

OFFICE OF THE CITY CONTROLLER



**HOUSING AND COMMUNITY DEVELOPMENT DEPARTMENT
FOLLOW-UP OF 2005 PERFORMANCE DIAGNOSTIC REVIEW**

Annise D. Parker, City Controller

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Report No. 2009-25



OFFICE OF THE CITY CONTROLLER
CITY OF HOUSTON
TEXAS

ANNISE D. PARKER

April 22, 2009

The Honorable Bill White, Mayor
City of Houston, Texas

SUBJECT: Housing and Community Development Department
Follow-Up of 2005 Performance Diagnostic Review (Report No. 2009-25)

Dear Mayor White:

The City Controller's Office Audit Division has completed a follow-up review of the Housing and Community Development Department's (HCDD) March 10, 2005 Performance Diagnostic Review Report that was prepared by the firm of Jefferson Wells International (JWI). The objective of our review was to determine the progress the HCDD had made towards implementation of the recommendations regarding opportunities to improve operational efficiency and effectiveness, processes, and procedures. Since HCDD management had chosen not to read the JWI report, the auditors evaluated the progress HCDD had made to address the underlying issues identified by JWI.

The Audit Division's report, attached for your review, identified 39 control issues from the JWI report. This report concluded that HCDD had made limited progress in addressing the control issues and details the remaining 22 issues that had not been fully addressed at the time of the follow-up review. These issues relate to the areas of culture, climate, and tone at the top; the internal organizational structure; policies and procedures; and program and project management. The Views of Responsible Officials as to actions taken to address the remaining issues are appended to the report as Exhibit III.

We appreciate the cooperation extended to our auditors by Department personnel during the course of the review.

Respectfully submitted,

Annise D. Parker
City Controller

xc: City Council Members
Anthony Hall, Chief Administrative Officer
Michael Moore, Chief of Staff, Mayor's Office
Richard Celli, Director, Housing & Community Development Department
Alfred Moran, Jr., Director, Administration and Regulatory Affairs Department
Michelle Mitchell, Director, Finance Department

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SCOPE AND PURPOSE

The City of Houston (City) Controller's Office Audit Division has completed a follow-up review of the findings and recommendations presented in the Housing and Community Development Department (HCDD) Performance Diagnostic Review Report (Report), performed by Jefferson Wells International (JWI), and dated March 10, 2005. Our review was designed to determine the progress HCDD has made towards correcting the issues identified in the Report.

Our review consisted primarily of conducting on-site interviews with department personnel, reviewing relevant documentation related to recommendations implemented, and creating a matrix detailing the status of actions taken by HCDD management. The scope was limited to the recommendations from the report and new concerns that came to our attention during the performance of this review.

BACKGROUND

The mission of HCDD is to provide leadership in the preservation, revitalization, and improvement of Houston's low and moderate-income neighborhoods by:

- Expanding the supply of safe, quality, affordable housing;
- Improving the infrastructure;
- Providing financial inducement to encourage economic development; and
- Providing the social and other supportive services necessary for viable neighborhoods.

To maximize results, HCDD leverages financial and other resources with those from the public, private, and non-profit sectors for the benefit of the citizens of Houston. In accomplishing this mission, HCDD operates various concurrent community and affordable housing development programs which include increasing home ownership through mortgage assistance programs, repairing or improving homes, and helping renovate and/or build affordable rental housing and transitional housing.

These housing programs are funded through both federal and local sources. The federal sources include:

- Community Development Block Grants (CDBG),
- Home Investment Partnerships Act (HOME),
- Emergency Shelter Grants (ESG),
- Housing Opportunities for Persons with Aids (HOPWA), and
- Section 108 Loans

Local funding sources include:

- Tax Incremental Reinvestment Zones (TIRZ) and
- Affordable Housing Bonds

Individual projects within a given program may be financed from a combination of both federal and local funding sources. HCDD attempts to leverage these resources with community resources to further expand the supply of affordable housing.

