OFFICE OF AUDIT
REGION 9
LOS ANGELES, CA

The County of Santa Barbara, CA

HOME Investment Partnerships Program

2013-LA-1007

JULY 9, 2013

Issue Date: July 9, 2013

Audit Report Number: 2013-LA-1007

TO: William Vasquez, Director, Los Angeles HUD Office of Community Planning and Development, 9DD

Tanya E. Schulze

FROM: Tanya E. Schulze, Regional Inspector General for Audit, Los Angeles Region 9, 9DGA

SUBJECT: The County of Santa Barbara, CA, Did Not Comply With HOME Investment Partnerships Program Requirements

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of the County of Santa Barbara's compliance with HOME Investment Partnerships Program rules and requirements.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8L, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at http://www.hudoig.gov.

If you have any questions or comments about this report, please do not hesitate to call me at 213-534-2471.

July 9, 2013

The County of Santa Barbara, CA, Did Not Comply With HOME Investment Partnerships Program Requirements

Highlights

Audit Report 2013-LA-1007

What We Audited and Why

We reviewed the County of Santa Barbara's HOME Investment Partnerships program due to concerns expressed by the U.S. Department of Housing and Urban Development's (HUD) Los Angeles Office of Community Planning and Development regarding the County's administration of its HOME program. Our objective was to determine whether the County performed its monitoring responsibilities and ensured that incurred HOME program expenditures were eligible and supported.

What We Recommend

We recommend that the Director of the HUD Los Angeles Office of Community Planning and Development require the County to (1) support more than $3.1 million in expenses or repay the program; (2) repay $444,499 in ineligible expenses from non-Federal sources; and (3) update and implement its written monitoring, record-keeping, and payment processing policies and procedures as well as controls to ensure compliance with required HOME program rules and requirements.

What We Found

The County demonstrated that expenditures totaling more than $3.9 million related to rental housing project costs were eligible and adequately supported. However, it incurred more than $3.5 million in unsupported and ineligible HOME costs. In addition, it did not perform the required monitoring of its community housing development organizations or conduct required onsite inspections of its HOME-funded rental housing properties.

TABLE OF CONTENTS

BACKGROUND AND OBJECTIVE

HOME Investment Partnerships Program
The National Affordable Housing Act of 1990 created the U.S. Department of Housing and Urban Development's (HUD) HOME Investment Partnerships Program. By establishing the HOME program, Congress intended to establish a partnership between the Federal Government and States, units of local government, and nonprofit organizations to expand the supply of affordable, standard housing for low-income families.

County of Santa Barbara
The County of Santa Barbara is the lead agency for the Santa Barbara County HOME Consortium, which is comprised of the surrounding cities of Buellton, Carpinteria, Goleta, Lompoc, Santa Maria, and Solvang. The consortium was formed in 1994 in order for the County and participating jurisdictions to qualify for HOME program funds directly from HUD. The funds are targeted at low- and very low-income families and used to finance and develop low-income and special needs housing opportunities. During fiscal years 2007 through 2012, HUD awarded the County more than $9.2 million in HOME program funds.

The County's Community Services Department (CSD), Housing and Community Development (HCD) Division, is responsible for the administration of the County's HOME program, which includes monitoring and inspection responsibilities and the processing of disbursements to its community housing development organizations (CHDOs). The formation of the CSD resulted from the County's management reorganization that realigned its former Department of HCD under the CSD as a division. Since July 1, 2007, the County has funded 12 HOME-funded projects, which consisted mainly of rental housing properties.

HUD's Los Angeles Office of Community Planning and Development last performed an onsite monitoring review of the County's HOME program during the period April 30 through May 4, 2012. The review identified many issues that the County needed to address to comply with HUD rules and requirements. Among the issues noted by HUD were the following:

- Executed written agreements between the County and CHDOs that did not include all of the required regulatory provisions.
- Lack of sufficient policies, procedures, and monitoring to ensure HOME program compliance.
- Insufficient supporting source documentation for invoices related to incurred HOME costs.

The County is implementing corrective actions to resolve the issues identified. Based on the results of the monitoring, HUD requested that OIG conduct a more comprehensive review of the County.

Audit Objective

The objective of our review was to determine whether the County performed its monitoring responsibilities and ensured that incurred HOME program expenditures were eligible and supported.

RESULTS OF AUDIT

Finding: The County's Lack of Monitoring Resulted in More Than $3.5 Million in Questioned Costs

The County disbursed more than $3.5 million in HOME funds to its CHDOs for ineligible and unsupported costs. In addition, it did not perform the required monitoring of its CHDOs or conduct the required onsite inspections of its HOME-funded rental housing properties. We attributed these deficiencies to the Community Services Department's lack of oversight to ensure that its staff implemented the required controls to ensure compliance with program rules and requirements. As a result, the County incurred more than $3.5 million in questioned HOME costs that could deprive it and surrounding cities' low- and very low-income families of needed benefits.

The County Disbursed More Than $3.5 Million for Ineligible and Unsupported Costs

The County demonstrated that expenditures totaling more than $3.9 million related to rental housing project costs were eligible and supported. The eligible costs included development hard costs, acquisition costs, related soft costs, and cost relating to payment of a loan. The supported costs had adequate documentation, which included invoices, copies of canceled checks paid to vendors, payroll records, appraisals, property purchase agreements, escrow instructions, settlement statements, title reports, and recorded grant deeds. However, the County disbursed more than $3.1 million for unsupported costs and $444,499 for ineligible costs (see appendix C). According to 24 CFR (Code of Federal Regulations) 92.508(a)(3)(ii), the County must maintain project records related to the source and application of funds for each project, including supporting documentation. In addition, according to 24 CFR 85.20(a)(2), the County's fiscal control and accounting procedures must be sufficient to permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes (see appendix D).

