

Office of the City Auditor

CONSENT CALENDAR

May 23, 2006

To: Honorable Mayor and
Members of the City Council

From: Ann-Marie Hogan, City Auditor

Submitted by: Ann-Marie Hogan, City Auditor

Subject: Audit: Seniors and Disabled Home Rehabilitation Loan Program

RECOMMENDATION

That Council request the City Manager to ensure that the recommendations in the attached report are implemented, and to report back by September 2007 regarding the implementation status of the report's recommendations. A date should be set for a follow-up report to Council if any recommendations remain unimplemented at the time of the September report.

SUMMARY

The attached Seniors and Disabled Home Rehabilitation Loan Program (SDHRLP) Audit was performed to:

- Determine whether the Housing Department's Seniors & Disabled Home Rehabilitation Loan Program is in compliance with the program guidelines, the Department of Housing and Urban Development (HUD) Community Development Block Grants (CDBG) funding requirements, and the California Department of Housing and Community Development (HCD) CalHome funding requirements.
- Determine whether the loan program has an adequate internal control structure.

The audit focused on Seniors and Disabled Home Rehabilitation loans completed between January 1, 2000 and June 30, 2005. Loans were reviewed for evidence of completion of major loan processes and for compliance with the City's program guidelines, CDBG requirements, and CalHome requirements. Our evaluation of internal controls focused on eligibility determination, program assistance, disbursements, record keeping, and program monitoring and oversight. The main concerns identified in the audit were:

- The existing program guidelines should provide clearer guidance on loan process time, loan limit for previously assisted properties, relocation expenses, loan write-off, reimbursement to homeowners, and conditions under which a repayment is required.
- The method staff used to verify income eligibility was not formalized or clearly documented.
- The procedures for assisting homeowners with the solicitation of contractor bids were not standardized.

Seniors and Disabled Home Rehabilitation Loan Program Audit

- Two out of four homeowners contacted had the misconception that the City selected a contractor for them. According to the program guidelines and staff, the City merely provides assistance to select a contractor.
- There was inadequate supervisory review over the accounting for loan activities.
- The City has no on-going procedures in place to verify whether a borrower continues to reside on the property.
- Supervisory reviews and final inspections were not documented; and supervisory reviews were performed only after rehabilitation was completed.
- There was no formal loan agreement between the homeowners and the City governing the rehabilitation and loan terms.

FISCAL IMPACTS OF RECOMMENDATION

Time from existing staff will be required within the next twelve months mainly to update the program guidelines, update the service contract with AmeriNational, and develop a boilerplate loan agreement for the program. Other recommended procedures are to be implemented on an ongoing basis. No additional cost is anticipated.

CURRENT SITUATION AND ITS EFFECTS

The SDHRLP may be improved by clarifying and formalizing existing loan procedures in the program guidelines and by standardizing the procedures for verifying income eligibility and assisting homeowners to secure bids. There is also a need to increase supervisory oversight. We also recommend the development of a formal loan agreement between the City and the borrowers to govern loan terms and requirements.

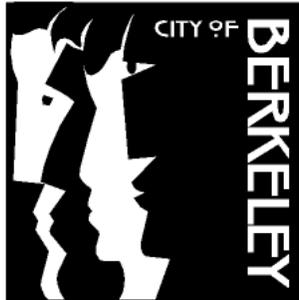
RATIONALE FOR RECOMMENDATIONS

As a recipient of State and Federal funds, the City is charged with the responsibility of ensuring that program benefits are distributed in accordance with program objectives and funding requirements. Clearly written program guidelines enhance program consistency. Adequate oversight and monitoring helps to prevent errors and improve service delivery.

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City of Berkeley



Seniors and Disabled Home Rehabilitation Loan Program Audit

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Presented to Council May 23, 2006

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SENIORS AND DISABLED HOME REHABILITATION LOAN PROGRAM AUDIT

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SENIORS AND DISABLED HOME REHABILITATION LOAN PROGRAM AUDIT

I. OBJECTIVES OF THE AUDIT

The City Auditor's Office has completed an audit of the Seniors and Disabled Home Rehabilitation Loan Program. The objectives of this audit are to:

- Determine whether the Housing Department's Seniors & Disabled Home Rehabilitation Loan Program (SDHRLP) is in compliance with the program guidelines, the Department of Housing and Urban Development (HUD) Community Development Block Grants (CDBG) funding requirements, and the California Department of Housing and Community Development (HCD) CalHome funding requirements.
- Determine whether the loan program has an adequate internal control structure.

