CALIFORNIA STATE AUDITOR

Department of Housing and Community Development

Awards of Housing Bond Funds Are Appropriate, but Cash Balances Are High and Monitoring Continues to Need Improvement

October 2012 Report 2012-037

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October 23, 2012 2012-037

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As required by the Health and Safety Code, sections 53533 and 53545, the California State Auditor presents its third audit in a series concerning the Housing and Emergency Shelter Trust Fund Acts of 2002 and 2006.

This report concludes that the Department of Housing and Community Development (HCD) and the California Housing Finance Agency (CalHFA) generally awarded funds in a timely manner and complied with legal requirements for making awards. However, HCD requested, and the Department of Finance (Finance) recommended, bond sales that were in excess of its cash needs at a time when the State's credit rating was declining and interest-rate volatility was high. As a result, the State paid as much as $49 million in interest annually on the idle capital while the State was facing cash shortfalls.

Nevertheless, without these bond proceeds, the sustainability of certain housing bond programs likely would have been at risk. For most of HCD's housing bond programs, private lenders and banking institutions provide financing to sponsors, comprising entities qualified to construct or manage housing developments, for the construction of housing projects. Once the sponsor successfully completes the housing project, the sponsor uses its HCD award to repay the construction loan. Various state officials explained that key stakeholders cited significant concerns regarding the State's ability to fund these awards given the economic crisis at the time. In fact, state officials believed that without selling bonds in excess of immediate cash needs, and thereby demonstrating to the financial institutions that the State had the ability to fund the awards used by sponsors to repay the construction loans, many of the housing bond programs would have been suspended, or halted altogether. Thus, the reasons for the excessive bond sales appear to have some merit.

Additionally, HCD did not always adhere to controls established for its CalHome and Building Equity and Growth in Neighborhoods (BEGIN) programs. For example, as we reported in November 2009, HCD still is not ensuring that recipients submit required status reports for its CalHome program. Further, we identified that HCD needs to improve its monitoring efforts during the period following final payment up to the completion of all contract requirements. For instance, HCD had not finalized and implemented on-site monitoring procedures for its BEGIN program.

Respectfully submitted,

Elaine M. Howle

ELAINE M. HOWLE, CPA
State Auditor

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Summary

Results in Brief

In 2002 and 2006 California voters passed the Housing and Emergency Shelter Trust Fund Acts (propositions 46 and 1C, respectively) to provide bonds (housing bonds) for use in financing affordable housing for low- to moderate-income Californians. The Department of Housing and Community Development (HCD) and the California Housing Finance Agency (CalHFA) primarily award, disburse, and monitor the housing bond funds received by various programs.

As of February 2012 HCD and CalHFA had awarded nearly all of the 2002 housing bond funds to recipients—such as low- to moderate-income individuals purchasing their first home and local entities and nonprofit corporations that construct or rehabilitate housing developments. However, for the housing bond funds authorized in 2006, although HCD and CalHFA made awards for 10 of the 13 programs in a timely fashion, we found that awards for three programs have been slow, which is generally due to circumstances surrounding the State's fiscal situation. However, both HCD and CalHFA have established and generally adhered to policies intended to ensure that only eligible applicants receive awards.

HCD, like several other state agencies and departments, has not distributed proceeds promptly from its bond sales. Specifically, HCD, which had a program fund balance of $796 million as of June 2012, requested and the Department of Finance (Finance) recommended bond sales that were in excess of HCD's cash needs at a time when California's credit rating was declining and interest-rate volatility was high. We estimate that the State paid, on average, roughly $49 million in interest annually on these excess funds while it was facing cash shortfalls. However, without these bond proceeds, the sustainability of certain housing bond programs likely would have been at risk. In particular, for most of HCD's housing bond programs, private lenders and banking institutions provide financing to sponsors, comprising entities qualified to construct or manage housing developments, for the construction of housing projects. Once the sponsor successfully completes the housing project, the sponsor uses its HCD award to assist in repaying its construction financing. Various state officials representing HCD, Finance, and the State Treasurer's Office (state treasurer) explained that key stakeholders, including private lenders and banking institutions, cited significant concerns regarding the State's ability to honor its awards given the economic crisis at the time. In fact, state officials believed that without selling bonds in excess of immediate cash needs, and thereby demonstrating to

Audit Highlights . . .

Our review of the activities related to the Housing and Emergency Shelter Trust Fund Acts of 2002 and 2006, which provide bonds (housing bonds), for use in financing affordable housing, highlighted the following:

- ***The Department of Housing and Community Development (HCD) and the California Housing Finance Agency (CalHFA) had awarded nearly all of the 2002 housing bond funds to recipients.***
- ***HCD and CalHFA have been slow in making awards for three of the 13 programs for housing bond funds authorized in 2006 mostly due to the State's fiscal situation.***
- ***HCD has not distributed proceeds promptly from its bond sales and has requested—and the Department of Finance recommended—bond sales that were in excess of HCD's cash needs at a time when the State's credit rating was declining and interest-rate volatility was high.***
    - ***The State paid roughly $49 million in interest annually on these excess funds while facing cash shortfalls.***
- ***HCD needs to consistently follow monitoring procedures for sponsors that participate in certain programs, including concerns we raised in our 2009 audit regarding procedures for approving certain bond fund advances and quarterly reporting.***
    - ***HCD did not require staff to centrally track all funding advances as specified in its manual.***

continued on next page . . .

- *HCD continues to lack sufficient controls to ensure that sponsors submit quarterly status reports to ensure funds are used for allowable activities and support targeted populations.*

» *Although the Building Equity and Growth in Neighborhoods Program has been in existence for more than 10 years, HCD has not established monitoring procedures for the completion phase of the program.*

» *Despite HCD having developed monitoring procedures for its projects that included a risk-based, on-site monitoring approach as we had recommended in 2009, HCD discontinued use of the assessment and now judgmentally decides—with approval from the program—which recipients warrant an on-site visit.*

the financial institutions that the State had the ability to disburse cash to sponsors to repay construction loans, many of the housing bond programs would have been suspended, or halted altogether. When we asked HCD and Finance to provide us with documentation demonstrating the various stakeholders' concerns, or the amount of bonds Finance ultimately recommended that the state treasurer sell, they could provide only limited support and explained that they had not retained much of the documentation that existed at one time. Without such documentation, HCD and Finance are hindered in their ability to adequately respond to questions from stakeholders or members of the public regarding the need for the excess cash balance and the resulting interest the decision has cost the State. Nevertheless, our review indicated that while Finance's policy decision to sell bonds in excess of immediate cash needs may have contributed to the State's financial strain, the reasons for doing so appear to have some merit.

Although HCD and CalHFA have established procedures for monitoring the majority of sponsors' use of funds and ensuring that occupants of bond-funded housing meet eligibility requirements, HCD still needs to consistently follow monitoring procedures for sponsors that participate in certain programs. For instance, it had not fully addressed concerns we raised in our 2009 audit regarding its monitoring of sponsors in the CalHome Program during the disbursement phase—the time period between the initial awarding of funds and the final disbursement. Specifically, we raised concerns that HCD did not follow its procedures for approving bond fund advances greater than 25 percent of the total award. Although HCD stated that it would follow such procedures, which would include the logging of advances on a central tracking report, during our current review we found that it did not require staff to centrally track all funding advances, as specified in HCD's CalHome Procedure Manual. Rather, advances are tracked in the individual project files and the CalHome Program manager explained that, as of January 2011, HCD no longer makes advances greater than 25 percent. However, given that the CalHome Program has made more than 450 awards, without centrally tracking all advances, the CalHome Program could not readily identify to which sponsors, if any, it disbursed funds in excess of 25 percent prior to January 2011, nor could it readily demonstrate that it had not made advances in excess of 25 percent since that time. Additionally, in our 2009 report, we found that HCD did not always ensure that recipients submitted quarterly status reports for its CalHome and Building Equity and Growth in Neighborhoods (BEGIN) programs, as required in its regulations. HCD uses these reports, in part, to assess the performance of program activities. In our current review, we found that HCD continues to lack sufficient controls to ensure that sponsors submit quarterly status reports. As a result, HCD cannot adequately ensure that sponsors use housing bond funds only for allowable activities and to support targeted populations.

Further, we identified that HCD needs to improve its monitoring efforts during the completion phase—or the period from final payment to the completion of all contract requirements by the recipient. For instance, for one of the seven programs we reviewed—the BEGIN Program—HCD had not finalized and implemented procedures to ensure that sponsors fulfilled all contract requirements. According to the manager of the BEGIN Program, HCD has not conducted site visits due to staff limitations, travel restrictions, and a lack of on-site monitoring protocols. Nevertheless, the lack of established monitoring procedures for the completion phase of the program is surprising given that this program has been in existence for more than 10 years.

We reported in 2009 that HCD developed monitoring procedures for its projects completed under its CalHome Program by adopting a risk-based, on-site monitoring approach. However, during our current audit we found that although HCD had implemented our recommendation in early 2010, it discontinued use of the assessment for the CalHome Program because it was believed to be too subjective and ineffective in identifying high-risk sponsors. Currently, program staff judgmentally decide which sponsors warrant an on-site visit, and the program manager approves the choice. As a result, HCD lacks assurance that staff are using consistent criteria and are selecting the highest risk sponsors in determining which ones warrant an on-site visit.

Recommendations

Going forward, to the extent Finance or HCD believes the State needs to issue bonds in excess of cash needs, it should perform and document an analysis demonstrating the appropriateness of the bond sale amount and the circumstances.

HCD should continue its efforts to monitor sponsors that receive awards of housing bond funds by doing the following:

- Require staff to follow its procedures related to centrally tracking advances to sponsors under the CalHome Program.

- Ensure that it receives, reviews, and centrally tracks required status reports from sponsors under its CalHome and BEGIN programs.

- Ensure that staff implement and follow newly developed monitoring procedures for the BEGIN Program.
- As it relates to selecting which sponsors to monitor, HCD should adopt a risk-based, on-site monitoring approach for its CalHome Program, which should include evaluating the criteria in its risk assessment tool.

Agency Comments

HCD and Finance agree with the audit report's recommendations and indicated that they are moving forward to implement them. In fact, HCD outlined steps it has already taken, or plans to take, to implement the report's recommendations. Additionally, while the audit report did not contain recommendations to CalHFA, it agreed with the report's conclusions.

Introduction

Background

For 20 years California voters and the Legislature have supported numerous efforts to aid low- to moderate-income and homeless populations in securing housing and shelter. In 1988 and 1990, voters approved the issuance of $600 million in general obligation bonds to fund state housing programs. After the last of those bond funds were spent, the Legislature typically appropriated less than $20 million annually from the State's General Fund for the programs. In fiscal year 2000–01, however, the Legislature appropriated more than $350 million from the General Fund for housing programs. Then, in 2002 and in 2006, the Legislature proposed and voters approved nearly $5 billion in Housing and Emergency Shelter Trust Fund Act bonds (housing bonds) to continue these efforts.

Housing and Emergency Shelter Trust Fund Act of 2002

In November 2002, California voters approved the Housing and Emergency Shelter Trust Fund Act of 2002 (Proposition 46), which provides $2.1 billion for the development of affordable rental housing, emergency homeless shelters, and down payment assistance to first-time, low- and moderate-income home buyers. Proposition 46 currently funds 22 housing programs: 12 programs already in existence when the bonds were approved and 10 new programs, eight established in 2002 and two established in 2005. The new programs include funds for down payment assistance to first-time, low-income home buyers; for construction of rental housing for low-income renters or exterior modification to rental housing to accommodate low-income renters with disabilities; and for supportive housing aimed at reducing homelessness. Proposition 46 allocates specific amounts for each of the programs, which are administered by either the Department of Housing and Community Development (HCD) or the California Housing Finance Agency (CalHFA).

Figure 1 on the following page shows the funding allocations for Proposition 46 by its four core areas, which we describe in the text box. The Appendix provides details on each program within the core areas.