<u>Unsupported Costs</u>

The County disbursed more than $3.1 million in HOME funds for unsupported costs related to the Dahlia Court II, College Park Apartments, Cypress Court, Creekside Village, and Casa de Familia properties. Without adequate supporting documentation, neither we nor the County could determine whether the CHDOs' incurred costs were eligible under the HOME program or permitted the adequate tracing of program expenditures.

The County disbursed more than $2.1 million for the Dahlia Court II and College Park Apartments properties without sufficient documentation from the CHDOs to substantiate the eligibility and reasonableness of costs incurred. The County disbursed funds for the Dahlia Court II property, which was under construction, without obtaining and reviewing documents evidencing the payment of incurred soft costs such as permits and architectural costs to vendors. In addition, it disbursed funds for the College Park Apartments property, which was completed in May 2008, without obtaining and reviewing adequate supporting source documents for the unknown type of costs related to this property. The records reviewed for this property included only escrow instructions. Further, the escrow funds disbursed exceeded the total HOME funds disbursed. The County was unable to locate additional supporting documents to substantiate the eligibility of program expenditures related to both of these properties.

The County disbursed a total of $517,957 for the Cypress Court and Creekside Village properties without sufficient documentation to permit the adequate tracing of program expenditures. It disbursed funds for the Cypress Court property, which was under construction, without reviewing supporting source documents for the incurred soft costs. During the audit, the County attempted to address this issue by providing us additional supporting documentation that it obtained from the CHDO in question. However, the County provided documents for permit fees that exceeded the HOME funds reimbursed by more than $197,000. In addition, the County disbursed funds for the Creekside Village property, which was completed in June 2012, for permit fees that exceeded the HOME funds reimbursed. Neither the County nor the CHDOs could provide further documentation to permit the adequate tracing of the program expenditure.

The County disbursed $438,756 in unsupported development hard costs related to the Casa de Familia property, which was under construction. The County did not require its CHDO to submit adequate and full documentation of incurred costs to support the eligibility and reasonableness of costs paid. It accepted invoices from the CHDO's general construction contractor, which had minimal information that the contractor considered to be required documentation. For example, the contractor's invoice included a line item amount with the general line item description "general requirements." The County believed that the construction contractor's invoices were sufficient, since the documents were based on the construction contract and contractor's interpretation that such documentation was in line with the industry standard. However, this practice is contrary to HUD's requirements, which include more documentation to support eligible HOME costs.

Overall, the County attempted but failed to locate and provide additional documents to show the eligibility of program expenditures related to these properties.

Ineligible Costs

The County disbursed $419,433 for ineligible development expenses that were not allowed under the terms of the executed loan agreement for the Dahlia Court II property. The loan agreement allowed the CHDO to incur certain development costs. However, the County approved other unallowable expenses incurred by the CHDO. The County's loan agreement specifically stated that changes in individual items comprising the project's budget required the prior written request of the CHDO and the written consent of the County (see appendix D). A County staff member noted that a former staff member had determined that the expenses were eligible uses of HOME funds and acknowledged that the County should have executed a formal amendment to the loan agreement. However, the County did not execute an amendment that would have corrected the problem. Current County staff could not comment on the previous management's oversight of contract or amendments.

The County disbursed $24,000 to People's Self-Help Corporation for operating expenses related to first-time homebuyer and foreclosure prevention counseling services. HUD requirements at 24 CFR 92.205 did not explicitly mention foreclosure counseling as an eligible HOME activity. According to 24 CFR 92.206(d)(6), staff and overhead costs directly related to carrying out the project, including housing counseling, may be charged to project costs only if the project is funded and the individual becomes the owner or tenant of the HOME-assisted project (see appendix D). County staff informed us that the expenses were for foreclosure counseling and that a homebuyer assistance program had not existed since 2006. Therefore, according to the regulations, the foreclosure counseling costs were not eligible. Staff could not comment on the previous management's execution and approval of agreements that did not take in to account HUD requirements.

The County disbursed $816 for delinquent taxes and $250 (total of $1,066) for a discount that was inappropriately not credited as a cost reduction related to the Creekside Village property. According to 24 CFR 92.214(a)(8), HOME funds may not be used to pay delinquent taxes on properties funded with HOME funds. In addition, according to 2 CFR 225, attachment A (C)(4) and (D)(1), applicable credits, such as discounts, related to allowable costs shall be appropriately credited either as a cost reduction or cash refund. Further, the total cost of Federal awards is comprised of the allowable direct cost of the program, plus its portion of allowable indirect costs, less applicable credits (see appendix D). In response to these issues, current County staff could not comment on the previous management's execution and approval of agreements that did not take in to account HUD requirements. In addition, County staff did not know that the discount had not been credited to the program. Its CHDO's general partner, the Housing Authority of the County of Santa Barbara, stated that its staff did not note the discount during the data entry of the invoice. Therefore, it did not take the discount.

The County Did Not Conduct and Document Monitoring and Onsite Inspections

The County contracted with various CHDOs to develop affordable housing. HUD regulations 24 CFR 92.504(a) requires the County to review the performance of these CHDOs at least annually. HUD regulations 24 CFR 92.504(d) require that the County perform onsite inspections of its HOME-funded rental housing properties to determine compliance with property standards and verify the information submitted by the CHDO related to the properties' occupancy by low-income households. In addition, HUD regulations 24 CFR 92.508(a)(6)(iii) requires that the County maintain evidence of these reviews and the corrective actions taken to resolve findings and concerns (see appendix D).

Monitoring Was Not Adequately Performed and Documented

The County did not perform the required annual monitoring and follow-up reviews of three of the four sampled CHDOs as required by HUD requirements. The limited monitoring records for three of the four sampled CHDOs consisted of two e-mails requesting a final construction update and the scheduling of a brief walk-through of a property. Discussions with a County staff member found that "the County's monitoring records indicated that there have been holes in the monitoring function and if monitoring had been performed, the documentation was either lacking or inconsistent."

