

Department of Housing and Community Development

Awards of Housing Bond Funds Are Appropriate, but Cash Balances Are High and Monitoring Continues to Need Improvement

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This report concludes that the Department of Housing and Community Development (HCD) and the California Housing Finance Agency generally awarded funds in a timely manner and complied with legal requirements for making awards. However, HCD requested, and the Department of Finance (Finance) recommended, bond sales that were in excess of its cash needs at a time when the State's credit rating was declining and interest-rate volatility was high. As a result, the State paid as much as \$49 million in interest annually on the idle capital while the State was facing cash shortfalls.

Nevertheless, without these bond proceeds, the sustainability of certain housing bond programs likely would have been at risk. For most of HCD's housing bond programs, private lenders and banking institutions provide financing to sponsors, comprising entities qualified to construct or manage housing developments, for the construction of housing projects. Once the sponsor successfully completes the housing project, the sponsor uses its HCD award to repay the construction loan. Various state officials explained that key stakeholders cited significant concerns regarding the State's ability to fund these awards given the economic crisis at the time. In fact, state officials believed that without selling bonds in excess of immediate cash needs, and thereby demonstrating to the financial institutions that the State had the ability to fund the awards used by sponsors to repay the construction loans, many of the housing bond programs would have been suspended, or halted altogether. Thus, the reasons for the excessive bond sales appear to have merit.

Additionally, HCD did not always adhere to controls established for its CalHome and Building Equity and Growth in Neighborhoods (BEGIN) programs. For example, as we reported in November 2009, HCD still is not ensuring the recipients submit required status reports for its CalHome program. Further, we identified that HCD needs to improve its monitoring efforts during the period following payment up to the completion of all contract requirements. For instance, HCD had not finalized and implemented on-site monitoring procedures for its BEGIN program.

In the report, the state auditor made the following recommendations to HCD and Finance. The state auditor's determination regarding the current status of recommendations is based on HCD's and Finance's responses to the state auditor as of December 2012.

Recommendation 1—See pages 16 and 17 of the audit report for information on the related finding.

To ensure that it does not exceed the maximum amount specified in state law for administrative costs for the BEGIN Program, HCD should continue to reevaluate, as appropriate, its administrative support costs projection and continue to monitor its future costs.

HCD's Action: Fully implemented.

HCD currently forecasts all costs for the life of the program and has a monitoring process to inform management of the need to adjust program administration to keep costs within statutory requirements. HCD indicated that it will continue to re-evaluate its administrative support cost projections and continue to monitor actual program costs. As such, HCD explained that it will maintain documentation of these business practices as needed.

Recommendation 2—See pages 19—23 of the audit report for information on the related finding.

Going forward, to the extent that Finance or HCD believes the State needs to issue bonds in excess of cash needs, it should document an analysis demonstrating the appropriateness of the bond sale amount and the circumstances.

HCD's Action: Fully implemented.

HCD stated that it agrees with our recommendations and will fully document any special circumstance that may require bonds to be issued in excess of the immediate cash need. HCD stated that Finance requests a Bond Cash Flow Analysis (drill) twice per year. As part of HCD's processes and procedures for this drill, HCD indicated that documentation is available that demonstrates whether or not it recommends a bond sale. HCD explained that it will now document the considerations and circumstances should Finance's final bond decision not match HCD's bond recommendation. According to HCD, Finance has the full authority over this process and makes the final decision on whether or not a bond sale is initiated. HCD stated that as the need arises, it will document the decisions and considerations made during these drills and that it will maintain the documentation and present the material when necessary.

Finance's Action: Fully implemented.

Finance stated that it agrees with our recommendation and explained that it has significantly increased the level of analysis that it conducts regarding the level of bond program cash needs by routinely surveying departments, analyzing usage rates, and assessing future demand. Finance indicated that it is retaining these analyses so that they will be available for any future audits.

Recommendation 3.a—See pages 25 and 26 of the audit report for information on the related finding.

HCD should continue its efforts to monitor sponsors that receive awards of housing bond funds by requiring staff to follow its procedures related to centrally tracking advances to sponsors under the CalHome Program.

HCD's Action: Partially implemented.

HCD stated that by March 2013, it will review and update all Proposition 1C and 45 CalHome disbursements through September 2012 in the centralized system to track and log advances to ensure current, complete, and accurate information. In addition, HCD explained that current processes for management approval and tracking advances have been implemented and were communicated to all appropriate staff on or about September 27, 2012. Further, a centralized tracking log has been developed and implemented for advance transactions. HCD stated that written policies regarding when and how staff is to update the tracking log have been developed but are currently under management review and not ready for finalization. HCD explained that management will continue to reiterate the importance of using these policies and procedures to ensure proper tracking.

Recommendation 3.b—See pages 26—28 of the audit report for information on the related finding.

HCD should continue its efforts to monitor sponsors that receive awards of housing bond funds by ensuring that it receives, reviews, and centrally tracks required status reports from sponsors under its CalHome and BEGIN programs.

HCD's Action: Partially implemented.

HCD explained that at the beginning of each quarter staff will contact their assigned sponsors via e-mail to request the required quarterly reports. HCD indicated that this will ensure that program staff are proactively requesting the information and documenting the request. Upon receipt, HCD stated that staff will review and record the report in the established centralized tracking report file.

In those instances when a sponsor fails to submit a report, HCD asserted that the program manager will take steps to obtain the report and document the response in the file and the centralized tracking report. HCD also explained that the CalHome and BEGIN programs have developed procedures, currently under review by program management, which will give program managers the ability to assess sponsor quarterly and annual reporting compliance. HCD stated that it anticipates completion of the written procedures on or before May 31, 2013. HCD also indicated that monitoring of reporting compliance is a key performance indicator for both staff and management.

Recommendation 3.c—See pages 28 and 29 of the audit report for information on the related finding.

HCD should continue its efforts to monitor sponsors that receive awards of housing bond funds by, upon finalizing monitoring procedures for the BEGIN Program, ensure that staff implement and follow them.

HCD's Action: Fully implemented.

HCD has developed a written monitoring process, including a risk assessment tool and checklist to be used for the monitoring of BEGIN projects. HCD explained that it finalized and implemented this process during October 2012. Further, HCD stated that BEGIN staff completed training by the end of November 2012 and staff are currently applying the risk assessment tool to develop the monitoring schedule. HCD indicated that once each recipient has been given a final score, they will be entered on the monitoring spreadsheet and sorted to identify those recipients that are at higher risk. HCD implemented the monitoring plan in December 2012 and scheduled its first monitoring visit for January 2013.

Recommendation 3.d—See page 29 of the audit report for information on the related finding.

As it relates to selecting which sponsors to monitor, HCD should continue its efforts to monitor sponsors that receive awards of housing bond funds by adopting a risk-based, on-site monitoring approach for its CalHome and BEGIN programs. For the CalHome Program, HCD should evaluate the criteria in its risk assessment tool and require staff to use a centralized tracking log for on-site monitoring visits, which should indicate when findings are resolved.

HCD's Action: Fully implemented.

The BEGIN Program has developed a written monitoring process, including a risk-assessment tool and checklist to be used for the monitoring of BEGIN projects and it implemented the process in December 2012. Additionally, HCD explained that CalHome management has evaluated and approved the criteria in its risk assessment tool. Further, HCD stated that the CalHome staff and management team has developed and implemented a centralized tracking log, which will be maintained by staff for all audit findings and monitored by CalHome management to ensure resolution to findings.