Housing Bond Core Areas

Multifamily housing programs: Provide funding for constructing or renovating rental housing projects. They also fund supportive housing for disabled or homeless persons. Funding generally takes the form of low-interest loans to awardees to partially fund the cost of construction.

Home ownership programs: Encourage home ownership by offering low-interest loans or grants that help low- to moderate-income Californians meet down payment requirements.

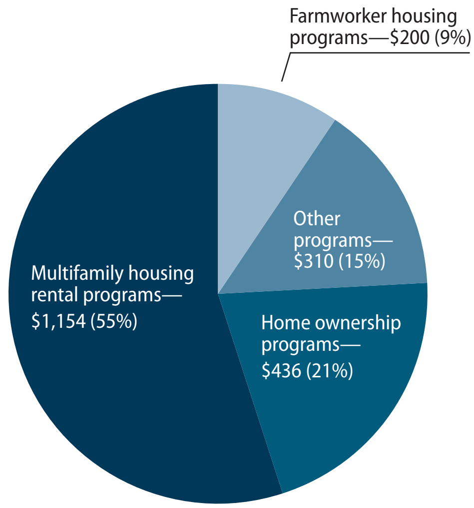
Farmworker housing programs: Provide funding for the construction or rehabilitation of housing for agricultural employees and their families. Funds support both rental and owner-occupied housing.

Development programs: Promote projects like parks, water, sewage, transportation, and housing in existing urban areas and near public transportation. (This core program area applies only to funds available through the Housing and Emergency Shelter Trust Fund Act of 2006.)

Other programs: Provide funding for developing emergency homeless shelters and transitional housing, incentives to cities and counties based on the number of new housing units approved, mortgage insurance for high-risk home buyers, and the capital needs of local government agencies responsible for enforcing housing codes.

Sources: Legislative Analyst's Office analysis of the 2003–04 Budget Bill and Implementation of the Housing Bond, dated March 28, 2007.

Figure 1
Proposition 46 Allocations by Core Area
(Dollars in Millions)



Sources: California Health and Safety Code, Division 31, Part 11; the Legislative Analyst's Office 2003–04 analysis of Proposition 46; and the Department of Housing and Community Development's *Cumulative Proposition 46 Bond Awards Report Through February 29, 2012*.

Note: For some programs, Proposition 46, the Housing and Emergency Shelter Trust Fund Act of 2002, requires that funds not awarded within a certain time frame revert to other housing bond programs. The amounts shown represent funding available as of February 29, 2012, and may not agree with the original funding level for programs presented in the law.

Many of the laws governing Proposition 46 programs restrict administrative costs. These restrictions generally limit the amount of funding HCD and CalHFA can use for administrative support to between 3 percent and 5 percent of individual program allocations.

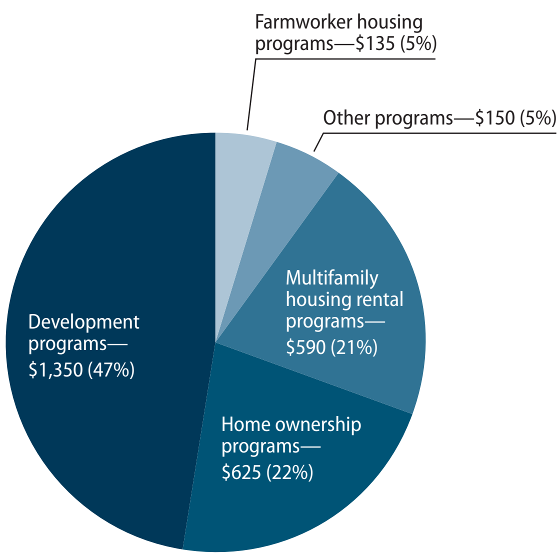
Housing and Emergency Shelter Trust Fund Act of 2006

In November 2006 California voters approved the Housing and Emergency Shelter Trust Fund Act of 2006 (Proposition 1C). It provides $2.85 billion to support the same four core areas as Proposition 46, plus a fifth one—development programs—that focuses on infrastructure.

Proposition 1C funds 13 housing programs, nine of which existed before the passage of the proposition. Three of the four new programs established in 2006 support urban development and parks, while the fourth is aimed at encouraging cost-saving approaches to creating or preserving affordable housing. Three of the four new programs established by Proposition 1C and included under the development core area—the Housing Urban-Suburban-and-Rural Parks Account (Housing-Related Parks);

Regional Planning, Housing, and Infill Incentive Account (Infill Incentive); and Transit-Oriented Development Implementation Program (Transit-Oriented Development)—constitute $1.35 billion (47 percent) of the total funds authorized. Previously, the California State Auditor (state auditor) was not required to audit these three programs. For that reason, our November 2009 audit report, *Department of Housing and Community Development: Housing Bond Funds Generally Have Been Awarded Promptly and in Compliance With Law, but Monitoring Continues to Need Improvement*, Report 2009-037, focused only on the remaining Proposition 1C programs, which constitute $1.5 billion of the bond funds. However, legislation enacted in September 2010 required the state auditor to review these three programs; therefore, this audit includes all programs funded by Proposition 1C. Figure 2 shows Proposition 1C funding by core area.

Figure 2
Proposition 1C Allocations by Core Area
(Dollars in Millions)



Source: California Health and Safety Code, Division 31, Part 12.

Department of Housing and Community Development

HCD is the State's lead housing agency. Its mission is to provide leadership, policies, and programs to preserve and expand safe and affordable housing opportunities and promote strong communities for all Californians. With more than 560 approved positions and a budget of approximately $327 million in fiscal year 2011–12, HCD focuses its efforts through three major divisions—Financial Assistance, Housing Policy Development, and Codes and Standards. The Financial Assistance and Housing Policy Development divisions primarily award the grant and loan funds available from the housing bonds. The Financial Assistance Division also offers technical assistance, promotes economic development, and manages HCD's portfolio of loans and grants.

HCD directly administers 21 of the 27 current housing bond programs, and CalHFA is responsible for the day-to-day program management of the other six programs. Additionally, through separate legislation, the Legislature appropriated $60 million of the funds from the Infill Incentive to a program established in state regulations—the California Recycle Underutilized Sites Program—which is administered by the California Pollution Control Financing Authority under the State Treasurer's Office (state treasurer).

Housing Bond Recipients

Sponsors: Local public entities; nonprofit corporations; joint ventures; partnerships; limited partnerships; trusts; corporations; cooperatives; and individuals qualified to own, construct, or rehabilitate housing developments.

Home Buyers: Persons, generally purchasing homes for the first time and of low- to moderate-income, who receive assistance through housing bond programs.

Sources: Department of Housing and Community Development's Web site and the California Health and Safety Code, Division 31, various sections.

Most programs operated directly by HCD provide funding to sponsors, as defined in the text box, that construct or manage housing projects. Generally, once a project is approved by HCD, banking institutions finance the building of the project and, upon its successful completion, the sponsor uses HCD funds to repay the loan. In many cases, these sponsors in turn provide services to the beneficiaries targeted by the programs. Typically, housing bond funds only partially finance projects. As of February 29, 2012, in addition to the approximately $4 billion it had awarded, HCD reported that its recipients received just over $27 billion from other funding sources.

California Housing Finance Agency

As the State's affordable housing bank, CalHFA supports the needs of renters and first-time home buyers by offering financing and programs that create safe, decent, and affordable housing opportunities for individuals within specified income ranges. Under an interagency agreement with HCD, CalHFA directly manages six Proposition 46 programs. In August 2007 the two parties executed another agreement for CalHFA to manage one program funded by Proposition 1C.

With more than 300 approved positions and a budget of approximately $50 million in fiscal year 2011–12, CalHFA addresses its mission through four types of programs: mortgage insurance, home ownership, multifamily, and special lending programs. Mortgage insurance programs aid first-time home buyers, low- to moderate-income borrowers, and individuals who may not qualify for traditional lending programs by providing primary mortgage insurance at favorable rates.

Home ownership programs aim to provide affordable housing opportunities by offering mortgages to first-time home buyers with low to moderate incomes. According to the manager of CalHFA's single-family special lending programs, CalHFA has helped 152,521 Californians purchase their first homes by issuing more than $19.3 billion in loans since 1976. CalHFA also reported that, as of June 30, 2012, it had assisted 38,078 families with down payment assistance through its California Homebuyer's Downpayment Assistance Program, amounting to more than $235 million in funding from both Proposition 46 and Proposition 1C.

CalHFA does not lend money directly to borrowers. Rather, it utilizes a network of approved private lenders to verify applicants' qualifications and offer mortgage loans. After CalHFA reviews the loan files for compliance purposes and ensures that certain requirements are met, it purchases the mortgage loans from the lenders and assumes responsibility for servicing all subordinate loans purchased.

Recent Changes to the Disbursement of Bond Proceeds

Prior to 2009 HCD would borrow money from the State's Pooled Money Investment Account (PMIA) to make disbursements to sponsors. The state treasurer periodically sold bonds to pay off these PMIA loans. However, according to the Pooled Money Investment Board (Investment Board), due to the State's fiscal crisis, the state treasurer was unable to issue bonds between July 2008 and December 2008 and thus was unable to replenish the PMIA account. To conserve cash for high-priority payments, such as debt service, special funds, and schools, in December 2008 the Investment Board voted to freeze disbursements for projects funded by general obligation bonds. Following the Investment Board's action, the Department of Finance (Finance) directed all agencies that have expenditure control and oversight of general obligation bond programs to cease authorizing any new grants or obligations for bond projects. This suspension of funding activity affected disbursements of bond proceeds from both Proposition 46 and Proposition 1C. As we describe further in the Audit Results section of this report, as a result of these actions, as well as the economic crisis and bleak housing market, both project sponsors and other housing bond stakeholders, including banking institutions, became concerned about the State's ability to fund bond projects.

In early 2009 state officials began to implement a new process for accessing bond funds by obtaining estimates of funding needs and issuing bonds in advance. This new process is designed to be used by entities that have been denied access to funding through PMIA.

Scope and Methodology

The California Health and Safety Code requires the state auditor to conduct periodic audits of housing bond activities to ensure that proceeds are awarded in a manner that is timely and consistent with legal requirements and that recipients use the funds in compliance with the law. Table 1 lists these requirements and the methods we used to address them.

Although California Health and Safety Code, Section 53533(d), requires the state auditor to perform periodic audits of all programs funded by Proposition 46, during the time period of the state auditor's November 2009 report, the corresponding section for Proposition 1C, Section 53545(a) (3), did not include three Proposition 1C funded programs—Transit-Oriented Development, Infill Incentive Account, and the Housing-Related Parks—in the periodic audit requirement. However, subsequent legislation enacted in September 2010 now requires the state auditor to conduct audits of these three additional programs. The Infill Incentive account funds two programs—the Infill Incentive Grant Program and the California Recycle Underutilized Sites Program. We focused our review on the Infill Incentive Grant Program because nearly all of the funds are allocated to the Infill Incentive account.

Assessment of Data Reliability

In performing this audit, we relied on various electronic data files obtained from the entities listed in Table 2 on page 12. We adhere to the standards of the U.S. Government Accountability Office, which require us to assess the sufficiency and appropriateness of computer-processed information that is used to support findings, conclusions, or recommendations. Table 2 shows the results of this analysis.