During its own monitoring reviews of Lompoc Housing Community Development Corporation, a CHDO, the County did not address the performance problems it identified as required by HUD regulations. For example, the CHDO did not submit to the County its required annual reports. However, the County disbursed HOME funds to the now-defunct CHDO without documentation to support the incurred costs. Monitoring documents showed that the CHDO had consistent performance problems. The deficiencies in both management oversight and financial systems included missing a scheduled monitoring meeting; many instances of postponing on-site monitoring visits; not addressing monitoring findings and concerns; and not submitting requested documentation such as audited financial statements, general ledgers, and other project-related documents. According to a County request letter, the CHDO had not submitted audited financial statements to the County since 2005. There are concerns as to why the County continued to disburse funds to the CHDO when there were continuing issues.

Onsite Inspections Were Not Always Performed

The County did not conduct onsite monitoring as often as required for its Rancho Hermosa and College Park Apartments properties. HUD requires the County to perform onsite compliance monitoring of these projects every year. Since construction for these properties had been completed for more than 1 year, these properties were subject to onsite inspections. The County's records for Rancho

Hermosa included a one-page status report stating that the County and HUD had inspected the property in May 2012. However, the County did not maintain sufficient documentation to show that it had conducted the inspections in May 2012. The County did not perform onsite inspections at the College Park Apartments in 2009, 2011, and 2012. The County's 2010 CHDO monitoring report stated that it conducted eight onsite inspections of housing units in 2010. However, the County could not provide documentation to show that it performed those inspections.

Internal Controls Were Inadequate and Staff Was Unaware of Requirements

Written Agreements Did Not Define Eligible Costs

The County's executed written agreements with the CHDOs did not define the eligible HOME costs. According to 24 CFR 92.504(c)(3)(i), written agreements must describe the use of the HOME funds, including the tasks to be performed, a schedule for completing the tasks, and a budget. These items must be in sufficient detail to provide a sound basis for the County to effectively monitor performance under the agreement (see appendix D). Four of the seven sampled loan agreements did not include budgets in sufficient detail to determine the eligibility of the incurred costs. For example, the County provided us an audited cost certification to show that HOME program costs for the Rancho Hermosa property were supported and eligible. However, the County could not provide documentation that disclosed specific supported and eligible HOME program costs for College Park Apartments, Cypress Court, and Creekside Village properties. As a result, we believed that such expenses were either unsupported or ineligible. Current County staff could not comment on the previous management's oversight of the executed missing contract provisions.

The Grants Management and Administrative Plan, Procedures, and Project Monitoring Schedule Were Outdated

The County's grants management and administrative plan, policies and procedures, and project monitoring schedule were outdated and considered internal control weaknesses. County staff was unsure as to when the County had updated these documents. Without a detailed and current written plan, policies and procedures, and a project-monitoring schedule, the staff would be unable to administer the HOME program funds in accordance with HUD rules and requirements. County staff agreed with our determination and informed us that the Housing and Community Development Division's policies and procedures were getting "a major overhaul." Additionally, two County staff members acknowledged that employee turnover, understaffing, and additional monitoring responsibilities created by the successful completion of projects contributed to unsuccessful and sporadic attempts at establishing and implementing formal policies and procedures.

Project Files Were Not Organized

The County's system for maintaining project files was disorganized and unmanaged. Project records should serve as a repository for essential project information and contain, at a minimum, the documentation prescribed in HUD regulations at 24 CFR 92.508 and 24 CFR 85.20 (see appendix D). The condition of the County's files hindered our ability to determine eligibility of incurred HOME costs. Previous County staff filed documents haphazardly into the projects' files without regard for duplication of documents and assurance that related documents were in the files. Also, previous staff did not always file documents in the appropriate physical or electronic location. As a result, County staff had trouble locating requested documents that should have been in project files. This practice resulted in projects files without documentation to support questioned HOME program costs. County management accepted responsibility for the condition of its project files. Further, County staff acknowledged that it had incomplete project files, as well as duplicate copies of records. As a corrective action, County management was implementing a filing system to ensure that project files would be maintained and organized in a logical manner to permit ready access to relevant information.

Staff Was Unaware of Requirements

County staff was not aware that it was violating HUD requirements when managing the HOME program. It was not aware of the extent of supporting source documents that the County must maintain in its files related to disbursed HOME funds. For example, the County had disbursed HOME funds for the Casa de Familia and Cypress Court property without reviewing supporting source documents. During the audit, the County attempted to address this issue by providing additional documentation that it obtained from the CHDO to support the questioned costs. However, those documents were not adequate and we considered the costs unsupported. In the case of documentation for Casa de Familia, County staff inquired about the applicable regulations related to supporting source document. Due to perceived construction industry practices, the County believed that general contractors involved in HOME-funded projects did not have to submit substantiation or backup documentation with respect to costs for a previously approved schedule of values. Although the County adopted this practice, it should have obtained supporting documents from the CHDO to determine the eligibility of the requests during the initial processing of the disbursement requests instead of after disbursing the funds.

The County Started Taking Corrective Action

The County had started to take corrective action to address some of the issues identified by HUD's monitoring efforts in 2012. The County submitted to HUD additional supporting documents related to the issues concerning the executed written agreements with CHDOs, and the matter was under HUD review. The County had a proposed submittal date of April 30, 2013, to implement the corrective actions related to the County's policies and procedures and supporting documents for invoices. As of the last date of our fieldwork, April 19, 2013, the County had not responded to HUD in relation to the deficiencies and corrective actions for its HOME policies and procedures and supporting documents for invoices. During the last week of fieldwork, a County official informed us that the County was executing a contract related to project monitoring services.

