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Audit Report Number	2010-LA-1008
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TO: William Vasquez, Director, Los Angeles Office of Community Planning and Development, 9DD

*Joan S. Hobbs*

FROM: Joan S. Hobbs, Regional Inspector General for Audit, Region IX, 9DGA

SUBJECT: The City of Los Angeles, CA, Generally Had Sufficient Capacity and Adequate Internal Controls To Administer Its Neighborhood Stabilization Program Funds

## **HIGHLIGHTS**

### **What We Audited and Why**

We completed a capacity review of the City of Los Angeles' Housing Department's (City) Neighborhood Stabilization Program (Program). We performed the review because Housing and Economic Recovery Act of 2008 (HERA) reviews are part of the Office of Inspector General's (OIG) annual audit plan and the program was identified as high risk. We previously audited several different aspects of the City's HOME Investment Partnerships program, all of which disclosed significant monitoring and oversight problems. Thus, given the significant amount of funds awarded and the prior audit results, we had concerns regarding the City's capacity to administer the Program funds. The City applied for additional funds through the American Recovery and Reinvestment Act of 2009 (ARRA).

Our objective was to determine whether the City had sufficient capacity and the necessary controls to manage and administer Program funds provided by the U.S. Department of Housing and Urban Development (HUD) under HERA and the funds the City applied for under ARRA.

## **What We Found**

We found no evidence indicating that the City lacked the capacity to adequately administer its Program funding.

## **Auditee's Response**

We provided the City a discussion draft report on March 9, 2010. The City declined an exit conference, but provided a written response on March 10, 2010, in which it agreed with our report.

The complete text of the City's response can be found in appendix A of this report.

# TABLE OF CONTENTS

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Background and Objective	4
Results of Audit	
The City Generally Had Sufficient Capacity and Adequate Internal Controls To Administer Its Program Funds	5
Scope and Methodology	12
Internal Controls	14
Follow-up on Prior Audits	15
Appendix	
A. Auditee Comments	16

## **BACKGROUND AND OBJECTIVES**

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The Neighborhood Stabilization Program (Program) was authorized under Title III of Division B of the Housing and Economic Recovery Act of 2008 (HERA) and provides grants to every State and certain local communities to purchase foreclosed-upon or abandoned homes and rehabilitate, resell, or redevelop these homes to stabilize neighborhoods and stem declining values in neighboring homes. HERA calls for allocating funds “to states and units of general local government with the greatest need,” and in the first phase of the Program, the U.S. Department of Housing and Urban Development (HUD) allocated \$3.92 billion in Program funds to assist in the redevelopment of abandoned and foreclosed-upon homes.

The City of Los Angeles is a participating jurisdiction which administers its entire Program under the City of Los Angeles’ Housing Department (City). The City was created to address the Los Angeles housing crisis. The City’s mission is to advocate safe and livable neighborhoods through the promotion, development, and preservation of decent, safe, and affordable housing.

The Federal Register, Volume 73, Number 194 (dated October 6, 2008), provided the public a list of grantees that would receive Program funds. The City received more than \$32.8 million in Program funding and amended its 2008-2009 action plan to outline the Program activities it planned to pursue with the newly acquired funds, including a homeownership and rental housing activity. The City’s Homeownership and Preservation Division is responsible for implementing both activities. HUD executed the City’s Program grant agreement on February 27, 2009; therefore, the City has until August 27, 2010 (18 months), to obligate the Program funds and until February 27, 2013 (4 years), to spend all of the Program funds. As of December 31, 2009, the City had obligated and spent \$3.6 million (11 percent) of the Program funds.

The City applied for \$100 million to continue its Program activities under a second round of competitive funding authorized by the American Recovery and Reinvestment Act of 2009 (ARRA). HUD announced the ARRA allocations on January 14, 2010, and the City was awarded the full amount of additional funding. The City plans to use the same homeownership and rental housing activities to administer both the HERA and ARRA funding.

### **Our Objective**

Our objective was to determine whether the City had sufficient capacity and the necessary controls to manage and administer Program funds provided by HUD under HERA and the funds the City applied for under ARRA.

## RESULTS OF AUDIT

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### The City Generally Had Sufficient Capacity and Adequate Internal Controls to Administer Its Program Funds

We did not find evidence indicating that the City lacked the capacity to adequately administer its Program funding. The City had (1) plans for and had begun the use of program funds; (2) written policies and procedures to support its Program activities; (3) experience with programs that were similar in nature to its Program activities; (4) a plan to hire additional staff; and (5) adequate records to support accounting transactions, procurements, and homeownership activities.

