OFFICE OF AUDIT
REGION 9
LOS ANGELES, CA

The County of San Bernardino, CA

Neighborhood Stabilization Program

2014-LA-1003

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

//SIGNED//

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

SUBJECT: The County of San Bernardino, CA, Adequately Ensured That NSP Developer Fees Met HUD 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 developer fees the County of San Bernardino paid to its Neighborhood Stabilization Program (NSP) developers.

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 8M, 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.

June 5, 2014

The County Adequately Ensured That NSP Developer Fees Met HUD Requirements

Highlights

Audit Report 2014-LA-1003

What We Audited and Why

We reviewed the developer fees the County of San Bernardino paid to its Neighborhood Stabilization Program (NSP) developers. Our objective was to determine whether the County adequately ensured that NSP developer fees paid to its developers met HUD requirements. We performed our review to address questionable costs identified during a prior Office of Inspector General (OIG) review (audit report 2014-LA-0002). During that review, we found that for one of the County's NSP-funded properties, there were instances in which project management costs were claimed and received by the developer when it appeared that the County should have paid the costs through an agreed-upon developer fee. HUD issued policy alerts stating that HUD considers such project management fees "double-dipping" and not allowed under NSP.

What We Recommend

This report contains no formal recommendations, and no further action is necessary.

What We Found

The County adequately ensured that NSP developer fees paid to its developers met HUD requirements. Documentation provided during OIG's initial review was incomplete and made it appear as though there were indications of "double-dipping"; however, based on a more indepth review, we concluded that was not the case and the developer fees paid were eligible expenses.

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BACKGROUND AND OBJECTIVE

Neighborhood Stabilization Program

Authorized under Section 2301 of Title III of the Housing and Economic Recovery Act of 2008 as amended, Congress appropriated $4 billion for the Neighborhood Stabilization Program (NSP) to provide grants to every State and certain local communities to purchase foreclosed-upon or abandoned homes and to rehabilitate, resell, or redevelop these homes to stabilize neighborhoods and stem the decline in value of neighboring homes. The Act states that amounts appropriated, revenues generated, or amounts otherwise made available to States and units of general local government under Section 2301 must be treated as though such funds were Community Development Block Grant funds under Title I of the Housing and Community Development Act of 1974. NSP1 references the grant program authorized under the Act.

Congress amended NSP and increased its funding as part of the American Recovery and Reinvestment Act of 2009 and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The Recovery Act provided HUD an additional $2 billion in NSP funds (NSP2) to competitively award to States, local governments, nonprofit organizations, or consortia or nonprofit organizations, which could submit proposals in partnership with for-profit organizations. The Dodd-Frank Act provided HUD an additional $1 billion in NSP funds (NSP3) to award to all States and select governments on a formula basis.

County of San Bernardino

The County of San Bernardino's Economic Development Agency's Department of Community Development and Housing administers the County's NSP. The Department's mission is to improve the quality of life for residents of the County through identifying, obtaining, and administering local, State, Federal, and private funding resources available for community development and housing programs. HUD awarded the County more than $33.1 million in NSP1 and NSP3 grant funds. Through December 2013, the County had drawn more than $28.6 million of its total NSP grant funds. The County had primarily used its NSP grant funds to acquire and rehabilitate several multifamily properties. The County had spent $16.8 million of its NSP funds toward program administration; single-family acquisition, rehabilitation, and home ownership activities; and the development of affordable multifamily housing properties that were in the predevelopment phase or developed by a contracted developer not allowed to earn or receive a developer fee, such as a public housing authority. In addition, the County had spent more than $11.8 million of its NSP grant funds to acquire and rehabilitate four affordable multifamily housing properties where the contracted developers were allowed to earn and receive developer fees.

The objective of the review was to determine whether the County adequately ensured that developer fees paid to its NSP developers met HUD requirements.

RESULTS OF AUDIT

The County Adequately Ensured That NSP Developer Fees Met HUD Requirements

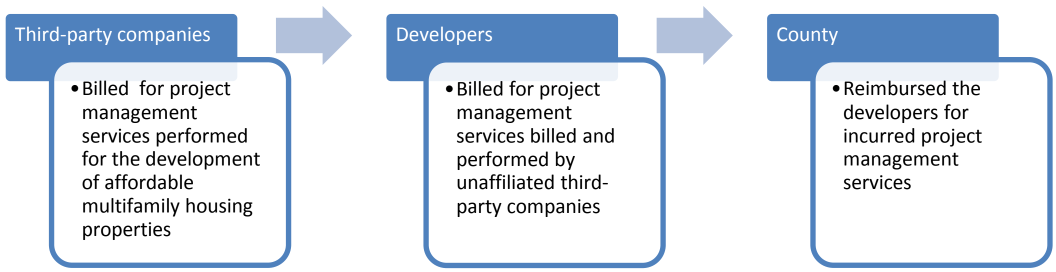
The County adequately ensured that NSP developer fees met HUD requirements for the two affordable multifamily housing properties reviewed. We reviewed $776,205 in developer fees paid and found that, contrary to initial indications, these fees were eligible and met HUD requirements. In addition, fees for project management services totaling $113,215 were eligible costs incurred by unaffiliated third-party companies.