Conclusion

The County incurred more than $3.5 million in ineligible and unsupported costs related to its HOME program. In addition, it did not conduct monitoring and on-site inspections of its HOME-funded properties as required by HUD. We attributed these deficiencies to the Community Services Department's lack of oversight to ensure that it implemented the required controls to monitor the County's CHDO's performance, HOME-assisted rental housing properties, and incurred program costs. In addition, the Department's lack of oversight did not ensure that the County executed written agreements and amendments in compliance with applicable HOME program rules and requirements. As a result, the County incurred questioned costs that could hamper it and surrounding cities' ability to address the needs of low- and very low-income families.

Recommendations

We recommend that the Director of the HUD Los Angeles Office of Community Planning and Development require the County to:

1A. Provide documentation to support the $3,110,602 in unsupported costs or repay the HOME Investment Trust Fund United States Treasury account from non-Federal funds.

1B. Repay to the HOME Investment Trust Fund United States Treasury account $444,499 from non-Federal funds for ineligible costs.

1C. Update and implement its written monitoring policies and procedures, as well as internal controls to ensure that it conducts and documents its monitoring and onsite inspections of HOME-funded properties as required by HOME program rules and requirements.

1D. Update and implement its written payment processing policies and procedures to ensure that program funds are supported and comply with applicable rules, requirements, and executed agreements.

1E. Update and implement its recordkeeping policy to ensure that the County maintains records as prescribed by HUD rules and requirements.

We recommend that the Director of the HUD Los Angeles Office of Community Planning and Development

1F. Provide training and technical assistance to ensure that applicable County staff is trained and aware of HOME program rules and requirements to ensure compliance.

SCOPE AND METHODOLOGY

We performed our onsite audit work at the County office located in Santa Barbara, CA, between November 2012 and April 2013. Our audit covered the period January 1, 2007, through November 1, 2012, and was expanded to other periods as necessary.

To accomplish our audit objective, we

- Reviewed applicable HUD rules and requirements;
- Reviewed County internal controls and procedures;
- Interviewed County officials; and
- Reviewed monitoring, independent public accountant, and HUD's Integrated Disbursement and Information System (IDIS) reports.

HUD's IDIS records showed that from January 1, 2007, through November 1, 2012, the County had disbursed more than $10.8 million in HOME funds. We selected for review all project-related disbursement voucher lines over $250,000. This process resulted in 11 line item expenditures within 8 vouchers totaling more than $5.2 million in HOME funds that was used toward seven properties managed by four different CHDOs. In addition, we expanded our review to include

- Four vouchers totaling nearly $1.7 million in line item expenses that occurred between September 2004 and January 2011 due to deficiencies related to unsupported costs,
- Four line item expenditures totaling more than $478,000 related to the expenditures in our sample since we determined that reviewing all line items within vouchers would best meet our objective, and
- Five vouchers disbursed between March and December 2009 totaling $24,000 due to concerns of eligibility regarding costs incurred for foreclosure prevention counseling services.

In total, we reviewed more than $7.4 million in HOME expenditures to determine whether the County used the funds for eligible and supported costs. The only computer data system we relied on during the audit was HUD's IDIS, which we used to select our sample. We confirmed several total voucher amounts to a County financial system source document and determined that the information was reliable enough for audit purposes.

We conducted the audit 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 findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

INTERNAL CONTROLS

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls 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.

Relevant Internal Controls

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

- Effectiveness and efficiency of program operations – Implementation of policies and procedures to ensure that program funds are used for eligible purposes.

- Reliability of financial information – Implementation of policies and procedures to reasonably ensure that relevant and reliable information is obtained to adequately support program expenditures.

- Compliance with applicable laws and regulations – Implementation of policies and procedures to ensure that monitoring, onsite inspections, and expenditures comply with applicable HUD rules and requirements.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- The County did not have adequate management oversight and controls in place to ensure that monitoring, onsite inspections, and disbursements complied with HUD rules and requirements (finding).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Unsupported 1/	Ineligible 2/
1A	$3,110,602	
1B		$444,499

1/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.

2/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

County Of Santa Barbara

Chandra L. Wallar
County Executive Officer

105 East Anapamu Street, Room 406
Santa Barbara, California 93101
805-568-3400 • Fax 805-568-3414
www.countyofsb.org

Executive Office

June 11, 2013

Tanya E. Schulze, Regional Inspector General for Audit
Office of the Inspector General, Region IX
U.S. Department of Housing and Urban Development
611 W. 6th Street, Suite 1160
Los Angeles, CA 90017

E-mail: tschulze@hudoig.gov

RE: **Draft Audit Report No. 2013-LA-10XX - County of Santa Barbara HOME Program**

Dear Ms. Schulze:

The County is in receipt of the May 24, 2013 U.S. Department of Housing and Urban Development (HUD), Office of Inspector General (OIG) Draft Audit Report (Report) for the County of Santa Barbara HOME Investment Partnerships (HOME) Program. The Report concluded that the County disbursed more than $3.5 million in HOME funds to Community Housing Development Organizations (CHDOs) for ineligible or unsupported costs, did not perform the required monitoring of its CHDOs, and did not conduct the required onsite inspections of HOME-funded rental housing properties. The County will address several statements in the Report.

I. Disbursement of more than $3.5 million in HOME funds to CHDOs for ineligible and unsupported costs

Comment 1

The Report includes references to the County's expenditure of "ineligible" and "unsupported costs." The County clarifies that HOME funds expended toward HOME projects were used to construct affordable housing for low-income households. The OIG has identified $3.1 million as unsupported costs and $444,499 as ineligible costs. The County maintained project records for each of these projects, however, the level and detail of supporting documentation was found to be insufficient by the OIG. To the contrary, the County finds the documentation acceptable. This letter will address each project identified and provide a discussion in support of the County's position with regard to the eligibility and support of the expenses of each of the projects noted by the OIG.