HCDD had historically contended with various operational inefficiencies that resulted in Department of Housing and Urban Development (HUD) findings for which the City was responsible for refunding multiple millions of program money. In 2005, the City's Finance and Administration Department (F&A) commissioned JWI to perform a diagnostic review of HCDD's operations. They issued the Report which included comparisons between best practices in other organizations and those practices at HCDD. Sections 1 through 5 of the Report also included 73 recommendations for improving HCDD's operations.

Since the Report was issued, there have been several changes in HCDD's top management. There have been four Directors, including the current one, since November 2002. Also, only one of the current Assistant Directors worked in HCDD during the Report review and that individual was not a member of top management at that time. In addition to the changes in Management, HCDD switched from coordinating with the Fort Worth HUD office to the Houston HUD office that was opened in late 2006.

In March 2007, the Mayor brought in the current Director to ensure that HCDD was organized to support its principal product lines. These product lines include single family home construction in neglected neighborhoods; home buyer's down payment assistance; rehabilitation of affordable, multi-family housing; home repair; and financing of neighborhood facilities and infrastructure in the lowest income neighborhoods. The HCDD Director has drawn on his experience in community development lending, outreach, and small business banking in order to attempt to achieve the Mayor's directive.

HCDD received a letter from HUD dated March 4, 2008 which summarized the outstanding findings from previous monitoring reviews. It detailed \$18.4 million in disallowed program expenditures and another possible \$7 million pending more details. After negotiations, HCDD received a response from HUD, dated May 21, 2008, which included a payment schedule for the City to repay a minimum \$15.5 million with non-Federal funds. The first payment was scheduled to be paid August 1, 2008. Subsequently, this schedule was modified and HCDD presented the new re-payment plan to Council on November 13, 2008. The letter from HCDD to the General Deputy Assistant Secretary of U.S. HUD asserts that the \$15.5 million will fully satisfy the monetary Findings specified in the March 2008 letter. However, HUD had not yet agreed to that assertion. Also, HCDD had not provided all details for the pending items.

AUDIT PROCEDURES

The Audit Team (Team), in the initial Planning Phase, prepared an audit program to evaluate the implementation of JWI's 73 recommendations. See EXHIBIT II for the recommendations. However, it was made abundantly clear by the current HCDD Director in the Entrance Conference that the HCDD Management Team had not read the Report and was unaware of the recommendations.

As a result, the Team researched the 73 recommendations and identified the process control weaknesses or issues/gaps that gave rise to the recommendations. In doing so, we discovered redundancies in the recommendations. The Team was able to associate the recommendations with the 39 control weaknesses and/or control gaps we identified in the Report's Appendix G. Using this list, the Team members determined the appropriate individuals within HCDD Management to interview, prepared questions to ask, conducted the interviews, performed limited attribute testing, and site visited three multi-family apartment complexes.

Additionally, the Team reviewed the Code of Federal Regulations (CFRs), which detail the requirements of the HCDD federally funded projects. The Team also had discussions with other City and Federal experts to gain a better understanding of HCDD operations. Because of this preparation, the Team was able to construct a matrix which correlated the Issues/Gaps, referenced the JWI recommendation(s),

explained the Action Taken by HCDD to correct or mitigate the Issues/Gaps, and identified any remaining issues (Residual Gaps.) This matrix is attached as EXHIBIT I.

CONCLUSION

Improvements Noted

Based on the results of our review, we conclude that HCDD has made progress towards correcting the issues identified in the Report. Most notably, HCDD had made the following improvements:

Culture, Climate, and Tone at the Top

- Communications with all employees improved.
- HCDD created a position to act as Liaison between HCDD, HUD, City Departments, and other outside entities (HUD Liaison.)
- The initial project evaluation was performed by people with specific HCDD program knowledge and financial expertise.