Table 1
Methods of Addressing Audit Objectives

	AUDIT OBJECTIVE	METHOD
1	Determine whether awards of housing bond funds were timely.	Because the law does not define timely, we judgmentally determined that, to be considered timely, the Department of Housing and Community Development (HCD) and the California Housing Finance Agency (CalHFA) should have awarded 90 percent of their bond funds by February 29, 2012. For those programs for which HCD and CalHFA had not yet awarded 90 percent of the bond funds, we interviewed program staff to obtain an understanding of the reasons and assessed whether these explanations seemed reasonable.
2	Determine whether HCD and CalHFA award bond funds in compliance with applicable statutory requirements.	• Selected six programs with significant Housing and Emergency Shelter Trust Fund Act of 2002 (Proposition 46) and Housing and Emergency Shelter Trust Fund Act of 2006 (Proposition 1C) awards and disbursements through February 29, 2012. Four of these programs we had not reviewed in either of our previous audits: the Transit-Oriented Development Implementation Program; the Regional Planning, Housing, and Infill Incentive Account; the Building Equity and Growth in Neighborhoods Program; and the Homebuyer Downpayment Assistance—School Facility Fee Program. The remaining programs were tested in our 2007 audit but were not included in our 2009 audit: HCD's Multifamily Housing Program and CalHFA's California Homebuyer's Downpayment Assistance Program. • We also selected for review another program—HCD's CalHome Program—because we had reported issues related to this program in our previous report. • Based on our review of relevant laws and regulations, we identified key legal provisions that the programs must implement when awarding funds. We judgmentally selected 46 awards granted by the five HCD-administered programs and randomly selected 58 awards from the two programs administered by CalHFA. In selecting our awards, we considered factors such as geographic distribution, type of sponsor, and amount of award. We then tested those awards to assess whether the entities met key legal provisions.
3	Determine whether the departments are ensuring recipients are using funds in compliance with applicable statutes.	• Reviewed relevant laws, regulations, program guidelines, policies, and procedures and interviewed officials to determine how HCD and CalHFA monitor recipients throughout the term of the award. We judgmentally selected 39 awards from the five HCD-administered programs and 58 awards from the two programs administered by CalHFA to assess whether the entities implemented processes that would allow them to ensure that recipients used housing bond funds in compliance with the law. Further, we tested whether HCD and CalHFA followed those processes. • Determined that CalHFA had implemented the recommendation from our previous audit that its Residential Development Loan Program obtain copies of the regulatory agreements before disbursing funds.
4	Determine the reasonableness of the cash balance from proceeds of general obligation bond sales used to support housing bond funded programs.	• While performing the steps described previously, we identified a cash balance of roughly $796 million from proceeds of general obligation bond sales used to support housing bond funded programs. To determine the factors contributing to this cash balance, we reviewed and evaluated the methodology used by HCD to estimate its cash needs. We also compared the amounts HCD requested for each period to its disbursements and the amounts the Department of Finance (Finance) ultimately recommended that the State Treasurer's Office (state treasurer) sell. • Interviewed officials from HCD, Finance, and the state treasurer to determine the reasoning behind the need for the large cash balance.
5	Determine whether HCD has completed its verification of data transferred to its new Consolidated Automated Program Enterprise System (CAPES).	• Interviewed HCD officials to determine the status of HCD's implementation of this recommendation, which was made in our 2009 audit report. According to HCD, it had not yet reconciled the Proposition 46 and Proposition 1C award information in CAPES. • Although we do not report this issue in the Audit Results section of this report, we will continue to follow up on the status of HCD's implementation of this recommendation as part of future audits and under our follow-up authority consistent with the Omnibus Audit Accountability Act of 2006 (California Government Code, sections 8548.7 and 8548.9).

Sources: California Health and Safety Code, sections 53533(d) and 53545(a)(3), and information and documentation identified in the table column titled *Method*.

Table 2
Methods of Assessing Data Reliability

INFORMATION SYSTEM	PURPOSE	METHOD AND RESULT	CONCLUSION
California Housing Finance Agency (CalHFA)			
Lender Access System Data as of May 16, 2012.	To identify the number and amount of loans awarded and disbursed by program as of February 29, 2012.	• We performed data-set verification procedures and electronic testing of key data elements and found no issues. • We performed accuracy testing on a random sample of 29 loans and found no errors. • We tested completeness by performing a sequence analysis of the loan numbers and found the data to be materially complete.	Sufficiently reliable for the purposes of this audit.
California Homebuyer's Downpayment Assistance Program Subordinate System Data as of May 25, 2012.	• To identify the total number and amount of applications submitted for resubordination as of February 29, 2012. • To identify the total number and amount of loans resubordinated as of February 29, 2012.	• We performed data-set verification procedures and electronic testing of key data elements and found no issues. • We performed accuracy testing on a random sample of five resubordinated loan applications and found no errors. • We tested completeness by performing a sequence analysis of the loan numbers and found the data to be materially complete.	Sufficiently reliable for the purposes of this audit.
Residential Development Loan Program Status Report Data as of May 22, 2012.	To identify the number and amount of awards and the amount and percent of funds disbursed from bond proceeds of the Residential Development Loan Program as of February 29, 2012.	• We performed data-set verification procedures and electronic testing of key data elements and found no issues. • We performed accuracy testing on the loans by selecting one loan per fiscal year and tracing key data elements to supporting documentation and found no errors. • We performed completeness testing by tracing supporting documents for each award to the data and verified that every award was represented in the data.	Sufficiently reliable for the purposes of this audit.
School Facility Fee System Data as of May 16, 2012.	To identify the number and amount of School Facility Fee loans for Housing and Emergency Shelter Trust Fund Act of 2002 (Proposition 46) distributed as of February 29, 2012.	• We performed data-set verification procedures and electronic testing of key data elements and found no issues. • We performed accuracy testing on 29 randomly selected loans by tracing the data back to supporting documents and found no errors. • We did not perform completeness testing because supporting documents were not reasonably accessible.	Undetermined reliability for the purposes of this audit.
Department of Housing and Community Development (HCD)			
HCD's accounting data maintained in the California State Accounting and Reporting System Data for the period June 2009 through February 2012.	• To identify the amount of local assistance expenditures charged to Housing and Emergency Shelter Trust Fund Act of 2006 (Proposition 1C) and Proposition 46 bond funds between June 2009 and February 2012. • To identify the amount of state operations expenditures charged to Proposition 1C and Proposition 46 bond funds between June 2009 and February 2012.	• We performed data-set verification procedures and electronic testing of key data elements and found no issues. • We performed accuracy testing on a random sample of 40 transactions and found no errors. • We tested completeness by tracing 29 haphazardly selected disbursements to the data and found no errors.	Sufficiently reliable for the purposes of this audit.
Cumulative Proposition 1C and Proposition 46 Bond Awards Reports Data as of February 29, 2012.	To identify the total number and amount of awards by program as of February 29, 2012.	• We performed data-set verification procedures and electronic testing of key data elements and found no material errors. • We performed accuracy testing on a random sample of 29 loans and found no errors. • We tested completeness by tracing 29 haphazardly selected loans to the data and found no errors.	Sufficiently reliable for the purposes of this audit.

Sources: California State Auditor's analysis of various documents, interviews, and data obtained from CalHFA and HCD.

Audit Results

Awards of Housing Bond Funds Were Generally Timely

For most of the programs they administer, the Department of Housing and Community Development (HCD) and the California Housing Finance Agency (CalHFA) have awarded funds from the bonds (housing bonds) issued under the Housing and Emergency Shelter Trust Fund Acts of 2002 and 2006 (Proposition 46 and Proposition 1C, respectively) in a timely manner. However, for three of the 13 Proposition 1C programs, a significant portion of funds remained unawarded.

As the direct administrators for many of the State's housing bond programs, HCD and CalHFA had awarded, by February 29, 2012[1], almost all of the $1.9 billion[2] in housing bond funds available for recipients under Proposition 46. In February 2012 HCD reported that it had awarded 98 percent of the $1.6 billion available under the programs it is responsible for, in the form of loans and grants to recipients. Additionally, CalHFA's records showed that it had awarded substantially all of the $275 million it had available for awards to recipients under Proposition 46.

Further, HCD and CalHFA promptly awarded between 75 percent and 100 percent of the funds available to recipients for 10 of the 13 programs funded by Proposition 1C. Overall, they awarded 81 percent, or nearly $2.1 billion, of the $2.6 billion in total bond funds available between the passage of the proposition in November 2006 and February 2012, as shown in Table 3 on the following page.

However, CalHFA has faced difficulty in awarding funds for the California Homebuyer's Downpayment Assistance Program (CHDAP). Initially, CHDAP received a $100 million allocation; however, it received an additional $100 million from the Residential Development Loan Program under Proposition 1C, resulting in a total allocation of $200 million. As of February 2012 only 38 percent, or $75.5 million, of the Proposition 1C funds available for this program had been awarded. According to the manager of CalHFA's single-family lending special programs, the decline in housing sales and program suspensions has led to a lower number of applicants seeking down payment assistance through the program, and thus fewer awards being made. The program manager explained that in addition to the economic factors contributing to the decline in housing sales, another main reason for decreased usage was the suspension

1 As we describe in the Scope and Methodology section of this report, in Table 1, in the absence of a specific definition of timeliness in statute, we judgmentally determined that, to be considered timely, HCD and CalHFA should have awarded at least 90 percent of their funds by February 29, 2012.

2 A portion of the $2.1 billion in housing bonds authorized by Proposition 46 is reserved for the State's administrative costs, leaving $1.9 billion to award to recipients.

of CHDAP and CalHFA's 30-Year Fixed Mortgage Loan Program in December 2008 through June 2009. These suspensions were the result of the Pooled Money Investment Board's decision to freeze bond funded disbursements, which we described in the Introduction. Thus, economic factors beyond the control of CalHFA, such as the state of the economy in general, have contributed to the delay in awarding these funds. Nevertheless, the program manager indicated that as the housing market recovers and interest rates remain low, CalHFA is seeing the number of applicants seeking assistance through CHDAP continuing to rise.

Table 3
Proposition 1C Percentages of Available Bond Funds Awarded by Program (As of February 29, 2012)

CORE PROGRAM AREA AND PROGRAM NAME	PERCENTAGE OF AVAILABLE PROGRAM FUNDS AWARDED*
Multifamily Housing Programs	
General	100%
Supportive Housing	100
Homeless Youth	89
Home Ownership Programs	
CalHome Program	75
Building Equity and Growth in Neighborhoods	76
California Self-Help Housing	99
California Homebuyer's Downpayment Assistance†	38
Farmworker Housing Program	
Joe Serna, Jr. Farmworker Housing Grant–General	96
Development Programs	
Housing Urban-Suburban-and-Rural Parks Account	5
Regional Planning, Housing, and Infill Incentive Account	96
Transit-Oriented Development Implementation Program	100
Other Programs	
Affordable Housing Innovation Fund	29‡
Emergency Housing and Assistance	100
Percentage Awarded of the Total Proposition 1C Funds Available	**81%**

Sources: California State Auditor's analysis of the data obtained from the California Housing Finance Agency's (CalHFA) Lender Access System and the Department of Housing and Community Development's (HCD) *Cumulative Proposition 1C Bond Awards Report as of February 29, 2012*.

* The amounts used to calculate these percentages represent the amounts disbursed and encumbered as of February 29, 2012. If recipients could not use some or all of their initial awards, awards were either disencumbered by HCD, or were returned to HCD by the recipient; inclusion of these disencumbered and returned funds would increase the percentage of program fund awards.

† CalHFA administers this program.

‡ Subsequent to our review, HCD made an additional award for an Affordable Housing Innovation Fund program, which increased the amount it awarded to roughly 54 percent of the funds available.

HCD has faced obstacles in awarding funds through the Housing-Related Parks Account and attributed the delay in awarding these funds to funding freezes.

Additionally, HCD has faced obstacles in awarding funds through the Housing Urban-Suburban-and Rural-Parks Account (Housing-Related Parks). As of February 2012 HCD had awarded just 5 percent of the Proposition 1C bond funds available for sponsors of Housing-Related Parks' projects. HCD attributed the delay in awarding these funds to funding freezes. In particular, although state law authorized HCD to begin awarding Housing-Related Parks' funds in July 2009, HCD did not make the program's first awards until October 2011. According to the manager of the division of housing policy, HCD was unable to make any awards during this two-year period because of budget-related funding freezes, including the Department of Finance's (Finance) suspension of funding activity in December 2008. The program manager explained that once these freezes were lifted, HCD was able to award $8.8 million in October 2011. As of June 30, 2012, roughly eight months later, HCD reported that it had awarded an additional $11.2 million in Housing-Related Parks' funds to recipients. Although it was generally able to make these awards promptly, HCD's ability to award funds in the future is hindered because it did not receive a budget appropriation for Housing-Related Parks during fiscal year 2012–13.