II. SCOPE AND METHODOLOGY

The scope of the audit primarily focused on Seniors and Disabled Home Rehabilitation loans completed between January 1, 2000 and June 30, 2005. Loans were reviewed for proper evidence of completion of major loan processes and for compliance with the City's program guidelines, CDBG requirements, and CalHome requirements. Our evaluation of internal controls focused on eligibility determination, program assistance, disbursements, record keeping, and program monitoring and oversight. Methodologies used to meet our objectives included:

1. Reviewing the City's SDHRLP guidelines, CDBG funding requirements, and CalHome funding requirements.
2. Interviewing program staff and conducting walkthroughs of current loan processes.
4. Reviewing loan files, loan documents, payments, and other pertinent documents. Thirty-six loans were originated between January 2000 and June 2005. Six (17%) of the 36 loans were reviewed.
3. Reviewing permit status recorded in the Building Permit Module of the City's financial system.
4. Comparing property ownership reflected in loan files with current County records.
5. Surveying homeowners to determine their level of satisfaction of the quality of work performed by the contractors.

The last day of fieldwork was October 31, 2005. The audit was conducted in accordance with generally accepted government auditing standards (GAGAS). Audit work was limited to those areas specified in the Scope and Methodology section of this report.

III. BACKGROUND

The Seniors Home Rehabilitation Loan Program was adopted by Council in November 1990, to assist very-low-income senior citizens who were also Berkeley residents in making necessary repairs to their homes to eliminate conditions that might constitute possible threats to the seniors' health and safety. The initial loan limit was \$10,000. In 1994, the program was expanded to include very-low-income disabled homeowners. In January 2000, the loan limit was increased to \$25,000 to cover costs of seismic retrofit and lead paint abatement. Today, the program limit is \$70,000, funded 100 percent by HUD's CDBG or the State's CalHome funds, or both, at zero percent interest. The loan term is 30 years, payable upon the sale or transfer of the property, when the property ceases to be owner occupied, or upon loan maturity, according to the program guidelines.

Beginning in 1991 and as of June 2005, 110 properties were rehabilitated or were being rehabilitated with assistance from the program. The loans on 43 properties (39%) had been repaid. The loans on 67 properties (61%) remained outstanding.

The SDHRLP is primarily staffed by an Associate Management Analyst (referred to as a program coordinator), an Assistant Architect (referred to as an inspector), and a part-time Housing Inspector (referred to as an inspector). According to the program coordinator, outreach is done by distributing program pamphlets at the Berkeley Senior Center, as well as coordinating with non-profit agencies and other City programs serving the seniors. Approximately 50 percent of the applicants are referred by non-profit agencies or other City programs.

The loan process begins with an eligibility interview with the interested homeowner. If the homeowner appears to qualify for assistance, a loan package is sent to the homeowner. Once an application is completed and returned to the City, the program coordinator implements a series of steps to determine eligibility, mainly by verifying the applicant's household income, age, disability, and ownership of the property. To qualify for program assistance, the assisted property must contain no more than two units. The applicant must hold title and reside at the assisted property. If the title is under a trust, the applicant must be the sole beneficiary of the trust. In addition, the applicant must be:

- Over 62 years old, or disabled, or likely to be permanently disabled, and
- "Very-low-income" as defined by HUD; and have insufficient equity in outside assets to readily generate the capital needed for the rehabilitation work.

Once eligibility is verified and approved, an inspector schedules a site inspection with the homeowner to determine what needs to be repaired. A preliminary scope of work/write-up with cost estimate is developed to first address building code violations and health and safety. The inspector also provides assistance to secure bids. The inspector identifies at least five interested contractors from a list of general contractors who have formally expressed interest in the City's housing rehabilitation projects and have good track records or from contractors referred by the homeowner. The preliminary work write-up is sent to the interested contractors. The contractors may attend a "bid walk" to clarify the scope of work with the inspector at the property. Normally contractors are asked to submit their bids within two weeks. Bid results are reviewed and presented to the homeowners. Homeowners may also hire a contractor of their choice as long as the contractor is licensed and qualified to do the work approved by the City.

Each loan is secured by a promissory note and a deed of trust filed with the County. Loan proceeds are deposited into an escrow account opened in the homeowner's name at AmeriNational, a disbursement service company located at Downey, California. Funds are disbursed from the account to pay for rehabilitation costs.

To request a progress payment, the contractor must submit a "Payment Tabulation & Certificate for Work Completed" form listing the work completed. The inspector verifies work completion through site inspections. Both the homeowner and the inspector must sign the certificate to certify that the work was properly completed. The program coordinator then submits to AmeriNational a payment authorization, co-signed by the homeowner, the contractor, and the inspector, to request a release of funds to the contractor. Checks payable to the contractor are issued and mailed to the program coordinator for delivery to the contractor by the inspector. Ten percent of each progress payment is withheld until all work is satisfactorily completed. AmeriNational sends monthly reports to the program coordinator to report payment activities on each of the active escrow accounts.