Internal Organizational Structure

- HCDD reorganized along product lines and aligned goals with the mission and strategy.
- HCDD hired 73 employees and promoted 60 employees since March 2005.
- More employees were offered training opportunities.
- HCDD developed user friendly program information packets for down payment assistance (DPA.)
- HCDD developed procedures for monitoring that addressed each program and have been approved by HUD. (*not formally incorporated in HCDD's Policies and Procedure Manual.*)
- HCDD arranged to make payments via electronic funds transfer.

Program and Project Management

- Relationship Managers (RM) were designated in each functional area to be the point of contact and reference for all projects throughout their lifecycle.
- HCDD no longer used open-ended requests for proposal (RFPs) and instead used specific product RFPs.
- HCDD implemented a process to check for duplicate recipients and/or payments in the DPA and Single Family Home Repair Program (SFHRP.)
- HCDD implemented, as part of the monitoring function, checks for ownership and tax status.
- Schedules were developed for monitoring and inspections.
- HCDD assigned an inspector at the beginning of a particular project and he/she remained on that project through completion.
- HCDD brought the inspection process in house after March of 2005 with the goal to help reduce cost and to provide better oversight.
- The Controller's Office Financial Reporting Division reported HCDD had made significant progress in identifying their portion of the SAP grants funds account.

Residual Gaps Noted

The key concern of the Report was that HCDD had several operating inefficiencies. Based on the results of our review, we conclude that the HCDD has made limited progress towards efficient and effective operations. HCDD still had the following issues:

Culture, Climate, and Tone at the Top

- Independent evaluation of projects was not performed as the Project Evaluation Team and Project Review Committee had been dissolved, and the HUD Liaison was not included.
- The first installment of the \$15.5M minimum HUD payback was not made¹ and part of the support for the other \$7M in question had not been provided to HUD.

Internal Organizational Structure

- Review of high level operating results across all product lines was not documented.
- Contracts for Services were monitored by the functional group that awarded the contract.

Policies and Procedures

- Policies and Procedures still needed to be updated; several had not been updated since 1983.
- Topics such as the following were either not included or not adequately addressed in the Policy and Procedures Manual:
 - Program monitoring procedures
 - Procedures for current organization structure
 - Home Quality Standards inspection program procedures
 - Life Safety Issue procedures
 - Code of Conduct
 - Conflict of Interest Policy
 - File access and security.
- HCDD lacked a Comprehensive Training Program.
- HCDD lacked a Succession Plan.

Program and Program Management:

- Existing inspection practices placed the City in a position susceptible to legal and/or financial liability.
- HCDD was not in compliance with HUD requirements as they relate to inspections of multi-family housing, Housing Quality Standards (HQS), and Life Safety issues.
- Reconciliations between the Integrated Disbursement and Information System (IDIS) and SAP amounts had not been fully completed.
- Approximately \$12M was in default or foreclosure on Multi-family projects, \$7M of which had been questioned by HUD.
- Although HCDD was conducting background checks prior to loan approval, they were not coordinating with Houston Police Department (for crime incident rates for other loan applicant owned properties,) Houston Fire Department (for Fire Code violations at other loan applicant owned properties,) and Public Works & Engineering Code Enforcement (for citations issued and construction permits issued at other loan applicant owned properties.)
- An effective process was not in place to address reconciliation issues attributable to other Department's spending.

¹ The first installment of the \$15.5M minimum HUD payback was made on November 25, 2008.

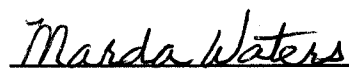
Housing and Community Development Department
Follow-up of 2005 Performance Diagnostic Review

- Access to the File Room was not restricted and there was no procedure to track the location of the files.
- Program checklists were not clear regarding HUD requirements.
- Financial information was not available in a centralized location.
- Two of 12 SFHRP files reviewed had warranty repair work complaints and no subsequent documentation to resolve the complaint.
- HCDD did not have a process in place to ensure all home repair warranty issues were resolved.
- HCDD personnel had difficulty locating and/or were unable to locate certain requested files during our fieldwork.
- Unsecured spreadsheets used in Program Management allowed for data corruption and required additional layers of reconciliation and other detective controls.
- HCDD lacked a comprehensive database containing the entire universe of single family home assistance recipients.