The County Adequately Monitored Developer Fees

The County determined that $776,205 in NSP developer fees paid to developers for services performed at two program-funded multifamily housing properties, Lantern Woods Apartments and Park Place Apartments, were in accordance with HUD requirements. During our previous internal review (audit report 2014-LA-0002), we reviewed the Park Place Apartments, for which the acquisition and rehabilitation of the property were undertaken with combined NSP funding from the County and the City of Rialto. During that review, it appeared that the County and Rialto Housing Authority staff (administrators of the City's NSP funding) had approved and reimbursed the developer $69,215 in ineligible project management services related to the Park Place Apartments. It appeared that the $69,215 in project management services should have been paid as part of, not in addition to, the $223,350 in developer fees received (audit report 2014-LA-0002).

While developers are permitted to charge a developer fee, HUD's NSP Policy Alert, dated August 27, 2010, and updated on November 16, 2011, prohibited developers from "double-dipping," or charging grantees both a developer fee and project management fee. Specifically, the Policy Alert states that "if a developer's budget called for directly paying a project manager and also a developer fee that would be double-dipping and would not be allowed. Direct costs or indirect costs of a developer related to project management should be paid only through the fee."

This review allowed us to conduct a more indepth review of the grantees' monitoring of its developer fees to determine whether there were instances of noncompliance with the Policy Alert. We found that the fees for the project management services totaling $113,215 were allowable program expenses incurred by unaffiliated third-party companies. Participating NSP developers hired unaffiliated third-party companies to provide project management services to oversee the developers' rehabilitation of the two properties. These companies billed the developers for services rendered at the properties. The developers billed the County for reimbursement under NSP. As a result, there were no instances of “double-dipping” related to the project management fees incurred under the County’s NSP. The diagram below summarizes the billing process for the project management services.



County staff admitted that the documentation it provided to the Office of Inspector General (OIG) during the initial review made it appear that there were instances of “double-dipping.” In addition, County reviewers who had approved and filed incomplete documentation, which resulted from the pressure of meeting NSP expenditure deadlines, further caused the indications of “double-dipping.” Complete documentation would have shown the complete transaction of the project management fees to an outside reviewer not familiar with the development arrangements.

Conclusion

The County ensured that its NSP developer fees paid to developers for services were eligible. Incomplete documentation had initially given the appearance of “double-dipping”; however, upon further review, we concluded that the fees paid met HUD requirements and were eligible expenses.

SCOPE AND METHODOLOGY

We performed our onsite audit work at the County's office located at 385 North Arrowhead Avenue, San Bernardino, CA, between March and April 2014. The audit covered the period March 1, 2009, to February 28, 2014, but was expanded as necessary to accomplish the objective.

To accomplish our objective, we

- Reviewed relevant background information, including prior OIG audit reports;
- Reviewed applicable HUD laws, regulations, and other HUD program requirements;
- Reviewed the County's controls and procedures as they related to our objectives;
- Interviewed County staff; and
- Reviewed sampled affordable multifamily housing properties' files pertaining to project contracts and expenditures.

Our universe consisted of four NSP-funded properties totaling more than $11.8 million toward acquisition and rehabilitation activities. Each of the four properties had a developer that was allowed to earn and receive a developer fee for services rendered to the grantee. We nonstatistically selected for review two of the four affordable multifamily housing properties, the Lantern Woods and Park Place Apartments. The County spent more than $5.1 million of its NSP funds toward the acquisition and rehabilitation of the sampled properties. In addition, the developers of these sampled properties were allowed to earn and receive $776,205 in developer fees for services rendered to the grantee. We selected these sampled properties based on previously identified instances of "double-dipping" related to project management fees and on the total amount of obligated funding for properties not previously reviewed (audit report 2014-LA-0002).

We considered data posted on HUD's Web site to verify our audit universe and select our sample. We compared the total grant drawn amounts reported in HUD's online Disaster Recovery Grant Reporting[1] system as of December 31, 2013, for each of the four projects in our audit universe to the County's Financial Accounting System source documents. We determined that the data were reliable for our intended use in addressing the audit objective.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards required that we plan and perform the audit to obtain sufficient, appropriate

[1] The Disaster Recovery Grant Reporting system was developed by HUD's Office of Community Planning and Development for the Disaster Recovery Community Development Block Grant program and other special appropriations, including NSP. Data from the system is used by HUD staff to review activities funded under these programs and for required quarterly reports to Congress.

evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provided 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:

- Policies and procedures –Implementation of controls to confirm that the County adequately ensured that developer fees paid to its NSP developers met HUD 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 Deficiencies

We evaluated the internal controls related to the audit objective in accordance with generally accepted government auditing standards. Our evaluation of internal controls was not designed to provide assurance regarding the effectiveness of the internal control structure as a whole. Accordingly, we do not express an opinion on the effectiveness of the County's internal controls.

APPENDIX A

AUDITEE COMMENTS

The County chose not to provide written comments for this audit report.