After a project is completed, the inspector conducts a final inspection of the property. Unfinished jobs are documented on a "punch list". Once all jobs, including items on the punch list, are completed and reinspected, a "Notice of Completion" signed by the homeowner is filed with the County.

Program oversight is performed by a Housing Inspector Supervisor (referred to as a supervising inspector) after project completion and prior to escrow closeout. According to the supervising inspector, he reviews the loan files to ensure all loan documents are in place and visits the property to ensure all work is priced reasonably, is in conformance with the contract, and is satisfactorily completed. After all outstanding issues are resolved, the ten percent retention is released to the contractor. Any unused amount left at the escrow account is returned to the City and applied to the loan principal.

IV. FINDINGS AND RECOMMENDATIONS

Finding 1: Program guidelines either have no guidance or unclear guidance on loan process time, loan limit for previously assisted properties, relocation expenses, loan write-off, reimbursement to homeowners, and conditions under which a repayment is required.

a. Loan process time

Standards are not established to assure funds are distributed in a timely manner. According to the Housing Director, it would not be in the best interest of the program's elderly and disabled clients to implement strict loan process timelines. In three out of six cases, the time from the date of loan application to the date of last payment from the escrow account was over two years. Program staff explained that process time was heavily impacted by the homeowner's physical health. If a homeowner becomes ill, a project may be held up for several months. An additional cause for delay, according to staff, has been that when it came to decision making, the senior homeowners often had to seek assistance from other family

members.

| | ----- Number of Days ----- | | | | | |
|---|----------------------------|--------------|------------|------------|------------|------------|
| | Loan #1 | Loan# 2 | Loan #3 | Loan #4 | Loan #5 | Loan #6 |
| # of days from loan application to director approval | 258 | 103 | 431 | 309 | 104 | 287 |
| # of days from director approval to first contract payment | 256 | 71 | 365 | 90 | 101 | 63 |
| # of days from first contract payment to last payment from escrow | 313 | 1,183 | 133 | 279 | 133 | 250 |
| Total # of days | 827 | 1,357 | 929 | 678 | 338 | 600 |

b. Loan limit for properties which had been previously assisted by the program

The program guidelines are unclear regarding whether or not a homeowner can have more than one SDHRLP loan, and if they can, what the loan ceiling is for the subsequent loans. The program guidelines state: *“The minimum loan shall be \$1,000. The maximum loan shall be \$35,000 with an option available to provide loans of up to \$70,000 if necessary.”* In one case, the City approved a loan for \$10,000 in 1994 and approved another loan for \$65,000 in 2003 for the same homeowner, exceeding the current loan limit of \$70,000. The second loan, however, was reduced to \$58,174 due to a return of unused funds.

c. Relocation expenses

The program guidelines do not stipulate policies for relocation or refer to similar adopted City policies or programs for standard procedures although temporary relocation may be required during construction. Out of six loans reviewed, there were two involved homeowners who requested relocation during construction. Housing staff explained that relocation expenses were determined based on other approved relocation programs or City policies.

d. Writing off uncollectible loans

An uncollectible \$10,000 loan was not properly written-off. The auditor identified one property that was foreclosed in 1998 due to a mortgage default. According to the program coordinator, the City’s rehabilitation loan was subordinated to the mortgage and the foreclosure was not sufficient to recover the default balance, and the City’s loan was deemed uncollectible. The program coordinator provided documentation to the auditor showing he had requested a write-off on November 19, 1998, and was not aware that the loan was not written off by Housing staff.

e. Reimbursement to homeowners

Five out of the six loan files reviewed contained payments made to homeowners or their family members to reimburse material or contract costs. CDBG disallows payments made for labor by homeowners to rehabilitate their own properties. Reimbursing homeowners for contract costs could increase the likelihood of inadvertently paying for homeowner labor.

The program guidelines do not have clear guidance for establishing policies on reimbursing labor cost to homeowners. According to the Housing Director, reimbursement to homeowners for labor cost should be limited to small jobs performed by handyman.

f. Conditions under which a repayment is required

The program guidelines were unclear in stating the conditions under which a repayment is required: “*The loan is payable upon the sale or transfer of the property, when property ceased to be owner occupied or upon the loan maturity date.*” Of the six loans reviewed, two properties were jointly owned by an individual or individuals other than the borrower’s spouse. The co-owners did not reside at the properties at the time of the loan application and were not co-applicants of the loans. The current guidelines appear to say that a repayment is not required as long as the property is occupied by any of the owners, which might not be the program’s intent if the other owners do not qualify for assistance.

Clear guidelines are important to consistent program implementation. This may be the case especially with new employees who are unfamiliar with the program.