We concluded our field work on August 18, 2008 and have not updated our audit procedures since that time.

ACKNOWLEDGEMENTS

The Team would like to thank the management of HCDD for their cooperation during our review. The Team would also like to thank all of the HCDD individuals with whom we had contact for their professionalism in their explanations of their processes.



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Auditor-in-Charge



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Audit Manager



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City Auditor

| HCDD REMEDIAL ACTION MATRIX | | | |
|--|--------------------------------------|--|--|
| Gap/Issue Identified in JWI Report Appendix G | JWI Recommendation | HCDD Action Taken | Residual Gap |
| Culture, Climate, and Tone at the Top | | | |
| 1. Information was concentrated in a few selected hands at top level | 1) | Per interviews with the Director, it was determined that monthly meetings were open to all employees that included a presentation by one of the divisions. This was intended to inform employees of the different departmental areas. Audit team members attended the May and July 08 meetings at which the Director presented an update of issues affecting the Department, including the HUD findings. | HCDD has taken some steps towards keeping employees informed. However, a review of the meeting documentation indicated that from Aug. 2007 thru July 2008, HCDD held 6 of the 12 monthly meetings. |
| 2. Several employees who possessed knowledge of critical information were not included by their immediate management, or only learned late in HUD's visit, that HUD was missing requested information. | 1) 25) | Since the Director came to HCDD, management has reorganized which included the creation of an Administrative Coordinator position further referred to as the HUD Liaison (HL). The position was designed to act as a liaison between HCDD, HUD, City Departments, and outside entities. The position also insured information and communication was bi-directional and complete. | None |
| 3. The department's Project Review Committee (PRC) was essentially dissolved in approximately 2000, when projects were increasingly selected and approved by only the Director and Assistant Director. | 4) 5) 21) 22) 23) 24) | A Project Evaluation Team (PET) was established in 2005, but was abolished in 2007. We noted the following: <ul style="list-style-type: none"> • There was no PRC • Applications were reviewed and prioritized by each functional area, e.g. Public Services, Multi-family, etc. • The projects were reviewed by a team | There was no independent review of the project prior to RCA or Council approval. |

| HCDD REMEDIAL ACTION MATRIX | | | |
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| Gap/Issue Identified in JWI Report Appendix G | JWI Recommendation | HCDD Action Taken | Residual Gap |
| | | <p>composed of the Director, the Assistant Director (AD), the applicable Division Manager (DM), and the Relationship Manager (RM) to be assigned.</p> <ul style="list-style-type: none"> • Single family down payment assistance and home repairs were evaluated in the order received. <p>Through our interview process, it was determined a comprehensive assessment of community development needs, commonly called the Consolidated Action Plan (CAP) was required. The HCDD solicited input from citizens, neighborhood based organizations, non-profit agencies, for-profit agencies, and other City Departments. This process facilitated a collaborative effort for all these groups to address local problems. To obtain this input, the HCDD publicized the CAP process on its Website, published an Information Booklet, and other pamphlets, which were distributed City-wide. In addition, public hearings were held to obtain the public's input and comments.</p> | |
| <p>4. Past issues which HUD raised were often ignored or, if answered, were addressed by senior personnel not necessarily involved in the daily details. This resulted in sub-optimal, even adverse, personal relations with HUD and suppression of internal and external communication of HUD findings.</p> | <p>1) 28A)</p> | <p>Part of the HCDD's reorganization was to appoint an HL. The duties of this employee included the research of Federal regulations; clarification of the requirements, if necessary; and to work closely with HUD on any issue.</p> | <p>Some of the deadlines outlined in HUD's March 2008 letter had not been addressed, most notably the condition for questionable expenses on foreclosed properties where the City was not in the first collateral position. This equated to \$7M as a potential payback to HUD.</p> |