Similarly, in our 2009 audit, we reported that HCD had delayed implementing the programs authorized under the Affordable Housing Innovation Fund funded by Proposition 1C housing bonds. At that time, HCD cited various reasons for the delay, including Finance's suspension of funding activity in December 2008, which resulted in HCD soliciting applications for only one of the five programs under the Affordable Housing Innovation Fund and postponing its solicitation of applications for several others. As of February 2012 HCD had awarded 29 percent, or $28 million[3], of the funds under these programs. HCD stated that complications arising from the downturn in the economy and changing conditions in the real estate market have contributed to the delay in implementing the programs under the Affordable Housing Innovation Fund. Further, legislation approved by the governor in September 2012 will shift funds from two programs under the Affordable Housing Innovation Fund to the Multifamily Housing Program. According to the author of this legislation, increasing funding for the Multifamily Housing Program could have a greater impact on solving the State's ongoing housing crisis while retaining the intent of the voters who enacted Proposition 1C. Regardless, HCD's explanations for its delay in awarding program funds under the Affordable Housing Innovation Fund have merit.

3 Subsequent to our review, HCD awarded an additional $23.25 million for a program under the Affordable Housing and Innovation Fund, which increased its awards to roughly 54 percent, or $51 million of the total funds available under these programs.

Although HCD Has Not Exceeded Statutory Limits on Administrative Costs, Its Estimates of Future Costs Exceed Those Limits for Certain Programs

Types of Set-Aside Costs

Statewide costs: Expenses, including bond issuance costs, incurred by the State Treasurer's Office, the State Controller's Office, and the Department of Finance.

Administrative support costs: Personnel, planning, training, and legal costs associated with the administration and coordination of the housing bond programs.

Default reserves: Amounts for unexpected costs incurred to protect the State's security interest. The Department of Housing and Community Development (HCD) could eventually disburse unused reserves in the form of loans and grants. These reserves are expressly authorized by statute for the Multifamily Housing and Farmworker Housing programs, and HCD believes it is prudent to keep a similar reserve for the Emergency Housing and Assistance Program-Capital Development and Transit-Oriented Development programs to protect the State's investment.

Sources: California Health and Safety Code, Division 31; California Government Code, Section 16724.6; State Administrative Manual, Section 9202.1; and HCD staff.

HCD ensured that it did not exceed limits on administrative costs set in the law for all programs involving housing bond funds by periodically reviewing these costs and the amounts already awarded as loans and grants. It prepared an analysis estimating the distribution of administrative costs, referred to as set-aside costs, for Proposition 46 funds and developed a similar analysis for Proposition 1C funds. Both analyses identified amounts set aside in three areas, as shown in the text box. Generally, for most of the housing bond programs, set-asides amount to 5 percent or less for administrative support costs.

According to HCD's most recent analyses, developed in February 2012, it anticipates using a total of $154 million, or 7.3 percent, of Proposition 46 bond funds and $184 million, or 6.5 percent, of Proposition 1C bond funds for the three types of set-asides. The set-aside costs for administrative support and statewide costs reduce the total amount of funding available for grants and loans. However, according to the deputy director of HCD's administration and management division, default reserves not used to support existing projects could eventually be awarded to new projects. The State's General Obligation Bond Law allows a portion of any fund created to account for bond proceeds to be used to pay statewide costs. Thus, as part of the set-aside costs, HCD set aside 0.24 percent of the Proposition 1C and 3 percent of the Proposition 46 funding for this purpose.

For programs in which statute establishes a limit on the amount of bond proceeds that can be set aside for administrative support costs, we verified that these costs did not exceed statutory limits. However, the administrative support costs that HCD set aside for one program with no statutory administrative cost limit—the Joe Serna, Jr. Farmworker Housing Grant Program (Farmworker Housing Program)—represented 22.8 percent of the program's Proposition 46 funds and 26.3 percent of its Proposition 1C funds.

According to HCD's budget office manager, the administrative support costs are higher for the Farmworker Housing Program because HCD is not allowed to collect interest revenue on the loans, as 100 percent of the interest is deferred for the term of the loan. Consequently, he explained, HCD must set aside a portion of the program's funds to pay for the administrative support costs, including costs associated with long-term monitoring of award recipients for the life of the program, thereby reducing the amount available to award. In contrast, for the Multifamily Housing Program, HCD collects interest revenue to cover a portion of the costs associated with the 55 year long-term monitoring requirement. According to HCD's chief deputy director, in 2007 HCD sponsored proposed legislation that would have allowed it to collect revenue from recipients of loans made by the Farmworker Housing Program. In particular, the legislation would have authorized HCD to require loan recipients to make annual debt service payments in the minimum amount necessary to cover the costs of project monitoring, not to exceed 0.42 percent of the loan amount. However, the bill was not brought to a final vote in the Senate. The chief deputy director further stated that it is too late to address this issue, because all of the Proposition 1C money has been awarded to sponsors and the contracts awarded do not require annual debt service payments. Thus, he concluded that pursuing legislation to authorize a funding mechanism similar to that for the Multifamily Housing Program will not change the need for a large percentage of set-aside support costs to monitor this program.

HCD's projected administrative support costs for the BEGIN Program total $5.3 million of the Proposition 46 bond funds for the program and $8.4 million of the program's Proposition 1C bond funds—exceeding the statutory limit.

Additionally, for the Building Equity and Growth in Neighborhoods (BEGIN) Program, HCD has projected that it will exceed the maximum allowable amount specified in state law for administrative support costs. In particular, HCD's projected administrative support costs for the BEGIN Program total $5.3 million, or 7.6 percent, of the Proposition 46 bond funds for the program and $8.4 million, or 6.7 percent, of the program's Proposition 1C bond funds. These amounts exceed the statutory limit of 5 percent by $1.8 million and $2.2 million, respectively. According to the deputy director of HCD's administration and management division, the projected administrative support costs are reevaluated every year and HCD will make policy changes, when possible, based on historical costs, staffing needs, and the economy, in order to keep the administrative costs below 5 percent. She explained that HCD expects these projected costs to decrease during the 20-year monitoring phase of the program. As of April 2012 HCD reported it had spent $2.9 million on administrative support costs for the BEGIN Program through Proposition 46 and 1C bond funds, which is 3 percent of the $195 million allocated to the program by the combined propositions. Although HCD has not yet exceeded the maximum amount specified in state law, it should continue to reevaluate, as appropriate, its administrative support costs projection, as well as continue to monitor its future costs to ensure that they do not exceed the 5 percent statutory limit for this program.

HCD and CalHFA Properly Made Awards to Eligible Applicants

HCD and CalHFA award housing bond funds through an application review and approval process that is program specific. At the end of this process, each agency makes a commitment to fund certain grants or loans. Generally, for the seven programs we reviewed, HCD and CalHFA established and adhered to processes for identifying eligible recipients and for properly making awards. Further, HCD has processes for ranking the applicants for programs required to use a competitive process. For instance, the Transit-Oriented Development Implementation (Transit-Oriented Development) and the Infill Incentive Grant programs issue notices of funding availability to solicit applications. Following the competitive process detailed in the notices, HCD evaluates, for example, the applicant's ability to secure sufficient funding commitments from other sources, such as state or locally administered funds authorized under the 2009 economic stimulus package or land donations. We found that for these programs, HCD categorized applicants based on their geographic location, subsequently ranked them according to scores from highest to lowest, and eliminated any applicants that did not meet minimum requirements. HCD awarded funds in rank order, ensuring that it complied with geographic distribution requirements, until the money was exhausted. In some cases, applicants that received relatively low scores under the competitive ranking process did not receive an award.

HCD awarded funds in rank order for two of its programs, ensuring that it complied with geographic distribution requirements, until the money was exhausted. In some cases, applicants that received relatively low scores under the competitive ranking process did not receive an award.

For programs not required to use a competitive application process, HCD and CalHFA have processes to ensure that applicants meet eligibility requirements. For instance, unlike the process HCD uses for programs making competitive awards, CalHFA awards funds to all eligible applicants for CHDAP. Although these applicants do not have to undergo a competitive application process, they do have to meet an array of statutory criteria to be eligible for assistance, such as meeting specific income levels as well as being first-time home buyers.

Further, state law was amended in 2009 to assist participants in CHDAP who are experiencing hardship. CHDAP provides loans to home buyers for down-payment assistance, and generally requires that the loans be repaid in full if the home is refinanced. The 2009 law provides an exception to this requirement for borrowers who meet certain criteria. For example, borrowers must demonstrate that the refinancing is necessary to avoid foreclosure. We verified that CalHFA implemented and followed an application process that includes steps to ensure that homeowners met the new program requirements. As of February 2012, 142 primary mortgages were refinanced from this change in law.

Although Excessive Bond Sales May Have Contributed to the State's Financial Strain, They Were Likely Necessary to Ensure the Viability of Certain Housing Bond Programs

HCD's request for bond proceeds to fund housing bond programs, and decisions made by Finance regarding the subsequent sale of those bonds, may have been an inefficient use of state funds. As of June 2012 HCD had a balance of $796 million in unspent proceeds from bond sales, which we estimate cost the State, on average, roughly $49 million in interest annually. These bonds were issued at a time when the State was both paying higher interest due to a poor credit rating and experiencing a cash shortfall. Officials from HCD and Finance cited issues surrounding the new method of obtaining capital, the economic crisis, private lenders discontinuing construction loans, and other factors as contributing to HCD's excess cash balance. Our analysis indicated that while HCD's initial projections proved to be too high, and Finance's policy decision to recommend that the State Treasurer's Office (state treasurer) issue bonds in excess of cash needs contributed to the State's financial strain, their rationale for issuing the bonds appears to be reasonable.

HCD and Finance May Have Contributed to the State's Financial Strain by Recommending That the State Treasurer Sell Bonds Before the Proceeds Were Needed

Like several other state agencies and departments, HCD has not promptly distributed proceeds from bond sales. According to the state treasurer, as of June 2012, the State had a balance of approximately $7 billion in unspent proceeds from general obligation bonds. Of this amount, roughly $3.2 billion (nearly 47 percent) was from bonds issued in fiscal year 2009–10 that had been idle for more than two years. According to the state treasurer's records, as shown in the text box, HCD had the fifth largest balance of unspent general obligation bonds in the State as of June 2012. We estimated that the State paid, on average, roughly $49 million in interest annually out of its General Fund on HCD's unspent bond proceeds.

Top Ten General Obligation Bond Balances by Department or Agency, as of June 2012 (in Millions)

Department of Water Resources	$2,161
Resources Agency (excluding the Department of Water Resources)	1,083
California Department of Transportation	882
Office of Public School Construction	798
Housing and Community Development	796
California Health Facilities Financing Authority	330
State Transit Assistance	200
Department of Public Health	159
University of California	146
Air Resources Board	97

Source: State Treasurer's Office.

As we described in the Introduction, beginning in 2009, HCD had to discontinue obtaining funds through loans from the Pooled Money Investment Account (which were later paid off by the sale of bonds) and instead had to obtain funds through the sale of bonds in advance of program disbursements.