City Manager’s Response:

The Housing Department (HD) agrees with the findings. Although the program guidelines do not indicate policy for reimbursement for relocation expenses and allowances, the program adheres to the CDBG relocation services project that is already in place in the department. Any relocation cases under the program are referred to the department’s relocation officer for relocation assessment and payment determination. The department fiscal unit already wrote off the uncollectible loan that was lost due to foreclosure.

Recommendation 1:

- 1.1 Establish general guideline for timeliness of loan process. Establish standard timeline as performance measure for key tasks that the City is responsible for. Extraordinary delays should be explained and documented in the loan file. Management should periodically review the performance measures to ensure program objectives are met and actions are taken to avoid unnecessary delays.
- 1.2 Clearly define in the program guidelines total loan amounts that a property owner may obtain so that benefits may be distributed consistently and equitably.
- 1.3 Clearly define in writing a policy on relocation expenses or refer to similar adopted policy so that benefits can be distributed consistently.
- 1.4 Establish clearly written policy on writing off uncollectible loans so that write-offs are properly documented and approved, and timely recorded.
- 1.5 Establish clearly written policy on reimbursement of expense paid by loan applicants or their family members. Establish dollar limits for labor cost reimbursement. Generally, cost incurred for repairs should be paid directly to the contractor instead of to the homeowner.
- 1.6 Clarify in the program guidelines whether a repayment is required when the property ceases to be occupied by the borrower/s and is occupied by a non-qualified co-owner.

City Manager’s Response:

- 1.1 *The Housing Department (HD) agrees with the recommendation. Implementation will be*

- completed no later than June 30, 2007.*
- 1.2 *HD agrees with the recommendation. Implementation will be completed by June 30, 2007.*
 - 1.3 *HD agrees with the recommendation. HD will revise the program guidelines by June 30, 2007.*
 - 1.4 *HD agrees with the recommendation. Coordination and written policy for writing off uncollectible loans due to foreclosure or by any other means will be included in the program guidelines by June 30, 2007.*
 - 1.5 *HD agrees with the recommendation. Implementation will be completed by June 30, 2007.*
 - 1.6 *HD agrees with the recommendation. HD will clarify in the program guidelines that when a qualified borrower ceases to occupy the property, the City will have an option to convert the loan to an amortized loan payable in 15 years with additional interest. This update will be completed by June 30, 2007.*

Finding 2: The method staff used to verify income eligibility was not formalized or clearly documented.

Tax returns, copies of bank statements, check stubs, notices from welfare agency, or social security reports were used to determine income eligibility. When borrowers claimed that they did not file tax returns, the non-filing status was not verified or documented. In three out of six cases, income information for other household members on the application form was unclear. Lacking formal and consistent requirements to verify income sources may lead to qualifying ineligible applicants for benefits.

City Manager's Response:
HD agrees with the finding.

Recommendation 2:

- 2.1 Revise the application form to include a section for listing household members and their income sources so that the information can be verified if needed.
- 2.2 Establish consistent written procedures or requirements for verifying income sources. In addition, establish criteria for verifying non-filing status by obtaining the borrower's transcript of tax return from the Internal Revenue Service.

City Manager's Response:

- 2.1 *HD agrees with the recommendation. HD will revise loan application to include section for each household member and individual incomes if any. This will be implemented by July 1, 2006.*
- 2.2 *HD agrees with the recommendation. HD will use HUD guidelines in determining income sources on its rehab guidelines and establish criteria for verifying non-filing status by June 30, 2007.*

Finding 3: The procedures for assisting homeowners with the solicitation of contractor bids were not standardized.

The following inconsistencies were observed during the audit:

- The supervising inspector indicated that the minimum requirement is to secure three bids. However, in at least two cases of the six loans reviewed, only two bids were secured.
- One inspector indicated she opened bid results without the presence of a homeowner or another staff. The other inspector indicated she opened bid results with the bidders, and the homeowner, or with a colleague in the absence of the bidders and the homeowner.
- Bids were submitted via fax, e-mail, or mail to one of the inspectors. This practice allows opportunities for tampering with or influencing the bid results.

In addition, although Housing keeps a list of contractors who are interested in participating in the loan rehabilitation program, the process of identifying interested contractors is not formally documented. Such documentation is important to show that the City follows a consistent and unbiased approach in assisting the homeowners to select a contractor.

City Manager's Response:
HD agrees with the finding.

Recommendation 3:

- 3.1 Bids submitted by the contractors should be sealed and mailed/delivered directly to the program coordinator or the supervising inspector, instead of to the inspector.
- 3.2 Formalize written procedures to assist homeowners to secure bids. The procedures should stipulate:
 - (i) The process for identifying interested bidders.
 - (ii) The minimum number of bid invitations.
 - (iii) The minimum number of bids to be secured and the dollar threshold for such requirement.
 - (iv) The process for submitting bids, opening bids, and presenting bid results to homeowners.