| HCDD REMEDIAL ACTION MATRIX | | | |
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| Gap/Issue Identified in JWI Report Appendix G | JWI Recommendation | HCDD Action Taken | Residual Gap |
| 4., continued | | | The HL was not included in the project evaluation process. |
| <p>5. A number of long time employees retired in 2004, however, many vacancies in key functional areas have existed for several years. As of January 5, 2005 some 36, or a quarter, of the Department's positions are vacant.</p> <p>Reductions in staffing levels over the last several years, especially in middle management, has resulted in increased work loads in many critical functions and increased the dependence on outsourced activities.</p> | <p>6) 7) 8) 9) 10) 11) 12) 13) 14) 15)</p> | <p>According to the Director, the first priority was to reorganize the HCDD along "product lines," such as Commercial (Multi-family), Single Family, Public Services, etc. Part of the reorganization involved an assessment of each position, employee, and their relationship to the new structure. Employee Performance Evaluations (EPE) Plans were then created for each position and discussed with the employees.</p> <p>The HCDD had 136 employees before the layoff in 2007. As of 02-25-08, there were 11 (11.4%) vacant positions of 158 listed on the organization chart. By the end of June, 2008, HCDD had 148 employees.</p> <p>To further cut costs, HCDD reduced outsourced activities, for example, the Inspection and Down Payment Assistance (DPA) approval functions were brought in house.</p> | The position assessments were not documented. |
| Internal Organizational Structure | | | |
| 6. Alleged favoritism by past Directors and senior management in personnel hiring, deployment and advancement practices. | <p>3) 16)</p> | Based upon our review of selected employee files and employee interviews, the employees hired/promoted since 2005 were qualified for the positions they filled. | None |

| HCDD REMEDIAL ACTION MATRIX | | | |
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| Gap/Issue Identified in JWI Report Appendix G | JWI Recommendation | HCDD Action Taken | Residual Gap |
| 7. No formal training plan was identified. Additionally, no cross-training, including back-ups for critical functions or succession planning existed. | 17) 18) 19) 20) | HCDD issued Employee Training Policy 1-13 effective 3-1-08. The employees interviewed stated that they received training and cross training within their division. At least 39 employees received HUD training of some sort since March 2005. | Policy 1-13 did not include a formal training plan, cross training for critical functions, and a succession plan. |
| 8. The organizational and reporting structure of the Department did not create an adequate segregation of duties or avoidance of potential conflicts of interest. | 2) 21) 22) 23) 24) | During our interviews, we determined the monitoring function was performed by personnel in each product line as follows: Multi-family (3) <ul style="list-style-type: none"> • Public Facilities (3) • Public Service & HOPWA Agencies (1) • Single Family Home Repair and Homebuyers Assistance Program (4) It was further stated that some of these individuals acted as the RM for various projects. HCDD followed the City's financial disclosure procedures, which only addressed executive level employees. | Review of high level operating results across all product lines is not documented Contracts for services are monitored by the functional group that awards the contract. HCDD did not have a formal Code of Conduct/Conflict of Interest policy. |
| 9. Many times the applicant does not fully understand the full extent of his/her commitment to the City and what is required in return for the funding provided. | 18) 39) | HCDD: <ul style="list-style-type: none"> • Developed training and seminars which were open to the public and structured to provide information on funding availability, qualifications, and obligations. • Directed the HL to communicate with | Even though HUD does not require such notice, many of the families occupying the multi-family housing restricted units were not aware that they could complain to HCDD about substandard living conditions. |