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#### **The City Had Adequate Plans for Using the Program Funds**

The City had plans for two activities using its Program funds:

1. The homeownership activity was designed to be implemented using two components:
  - a. The purchase assistance with rehabilitation program was designed to offer a financing mechanism to eligible home buyers to enable them to directly acquire foreclosed-upon or abandoned single-family homes using Program funds. The program would provide mortgage assistance and rehabilitation loans for health- and safety-related repairs totaling up to \$125,000 for low- and moderate-income households (less than 80 percent of area median income) and \$100,000 for middle-income households (81-120 percent of area median income).
  - b. The City's subrecipient was to purchase clusters of foreclosed-upon or abandoned properties from lenders, loan servicers, and the National Community Stabilization Trust at a discount. The properties were to be rehabilitated, if needed, and resold to eligible home buyers whose incomes did not exceed 120 percent of the area median income.

All homes purchased through the homeownership activity would be required to be single family, vacant, and foreclosed upon or abandoned pursuant to program guidelines. In addition, aside from meeting income guidelines, eligible home buyers would be required to provide a minimum downpayment, receive 8 hours of home-buyer education from a HUD-certified education provider, and occupy the properties as their primary residences. The City anticipated that approximately 125 units of foreclosed-upon single-family

housing units would be acquired and rehabilitated through the homeownership activity. It budgeted more than \$15.5 million for homeownership activities.

2. The rental housing activity was designed in a similar way as the second component of the homeownership activity. However, the properties acquired for this activity would be multifamily properties. The City envisioned that these properties would be acquired and then offered through a competitive request for qualifications/proposal process for rehabilitation and ownership to entities with demonstrated capacity and experience who would maintain the properties as affordable rental housing. Properties could be bundled together and offered to these organizations to achieve economies of scale with the rehabilitation work and long-term ownership. If necessary, the City's subrecipient would rehabilitate the properties and then offer them for sale. The City anticipated that approximately 186 units of foreclosed-upon multifamily rental housing would be acquired and rehabilitated for occupancy by lower and middle-income households. A minimum of 100 units would be restricted to occupancy by households having income at or below 50 percent of the area median income. The City had budgeted more than \$14 million for rental housing activities.

Properties eligible for both activities would be required to be located within specific target areas or census tracts, which had been defined by the City as areas with the greatest need. The City had budgeted about \$3.3 million in Program funds to administer its Program activities.

As of December 31, 2009, the City had spent about 11 percent (around \$3.6 million) of its more than \$32 million in funding on Program administration and homeownership activities. The City had funded 14 home-buyer loans through the purchase assistance with rehabilitation program, and the City's subrecipient had acquired 13 single-family properties to be rehabilitated and resold.

In January 2010, the City acknowledged that it needed to restructure to ensure that it could spend the Program funding within the required timeframes. Effective January 2010, the City had suspended the acceptance of reservation requests for the purchase assistance with rehabilitation program funds under its homeownership activity since the program was not the most effective method for implementing the homeownership activity. Home buyers, real estate agents, lenders, and City staff had expended a great deal of time and effort with marginal results.

We believe that the City has adequate capacity to use the Program funds within the required timeframes. First, we noted that the City's rate of using funds in December 2009 had increased, as compared to the rate of using funds in prior months (September and November 2009). Second, the City had restructured by putting all of its effort and support into executing Program activities through its subrecipient, whose activity level had been increasing, after an initial ramping up period. Since January 2010, the City had assisted three home buyers with the purchase of properties (totaling \$162,644) and executed three rehabilitation construction contracts (totaling \$101,989). In addition, the

City was executing seven more rehabilitation construction contracts (estimated to total \$217,686). The City's subrecipient had also acquired eight more properties and was executing rehabilitation construction contracts, averaging about \$178,438 each, for a total of 17 Program-assisted properties. In addition, the City's subrecipient was screening and/or acquiring 30 single-family properties to rehabilitate and resell. Lastly, the City planned to execute rental housing activities in the near future. Rental housing activities use Program funds at a more rapid rate, as rental housing activities include multifamily properties, which use a larger amount of funds for acquisition and rehabilitation. Based on this increased activity level, we believe that the City will be able to use the Program funds within the required timeframes.

### **Written Policies and Procedures Were Adequate**

At the initiation of our review in October 2009, the City's Program procedures were incomplete for its subrecipient's homeownership activities, and lacked procedures for the rental housing activity. However, in February 2010, before the subrecipient had sold any property or executed any rental housing activity, the City completed its Program procedures. The City's procedures were sufficient to support its homeownership and rental housing activities. They complied with the major provisions of HERA and addressed the major aspects of each activity, including program requirements and City, subrecipient, and home-buyer responsibilities. In addition, the City had established written procedures for monitoring its Program activities and had complete written policies and procedures to support its financial management and procurement functions.