City Manager's Response:

- 3.1 *Implemented. HD has implemented procedures requiring all bids submitted be sent to the Program Coordinator to open, review, and record with the supervising inspector. Bids will be forwarded to the inspector after they are opened.*
- 3.2 *Implemented. HD has implemented the following procedures:*
 - (i) *A minimum of six contractors is selected by the client from the City's list of qualified contractors and/or the contractor of their choosing who meets the City's qualifications.*
 - (ii) *A minimum of six contractors will be notified and invited to attend the bid walk through.*
 - (iii) *A minimum of three bids should be submitted, but two will be acceptable if the client agrees to accept two bids for all contracts in excess of \$1,000.*
 - (iv) *Clients are notified of the bid date and have the option to attend. Clients must notify the program coordinator if they intend to be present at the opening. Otherwise, they will receive the results by mail or fax.*

Finding 4: Two out of four homeowners contacted indicated that the City selected a contractor

for them.

The auditor contacted four homeowners to inquire about the work quality of two contractors frequently awarded work by participants in the program. All four properties owners rated both contractors' work quality as high and expressed satisfaction. However, two property owners indicated that they thought the contractors were selected by the City. The program guidelines state that staff shall provide "*assistance in securing bids from licensed contractors to perform eligible work*". The auditor acknowledged that the contacted homeowners might not always have correct memory of what they had been told. However, this misconception that the contractors were assigned by the City could put Housing staff at risk for appearing to have improperly awarded work to bad contractors if disputes arise.

One of the Housing inspectors explained that homeowners were always informed that they were allowed to use any contractor of their choice as long as they meet minimum qualification. Since most of the homeowners were elderly and had no experience working with contractors, they often needed assistance to find a contractor. In addition, pre-1978 properties were likely to contain lead. The State requires lead abatement activities be performed by certified workers. In lead abatement cases, the homeowners might not be able to select a non-certified contractor and the City might have been asked for assistance in selecting a certified contractor.

City Manager's Response:
HD agrees with the finding.

Recommendation 4:

Update the program guidelines to document that staff must clearly explain to the homeowners that they are responsible for selecting a contractor. Further document in the loan agreement (Recommendation 9) that homeowners are responsible for selecting contractors.

City Manager's Response:
HD agrees with the recommendation. Implementation will be completed by June 30, 2007.

Finding 5: There was inadequate supervisory review over the accounting for loan activities.

At the time covered by the audit, one accountant in the Housing Department was responsible for setting up new loans in the stand-alone loan system (GMS), for making accounting entries to agree account balances in FUNDS to GMS, and for drawing down CDBG fund by accessing HUD's Integrated Disbursement and Information System (IDIS). Her accounting entries were not reviewed or approved by a supervisor in her department, although the draw down was approved by a supervisor. Inadequate oversight may result in undetected inadvertent or intentional errors, as well as delays in corrective actions.

City Manager's Response:
HD agrees with the finding.

Recommendation 5:

- 5.1 All journal entries to record loan activities should be reviewed and approved by a supervisor. Also, the review and approval should be documented.
- 5.2 The accountant provides a loan activity report on a quarterly basis to the program coordinator. The program coordinator should review the report for timely recording of loan activities. Evidence of this review should be documented.

City Manager's Response:

- 5.1 *Implemented November 2005.*
- 5.2 *The program coordinator now reviews the activity report (as of January 2006). Documentation of the review will be implemented by April 30, 2006.*

Finding 6: The City has no on-going procedures in place to verify whether a borrower continues to reside on the property. The City was not aware that the titles of three properties were transferred.

The auditor used ACL, data analysis software, to compare the borrower names of the 66 outstanding loans to the property owner names recorded with the County. In one case, the property was transferred to a daughter. In two cases, it appeared that the title was later transferred entirely to the co-owner identified at the time the loan was originated.

Without on-going procedures for verifying a borrower's continued occupancy of the assisted property, a borrower or a new homeowner may be able to avoid repaying the rehabilitation loan prior to maturity, even when there is a change in occupancy or title that requires a loan repayment. Both the program guidelines and CalHome regulations generally require loan repayment when there is a transfer of title (there are a few exceptions) or when the property ceases to be owner occupied.

City Manager's Response:

HD agrees with the finding.

Recommendation 6:

- 6.1 Follow up on the three properties identified during this audit to verify if the title has been transferred, and if the property continues to be occupied by the borrower. Pursue a repayment if appropriate.
- 6.2 Require homeowners to certify occupancy every five years. This requirement should be stipulated in the program guidelines.