| HCDD REMEDIAL ACTION MATRIX | | | |
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| Gap/Issue Identified in JWI Report Appendix G | JWI Recommendation | HCDD Action Taken | Residual Gap |
| | | <p>HUD regularly to obtain the latest requirements.</p> <ul style="list-style-type: none"> Developed packets for DPA applicants that detail of the programs and direct them to HUD's website for further regulatory information and guidance. | |
| Policies and Procedures | | | |
| <p>10. No single set of consolidated policies and procedures, especially in the following areas:</p> <p>10a. Many sections and functions appear to lack specific policies, procedures and guidelines.</p> <p>10b End-to-end processing and management of applications.</p> <p>10c. That govern or support project prioritization.</p> <p>10d. That compares returns and benefits between proposed projects.</p> <p>10e. How agencies are selected for specific programs, their funding, and their affordability period.</p> <p>10f. How funding would be allocated between programs, projects and or individual agencies.</p> <p>10g. Repeat investment with the same owners where delinquency has occurred on other loans.</p> <p>10h. Receiving timely reports required by the Department.</p> <p>10i. For inspecting home repairs and insuring compliance.</p> | <p>4) 4a) 4b) 25) 26) 27) 28) 28a) 28A) 29) 31) 34) 37) 53) 54) 55) 57) 72) 73)</p> | <p>The HCDD had not formalized policies and procedures for their current structure.</p> | <p>The Policies and Procedures manual was not current.</p> |

| HCDD REMEDIAL ACTION MATRIX | | | |
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| Gap/Issue Identified in JWI Report Appendix G | JWI Recommendation | HCDD Action Taken | Residual Gap |
| <p>10j. When developer's fees can be disbursed.)</p> <p>10k. Ensuring the final budget is closed before funding begins.</p> <p>10l. Reconciling payments and deposits to the on-line bank statement.</p> <p>10m. Assuring appropriate personnel in HCDD & Legal have the most current HUD regulations.</p> <p>10n. Identifying the specific physical units to be classified as "affordable" and indicating them as such in the Loan agreement and other legal documentation.</p> <p>10o. Ensuring the appraiser is aware of a property's status as low-income.</p> <p>10p. Loan servicing, loans aging and specific guidelines for collecting on defaulted loans.</p> <p>10q. Analyzing financial statements in a consistent, objective manner.</p> <p>10r. Determining interest or penalties on unpaid monthly loan payments.</p> | | | |
| <p>11. Reviews of various annual monitoring activities also indicate that they were performed infrequently.</p> | <p>25) 40)</p> | <p>During our interviews, we determined the monitoring function was performed by personnel in each product line as follows:</p> <ul style="list-style-type: none"> • Multi-family (3) • Public Facilities (3) • Public Service & HOPWA Agencies (1) • Single Family Home Repair & Homebuyers Assistance Program (4) | <p>Formalized monitoring procedures were not included in the Policies and Procedures manual.</p> |

| HCDD REMEDIAL ACTION MATRIX | | | |
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| Gap/Issue Identified in JWI Report Appendix G | JWI Recommendation | HCDD Action Taken | Residual Gap |
| | | During our review we noted that the monitoring personnel were following some procedures that were drafted by the HL and approved by HUD. They maintained schedules of the projects subject to monitoring and the timing of the related activities. | |
| 12. Reviews identified several Loans where draws occurred before the note was executed or where a title company did not disburse funds promptly. | 25) | The title company received disbursement by City check for DPA. This process was changed to electronic funds transfer, reducing City involved delays. | The HCDD had not formalized Policies and Procedures to match their current structure. |
| 13. Loan payments were deferred due to insufficient additional net cash flow or insufficient surplus cash. However, the owner provides the City unaudited financials as “proof” of insufficient net cash flow. Cash Flow statements were taken at face value; no audits were performed. | 53) 55) | Several files examined had audited financial statements used as part of the basis for determining eligibility. It should be noted that most ‘loans’ are not traditional in nature. They are not initiated for profit, but rather to provide affordable housing to qualified recipients. | None |
| Program and Project Management | | | |
| 14. There is no focal point for coordination of all application and subsequent project related processing: from receipt/inception through rejection/completion and conclusion. | 4) 4a) 4b) 5) 28) 29) 30) 36) | A PET was established in 2005, but was abolished in 2007. As of fieldwork we noted the following: <ul style="list-style-type: none"> • There was no PRC • The projects were reviewed by a team composed of the Director, the (AD), (DM), and the RM to be assigned. | None |