### **The City Had Experience with Similar Programs**

The City had extensive experience with other programs that mirrored its Program activities.

- The City had operated low-income purchase assistance with rehabilitation and moderate-income purchase assistance with rehabilitation programs, which closely resemble the homeownership activities, since 1994 and 2005, respectively. From 2007 to 2009, the City loaned more than \$28.5 million to assist 310 households in purchasing and rehabilitating homes throughout Los Angeles.
- The City had operated major projects acquisition and new construction and acquisition and rehabilitation programs to create affordable rental housing, which resemble the rental housing activities, since 1979. From 2007 to 2009, affordable housing developers funded under this program successfully completed rehabilitation of 732 affordable housing units with a total of \$26.7 million in City funding and a total development cost of \$166.2 million.

The City's low-income purchase assistance with rehabilitation program is funded by HUD's Community Development Block Grant (CDBG) program but in the past, had also been partially funded by HUD's HOME Investment Partnerships Program (HOME). The City's major projects acquisition and new construction and acquisition and rehabilitation programs are partially funded by both CDBG and HOME. In our prior audits of the City's HOME program, we had findings related to inadequate or lacking City monitoring, which was caused by either inadequate or lacking policies and procedures. However, during our Program review, we found that the City was monitoring its Program activities and had adequate policies and procedures for its Program.

### **Staffing Levels Were Appropriate**

The City's staffing level appeared to be appropriate to administer its HERA Program funding and planned activities. There were 10 individuals within the responsible Homeownership and Preservation Division working on Program activities. All 10 individuals had direct program responsibilities and spent between 28 and 100 percent of their time on Program activities. We were initially concerned about the loan processing staff's concerns about time restraints imposed by the City's mandatory furloughs and the loss of a staff member. However, through observation, we noted that the loan processing staff had adjusted to the mandatory furloughs, the rate of the homeownership activities was not overwhelming, and in February 2010, the division obtained a displaced staff member through the City's layoff process, who would also directly assist with Program activities.

The City informed us that it planned to hire additional staff for the additional funding under the second competitive round of Program funding through ARRA (see Background and Objective section). We agree that this measure should facilitate the City's efforts to accomplish an increased Program workload.

### **The City Had Support for Its Financial Transactions, Procurements, and Homeownership Activities**

We reviewed nonstatistical samples of Program financial and accounting transactions, procurements, and homeownership activity files.



**Financial Data:**

All Program accounting transactions reviewed were accurate, adequately supported, eligible, and consistent with the proposed activities in the City’s amendment to its 2008-2009 action plan.

**Procurement:**

All contract services reviewed were properly procured consistent with the City’s policies and procedures, as well as 24 CFR (Code of Federal Regulations) Part 85, Administrative Requirements for Grants and Cooperative Agreements to State, Local, and Federally Recognized Indian Tribal Governments.

**Homeownership Activity Files:**

Our review of files for the City’s homeownership activity indicated that the City was in compliance with all applicable program requirements.

**Site Visits Confirmed That Assisted Properties Met Program Requirements**

We conducted site visits and were able to confirm that the Program-assisted and -funded properties were located within the areas targeted by the City as having the “greatest needs.”

Example of property assisted through the purchase assistance with rehabilitation program.



Examples of properties acquired and being rehabilitated through the City's subrecipient.



## **Conclusion**

The City appeared to generally have sufficient capacity and adequate controls to administer its award of Program funding through HERA in accordance with HERA requirements. The City's procedures and controls should also be adequate to administer the continuation of these activities under the second round of Program funds through ARRA since the City plans to administer the funds using the same activities. However, given that the ARRA funding is more than three times that of the City's HERA funding, we generally agree with the City's plans to hire additional staff to ensure that it can adequately administer an increased activity level.

## SCOPE AND METHODOLOGY

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We performed our on-site audit work at the City, located at 1200 West 7th Street, Los Angeles, California, between October 2009 and February 2010. Our audit generally covered the period February through December 2009. We expanded our scope as necessary.