City Manager's Response:

- 6.1 *Partially implemented. Staff already contacted one of the borrowers and the title was transferred back to both qualified borrower and to the co-owner. Staff will continue to investigate the other two properties and resolve the issue by July 1, 2006.*
- 6.2 *HD agrees with the recommendation. Certification of occupancy will be included in the program guidelines by June 30, 2007.*

- Finding 7:** (a) Supervisory reviews and inspections were not documented.
(b) Supervisory reviews were performed after project completion, instead of before a project started.

The supervising inspector does not document his reviews and inspections. According to the supervising inspector, he was asked by the Housing Director to conduct limited oversight over the SDHRLP beginning in 2001 after a former manager left. Accordingly, he inspects every rehabilitated property together with the inspector after all rehabilitation work is completed to ensure that the work is performed in accordance with the work specifications included in the contract agreement.

Supervisory review is an important monitoring control to assure quality and to ensure adherence to program guidelines. Clear documentation of review results serves as a track record of staff performance and program effectiveness. Over time, the records may be used to identify areas for improvements. In addition, documentation evidences the City's monitoring efforts over the loan program that is commonly required by funding agencies. Reviewing the final work write-up prepared by the inspectors before a project starts allows the supervisor to detect a problem at an early stage and make timely correction and to ensure program compliance.

In all six cases, there was little documentation of the final inspection. A final inspection is a monitoring and quality assurance measure to ensure all rehabilitation work is satisfactorily completed in accordance with the contract agreement and to identify outstanding items. The results of the inspection should be documented to substantiate the closeout of a project. Generally, by signing the documented final inspection or a certificate of final inspection, a homeowner denotes his or her acceptance of the work and material provided by a contractor under the terms of the contract agreement. This acceptance warrants the release of retentions. The individual "Payment Tabulation & Certificate for Work Completed", prepared by a contractor to request a progress payment, should not be used as a replacement for a written final inspection.

City Manager's Response:
HD agrees with the finding.

Recommendation 7:

- 7.1 The supervising inspector should also review the final work write-up prior to bid solicitation to ensure:
- (a) The scope of repairs is clearly stated and specifications are sufficiently detailed to form a basis for obtaining bids from contractors.
 - (b) The repairs are necessary to correct threats to the health and safety of the occupants or to bring the property into code compliances.
 - (c) The cost estimates are reasonable.
- 7.2 Document supervisor reviews and final inspections in the loan file. A punch list may be included to reflect unfinished jobs or issues that are to be resolved. After all work including items on the punch list, is satisfactorily completed, the written final inspection should be signed by the contractor, the inspector, the supervising inspector, and the homeowner, and

retained in the loan files.

- 7.3 We further recommend the use of an evaluation form to document each homeowner's opinion about the contractors they used. Based on the review of the evaluations, the supervisor should assess whether there are indications of improperly awarded contracts. Frequent dissatisfaction expressed with the same contractor should be investigated.

City Manager's Response:

HD agrees with recommendations 7.1, 7.2, and 7.3. The supervising housing inspector will take a more active role in reviewing and monitoring the various stages of each project beginning July 1, 2006. HD will take this opportunity to assess and formalize the role of the supervisor and incorporate them into the program guidelines by June 30, 2007.

Finding 8: For each loan, there was no formal loan agreement between the homeowner and the City governing the rehabilitation and loan terms.

A formal loan agreement was not executed between the City and the homeowner for each loan. Although promissory notes secured by deeds of trust are recorded, CalHome program regulations also require a formal loan agreement be executed for each homeowner rehabilitation loan. A CalHome representative indicated that the CalHome program regulations were first issued in 2003. If so, the CalHome requirements only apply to funds received after 2003. In addition, The City's on-line contract procedure manual states that "*a binding contract is not formed, and work may not begin under the contract until the contract is executed. "Executed" means signed by all parties to the agreement (the Contractor, the City Manager and the City Auditor). The Council merely authorizes the City Manager to execute a contract. Please note a contract is not formed simply by Council authorization.*" It appears that the lack of an executed loan agreement is not in compliance with the City's contract policies. Also, with the lack of a loan agreement signed by the both the City and a borrower, important provisions to protect the public interest, if not included in the promissory notes, may not be legally enforceable.

City Manager's Response:

HD agrees with the finding.

Recommendation 8:

Work with the City Attorney's Office to develop a boilerplate loan agreement and a standard express approval process for the SDHRLP contracts. Loan agreements should be bluebacked and executed in accordance with the City's contract policies.

City Manager's Response:

HD agrees with the recommendation and will work with the City Attorney to develop a loan agreement boilerplate and an express contract approval process for the program by June 30, 2007.

Finding 9: The service agreement with United States Escrow, Inc. (Now AmeriNational Community Services-the escrow company used for loan disbursement services) does not correctly reflect services currently received.