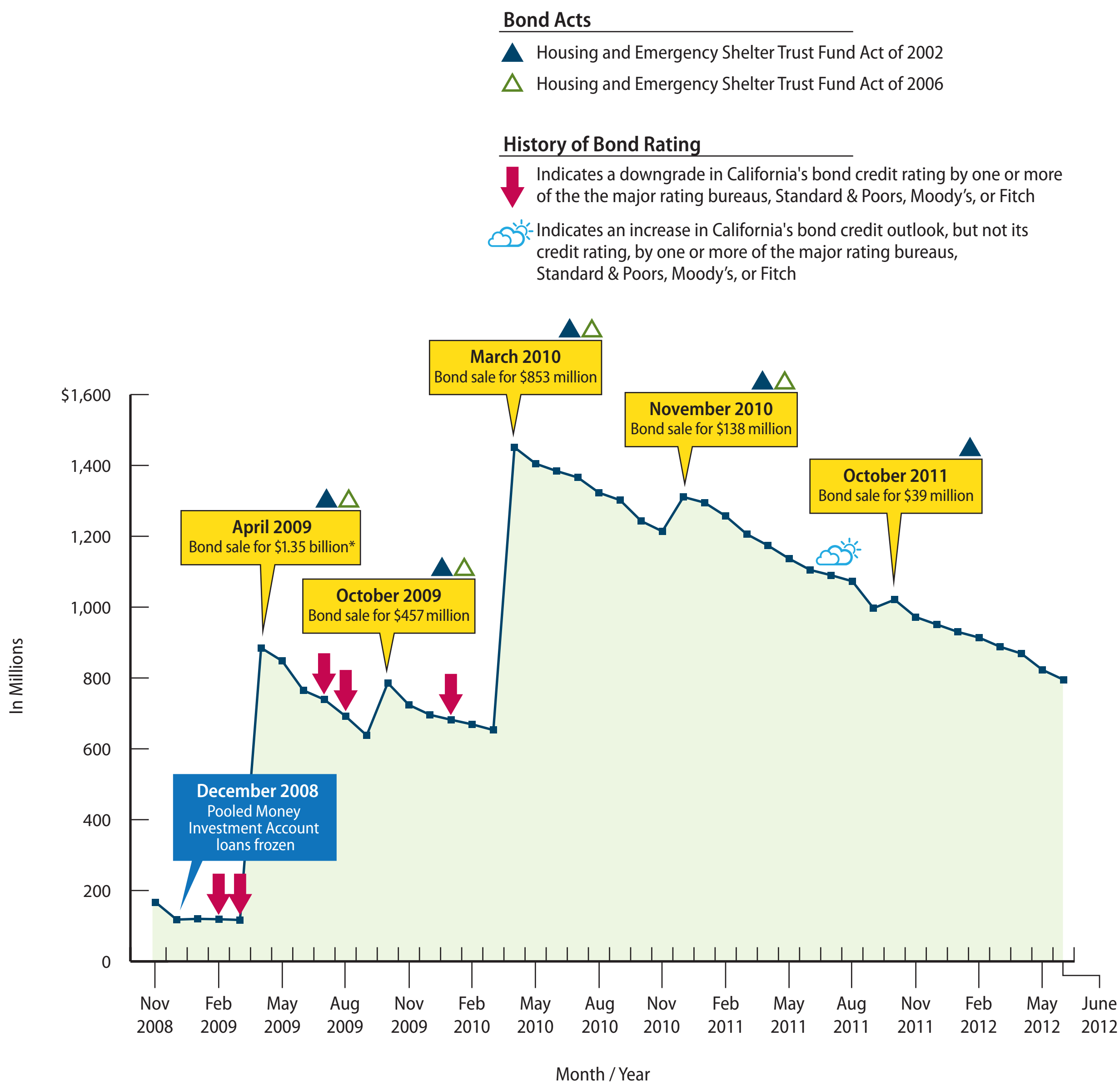
As a result, HCD requested $786 million in general obligation bond funds for fiscal year 2009–10 to finance housing bond programs. However, HCD's total disbursements for fiscal year 2009–10 amounted to only about $348 million—approximately 44 percent of the projected cash needs. HCD stated that its request was based primarily on information from award sponsors, which turned out to be an overly aggressive estimate of their future cash needs. HCD explained that there was a large amount of uncertainty related to the amount of cash that would be available and how that cash would be allocated to projects, which may have caused sponsors to provide optimistic projections of cash needs in an attempt to obtain funding for their projects. HCD indicated that it has since significantly refined and improved its methodology for projecting funding needs. We determined, based on our analysis, that HCD's February 2010 projection improved, although it was still above actual disbursements. For instance, HCD was able to disburse approximately $358 million, or 75 percent, of its projection for fiscal year 2010–11. However, HCD's inaccurate projection of its cash needs and Finance's policy decision to recommend that the state treasurer issue bonds during a time of increasing interest rates—although it may have been warranted, as we describe later—may have contributed to the strain on the State's finances.

As a result of having bonds sold in excess of the cash needs for disbursements, HCD accumulated a cash balance from bond proceeds that, at its peak in April 2010, exceeded $1.45 billion.

As a result of having bonds sold in excess of the cash needs for disbursements, HCD accumulated a cash balance from bond proceeds that, at its peak in April 2010, exceeded $1.45 billion. Figure 3 shows HCD's cash balance from bond proceeds between November 2008 and June 2012 and illustrates its substantial reserve. Since the last bond sale of roughly $39 million in October 2011, HCD has steadily reduced its cash balance.

The timing of these bond sales in excess of HCD's immediate cash need was not ideal. The state treasurer issued these general obligation bonds in 2009 and 2010, when the State's credit rating was declining and interest-rate volatility was high. This timing increased the State's interest cost. The credit-rating agencies downgraded the State's credit rating beginning in the spring of 2009 and did not affirm a higher rating (with a stable outlook) until the fall of 2011. According to the state treasurer, interest rates on general obligation bonds sold in the fall of 2010 were between 0.7 percent and 1 percent higher than those on bonds sold in the fall of 2011. Our calculations indicate that the bonds sold in spring of 2010 for propositions 46 and 1C were similarly affected by the credit-rating downgrade.

Figure 3
Housing and Community Development's Cash Balance of Bond Proceeds From Housing Bond Acts of 2002 and 2006



Sources: State Controller's Office data and reports provided by the State Treasurer's Office.

* The cash balance increased less than the amount of the bond sale because a portion of the bond proceeds were used to pay off Pooled Money Investment Account loans.

HCD and Finance Have Identified Several Causes That Contributed to HCD's Outstanding Cash Balance

To explain the excessive issuance of bonds, officials from HCD, Finance, and the state treasurer cited various reasons. HCD and Finance identified the new process related to bond funding, which Finance began to implement in early 2009, as one factor contributing to HCD's cash balance. For instance, it appears that Finance's initial instructions could have been better; however, HCD noted that it is unsure whether precise cash need projections were possible given the volatility of the housing market at the time. The instructions sent to HCD for completing the spring 2009 general obligation bond cash survey consisted of limited direction. In contrast, the spring 2010 survey was accompanied by several pages of instructions and required HCD to evaluate multiple scenarios. Finance explained that the situation was unprecedented and the process was new. In addition, HCD asserted that the short time limits imposed by Finance to complete and return the spring 2009 cash survey may have contributed to the inaccurate cash projections, causing them to be too high. However, HCD further explained that it does not know the extent to which any one factor affected the accuracy of its projection. Another factor that HCD cited as contributing to its cash balance was $127 million in federal economic stimulus funding that project sponsors used in lieu of bond proceeds to fund some projects. As a result of this additional funding, HCD stated that it no longer needed to disburse bond proceeds that it had initially projected to use to fund these awards.

Finance made a decision to recommend that the state treasurer issue $853 million in bonds even though HCD had an existing balance of $653 million and only projected additional cash needs of $158 million through June 2011.

HCD also cited a policy decision made by Finance as an additional factor contributing to its fund balance. In particular, in March 2010, Finance made a decision to recommend that the state treasurer issue $853 million in bonds even though HCD had an existing balance of $653 million and only projected additional cash needs of $158 million through June 2011. Finance explained that the economic crisis, coupled with significant concerns raised by stakeholders such as project sponsors, private lenders, and banking institutions, left the State with no choice but to recommend that the state treasurer issue additional bonds to calm concerns raised by these stakeholders, and ensure the continuance of certain programs funded by housing bond proceeds. Specifically, as discussed in the Introduction, most of HCD's programs provide funding to sponsors that construct or manage affordable housing projects, such as rental and farmworker housing. Private lenders and banking institutions finance the construction loans for these projects, and, upon the sponsor's successful completion of the housing project, the sponsor uses its HCD award to repay the construction loans. Thus, the financial risk during the construction phase of the project resides with the private lenders and banking institutions—not with the State. Finance stated that by early 2009 HCD had more than $1.7 billion in commitments that had not been funded; therefore, it decided to sell enough bonds to substantially fund all of HCD's existing project commitments. Further, in November 2010, Finance stated that due to concerns about the State's ability to enter the bond market, it recommended that the state treasurer sell additional bonds to cover HCD's projected cash needs through

December 2011. At that time, HCD had a cash balance of housing bond proceeds of more than $1.2 billion and according to Finance, based on its recommendation, the state treasurer sold an additional $138 million in bonds—increasing HCD's cash balance yet again.

Banking institutions were no longer willing to finance the construction of affordable housing projects, as they were concerned that the State would not have sufficient funds to repay the loans once projects were completed.

According to HCD, Finance, and the state treasurer, because of the bleak forecast for the economy and the housing market at the time, banking institutions were no longer willing to finance the construction of affordable housing projects, as they were concerned that the State would not have sufficient funds to repay the loans once the projects were completed. Finance explained that these construction loans are crucial to the financing of many of HCD's affordable housing projects, and without these loans, HCD could no longer continue the programs. Affordable housing developers raised concerns regarding financial pressure from creditors and the risk of losing financing from other lenders because there was no guaranteed delivery of state funds. Thus, Finance asserted that recommending the state treasurer issue excess bonds was the only option it had in order to restore private lenders' and banking institutions' confidence that HCD could repay construction loans upon completion of the projects. When we asked HCD to provide documentation describing the banking institutions' concerns, it could provide only limited documentation regarding sponsors' concerns. Similarly, when we asked Finance to provide documentation supporting the amount of bonds it decided to recommend that the state treasurer sell or correspondence demonstrating the banking institutions' concerns, Finance could provide only limited documentation and explained that it had not retained much of the documentation that existed at one time. However, officials from HCD and the state treasurer confirmed that banking institutions and private lenders, as well as housing developers, had repeatedly expressed the concerns Finance noted. Regardless, without such documentation, HCD and Finance are hindered in their ability to adequately respond to questions from stakeholders or members of the public regarding the need for the excess cash balance and the resulting interest the decision has cost the State.

Although CalHFA Has Adequate Monitoring Processes, HCD's Processes Need Improvement

While HCD and CalHFA have established procedures for monitoring the majority of sponsors' use of funds and ensuring that occupants of bond-funded housing meet eligibility requirements, HCD still needs to consistently follow monitoring procedures for sponsors that participate in certain programs. In particular, HCD had not fully addressed concerns we raised in our previous audit report regarding its monitoring of sponsors in the CalHome Program. Further, for one of the seven programs we reviewed—BEGIN—HCD had not finalized and implemented procedures to ensure that sponsors fulfilled all contract requirements. As a result, HCD could not always ensure that sponsors for these two programs used funds in accordance with program requirements or that the programs benefited only targeted populations. Regardless of the type of housing assistance provided by bond-supported programs, monitoring comprises two phases: disbursement and completion, as shown in the text box.

Monitoring Phases for Housing Bond Programs

Disbursement phase: Period from award commitment to final state payment to recipient.

Completion phase: Period from final state payment to fulfillment of all contract requirements by recipient.

HCD Did Not Always Apply Appropriate Monitoring Procedures During the Disbursement Phase

HCD did not have processes in place to ensure that all sponsors met legal requirements during the disbursement of propositions 46 and 1C funds. However, we found that CalHFA did have such procedures and appropriately followed them before disbursing bond funds. Table 4 on page 27 provides examples of the types of monitoring procedures we reviewed for the seven programs we tested during the disbursement phase. The second column in the table provides examples of the monitoring procedures we found to be working, and the third column identifies the exceptions we found, which we discuss in more detail later in this section.

In selecting the programs to review, we considered the amount of funds allocated to each program, the percentage of those funds that HCD and CalHFA awarded, whether we had tested and made recommendations for the program during a previous audit, and the current status of the program. Also, in selecting projects to review within each program, we considered factors such as award amount and whether the project was in the disbursement phase or in the completion phase. Because of the variability of these factors among the programs, the number of projects we tested per program ranged from as few as nine for the Infill Incentive Grant and Transit-Oriented Development to as many as 29 for the Homeowner Downpayment Assistance—School Facility Fee (School Facility Fee) and California Homebuyer's Downpayment Assistance Program.

