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HOUSING & COMMUNITY DEVELOPMENT
DIRECTOR

August 21, 2009

Ms. Lynn L. Jacobs, Director
State of California
Department of Housing and Community Development
1800 Third Street
Sacramento, CA 95811-6942

Dear Ms. Jacobs:

Enclosed is our Audit Report on the Review of the State of California's Allocation Formula for the Neighborhood Stabilization Program, Sacramento, CA. If you have any questions please contact Helen Sparks, Assistant Regional Inspector General for Audit, at (415) 489-6697.

Sincerely,

Joan S. Hobbs

Joan S. Hobbs
Regional Inspector General for Audit

Enclosure

cc: Peter Grace, Special Assistant to the Secretary, Office of the Secretary, S
Elizabeth Willmott, Senior Program Manager for Economic Recovery, P
Christopher Westlake, Deputy Director, State of California Department of Housing and Community Development
Rita Levy, General Manager, State of California Department of Housing and Community Development

AUDIT REPORT

REVIEW OF THE STATE OF CALIFORNIA'S ALLOCATION FORMULA FOR THE NEIGHBORHOOD STABILIZATION PROGRAM

SACRAMENTO, CA

2009-LA-1016

AUGUST 21, 2009

OFFICE OF AUDIT
REGION IX
LOS ANGELES, CALIFORNIA

audit report

Issue Date
September 21, 2009
Audit Report Number
2009-LA-1016

TO: Maria Cremer, Acting Director, San Francisco Office of Community Planning and Development, 9DD

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

SUBJECT: State of California's Department of Housing and Community Development, Sacramento, California, Review of the Allocation Formula for the Neighborhood Stabilization Program

HIGHLIGHTS

What We Audited and Why

We audited the State of California's Department of Housing and Community Development (State) to determine the basis and method used to allocate its $145 million in Neighborhood Stabilization Program (NSP) grant funds. Our objective was to determine whether the methodology the State used in allocating its NSP grant funds was logical, equitable, and in accordance with U.S. Department of Housing and Urban Development (HUD) requirements.

What We Found

The State generally logically and equitably allocated its NSP grant funds to those areas with greatest need, as described in the Housing and Economic Recovery Act of 2008.

We provided the State a discussion draft report on August 11, 2009, and held an exit conference with appropriate officials on August 13, 2009.

The auditee provided comments on the draft report on August 19, 2009 and we provided the auditee the final report on August 21, 2009.

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BACKGROUND AND OBJECTIVE

The Neighborhood Stabilization Program (NSP) is authorized under Division B, Title III, of the Housing and Economic Recovery Act of 2008 (HERA). It was established for the sole purpose of stabilizing communities that have suffered from foreclosures and abandonment. Additionally, the program provides grants to all states and selected local governments on a formula basis to assist in the redevelopment of abandoned and foreclosed homes and residential properties.

There is additional NSP funding authorized by the American Recovery and Reinvestment Act of 2009 and substantive revisions to NSP initially published in the Housing and Economic Recovery Act of 2008. These revisions include, but are not limited to:

- Funds can be used to establish and operate land banks for homes and residential properties that have been foreclosed upon. This allows a governmental or nongovernmental nonprofit entity to assemble, temporarily manage, and dispose of vacant land for the purpose of stabilizing neighborhoods and encouraging re-use or redevelopment of urban property.
- Substantially all program income must be disbursed for eligible NSP activities before additional cash withdrawals are made from the US Treasury.
- Purchase discount requirements for foreclosed homes or residential property were modified from five percent to one percent.

The allocation process is further changed because the funds are awarded on a competitive basis.

The State of California's Department of Housing and Community Development (State) received an allocation of more than $145 million in NSP grant funds, which it did not allocate to the 46 Community Development Block Grant (CDBG) entitlement jurisdictions that received NSP funds directly from HUD. The NSP funds were allocated to those cities and metropolitan, urban, and other areas with greatest need, including those

- With the greatest percentage of home foreclosures,
- With the highest percentage of homes financed by a subprime mortgage-related loan, and
- Identified by the State or unit of general local government as likely to face a significant rise in the rate of home foreclosures.

Our objective was to determine whether the methodology the State used in allocating its NSP grant funds was logical, equitable, and in accordance with HUD requirements.

RESULTS OF AUDIT

The Methodology the State Used in Allocating Its NSP Grant Funds Was Generally Logical, Equitable, and in Accordance with HUD Requirements

The methodology the State used in allocating its NSP grant funds was generally logical, equitable, and in accordance with HUD requirements. The State allocated its NSP grant funds based on a methodology and data provided by HUD.