The City engaged United States Escrow, Inc. to render disbursement services for property improvements in connection with the 90-ESP-709 Homeless Shelter Project in 1984. A copy of this contract was provided by AmeriNational. The contract was not signed by the City. AmeriNational indicated the City never returned a signed copy to them. It also appeared that Housing staff was not aware of the existence of such a contract. Over the past 20 years, the services were informally expanded to include other programs such as the Development Loan Program and the SDHRLP. These programs are not covered in the original agreement.

City Manager's Response:
HD agrees with the finding.

Recommendation 9:

Execute a new service contract with AmeriNational. The scope of services should be reviewed and updated to reflect the City's needs.

City Manager's Response:
HD agrees with the recommendation. The City of Berkeley will execute a new contract with AmeriNational by June 30, 2007. The contract will be updated to reflect the City's needs.

Finding 10: Conditional and unconditional lien waivers were not obtained.

Five of the six loans reviewed did not contain evidence that an unconditional lien waiver was obtained. An unconditional lien waiver, when properly executed, releases a homeowners from claims made by unpaid contractors, subcontractors, and suppliers who are not paid for the services rendered or material supplied to the prime contractors. Conversely, when a lien waiver is not obtained, the homeowner is not protected from unwarranted claims.

City Manager's Response:
HD agrees with the finding.

Recommendation 10:

Update program procedures requiring lien waivers be obtained from the prime contractor and subcontractors before or after each payment where appropriate.

City Manager's Response:
Partially implemented. Staff is currently implementing the procedure and will complete updating program procedures by June 30, 2007.

Finding 11: Some loan documents were missing.

The review of six loan files revealed some loan documents (see the list below) were not in the loan files. Most of these exceptions appeared to be isolated incidences and did not warrant an immediate

concern. However, in two cases, a “Notice to Proceed” was missing.

| Exceptions | Number of Occurrences |
|---|-----------------------|
| “Notice to Proceed” was not in file. | 2 loans of 6 |
| Lack of evidence of a Homeowner's Insurance Policy. | 1 loan of 6 |
| No environmental review. | 1 loan of 6 |
| “Notice of Completion” was not filed with the County. | 1 loan of 6 |

The “Notice to Proceed” is issued by a homeowner after a contract agreement is executed, notifying a contractor of the time to commence the rehabilitation work. The completion date on the contract agreement often refers to and is determined by the start date on the “Notice to Proceed”. For the purpose of determining the required completion date, it is important to have the “Notice to Proceed” signed and retained in the loan file. Since it is a separate piece of document sent to the contractor, the contractor often fails to return a signed copy to the City, according to a Housing inspector.

City Manager’s Response:
HD agrees with the finding.

Recommendation 11:

Add “Notice to Proceed” to the existing loan file checklist to help ensure this document is received, properly completed, and retained in the loan files.

City Manager’s Response:
HD agrees with the recommendation. HD will include Notice to Proceed on its checklist by July 1, 2006.

SAFETY

Finding 12: Documented safety inspections were not conducted periodically in accordance with the City’s Injury and Illness Prevention Plan (IIPP).

The City’s IIPP was developed in accordance with the California Occupational Safety and Health Act (OSHA) to suit the City’s needs. Periodic and documented safety inspections are required to timely identify existing or potential hazards that may result in injuries and accidents. The IIPP states that “each department head, manager, and supervisor will be responsible for periodically reviewing the health and safety needs of employees under their direction and will serve as the initial contact for their employees’ health and safety related question.” Documented safety inspections were not performed in accordance with the IIPP at the Housing Department. During the audit, management assigned two Housing staff to monitor safety issues at the north and south Housing areas on the second floor of the Civic Center Building. Neither of the two staff received formal training on conducting safety inspections during the last two years. A positive finding is that the Housing Department’s lost time for calendar year 2004 had improved compared to calendar year 2003.

Annual Sick leave hours per FTE dropped from 74.3 hr in 2003 to 66.9 hr in 2004; WC hours per FTE dropped even more significantly, from 39.7 hr to 6.2 hr.

City Manager's Response:
HD agrees with the finding.

Recommendation 12:

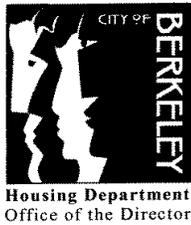
Management of the Housing Department should work with the IIPP Program Administrator to ensure appropriate training is given to the designated staff so that safety inspections can be properly conducted and documented in accordance with the City's IIPP over the Housing areas; and identified unsafe conditions can be corrected in a timely manner.

City Manager's Response:
HD agrees with the recommendation. HD will assign a safety inspector by July 1, 2006 to perform documented safety inspections in accordance with IIPP.