| HCDD REMEDIAL ACTION MATRIX | | | |
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| Gap/Issue Identified in JWI Report Appendix G | JWI Recommendation | HCDD Action Taken | Residual Gap |
| | | RM acted as the primary contact for the application, coordinated information during construction, and was responsible for the follow-up monitoring during the affordability period. | |
| 15. An annual HQS inspection which was performed immediately prior to the Monitoring & Evaluation report date contained major violations cited. There was no evidence, however, that these respective findings were followed up on by the Department in a timely manner. | 31) 41) 42) | During our review, an auditor accompanied a project manager on an inspection of three multi-family apartment complexes. A report was issued with pictures of the problem areas. | Formalized inspection Policies and Procedures were not in place and all follow-up was to be performed by the responsible manager. There was no evidence of responsible manager follow-up. HQS training is neither required for nor provided to HCDD inspectors. |
| 16. Only one Program – HOPWA – appears to have had a formal Program Manager. | 34) | In order to improve efficiencies, in April 2007 HCDD was reorganized along business lines. The Assistant Directors and Division Managers served as functional managers with access to Program information from the HL. | Only one Program – HOPWA – appears to have had a Program Manager. Also, the HL was not included in the project evaluation process |
| 17. The Department operates several Programs and receives Funding from several sources, Federal and City of Houston. Although data generally exist on activities within each Program, such data are dispersed throughout the organization or captured at the individual activity or sub-category level. | 34) 35) 36) | Since the Director came to HCDD, management has reorganized which included the creation of an Administrative Coordinator position further referred to as the HL. The position was designed to act as a liaison between HCDD, HUD, City Departments, and outside entities. The position also insured information and communication was bi-directional and complete. | Checklists are not clear regarding HUD program specific requirements. |

| HCDD REMEDIAL ACTION MATRIX | | | |
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| Gap/Issue Identified in JWI Report Appendix G | JWI Recommendation | HCDD Action Taken | Residual Gap |
| | | During our project review for each primary HCDD program (e.g. DPA, SFHRP & Commercial) we noted that files contained checklists for each major process (e.g. application, underwriting, closing, etc.). Additionally, we noted that the Commercial Division developed a Master Checklist for the project as a whole, including monitoring and the draw process. | |
| 18. Some management reports were only generated infrequently or no longer forwarded up the chain of command. | 43) 46) 57) | Loan schedules were provided on 09/16/08 that showed delinquent loans of approximately \$1M, of which \$350k has been reserved. Supporting schedules of balances and payment histories are maintained. Not all loans are in the general ledger. This is due to the fact that most loans are forgivable or based on net cash flow from rent and management fees received. It was noted that Loan aging is reviewed by the Commercial Division AD. | Financial information was not available in one centralized location, causing reconciliation and reporting of all loan information to remain informal and inconsistent. This compounds their inability to effectively monitor/manage their portfolios. |
| 19. The Department had historically used open RFPs (Request For Proposals) for projects. | 38) | From 2006 through July 2008, HCDD had only issued one "open" RFP - the one for Neighborhood Facilities Development and Renovation Program, released in November 2007. | None |
| 20. Reports from the database of Homebuyer provided assistance identified some potential discrepancies: | 47) | For DPA applications, HCDD checked the DPA program database to determine if the applicant had received prior home | None |