State Methodology

The State's allocation of the NSP grant funds totaling more than $145 million was based on a three-step method. First, the State deducted from its total NSP funds its eligible anticipated administrative costs amounting to more than $7.2 million. Second, the State will competitively award the NSP funds to be used to meet the low-income set-aside criteria using a separate NOFA process. As of the last day of our fieldwork, the funds that will be made available to meet the low-income set-aside criteria had not been finalized but will be at least $38 million. The amount will be adjusted to include whatever NSP funds are not accepted and/or declined by the jurisdictions allocated NSP funds in the third step of the State's methodology. Third, it allocated more than $99.6 million to those cities and metropolitan, urban, and other areas not among the 46 CDBG entitlement jurisdictions that received direct NSP funds from HUD. The jurisdictions receiving an allocation by this step have an opportunity to accept their allocation through a notice of funding availability (NOFA) application.

HUD Methodology

HUD's allocation of the NSP grant funds appropriated by Title III of Division B of HERA was made based on a two-step method. First, HUD made statewide allocations, followed by local (sub state) allocations, resulting in the State's being allocated more than $145 million in funds to administer. In determining its substate allocations, HUD used the following elements:

- Amounts available for allocation (less the minimum state grants),
- Local and state foreclosure data,
- Local and state vacancy rates, and
- A pro-rata ratio.

The State's methodology for allocating its grant funds was modeled after HUD's substate methodology. Specifically, in determining its allocations, the State used the following elements:

- Amount available for allocation (less 25 percent of funds to meet low-income set-aside criteria and administrative costs),
- Local and state foreclosure data, and
- A pro-rata ratio.

Although HUD and the State's methodology used nearly the same elements, the State did not use vacancy rates as a factor. HUD used vacancy rates to account for the problem of abandonment. The State determined that it would not incorporate vacancy rates as factors in its methodology because HUD has a low vacancy rate and abandonment risk score for California. Additionally, based on a survey of 53 cities, counties, and nonprofits that the State conducted between September and October 2008, there was interest in foreclosed properties, and some cities, counties, and nonprofits had waiting lists of interested buyers.

HUD Data

HUD provided local-level data for all of its NSP state grantees on its HUD user Web site for use in allocating their funds. The State used local-level data obtained from HUD in its methodology to allocate its NSP funds.

During our review of the State's calculations, we found a difference between the data the State used and the data obtained from HUD. There were a total of six instances in which there were discrepancies in the data. However, the total of these errors represented only 0.17 percent of the State's total NSP grant funds. Because of the insignificance of this amount, we chose to not issue a recommendation but will address this issue with the State in a separate memorandum.

Conclusion

The State generally logically and equitably allocated its NSP grant funds to those areas with greatest need, as described in the Housing and Economic Recovery Act of 2008.

SCOPE AND METHODOLOGY

We performed the audit work between May 13 and July 16, 2009, in Sacramento, California. We reviewed the State's NSP allocation formula to determine whether the formula the State used to allocate its NSP grant funds—to those recipients that were not among the 46 CDBG entitlement counties or cities that received other NSP funds—was logical and equitable. More specifically, to accomplish the audit, we performed the following:

- Reviewed relevant HUD regulations, including the Housing and Economic Recovery Act of 2008, Title III of Division B, and the notice of allocation regulations at 73 F.R. (*Federal Register*) 58330;
- Reviewed the NSP contract between the State and HUD;
- Reviewed the State's NSP substantial amendment;
- Reviewed pertinent correspondence between HUD's Office of Community Planning and Development and the State relating to the State's allocation methodology;
- Reviewed HUD's methodology used to allocate the $3.92 billion in NSP funds appropriated by Title III of Division B of the Housing and Economic Recovery Act of 2008;
- Reviewed the State's methodology used to allocate its NSP grant funds; and
- Verified that the State used its documented methodology and the data sets provided by HUD to determine its NSP grant fund allocations.

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

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

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

Relevant Internal Controls

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

- Policies and procedures the State used to allocate its $145 million in NSP grant funds.

We assessed the relevant controls identified above.

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

Significant Weaknesses

We did not identify any significant weaknesses in the relevant controls identified above.

Appendix A

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

STATE OF CALIFORNIA -BUSINESS, TRANSPORTATION, AND HOUSING AGENCY ARNOLD SCHWARZENEGGER, Governor

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August 13, 2009

Ms. Joan S. Hobbs
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Region IX
611 West Sixth Street, Suite 1160
Los Angeles, CA 90017-3101

Dear Ms. Hobbs:

Thank you for your thorough review of the Department of Housing and Community Development's administration of the Neighborhood Stabilization Program authorized by the Housing and Economic Recovery Act of 2008.

The Department strives to insure that all of its programs are administered as efficiently and effectively as possible, consistent with the rules of those programs, and providing the highest value both to those who financially support them and those who receive those programs' benefits.

I appreciate your assisting us in those efforts.

Sincerely,

Lynn L. Jacobs
Director