Project	Expenses Reviewed by OIG	Ineligible as per OIG	Unsupported as per OIG
Dahlia Court	**$972,116**	**$419,433**	**$49,172**

The $419,433 of expenses associated with Dahlia Court which OIG identified as "ineligible expenses" are HOME-eligible expenses. This project is still under construction and the County has not released its final disbursement nor closed out the project. Dahlia Court will serve low-income households. During the course of construction, changes in individual items comprising the budget were made pursuant to Section

Renée E. Bahl
Assistant County Executive Officer
rbahl@co.santa-barbara.ca.us

Terri Maus-Nisich
Assistant County Executive Officer
tmaus@countyofsb.org

Dennis Bozanich
Assistant to the County Executive Officer
dbozanich@co.santa-barbara.ca.us

3.3 of the loan agreement. The total overall budget did not change. Prior to disbursement, a request to change the budget was received by the County from the developer, was reviewed by County staff for HOME eligibility, was determined to be eligible under HOME regulations, and staff approved the invoice (attached). Accordingly, the County has revised the project budget (attached). Moreover, an independent cost certification audit of the project will be conducted after the project is completed.

The County requests clarification from the OIG on $49,172 of the projects costs which the OIG found to be "unsupported expenses." During the time OIG staff were on-site at County offices, staff provided invoices to the OIG for the entire $49,172.

Comment 2

Project	Expenses Reviewed by OIG	Ineligible as per OIG	Unsupported as per OIG
Foreclosure Counseling	**$24,000**	**$24,000**	**$24,000**

The OIG's report indicates that $24,000 paid for Foreclosure Counseling is "ineligible". Regulations at 24 CFR 92.206(d)(6) permit housing counseling if the services involve home-buyer assistance. In 2008 Peoples' Self-Help Housing Corporation (PSHHC) engaged in counseling services designed to help low- and moderate-income households avoid foreclosure and remain in their homes at a time when home foreclosures were affecting many homeowners throughout the County. In addition to County HOME funds, PSHHC used HUD Housing Counseling funds and local grant funds. Valuable housing counseling services were provided to 510 low and moderate income households. As a result of the counseling services provided, 56 households successfully modified their mortgages, 2 households initiated repayment plans, and 12 sold their homes. Only 1 household had its mortgage foreclosed, 1 household declared bankruptcy, 1 household was referred to legal assistance, and 27 households withdrew from counseling. 233 households continued to receive counseling.

Comment 3

Project	Expenses Reviewed by OIG	Ineligible as per OIG	Unsupported as per OIG
Creekside Village	**$1,218,227**	**$1,066**	**$27,957**

The County provided support documentation to the OIG for the $27,957 in "unsupported costs." Permit fees for this project totaled $36,247.18, and $27,957.00 in HOME funds were applied toward the $36,247.18 in permit fees, with the balance of $8,290.37 in permit fees paid from County 'local in lieu' funds. All expenses related to the $36,247.18 in permit fees are fully eligible and documented, and the documentation was provided to the OIG. The County provided adequate documentation, and the expectation by OIG that the permit invoices would be split for each funding source is unreasonable. The County requests the OIG identify the statute or regulation or other authority that requires that the permit invoices be split for each funding source. The County will continue to monitor project expenditures to determine that they are used for eligible activities.

Comment 4

Project	Expenses Reviewed by OIG	Ineligible as per OIG	Unsupported as per OIG
Casa de Familia	**$529,637**	**$0**	**$438,756**

The OIG examined expense vouchers totaling $529,637 and found that $438,756 was "unsupported expenses." These expenses are from the general contractor which was selected by the developer Good Samaritan to construct Casa de Familia. The general contractor, Carroll Construction, was selected by a publicly bid contract and was the lowest responsive bidder. The general contractor provided to the developer a 'schedule of values' which is a breakdown of the construction cost into specific and measurable categories of cost. For each invoice submitted, the General Contractor submitted an invoice showing costs for the amount of work completed. This is standard construction practice. The contract between the General Contractor and the client, in this case Good Samaritan, represents the cost of the project based on the agreed upon bid. The invoices represent incremental draws against the total project cost. For the $438,756 disbursed to the contractor, the County provided OIG with: 1) the loan agreement budget; 2) contracts with contractors that tie to the loan agreement budget; 3) invoices from contractors that tie to the contract budget; and 4) proof of payment such as a cancelled check from Good Samaritan to the contractor. The County considers this documentation adequate and consistent with standard norms for fixed price contracts.

Comment 5

Project	Expenses Reviewed by OIG	Ineligible as per OIG	Unsupported as per OIG
College Park Apartments	**$2,104,717**	**$0**	**$2,104,717**

The County loaned a total of $2,198,400 in HOME funds toward the College Park project. In 2004, an initial loan of $486,000 in HOME funds was provided to the project for architectural construction drawing costs. This loan was incorporated in 2005 into a 2nd loan of $1,685,466 as construction financing toward this project. In 2008, a 3rd loan was made by the County to the project, which incorporated the $1,685,466 loan, in addition to $512,934 in new HOME funds, for a total of $2,198,400 in the execution of the permanent financing. $1,712,400 in HOME funds ($2,198,400-$486,000) was applied toward permanent financing, which together with other financing, retired the construction loan on this project. The use of HOME funds to pay off a construction loan is eligible under HOME regulations at CFR 92.206(g) when: "(1) the loan was used for eligible costs specific in this section, and (2) the HOME assistance is part of the original financing for the project and the project meets the requirements of this part." The College Park project met these two conditions.