The length of the disbursement phase varies among programs, depending on the type of assistance the program provides. For example, due to recent legislative changes that extend the time periods that Transit-Oriented Development or Infill Incentive Grant funds are available, HCD has extended the disbursement phase which can now last up to seven years. The disbursement phase begins when HCD or CalHFA commits to providing funding and ends when a recipient has received all funds earmarked for an approved loan or grant. Both entities indicated that the purpose of monitoring during this phase is to ensure that sponsors exhibit reasonable progress in meeting goals and that bond funds are provided to recipients only for allowed costs. For example, HCD ensures that Transit-Oriented Development and Infill Incentive Grant sponsors are spending funds appropriately by requiring them to submit documentation supporting their progress payment disbursement requests. It also requires sponsors receiving funds from the Transit-Oriented Development and Infill Incentive Grant to have an agreement in place that ensures the future affordability of the property.

HCD Continues to Need to Improve Its Process for Monitoring Advances for Its CalHome Program

HCD disburses funds for its CalHome Program on either an advance basis or a reimbursement basis. In the case of an advance, its standard agreement allows a sponsor to receive a 25 percent advance of awarded funds. The standard agreement states that after the sponsor submits supporting documents for at least two-thirds of an advance, it can receive an additional 25 percent. During our 2009 audit, we recommended that HCD follow its procedures on restrictions of bond fund advances greater than 25 percent of the total award under the CalHome Program. In response to this recommendation, HCD stated that it had developed and implemented a procedure for granting advances in excess of 25 percent that requires substantiation from the sponsor, the addition of the request to the tracking report by CalHome staff, and review and approval of the request by the manager of the CalHome Program. In its response, HCD explained that the request for the advance is then documented, processed, and filed in the sponsor's file. HCD stated that it believed this procedure ensured that the appropriate controls were in place.

Although HCD did not grant advances in excess of 25 percent for any of the eight projects we reviewed that were subject to this restriction, it did not require staff to centrally track all funding advances.

Although HCD did not grant advances in excess of 25 percent for any of the eight projects we reviewed that were subject to this restriction, it did not require staff to centrally track all funding advances, as required in HCD's CalHome Procedure Manual. Of the 10 projects we reviewed, one—a project development loan—was not subject to the restriction on advancing bond funds and another relinquished its award without requesting any funds; the remaining eight did not advance more than 25 percent of the sponsors' award. Although HCD has a central tracking log for advances, during our current review we found that program staff are not consistently recording project details in the log, including any advances made to sponsors, regardless of whether the advance exceeds 25 percent. As such, the log is incomplete and contains inaccuracies. Instead of requiring staff to use the log, HCD has program staff record and track all advances in the individual project files and the CalHome Program manager explained that, as of January 2011, HCD no longer makes advances greater than 25 percent. Given that the CalHome Program has made more than 450 awards, it could not readily identify to which sponsors, if any, HCD disbursed funds in excess of 25 percent prior to January 2011, nor could it readily demonstrate that it had not made advances in excess of 25 percent since that time.

HCD Needs to Improve Its Tracking of Periodic Reports During the Disbursement Phase

Depending on the length of the disbursement phase, many of the housing bond programs HCD administers require the submission of periodic reports. For example, the CalHome Program's regulations and standard agreement and the BEGIN Program's handbook require sponsors to submit quarterly and annual performance reports to HCD, which uses these reports to assess the status of sponsor activities. These reports are due 30 days after the end of every quarter and fiscal year end, and generally include the current status of program activity, future planned activities, problems or delays encountered and the courses of action to be taken to address them, and the actions taken to meet expenditure deadlines. However, HCD's files did not contain all of the required quarterly reports for one of the 10 BEGIN projects we reviewed. In addition, HCD's files did not contain all of the annual reports for five of the 10 BEGIN projects we tested, nor did they contain the annual reports for seven of the nine CalHome projects we reviewed, as was required. In these instances, HCD could not demonstrate that it had received and reviewed these reports, nor did it consistently track or notify recipients in breach of this requirement.

HCD's files did not contain all of the required reports for some of the BEGIN and CalHome projects we reviewed.

In our 2009 audit, we also identified this issue for the CalHome Program and, as a result, recommended that HCD take steps to ensure that it receives and reviews required status reports from sponsors of its CalHome Program. In response to this recommendation, HCD explained that as sponsors receive an award, they are added to a quarterly report tracking log. Previously, staff had maintained their own logs, but going forward it would be centralized. If reports are late, HCD stated that staff call or e-mail the contractor and note on the log who called, who the contact was, the date called, and the result. HCD asserted that the manager of the CalHome Program periodically reviews the log and ensures that follow-up is performed as necessary.

Table 4

Summary of Testing Results From Our Evaluation of the Two Entities' Monitoring of Seven Housing Bond Programs During the Disbursement Phase

ENTITY AND PROGRAM NAME	EXAMPLES OF OUR EVALUATION OF MONITORING PROCEDURES REVIEWED	ERRORS IDENTIFIED IN TESTING MONITORING PROCEDURES
Department of Housing and Community Development (HCD)		
CalHome Program	Ensures that sponsors demonstrate that they have sufficient organizational stability and capacity to carry out the activity for which they are requesting funds. To demonstrate this, sponsors must have been operating as housing developers or housing program administrators for a minimum of two years prior to the date of application. Requires submittal of plans that describe how sponsors plan to reuse funds they receive as loan repayments from the low- and moderate-income home buyers they have assisted. The funds must be used for the same purpose.	HCD did not consistently require staff to centrally track advances to sponsors under the CalHome Program. HCD did not always receive quarterly and annual status reports from sponsors, as required by its CalHome Program regulations, nor did it centrally track receipt of these reports or notify sponsors in violation of this requirement.
Building Equity and Growth in Neighborhoods	Ensures the qualifying city, county, or city and county has demonstrated that it has provided incentives or reduced or removed regulatory barriers to affordable housing for a specific project. Requires submittal of plans that describe how sponsors plan to reuse funds they receive as loan repayments from the low- and moderate-income home buyers they have assisted. The funds must be used for the same purpose.	HCD did not have desk review procedures in place to verify the documentation provided by its sponsors prior to disbursing bond funds. HCD did not always receive quarterly status reports from award sponsors, as required by its regulations. Additionally, it did not track or notify sponsors of this breach of regulations.
Multifamily Housing Program—General	Approves management plans, obtains operating budgets, and ensures that its sponsors have a recorded regulatory agreement that includes information such as standards for tenant selection and rent schedules, in addition to procedures for permitting rent increases.	None observed.
Transit-Oriented Development Implementation Program	Approves management plans; ensures that a standard agreement is executed; and obtains operating budgets, regulatory agreement, promissory note, deed of trust, and certificate of occupancy prior to closing on a loan. Ensures that a housing covenant is recorded, and sponsors submit draw requests backed up by invoices that are verified by HCD prior to disbursement of grant funds.	None observed.
Infill Incentive Grant Program	Ensures that a housing covenant is recorded and sponsors submit draw requests backed up by invoices that are verified by HCD prior to disbursement of grant funds.	None observed.
California Housing Finance Agency (CalHFA)		
California Homebuyer's Downpayment Assistance Program	Ensures that home buyers qualify as a first-time home buyer and have a low or moderate income.	None observed.
Homebuyer Downpayment Assistance Program—School Facility Fee	Ensures that the home was built after 2001 and verifies the amount of the school facility fee with the school district. Ensures that the home buyer either qualified as a first-time home buyer or purchased a home located in an economically distressed area. For first-time home buyers, ensures that the home buyer's income was within limits for the county in which the home was located. For economically distressed areas, ensures that the home had not been owned previously.	None observed.

Source: California State Auditor generated based on information from HCD and CalHFA.

However, during our current review, we found that HCD is not following this process. In fact, HCD states that there is no centralized tracking of sponsors' submission of required reports, as the reports continue to be tracked by individual staff. Nevertheless, HCD acknowledged the importance of centrally tracking this information and stated it would implement procedures requiring staff to do so.

HCD Needs to Improve Its Monitoring Efforts During the Completion Phase

We reviewed HCD's monitoring of the completion phase for three programs: BEGIN, CalHome, and Multifamily Housing. While HCD had processes in place that should assist in ensuring compliance during the completion phase, it did not consistently follow its processes for the CalHome and BEGIN programs.

The duration of monitoring during the completion phase—which begins when HCD has finished disbursing funds for a loan or grant and lasts until the completion of contractual requirements—varies greatly, depending on the type of housing assistance involved. For example, the CalHome Program regulations require HCD and sponsors to enter into a 20-year monitoring agreement because sponsors are required to deposit the repayments of a CalHome loan into a separately maintained account, and these funds may be used only for CalHome-eligible activities. In contrast, the completion phase for the Multifamily Housing and Transit-Oriented Development programs can last as long as 55 years because sponsors are required to ensure that the housing remains affordable for at least that length of time.

__For the BEGIN Program, the program manager explained that HCD has not conducted site visits of sponsors since July 2010, nor has it implemented monitoring procedures to identify sponsors with potential issues.__

According to HCD's policies for both the CalHome and BEGIN programs, on-site monitoring is a critical component of its monitoring plans. On-site monitoring allows HCD to confirm information provided by sponsors, ensure that sponsors' expenditures were for eligible purposes, and verify that the number of housing units claimed by sponsors has actually been produced. However, for the BEGIN Program, the program manager explained that HCD has not conducted site visits of sponsors since July 2010, nor has it implemented monitoring procedures to identify sponsors with potential issues. The manager of the BEGIN Program stated that HCD has not conducted site visits due to staffing constraints, travel restrictions, and a lack of on-site monitoring protocols specific to BEGIN, which was previously using CalHome monitoring procedures, but found them insufficient for its purposes. However, the manager indicated that the program is in the process of finalizing procedures to monitor all active projects, which should be implemented by October 2012. The lack of on-site monitoring for the completion phase of the program is surprising given that this program has been in existence for roughly 10 years. During that time, the program has made more than 60 awards, amounting to nearly $52 million, in Proposition 46 funds and another 60 awards, amounting to about $88 million, in Proposition 1C funds as of February 29, 2012. Additionally, for the 10 BEGIN Program awards we reviewed, HCD had not verified any documentation submitted by sponsors, even though it reported that some of these sponsors had received their entire award. As a result, HCD has little, if any, assurance that sponsors complied with housing bond requirements related to occupants' income limits or their status as first-time home buyers.

In our 2009 audit we recommended that HCD, when practical, adopt a risk-based on-site monitoring approach for its CalHome Program. In its response to that audit, HCD stated that it had adopted a risk-based approach and had also reexamined and recommunicated its travel expenditure policy to support field visits to conduct site monitoring. Although HCD initially implemented our recommendation, during our current review we found that for its CalHome Program, HCD had discontinued its use of the risk-based approach for on-site monitoring. The manager of the CalHome Program explained that using the risk evaluation form that was developed to determine which sponsors to select for site visits was too subjective and was ineffective given the limited number of staff. The manager explained further that on the completed forms all sponsors appeared to be low risk. Nevertheless, rather than discontinuing a risk-based approach for selecting which sponsors to monitor on-site, we believe it would have been prudent for CalHome to revise the criteria it was using to more effectively assess sponsors' risk. Instead, the program manager stated that he delegates the responsibility for determining project risk to program staff, and the program manager approves site visits based on staff recommendations. CalHome has made more than 450 awards and staff perform only one site visit per month. Consequently, because HCD does not use a risk evaluation form to inform its on-site monitoring, it lacks assurance that staff are using consistent criteria and are selecting the highest risk sponsors in determining which ones warrant an on-site visit.

CalHome has made more than 450 awards and staff perform only one site visit per month.