V. CONCLUSION

As a participating jurisdiction in the CDBG and CalHome Programs, the City is charged with the responsibility to monitor the programs to ensure these public funds are distributed fairly, effectively, and in accordance with program regulations. Based on the results of this audit, the Senior and Disabled Home Rehabilitation Loan Program serves its purpose of assisting senior and disabled Berkeley homeowners to perform necessary repairs to their home and to allow them to have a healthier and safer place to live. The SDHRLP loan files currently stored at the Housing Department were well organized and could be easily retrieved. A checklist is used to ensure required loan documents are retained in the files. Copies of loan applications, promissory notes, deeds of trust, and title reports could be easily located in the loan files in all six cases.

The program, however, may be improved by expanding the existing guidelines to cover or clarify policies on timeliness standards, relocation expenses, loan limit amount, loan write-offs, reimbursable expenses, and conditions under which a repayment is required. Clearly written guidelines increase program consistency and minimize delays. Other areas that can be improved are the procedures for verifying income eligibility, procedures for assisting homeowner to secure bids, oversight of loan activities accounting, documentation of final inspections, and procedures for reviewing and monitoring rehabilitation projects. We also recommend formal loan agreements between the City and the borrowers be executed as required.



MEMORANDUM

Date: April 26, 2006
To: Honorable Mayor and
Members of the City Council
From: Stephen Barton, Housing Director *SB*
Subject: Seniors and Disabled Home Rehabilitation Loan Program

The Seniors and Disabled Home Rehabilitation Loan Program (SDHRLP) provides rehabilitation loans for low-income seniors and disabled Berkeley homeowners. These loans provide the funds to assist these homeowners in making needed repairs that would otherwise pose a threat to personal health and safety.

The need for the SDHRLP program is apparent as Berkeley's population continues to age. In order for many low-income seniors and disabled homeowners to remain comfortably and safely in their homes, Housing Code violations must be addressed and deteriorated components must be upgraded, and the property may need to be modified for accessibility. Providing low interest, deferred loans allows owners to remain in the home they have lived in for an extended period of time at an affordable rate.

The SDHRLP was instituted approximately fifteen years. One of its objectives was to keep away predatory lenders and contractors in the private market taking advantage of vulnerable seniors and disabled homeowners. This can include poor quality work on homes and high-pressure sales that promise quick cash and easy home financing. To put less burden on the low-income and very low-income seniors and disabled homeowners when repayment is due, the City revised the interest rate of the program from a 3 ½% deferred interest rate to 0% deferred interest rate and, over time, increased the maximum loan amount from \$10,000 to \$70,000 to address the rising cost of construction. As a means to augment funding for the SDHRLP, staff was successful in applying for and receiving a total of \$750,000 CalHome funds from the State in 2001 and 2004.

The SDHRLP program is very effective in addressing the needs of the targeted populations. Since the program's inception, it has provided over 125 low interest loans totaling over \$2.5 million. Currently, the program assists approximately eight low-income homeowners annually. Although program staff has decreased over the years to reduce administrative overhead, the level

Seniors and Disabled Home Rehabilitation Loan Program Audit

of service has remained consistent. Starting with the inquiry by an elderly or disabled homeowner, staff works with the clients to take in the initial loan information. If the client income and household threshold requirements are met, an inspector visits the home and completes a survey to assess repair needs and code violations. The inspector prepares a draft scope of work and cost estimates for the work that needs to be done. Upon receiving client approval, staff solicits construction bids from three to six contractors on owner's behalf. Bids are typically received within two weeks and are then presented to the owner who selects a preferred contractor. Staff prepares and presents documents to be signed by both the owner and the contractor. The loan then requires completion of the underwriting and in-house approval.

After the final approvals, the promissory note, deed of trust, owner-contractor agreement documents are signed and staff places the loan proceeds in an AmeriNational Services escrow account to ensure the timely payment to the contractor in accordance with the agreed-upon scope of work. Staff monitors the construction, approves change orders and payments, and is in constant communication with the homeowners and contractors until completion of the work. A final inspection is done after the work is completed to the owner's satisfaction. Staff maintains and monitors loan repayments pursuant to the loan agreements with the clients, which according to current policy, the full loan amount is payable upon sale or transfer of the property, when property ceases to be owner occupied, or upon the loan maturity date.

The Housing Department appreciates the Auditor's Office extensive review of the SDHRLP with findings that focus primarily on ambiguities in the program guidelines. We are particularly encouraged that the reported client survey revealed client satisfaction with the assistance they received.

The Housing Department will include updating the SDHRLP program guidelines and on-going procedures in its work program for next fiscal year. This is intended to make the program more efficient and responsive to clients, and improve program accountability as suggested in the accompanied City Auditor's review of the program.