found that HCD generally awarded funds in a timely manner. Therefore, we did not perform work in this area during the current audit.
2 Determine whether HCD awards bond funds in compliance with applicable statutory requirements.	In our 2014 housing bond audit, we found that HCD did not meet some of the requirements we reviewed. However, in that audit, we determined that HCD had awarded nearly all funds available, and therefore we did not perform work in this area during the current audit.
3 Determine whether HCD is ensuring that recipients are using funds in compliance with applicable statutes.	<ul style="list-style-type: none"> • We reviewed relevant laws, regulations, program guidelines, and policies, and we interviewed key staff to determine whether HCD adequately monitored recipients from 2014 through March 2018. • We judgmentally selected 20 awards from the eight HCD-administered programs to assess whether HCD implemented processes that would allow it to ensure that recipients used housing bond funds in compliance with the law. Further, we tested whether HCD followed those processes. • To follow up on concerns from our 2014 audit, we ensured that HCD performed adequate monitoring for one Catalyst program award. • We interviewed staff and reviewed HCD's administrative cost-tracking tool to determine how HCD plans to continue its monitoring efforts without exceeding administrative spending restrictions.
4 Determine whether CAPES can adequately perform key functions necessary for HCD to appropriately administer bond awards and comply with statute and program regulations.	<ul style="list-style-type: none"> • We interviewed HCD management to determine the overall status of CAPES. • We identified the total cost of CAPES since its inception. • We interviewed staff and reviewed reports and program processes to determine whether programs were consistently using CAPES.

Source: Analysis of state law and information and documentation identified in the table column titled *Method*.

Assessment of Data Reliability

In performing this audit, we obtained electronic data from the sources listed in Table 4. Table 4 describes the analyses we conducted using data from these sources, our methods for testing, and the results of our assessments.

Table 4
Methods of Assessing Data Reliability

INFORMATION SOURCE	PURPOSE	METHOD AND RESULT	CONCLUSION
HCD Cumulative Propositions 46 and 1C Bond Awards	To identify the funds available for each HCD program as of December 31, 2017	<ul style="list-style-type: none"> We performed data-set verification procedures and electronic testing of key data elements and found no significant issues. To test the accuracy of the Cumulative Proposition 1C bond awards, we traced key data elements from a random selection of 29 Proposition 1C awards to supporting documentation and found no errors. To test the completeness of the data, we traced a haphazard selection of 29 Proposition 1C awards to the data and found no errors. We found no significant difference between the current cumulative Proposition 46 source information and the information we reviewed and tested in the 2014 housing bond audit. Therefore, we relied on the accuracy and completeness testing from our 2014 assessment, finding the information to be complete and accurate. 	Sufficiently reliable for the purposes of this audit.

Source: Analysis of various documents, interviews, and data listed in this table.

We conducted this audit 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. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives specified in the Scope and Methodology section of the report. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Respectfully submitted,



ELAINE M. HOWLE, CPA
California State Auditor

Date: September 20, 2018

Staff: Nicholas Kolitsos, CPA, Audit Principal
Michelle J. Sanders
Kevin Wedman
Sean Wiedeman, MBA

Legal Counsel: Joseph L. Porche, Staff Counsel

For questions regarding the contents of this report, please contact Margarita Fernández, Chief of Public Affairs, at 916.445.0255.

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State of California
BUSINESS, CONSUMER SERVICES AND HOUSING AGENCY

Edmund G. Brown Jr. Governor
Alexis Podesta, Secretary

August 29, 2018

Ms. Elaine M. Howle*
State Auditor
621 Capitol Mall, Suite 1200
Sacramento, CA 95814

RE: Response to California State Auditor's Draft Report: California Department of Housing and Community Development: Its Oversight of Housing Bond Funds Remains Inconsistent

Dear Ms. Howle:

The Business, Consumer Services and Housing Agency (BCSH) welcomes the opportunity respond to the California State Auditor's (CSA) draft report, titled "California Department of Housing and Community Development: Its Oversight of Housing Bond Funds Remains Inconsistent".

We concur with the recommendations and are pleased to report that the Department of Housing and Community Development (HCD) has already completed many of the recommended improvements and is currently implementing the others.

HCD has initiated key improvements efforts to ensure our Housing Bond Programs are appropriately and consistently monitored. These include hiring additional staff to make our monitoring efforts more robust and initiating ongoing onsite monitoring of the CalHOME program. In addition, we have made improvements to the Consolidated Automated Program Enterprise System (CAPES) and launched training programs to improve utilization of CAPES staff. Finally, we have increased our oversight of administrative fees expenditure by increasing the frequency of senior management review to result in more frequent identification of, and discussion about, at-risk programs.

①

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Department of Alcoholic Beverage Control | Alcoholic Beverage Control Appeals Board | Department of Business Oversight
California Housing Finance Agency | Department of Consumer Affairs | Department of Fair Employment & Housing
Horse Racing Board | Department of Housing and Community Development | Seismic Safety Commission

* California State Auditor's comment appears on page 35.

We look forward to providing an update on progress made in our six-month progress report. By improving our oversight in these key areas, we will be better able to serve the public by providing leadership, policies, and programs to preserve and expand safe and affordable housing opportunities for all Californians.

If you have any questions, please contact Doug McCauley, HCD Chief Deputy Director at (916) 263-7400 or Doug.McCauley@hcd.ca.gov.

Sincerely,

A handwritten signature in black ink, appearing to read "Alexis A. Podesta". The signature is fluid and cursive, with the first name being the most prominent.

Alexis A. Podesta
Secretary

Comment

CALIFORNIA STATE AUDITOR'S COMMENT ON THE RESPONSE FROM THE BUSINESS, CONSUMER SERVICES AND HOUSING AGENCY

We look forward to HCD's 60-day response to our audit report, which should include documentation demonstrating the actions it has taken in implementing our recommendations.

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