Additional cost documentation for this project is contained in an Independent Auditor's Report which was conducted in 2008 by Keller and Associates, which audited the Final Cost Certification for the project. This is a requirement of projects receiving funding from the California Tax Credit Allocation Committee (TCAC). The Report summarizes evidence reviewed by the auditors which supported the amounts and disclosures in the Final Cost Certification. The Report included an assessment of the accounting principles used and significant estimates made by the Project's Limited Partnership's management. The Auditor ultimately concluded that the final cost of the project accurately represented the final development costs incurred by the Partnership in the development of College Park Apartments. OIG was provided the Cost Certification. Additionally, the Cost Certification was approved and accepted by the State Tax Credit Allocation Committee. It is unclear to the County why the OIG has questioned that "escrow funds disbursed exceeded the total HOME funds disbursed." (page 5, first paragraph). Escrows are an accepted method of disbursing funds to construction projects. In the case of the College Park Apartments project, HOME funds constituted only a portion of the total funding used for the project, and the escrow included other sources of funding.

The CHDO which developed this project, the Lompoc Housing and Community Development Corporation (LHCDC), is no longer developing housing. The CHDO was removed as Managing Partner of the College Park Apartments project, and the project is now being successfully managed by a subsidiary of People's Self-Help Housing Corporation, an experienced affordable housing development and management organization. The County District Attorney's office has an open criminal investigation concerning LHCDC and any documents the District Attorney obtained are currently not subject to disclosure (see attached letter).

Comment 3

Project	Expenses Reviewed by OIG	Ineligible as per OIG	Unsupported as per OIG
Cypress Court	**$490,000**	**$0**	**$490,000**

HOME funds in the amount of $500,000 were allocated to the Cypress Court project. Of this amount, $490,000 in HOME funds was wired by the County to escrow to pay project permit fees in excess of $600,000. All expenses related to the $600,000 in permit fees are fully eligible and documented, and the documentation including the invoice and cancelled check was provided to the OIG. Upon project completion, an independent audited cost certification, which is required by the California Tax Credit Allocation Committee (TCAC) to verify all costs expended on the project, will be provided to the OIG. The County provided adequate documentation, and the expectation by OIG that the permit invoices would be split for each funding source is unreasonable.

II. County did not perform the required monitoring of its CHDOs or on-site inspections of HOME-assisted rental housing properties. The County did not maintain sufficient documentation to show that the required reviews of the CHDOs and on-site inspections were conducted.

Comment 6

County staff is in the process of developing enhanced policies and procedures to tighten monitoring procedures for CHDOs. In February 2013, the Board of Supervisors approved the expenditure of $75,000 for consultant services for documentation review and on-site physical inspections of affordable housing units under restrictive covenants, as required under the federal HOME program. Additionally, the County has contracted with another consultant to assist in amending the County's standard policies and practices for the HOME program. Staff and consultant resources will be assigned to implement these new policies and procedures to ensure that each HOME-assisted activity is monitored in accordance with the regulatory requirements.

Additional County Comments:

Comment 7

In the Highlights section of the Report, the OIG recommends that HUD require the County to repay $444,499 in "ineligible expenses" from nonfederal sources. In the exit interview with OIG on June 6, 2013, OIG staff stated that the final determination of any repayment would be decided upon conclusion of the resolution process. The County requests that the recommendation to repay be removed from the Report accordingly.

Comment 8

Additionally, under the Highlights section and in places throughout the Report, the OIG characterizes that the County has $3.5 million in unsupported <u>and</u> ineligible HOME costs. However in the body of the Report, the OIG describes the costs as either unsupported <u>or</u> ineligible HOME costs. The County requests that the phrase "unsupported and ineligible" in the Highlights section and in other areas of the Report be adjusted accordingly.

If you have any questions or require further information, please feel free to contact me at (805) 568-3400 or Dinah Lockhart, Deputy Director at (805) 568-3523. We look forward to resolving these issues quickly so the County can focus its efforts on providing affordable housing to those in need.

Sincerely,

Chandra Wallar

Chandra L. Wallar
County Executive Officer

Attachments:

1. Letter from District Attorney's Office
2. County email approval of budget adjustment for Dahlia Court
3. Revised Budget for Dahlia Court

cc: Santa Barbara County Board of Supervisors
Bob Geis, County Auditor-Controller
Dennis Marshall, County Counsel
Renée Bahl, Assistant County Executive Officer
Herman Parker, Community Services Director
Dinah Lockhart, Deputy Director of Housing & Community Development
William Vasquez, Director, Office of Community Planning and Development, 9DD

OIG Evaluation of Auditee Comments

Comment 1 We disagree with the County's contention that the $468,605 in questioned costs was eligible and supported. While the County provided additional documentation in response to the draft report, it did not change our conclusion. (Note: we did not include the additional documentation in the audit report; however, it is available upon request.) For the $419,433 in ineligible costs, the County provided email correspondence related to the CHDO's disbursement requests and the County's requests for written explanation for the budget changes. However, the County did not provide documentation that showed whether the CHDO had addressed the County's concern about justifying the revised budget. Further, it was not until June 10, 2013, as a result of our audit finding, that the County executed the budget revision to retroactively amend the loan agreement to show the eligibility of the $419,433 in questioned costs. While the expenses may or may not be HOME-eligible, these expenses were not in accordance with Section 3.3 of the loan agreement that was in effect at the time of the actual expenditures; therefore, we did not change our conclusion.

For the $49,172 in unsupported expenses, we acknowledge that the County provided invoices. However, it did not provide canceled checks, as required under 24 CFR 85.20(b)(6) to be part of the source documentation, to show that the incurred expenses were actually paid. Consequently, we did not revise our conclusion. During the audit resolution phase the County may be able to resolve the questioned costs if it is able to provide corresponding canceled checks that show expenses were paid.