To accomplish our objective, we reviewed

- HERA.
- ARRA.
- The Program bridge notice, dated June 11, 2009.
- HUD regulations at 24 CFR Parts 85, 91, 92, and 570.
- HUD monitoring reports.
- HUD risk analyses for the CDBG, HOME, Emergency Shelter Grant, and Housing Opportunities for Persons with AIDS programs.
- The City's single audit report for the year ending June 30, 2008.
- The City's substantial amendment to its 2008-2009 action plan to include proposed Program activities.
- The Program grant agreement, dated February 27, 2009.
- The City's application for the second competitive round of Program funds.
- Disaster Recovery Grant Reporting system financial data.
- Organizational charts.
- The City's internal policies and procedures that support Program activities. We also reviewed the City's financial management, procurement, and monitoring policies and procedures.
- The City's progress in obligating funds based on the latest information reported in HUD's Disaster Recovery Grant Reporting system as of December 30, 2009.
- Budget reports, journal and payment vouchers, and supporting documentation, including the review of a nonstatistical sample<sup>1</sup> of \$605,287 of more than \$1.4 million in Program expenses as of November 30, 2009. We generally found that each expense was accurate, supported, allowable, and reasonable.
- The procurement process and selections for lenders, appraisers, lead and title services, and contractors.
- A nonstatistical sample<sup>2</sup> of 6 of 26 available project files covering homeownership activities. We generally found that the project files followed applicable Program rules and regulations.

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<sup>1</sup> Our sample was based on expenditures covering the homeownership activity areas such as appraisal and title fees, property acquisition transactions, contractor reimbursements, and Program administration. We selected all journal vouchers; all payment vouchers made to the City's subrecipient and consultant; the lowest, middle, and highest amount payment vouchers made to titles companies; and the highest amount payment voucher made to all of the remaining vendors.

<sup>2</sup> Our sample was based on the lowest, middle, and highest amount activities through December 2009 for the City and its subrecipient.

We also interviewed City staff and several key officials responsible for Program execution and conducted site visits to a nonstatistical sample<sup>3</sup> of 23 properties assisted and/or funded under the Program. We found that each property was in an eligible target area and supported the City's execution of eligible Program activities.

We conducted the review in accordance with 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 finding and conclusion based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our finding and conclusion based on our audit objective.

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<sup>3</sup> We conducted site visits to 23 out of the 26 properties assisted through the City and/or funded through the City's subrecipient through December 2009.

# INTERNAL CONTROLS

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Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are achieved:

- Program operations,
- Relevance and reliability of information,
- Compliance with applicable laws and regulations, and
- Safeguarding of assets and resources.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. They include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

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## Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objective:

- Implementation of policies and procedures to ensure that Program activities meet established objectives.
- Implementation of policies and procedures to ensure that Program activities comply with applicable laws and regulations.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

## Significant Weaknesses

Based on our review, we did not find any weaknesses in the internal controls.

## FOLLOW-UP ON PRIOR AUDITS

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### **Audit of the City of Los Angeles Housing Department – HOME Affordability Monitoring and Inspections, 2008-LA-1016, dated September 18, 2008**

We audited the City’s HOME affordability monitoring and inspection requirements regarding HOME-assisted rental units, prompted by a prior audit (2008-LA-1004), which detected problems in this area. We found that the City did not comply with HOME affordability monitoring and inspection requirements for its HOME-assisted rental housing. It failed to maintain the required tenant eligibility information for 26 HOME-assisted rental housing projects totaling nearly \$38 million. In addition, it did not maintain complete tenant eligibility information, did not ensure that its contractor conducted occupancy monitoring in accordance with HOME program requirements, and failed to inspect HOME-assisted rental housing projects when required. On December 2, 2008, we entered into management decisions with HUD to correct the items in the recommendations, which have a target completion date of April 16, 2010.<sup>4</sup>


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<sup>4</sup> There are other prior audits that are pending resolution; however, this was the only audit that was directly related to the City’s administration of its HOME program and included program activities similar to those being used to implement Program funds.


# APPENDIX

## Appendix A

### AUDITEE COMMENTS



Los Angeles Housing Department  
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Antonio R. Villaraigosa, Mayor  
Mercedes Márquez, General Manager

March 10, 2010

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Los Angeles CA 90017

Attn: Tanya Schulze, Assistant Regional Inspector General for Audit


**RE: Discussion Draft – Neighborhood Stabilization Program Capacity Review**

Dear Ms. Hobbs,

We are very pleased with the Office of the Inspector General's favorable review of the Los Angeles Housing Department's implementation of the Neighborhood Stabilization Program. In our development of the program, we have made regulatory compliance a priority, and are gratified that our efforts have been recognized.

As noted in the report, we have made significant progress in meeting NSP goals in the last several months of the period reviewed by OIG, and we are pleased to report that additional progress has been made. We are very confident that we will meet all timeliness and regulatory requirements.

As always, we appreciate your staff's professionalism and diligence in reviewing LAHD's programs. As you know, we appreciate any opportunity to improve our operation, and in doing so, increase affordable housing opportunities for the City's neediest residents.

Sincerely,  
  
DOUGLAS GUTHRIE  
General Manager

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