Finally, in our November 2009 audit, we recommended that HCD promptly communicate to sponsors the concerns and findings identified during on-site visits for its CalHome Program. Generally, program staff complete a checklist of the required elements of the program and describe their findings in a report. At the time of our 2009 audit, the former manager of the CalHome Program was developing a centralized log to track the site monitoring results. The manager expected to complete the centralized tracking log, which would include the name of the sponsor and the dates of the site visit, checklist completion, letter of findings, and clearance of findings, by October 2009. Currently, although CalHome centrally tracks the date of an on-site visit and the date it sends the report to the sponsor, it does not centrally track the status of findings, including when they are resolved. We selected five sponsors to review and for the two where HCD reported findings, we determined that it appropriately sent the report to, and followed up with, each sponsor to ensure a timely response to the findings. However, without centrally tracking the status of findings, HCD lacks assurance that sponsors are promptly resolving deficiencies.

Recommendations

To ensure that it does not exceed the maximum amount specified in state law for administrative costs for the BEGIN Program, HCD should continue to reevaluate, as appropriate, its administrative support costs projection and continue to monitor its future costs.

Going forward, to the extent that Finance or HCD believes the State needs to issue bonds in excess of cash needs, it should document an analysis demonstrating the appropriateness of the bond sale amount and the circumstances.

HCD should continue its efforts to monitor sponsors that receive awards of housing bond funds by doing the following:

- Require staff to follow its procedures related to centrally tracking advances to sponsors under the CalHome Program.
- Ensure that it receives, reviews, and centrally tracks required status reports from sponsors under its CalHome and BEGIN programs.
- Upon finalizing monitoring procedures for the BEGIN Program, ensure that staff implement and follow them.
- As it relates to selecting which sponsors to monitor, HCD should adopt a risk-based, on-site monitoring approach for its CalHome and BEGIN programs. For the CalHome Program, HCD should evaluate the criteria in its risk assessment tool and require staff to use a centralized tracking log for on-site monitoring visits, which should indicate when findings are resolved.

We conducted this audit under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to 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 objectives specified in the scope section of the report. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Respectfully submitted,

Elaine M. Howle

ELAINE M. HOWLE, CPA
State Auditor

Date:	October 23, 2012
Staff:	Laura G. Kearney, Project Manager Angela Dickison, CPA John Dickey Megan M. Garth, MPP Michael Henson
Legal Counsel:	Scott A. Baxter, JD
IT Audit Support:	Michelle J. Baur, CISA, Audit Principal Kim L. Buchanan, MBA

For questions regarding the contents of this report, please contact Margarita Fernández, Chief of Public Affairs, at 916.445.0255.

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Appendix

PROGRAMS FUNDED BY THE HOUSING AND EMERGENCY SHELTER TRUST FUND ACTS OF 2002 AND 2006

Table A presents key details of programs funded by the Housing and Emergency Shelter Trust Fund Act of 2002 (Proposition 46) and the Housing and Emergency Shelter Trust Fund Act of 2006 (Proposition 1C). The programs are categorized into five core areas: multifamily housing programs, home ownership programs, farmworker housing programs, development programs, and other programs. For each program, the table provides the year it was established, a brief description, and the program's allocation under each proposition as of February 29, 2012. The color of the shaded areas indicate the agency directly managing the program.

The Department of Housing and Community Development (HCD) directly administers 16 of the 22 programs funded under Proposition 46, while the California Housing Finance Agency (CalHFA) manages the other six programs. For the 13 Proposition 1C programs, HCD is responsible for directly managing 12 programs, while CalHFA manages one.

Table A
Key Details for Programs Funded by the Housing and Emergency Shelter Trust Fund Acts of 2002 and 2006

CORE AREA AND PROGRAM NAME	YEAR PROGRAM ESTABLISHED	DESCRIPTION OF PROGRAM	PROPOSITION 46* ALLOCATION	PROPOSITION 1C† ALLOCATION
Multifamily Housing Programs				
Downtown Rebound Program	2000	Loans and/or grants for rental housing development projects located within one-quarter mile of an existing or planned major transit node. Funding priority is given to projects developed within walking distance of schools; major employment centers; or public amenities, including shopping, parks, and major entertainment venues.	$15,000,000	
Exterior Accessibility Grants for Renters Program	2002	Grants for exterior modification to rental housing to accommodate low-income renters with disabilities.	5,000,000	
Local Housing Trust Fund Matching Grant Program	2002	Matching grants to local housing trust funds that provide loans for the construction of rental housing projects or units within rental housing projects for low-income persons and families earning less than 60 percent of the area median income.	25,000,000	
Multifamily Housing Program—General	1999	Deferred-payment loans for the development and construction of new, and the rehabilitation or acquisition and rehabilitation of existing, transitional, or rental housing developments.	810,000,000	$345,000,000
Multifamily Housing Program—Governor's Homeless Initiative	2005	Interagency effort among the Department of Housing and Community Development (HCD), the California Housing Finance Agency, and the Department of Mental Health aimed at reducing the number of persons with severe mental illness who are chronically homeless by developing permanent supportive housing.	40,000,000	

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Agency directly managing program: = Department of Housing and Community Development = California Housing Finance Agency

CORE AREA AND PROGRAM NAME	YEAR PROGRAM ESTABLISHED	DESCRIPTION OF PROGRAM	PROPOSITION 46* ALLOCATION	PROPOSITION 1C† ALLOCATION
Multifamily Housing Program—Homeless Youth	2002	Loans to facilitate and support the development and operation of housing for homeless youth.		$50,000,000
Multifamily Housing Program—Nonresidential Space for Supportive Services	2002	Grants for nonresidential space for supportive services providing job training, health services, and child care within or immediately proximate to projects funded by other multifamily housing programs.	$20,000,000	
Multifamily Housing Program—Supportive Housing Program	2002	Loans for supportive housing for individuals and households moving from emergency shelters or transitional housing or those at risk of homelessness. Loans are used for rental units linked to supportive services where occupancy is restricted to households that include a disabled adult who is homeless or at risk of homelessness.	195,000,000	195,000,000
Preservation Opportunity Program	2002	Loans for at-risk units that will likely convert to market-rate housing.	0	
Residential Development Loan Program	2005	Low-interest rate loans to local governments for site acquisition and predevelopment expenses related to affordable infill owner-occupied housing developments.	44,578,545	
Subtotals			**1,154,578,545**	**590,000,000**
Home Ownership Programs				
Building Equity and Growth in Neighborhoods	2002	Grants to cities, counties, or cities and counties to be used for down payment assistance to first-time low- and moderate-income home buyers purchasing newly constructed homes within a Building Equity and Growth in Neighborhoods project.	70,000,000	125,000,000
CalHome Program	2000	Grants and loans to private nonprofit and local government agencies that aid households with low and very low incomes. Grants are used for first-time home buyer down-payment assistance; home rehabilitation, including installation or retrofitting of ignition resistant exterior components on existing manufactured homes and mobile homes; home buyer counseling; self-help mortgage assistance programs; or technical assistance for self-help home ownership. Loan funds may be used for purchase of real property, site development, predevelopment and construction period expenses incurred on home ownership development projects, and permanent financing for mutual housing or cooperative developments.	120,000,000	290,000,000
California Self-Help Housing Program	1978	Grants to public entities and private nonprofit entities to provide assistance to persons and families of low to moderate income who are owner-builders or self-help rehabilitators.	10,000,000	10,000,000
California Homebuyer's Downpayment Assistance Program	2000	Down-payment assistance, including deferred-payment low-interest loans to reduce principal and interest payments and make financing affordable for first-time low- to moderate-income home buyers.	153,553,552	200,000,000
Extra Credit Teacher Home Purchase Program	2000	Federal mortgage credit certificates and reduced-interest loans funded by mortgage revenue bonds to eligible teachers, principals, vice principals, assistant principals, and classified employees who agree to teach or provide administration or service in high-priority schools.	23,050,000	
Homeowner Downpayment Assistance Program—School Facility Fee	2002	Assistance to qualified home buyers in the form of a partial or full rebate of the school facility fees on affordable housing.	50,000,000	
Homeownership in Revitalization Areas Program	2002	Down-payment assistance to low- and moderate-income first-time home buyers who are purchasing a residence in a community revitalization area as documented by a nonprofit organization. Down-payment assistance may include loans to provide deferred-payment subordinate loans to borrowers to be used for down payments or closing costs, totaling up to 6 percent of a home's purchase price.	9,150,000	
Subtotals			**435,753,552**	**625,000,000**

Agency directly managing program: [blue] = Department of Housing and Community Development [green] = California Housing Finance Agency

CORE AREA AND PROGRAM NAME	YEAR PROGRAM ESTABLISHED	DESCRIPTION OF PROGRAM	PROPOSITION 46* ALLOCATION	PROPOSITION 1C† ALLOCATION
Farmworker Housing Programs‡				
Joe Serna, Jr. Farmworker Housing Grant Program—General	1977	Grants and loans for construction or rehabilitation of housing for agricultural employees and their families. Also includes loans and grants for the acquisition of manufactured housing as part of a program to address and remedy the impacts of current and potential displacement of farmworker families.	$155,000,000	$135,000,000
Joe Serna, Jr. Farmworker Housing Grant Program—Migrant Housing	2001	Projects that serve migratory agricultural workers, including grant funds reserved for development of housing for migrant farmworkers.	25,000,000	
Joe Serna, Jr. Farmworker Housing Grant Program—Wellness Program	2000	Health services to achieve the goal of advancing comprehensive strategies for improving the health status of agricultural workers and their families.	20,000,000	
Subtotals			**200,000,000**	**135,000,000**
Development Programs				
Regional Planning, Housing, and Infill Incentive Account	2006	Legislation in 2007 established the Infill Incentive Grant Program of 2007 and requires that funds from the account be used for selected capital improvement projects related to qualifying infill projects or areas. This legislation appropriated $240 million of the $850 million to be used for this program in fiscal year 2007–08. The same legislation established a second program—the California Recycle Underutilized Sites Program—to provide grants and loans to clean up environmentally contaminated sites that also promotes infill residential and mixed-used development, consistent with regional and local land use plans. It also designated the California Pollution Control Financing Authority under the State Treasurer's Office as the administering agency of the loans and grants for this program. The legislation appropriated $60 million of the $850 million to be used for this program in fiscal year 2007–08.		850,000,000
Housing Urban-Suburban-and Rural Parks Account (Housing-Related Parks)	2006	Legislation in 2008 established the Housing-Related Parks Program and requires that funds from the account be used to provide grants for the creation, development, or rehabilitation of park and recreation facilities to cities, counties, and cities and counties that meet certain criteria.		200,000,000
Transit-Oriented Development Implementation Program	2006	Assistance to cities, counties, cities and counties, transit agencies, and developers to establish higher-density uses within close proximity to transit stations.		300,000,000
Subtotals				**1,350,000,000**
Other Programs				
Affordable Housing Innovation Fund	2006	Grants and loans to entities that develop, own, invest in, or make loans for affordable housing. Also used to create pilot programs to demonstrate innovative, cost-saving approaches to creating or preserving affordable housing. Legislation in 2007 established several programs, including the Affordable Housing Revolving Development and Acquisition Program, to use money from this fund to provide loans to applicants to purchase real property for the development or preservation of housing affordable to low-income households.		100,000,000
Code Enforcement Incentive Program	2000	Grants for capital expenditures dedicated to local building code enforcement efforts.	5,000,000	
Emergency Housing and Assistance Program–Capital Development	1993	Capital development grants for programs such as acquisition, leasing, construction, or rehabilitation of sites for emergency shelter and transitional housing for homeless persons.	195,000,000	50,000,000

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Agency directly managing program: = Department of Housing and Community Development = California Housing Finance Agency

CORE AREA AND PROGRAM NAME	YEAR PROGRAM ESTABLISHED	DESCRIPTION OF PROGRAM	PROPOSITION 46* ALLOCATION	PROPOSITION 1C† ALLOCATION
Workforce Housing Reward Program	2002	Capital grants to provide local assistance for the construction or acquisition of capital assets for cities, counties, and cities and counties that provide land use approval to affordable housing developments.	$100,000,000	
Mortgage Guaranty Insurance Program	1993	Bond and loan insurance to facilitate financing for low- and moderate-income housing by reducing risk to the lender.	9,667,903	
Subtotals			**309,667,903**	**150,000,000**
Totals			**$2,100,000,000**	**$2,850,000,000**

Agency directly managing program: = Department of Housing and Community Development = California Housing Finance Agency

Sources: Health and Safety Code, Division 31, parts 11 and 12, and HCD's *Cumulative Proposition 46 Bond Awards Report Through February 29, 2012*.