Comment 2 According to 24 CFR 92.206(d)(6), staff and overhead costs directly related to carrying out the project, including housing counseling, may be charged to project costs **only if** the project is funded and the individual becomes the owner or tenant of the HOME-assisted project. County staff informed us that a homebuyer assistance program had not existed since 2006. Therefore, the County could not directly relate the counseling to any funded projects, nor did any of the individuals become the owner or tenant of HOME-assisted projects. Furthermore, the incurred counseling expenses did not assist homebuyers; instead, it was used for homeowners facing foreclosure including moderate-income households that would not have been eligible under the HOME program. Consequently, the County incurred $24,000 on counseling expenses that are ineligible and did not meet the objective of the HOME program to expand the supply of decent, safe, sanitary, and affordable housing for very low-income and low-income families.

Comment 3 According to 24 CFR 92.508(a), the County must establish and maintain sufficient records to enable HUD to determine whether the County has met these requirements. 24 CFR 92.508(a)(3)(ii) states that the County needs to maintain project records related to the source, application, and tracing of funds for each project, including supporting documentation in accordance with 24 CFR 85.20 (b)(2) and (6). Contrary to these requirements, the County did not maintain or provide us adequate supporting source documentation that allowed us to trace the application of the funds for each project to substantiate the use of HOME program funds. The County provided documentation that showed the payment of the permit fees lumped together without clear distinction of the source funding used to pay the fees. We are not saying that the County should pay these fees separately. Instead, the County could pay these expenses in lump payments as long as reviewers such as HUD and OIG can clearly trace these payments to supporting documentation for the projects and corresponding permit fees. By signing its Funding Approval and HOME Investment Partnerships agreements, the County agreed to meet the requirements, regulations, and expectations to ensure its incurred costs were supported and traced to the appropriate funding sources.

Comment 4 The focus of our review was to determine the compliance of incurred expenses with HOME program requirements, not whether the procurement process was in compliance with rules and requirements. We did not take issue with the procurement of the contractor. The essence of the finding is that the County did not maintain adequate documentation to validate the eligibility of the expenses. The County's practice of only obtaining invoices based on the construction contract, and the contractor's interpretation that such documentation was in line with industry standards, is contrary to HUD's requirements at 24 CFR 85.20(b) (see appendix D). This requirement provides grantees standards for accounting records and source documentation. As stated in the report, the County accepted invoices from the CHDO's general construction contractor that included general line items such "general requirements" that did not specify services rendered or products delivered for the project. The County stated this is industry standard, yet those standards did not take into consideration HUD requirements to provide sufficient documentation.

Comment 5 As noted in the audit report, the budgets attached to the loan agreements for this property were not in sufficient detail to allow us to determine the eligibility of the incurred costs. In addition, the County was unable to locate additional supporting documentation to substantiate the eligibility of the HOME program expenditures. Furthermore, the accounting records reviewed for this property included only escrow instructions and no supporting documentation such as a property purchase agreement, an appraisal, recorded deed of trust, title reports, construction invoices, or a deed of reconveyance that support the use of the funds indicated in the escrow instructions.

At the conclusion of our fieldwork, the County provided us the audited cost certification for this property, however, it did not support the $2.1 million in questioned costs. Instead, the document referred to "County of SB Partial HOME" funds that totaled more than $1.7 million. There was no explanation for the discrepancy. In addition, the cost certification stated the County used HOME program funds towards "Structures", a general term, rather than explaining the costs that were paid by HOME program funds. 24 CFR 92.508(a)(3)(ii) and 24

CFR 85.20(b)(2) and (6) provides grantees recordkeeping and financial management systems requirements to maintain supporting documentation for incurred costs. The County did not ensure its documentation of related projects costs were in compliance in HUD rules and requirements. As stated during the exit conference, the County will have the opportunity to work with HUD to address this issue during the audit resolution process and provide the necessary documentation to support the questioned costs.

Comment 6 We acknowledge the County's efforts and corrective actions towards addressing its monitoring issues related to its CHDOs and HOME-funded properties.

Comment 7 During the audit resolution process the County will have the opportunity to provide any additional documentation to address the $444,499 in ineligible expenses. See also Comments 1, 2, and 3.

Comment 8 The report accurately states that the County incurred more than $3.5 million in unsupported **and** ineligible expenses. Of this amount, OIG identified more than $3.1 million in unsupported costs and more than $444,000 in ineligible costs that the County must address during the audit resolution process. Consequently, stating the entire questioned costs as either unsupported or ineligible would not be an accurate statement, so we did not change the report.

Appendix C

SUMMARY OF QUESTIONED COSTS

Project name	Type of expenses reviewed	Amount of expenses reviewed	Ineligible	Unsupported
Dahlia Court II	Acquisition and related soft costs	$972,116	$419,433	$49,172
People's Self-Help Housing Corporation Foreclosure Counseling	Related soft costs	$24,000	$24,000	$0
Creekside Village	Related soft costs	$1,218,227	$1,066	$27,957
Casa de Familia	Development hard cost	$529,637	$0	$438,756
College Park Apartments	Unknown	$2,104,717	$0	$2,104,717
Cypress Court	Related soft costs	$490,000	$0	$490,000
Santa Rita Village	Acquisition	$1,568,132	$0	$0
Rancho Hermosa	Cost relating to payment of loan	$562,176	$0	$0
Total		**$7,469,005**	**$444,499**	**$3,110,602**

Appendix D

CRITERIA

Loan Agreement Between the County and People's Self-Help Housing Corporation for Dahlia Court II, Article 3: Loan Disbursement, Section 3.3 – Amount of Disbursement
"Loan proceeds shall be disbursed up to the amount of the Loan shown in the Budget and only for Lender approved items. Changes in individual items comprising the Budget shall require the prior written request of Borrower and the written consent of Lender. However, Lender's obligations shall in no event exceed the Loan amount specified in this Loan Agreement. Any costs above this amount necessary for the completion of the Project shall be the sole responsibility of Borrower."

24 CFR 92.205, Eligible Activities: General.

(a) Eligible activities.

(1) HOME funds may be used by a participating jurisdiction to provide incentives to develop and support affordable rental housing and homeownership affordability through the acquisition (including assistance to homebuyers), new construction, reconstruction, or rehabilitation of non-luxury housing with suitable amenities, including real property acquisition, site improvements, conversion, demolition, and other expenses, including financing costs, relocation expenses of any displaced persons, families, businesses, or organizations; to provide tenant-based rental assistance, including security deposits; to provide payment of reasonable administrative and planning costs; and to provide for the payment of operating expenses of community housing development organizations. The housing must be permanent or transitional housing. The specific eligible costs for these activities are set forth in §§ 92.206 through 92.209.

(2) Acquisition of vacant land or demolition must be undertaken only with respect to a particular housing project intended to provide affordable housing.

(3) Conversion of an existing structure to affordable housing is rehabilitation, unless the conversion entails adding one or more units beyond the existing walls, in which case, the project is new construction for purposes of this part.

(4) Manufactured housing. HOME funds may be used to purchase and/or rehabilitate a manufactured housing unit, or purchase the land upon which a manufactured housing unit is located. Except for existing, owner-occupied manufactured housing that is rehabilitated with HOME funds, the manufactured housing unit must, at the time of project completion, be connected to permanent utility hook-ups and be located on land that is owned by the manufactured housing unit owner or land for which the manufactured housing owner has a lease for a period at least equal to the applicable period of affordability.

24 CFR 92.206, Eligible project costs.

HOME funds may be used to pay the following eligible costs:

(d) Related soft costs. Other reasonable and necessary costs incurred by the owner or participating jurisdiction and associated with the financing, or development (or both) of new construction, rehabilitation or acquisition of housing assisted with HOME funds. These costs include, but are not limited to:

(6) Staff and overhead costs directly related to carrying out the project, such as work specifications preparation, loan processing inspections, and other services related to assisting potential owners, tenants, and homebuyers, e.g., housing counseling, may be charged to project costs only if the project is funded and the individual becomes the owner or tenant of the HOME-assisted project. For multi-unit projects, such costs must be allocated among HOME-assisted units in a reasonable manner and documented.

24 CFR 92.214 Prohibited Activities.

(a) HOME funds may not be used to:

(8) Pay delinquent taxes, fees or charges on properties to be assisted with HOME funds.

24 CFR 92.504, Participating jurisdiction responsibilities; written agreements; on-site inspection

(a) *Responsibilities*. The participating jurisdiction is responsible for managing the day to day operations of its HOME program, ensuring that HOME funds are used in accordance with all program requirements and written agreements, and taking appropriate action when performance problems arise. The use of State recipients, subrecipients, or contractors does not relieve the participating jurisdiction of this responsibility. The performance of each contractor and subrecipient must be reviewed at least annually.

(c) *Provisions in written agreements*. The contents of the agreement may vary depending upon the role the entity is asked to assume or the type of project undertaken. This section details basic requirements by role and the minimum provisions that must be included in a written agreement.

(3) For-profit or nonprofit housing owner, sponsor or developer (other than single-family owner-occupant)—

(i) *Use of the HOME funds*. The agreement between the participating jurisdiction and a for-profit or non-profit housing owner, sponsor or developer must describe the use of the HOME funds, including the tasks to be performed, a schedule for completing the tasks, and a budget. These items must be in sufficient detail to provide a sound basis for the participating jurisdiction to effectively monitor performance under the agreement.

(d) *Onsite inspections*—

(1) *HOME assisted rental housing*. During the period of affordability, the participating jurisdiction must perform on-site inspections of HOME-assisted rental housing to determine compliance with the property standards of § 92.251 and to verify the information submitted by the owners in accordance with the requirements of § 92.252 no less than: every three years for projects containing 1 to 4 units; every two years for projects containing 5 to 25 units; and every year for projects containing 26 or more units. Inspections must be based on a sufficient sample of units.

24 CFR 92.508, Recordkeeping

(a) *General*. Each participating jurisdiction must establish and maintain sufficient records to enable HUD to determine whether the participating jurisdiction has met the requirements of this part. At a minimum, the following records are needed:

  (3) *Project records*.

    (ii) The source and application of funds for each project, including supporting documentation in accordance with 24 CFR 85.20.

  (6) *Program administration records.*

    (iii) Records documenting required inspections, monitoring reviews and audits, and the resolution of any findings or concerns.

24 CFR 85.20, Standards for financial management systems

(a) A State must expand and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contractors, must be sufficient to—

  (2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

(b) The financial management systems of other grantees and subgrantees must meet the following standards:

  (2) Accounting records. Grantees and subgrantees must maintain records which adequately identify the source and application of funds provided for financially-assisted activities. These records must contain information pertaining to grant or subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income.

  (6) Source documentation. Accounting records must be supported by such source documentation as cancelled checks, paid bills, payrolls, time and attendance records, contract and subgrant award documents, etc.

2 CFR 225, Attachment A, General Principals for Determining Allowable Costs

(C) *Basic Guidelines*

  (4) *Applicable Credits.* Applicable credits refer to those receipts or reduction of expenditure-type transactions that offset or reduce expense items allocable to Federal awards as direct or indirect costs. Examples of such transactions are: purchase discounts, rebates or allowances, recoveries or indemnities on losses, insurance refunds or rebates, and adjustments of overpayments or erroneous charges. To the extent that such credits accruing to or received by the governmental unit relate to allowable costs, they shall be credited to the Federal award either as a cost reduction or cash refund, as appropriate.

(D) *Composition Costs*

  (1) *Total Cost.* The total cost of Federal awards is comprised of allowable direct cost of the program, plus its portion of allowable indirect costs, less applicable credits.