Notes: The amounts shown in the funding columns for Proposition 46 represent funding available to the programs on February 29, 2012, and as a result may not agree with the original funding levels for the programs presented in the law. Additionally, the number of programs has decreased from 23 to 22 for Proposition 46 due to the reversion of funds from the Preservation Opportunity Program to the Multifamily Housing Program. The following programs received additional funding from other housing bond programs due to reversions required by statute, transfers from existing programs to new programs, or program discontinuation:

	Original Allocation by Proposition 46 in 2002 (in Millions)	Change (in Millions)	Current Balance (in Millions)
California Homebuyer's Downpayment Assistance Program	$117.5	$36.0	$153.5
Downtown Rebound Program	0.0	15.0	15.0
Multifamily Housing Program—Governor's Homeless Initiative	0.0	40.0	40.0
Multifamily Housing Program—General	800.0	10.0	810.0
Residential Development Loan Program	0.0	44.5	44.5
Preservation Opportunity Program	50.0	(50.0)	0.0
Building Equity and Growth in Neighborhoods Program	75.0	(5.0)	70.0
CalHome Program	115.0	5.0	120.0
Extra Credit Teacher Home Purchase Program	25.0	(1.9)	23.1
Homeownership in Revitalization Areas Program	12.5	(3.5)	9.0

In addition, the California Homebuyer's Downpayment Assistance Program received an additional $100 million from Proposition 1C from the Residential Development Loan Program. This program's total allocation from Proposition 1C is currently $200 million.

* Housing and Emergency Shelter Trust Fund Act of 2002.

† Housing and Emergency Shelter Trust Fund Act of 2006.

‡ The Proposition 1C bond act allows the HCD to use the Joe Serna, Jr. Farmworker funds on any of the Joe Serna programs listed under Farmworker Housing Programs; however, HCD has chosen to use the funds for the general program exclusively.

(Agency comments provided as text only.)

October 5, 2012

Business, Transportation and Housing Agency
980 9th Street, Suite 2450
Sacramento, CA 95814

Elaine M. Howle, State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Dear Ms. Howle:

Attached please find responses from the California Housing Finance Agency (CalHFA) and the Department of Housing and Community Development (HCD) to your draft audit report *Department of Housing and Community Development: Awards of Housing Bond Funds Are Appropriate, But Cash Balances Are High and Monitoring Continues to Need Improvement* (#2012-037). Thank you for allowing the departments and the Business, Transportation and Housing Agency (Agency) the opportunity to respond to the report.

We are pleased to note that your audit found that awards of housing bond funds were generally timely, that both departments made awards to eligible applicants, and that CalHFA has adequate monitoring processes. Further, we appreciate your identification of opportunities for improvement and your recommendations for best practices HCD can follow. As noted in its response, HCD concurs with the findings described in the report; it has implemented or is in the process of implementing the recommendations, and expects to complete all corrective actions by March 2013.

If you need additional information regarding the departments' responses, please do not hesitate to contact Michael Tritz, Agency Deputy Secretary for Audits and Performance Improvement, at (916) 324-7517.

Sincerely,

(Signed by: Brian P. Kelly)

BRIAN P. KELLY
Acting Secretary

Attachments

(Agency comments provided as text only.)

October 3, 2012

California Housing Finance Agency
P.O. Box 4034
Sacramento, CA 95812

Brian P. Kelly
Acting Secretary
Business, Transportation & Housing Agency
980 Ninth Street, Suite 2450
Sacramento, CA 95814-2719

Re: BUREAU OF STATE AUDITS REVIEW OF PROP 46/PROP 1C FUNDS

Dear Secretary Kelly:

The Bureau of State Audits (BSA) has completed its most recent review of the Housing and Emergency Shelter Trust Fund Acts of 2002 (Proposition 46) and 2006 (Proposition 1C). The report has been reviewed and there were no audit findings or recommendations for CalHFA.

Please note that the BSA will add language to the final report about CHDAP as recommended by CalHFA, and CalHFA will subsequently review and comment.

CalHFA employees are dedicated to ensuring that these funds are used as efficiently and effectively as possible. We wish to thank the BSA for its diligence and hard work in completing the audit, in particular the efforts of Laura Boll, Angela Dickison, John Dickey, Megan Garth and Michelle Baur.

I look forward to continuing our successful participation in these programs. Please contact me at (916) 326-8088 if there are any questions regarding this audit.

Sincerely,

(Signed by: Claudia Cappio)

Claudia Cappio
Executive Director

(Agency comments provided as text only.)

October 5, 2012

Department of Housing and Community Development
Office of the Director
1800 Third Street, Room 450
Sacramento, CA 95811

Mr. Brian Kelly, Acting Secretary
Business, Transportation and Housing Agency
980 Ninth Street, Suite 2450
Sacramento, CA 95814

Dear Secretary Kelly:

The Department of Housing and Community Development (Department) was pleased to assist the Bureau of State Audits in its periodic audit of the Proposition 46 and Proposition 1C housing bond programs. The Department continues to improve processes to ensure that bond funds are awarded in a timely manner and that housing and infrastructure bond programs are administered effectively. The Department is taking the necessary corrective action to address the recommendations listed below. In several cases, the recommendations are either standard practice or already in the process of being implemented:

Recommendation 1: To ensure it does not exceed the maximum amount specified in law for administrative costs for the Building Equity and Growth in Neighborhoods (BEGIN) Program, the Department should continue to revisit and revise, as appropriate, administrative support costs projection, and continue to monitor future costs.

Department's Response and Corrective Action Plan: As indicated in the recommendation, the Department currently forecasts all costs for the life of the program and has a monitoring process to inform management of the need to adjust program administration to keep costs within statutory requirements. The Department agrees that this process should be continued and used as planned to monitor compliance with the administrative cost limits of the BEGIN Program.

Recommendation 2: Going forward, to the extent the Department believes the State needs to issue bonds in excess of cash needs, it should document an analysis demonstrating the appropriateness of the bond sale amount and the circumstances.

Department's Response and Corrective Action Plan: The Department agrees with the recommendation and will fully document any special circumstance that may require bonds to be issued in excess of the immediate cash need.

Mr. Brian Kelly, Acting Secretary
Page 2

Recommendation 3: The Department should continue efforts to monitor recipients that receive awards of housing bond funds by doing the following:

a) Require staff to follow its procedures related to centrally tracking advances to sponsors under the CalHome Program.

   Department's Response and Corrective Action Plan: By March 2013, the Department will review and update all Proposition 1C and 46 CalHome disbursements through September 2012 in the centralized system to track and log advances to ensure current, complete and accurate information. In addition, current processes for management approval and tracking advances have been implemented and were communicated to all appropriate staff on or about September 27, 2012.

b) Ensure that the Department receives, reviews and centrally tracks required status reports from sponsors under its CalHome and BEGIN programs.

   Department's Response and Corrective Action Plan:
   Quarterly and Annual Reports -- At the beginning of each quarter staff will contact their assigned sponsors via e-mail to request the required Quarterly Reports. This will ensure that Program staff is proactively requesting the information and documenting the request. Upon receipt, staff will review and record the report in the established centralized tracking report file. Should a sponsor fail to provide a report, the Program manager will take steps to obtain the report and document the response in the award file and centralized tracking report.

c) Upon finalizing monitoring procedures for the BEGIN Program, ensure staff implement and follow them.

   Department's Response and Corrective Action Plan: The Department has developed a written monitoring process, including a risk assessment tool and checklist to be used for the monitoring of BEGIN projects. The Department expects to finalize and implement this process during October 2012 and staff will immediately begin applying the risk assessment tool to each recipient in their portfolio to determine which recipients are high-risk and require a monitoring visit. Once staff has identified the high-risk recipients, they will begin making arrangements to monitor one recipient per month. The Program anticipates the first monitoring visit will occur in November 2012 and each month thereafter, with a minimum of ten (10) contracts being monitored by June 30, 2013. The volume of site inspections the Program can perform may be limited by the availability of administrative cost as discussed in Recommendation 1 above.

d) As it relates to selecting which sponsors to monitor, the Department should adopt a risk-based, on-site monitoring approach for its CalHome and BEGIN programs, For the CalHome Program, evaluate the criteria in its risk assessment tool, and require staff to use a centralized tracking log for site visits, which should indicate when finding are resolved.

Mr. Brian Kelly, Acting Secretary
Page 3

Department's Response and Corrective Action Plan: The Department concurs with this recommendation. As stated above, the BEGIN Program is currently finalizing its risk-based monitoring process and will have it implemented by the end of November 2012. The CalHome Program has initiated a modification of its current risk assessment tool to address concerns regarding its effectiveness. The new tool will use a more empirical approach to rating contracts based on quantifiable risk factors. Risk assessment measures have been modified to primarily focus on the following criteria:

- Recipients who have drawn money against their award and are actively forwarding borrower summaries;
- Recipients who possess multiple awards with active contracts;
- Recipients or staff who are requesting technical assistance; and
- Localities where no site visits have been performed.

The completed risk assessment is submitted to the Program manager for review and approval prior to scheduling site visits. Further, a centralized log will be established for tracking site visits and the resolution of findings.

If you have any questions or need additional clarification, please contact Marc Wilson, Deputy Director, Special Projects and Accountability at (916) 324-7962.

Sincerely,

(Signed by: Linn Warren)

Linn Warren
Director

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(Agency comments provided as text only.)

October 4, 2012

Department of Finance
State Capitol, Room 1145
Sacramento, CA 95814

Ms. Elaine Howle, State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Dear Ms. Howle:

Thank you for an opportunity to respond to the Bureau of State Audits' report entitled "Department of Housing and Community Development: Awarding of Housing Bond Funds are Appropriate, But Cash Balances Are High and Monitoring Continues to Need Improvement." As part of your review of the Department of Housing and Community Development's oversight of the bond program required by Health and Safety Code, sections 53533 and 53545, your staff reviewed the Department of Finance's (Finance) role in making recommendations to the State Treasurer for the amounts to sell in general obligation bond sales.

Your report acknowledges that in 2009 and early 2010 the housing programs were at risk of suspension as a result of a lack of confidence in the state's ability to complete repayment of various construction loans. The state had been unable to sell general obligation bonds in the fall of 2008, at the time of a worldwide economic crisis. This situation and the Pooled Money Investment Board's decision to not provide new or increased loans from the Pooled Money Investment Account for many general obligation bond programs led to growing concerns of the state's ability to provide funding for bond programs. The unease of private lenders, banking institutions, housing sponsors, and construction firms were of such concern that having adequate amounts of cash on hand was necessary to convince the housing entities to continue with their projects. Your report points out that Finance's recommendation to sell more general obligation bonds during that time period than immediately necessary was probably the right thing to do, but that going forward you recommend that Finance document its analysis of the reported need and retain key supporting documents.

We agree and appreciate that you acknowledge the improvements that our staff have made since that time. Over the past 18 months, Finance has significantly increased the level of analysis that it conducts regarding the level of bond program cash needs by routinely surveying departments, analyzing usage rates, and assessing future demand. We are retaining these analyses so that they will be available for any future audits.

If you have any questions please contact Karen Finn, Program Budget Manager at 916-324-0043.

Sincerely,

(Signed by: Michael Cohen)

MICHAEL COHEN
Chief Deputy Director

cc: Members of the Legislature
Office of the Lieutenant Governor
Little Hoover Commission
Department of Finance
Attorney General
State Controller
State Treasurer
Legislative Analyst
Senate Office of Research
California Research Bureau
Capitol Press