| HCDD REMEDIAL ACTION MATRIX | | | |
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| Gap/Issue Identified in JWI Report Appendix G | JWI Recommendation | HCDD Action Taken | Residual Gap |
| - the same named homebuyer obtained assistance on two homes within the same zip code; - duplicate entries to the same person(s) on different dates.) | | buyer's assistance. | |
| 21. Reports from the Home Repair database identified some potential discrepancies: - Homeowners obtained multiple assistance; - Individuals received duplicate payments on the same property. | 46) 47) | Using the Single Family Home Repair Program (SFHRP) eligibility screening form, HCDD asked the applicant if they had obtained prior assistance. HCDD verified their response by checking the SFHRP data base. | None. |
| 22. There does not appear to be any process for identifying (and preventing) homeowners from obtaining down payment assistance on a "primary residence" but then leasing it OR obtaining emergency or rehabilitation repairs to one house, then selling or renting that house, and obtaining repairs to additional house(s.) | 44) 48) | Through the interviews conducted, we noted that the monitoring function reviewed the ownership status to ensure that the recipient was still the registered owner through a certified letter and verification by Harris County Appraisal District (HCAD). Using the SFHRP eligibility screening form, HCDD asked the applicant if they had obtained prior assistance. HCDD verified their response by checking the SFHRP data base. | HCDD did not have a comprehensive database containing the entire universe of Single Family Home Assistance recipients. HCDD did not search HCAD for multiple property ownership during the eligibility period. |
| 23. There was very limited documentation of repairs. | 70) | HCDD continued to rely on the City's Permitting and Code Enforcement capabilities for proper completion of repairs; i.e. the issuance of the Certificate of Occupancy. | SFHRP files are not complete. Of eight files reviewed for approved Tier I, II, or III projects, the files were missing 8 of the 64 required documents. |

| HCDD REMEDIAL ACTION MATRIX | | | |
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| Gap/Issue Identified in JWI Report Appendix G | JWI Recommendation | HCDD Action Taken | Residual Gap |
| <p>24. The two sets of inspection Field Reports, which were located, indicated an average inspection rate of approximate only two properties per week.</p> <p>12 Properties subject to HQS Compliance reviews...were funded with TIRZ and Bond Funds: none were inspected in 2004, 7 in 2003.</p> <p>Approximately half of the properties shown as subject to annual HQS compliance reviews have not been inspected in the last 14 months and have no inspection date scheduled in 2005.</p> <p>A considerable time gap existed between monitoring visits of many properties subject to annual reviews, including the subsequent follow up on ones with identified violations.</p> | <p>25) 27) 73)</p> | <p>In order to meet inspection requirements, the HCDD maintained an annual Inspection Schedule of properties.</p> <p>As part of HCDD's existing inspection process, a comprehensive report was prepared which detailed the deficiencies identified during the inspection. This report was addressed to the property owner or property management company. The deficiency must have a response within 45 days of the report date.</p> | <p>A review of the 2008 Annual Inspection Schedule indicated the following:</p> <ul style="list-style-type: none"> • Only three (30%) of the ten properties funded by bonds were inspected in 2007 or 2008. Of the remaining seven, five had no indication they had been inspected, one indicated the last inspection was in May 2005, and one indicated it was last inspected in July 2006. • For those 14 properties funded by CDBG Program funds, one property (7%) had not been inspected. • For the 23 properties funded either in whole or in part by HOME Program funds, five (23.7%) had not been inspected. • A review of the HCDD 2008 inspection schedule indicated that 514 restricted units did not have a Last HQS inspection date listed. This represented 9.27% of the total available restricted units of 5,539. <p>Three properties were inspected on June 26, 2008. Numerous Life Safety issues (such as exposed live electrical wires, unlocked electrical panels, plugged/leaking toilets, roach infestations, bulging/leaking roofs,) as well as building code violations were identified in the report with pictures to support the violations.</p> |

| HCDD REMEDIAL ACTION MATRIX | | | |
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| Gap/Issue Identified in JWI Report Appendix G | JWI Recommendation | HCDD Action Taken | Residual Gap |
| | | | <p>The Life Safety issues were not immediately addressed by the inspector to property management.</p> <p>A process was not in place to notify Public Works and Engineering Department (PW&E) Code Enforcement, Houston Fire Department, or other agency of immediate corrections needed. As a result, the City of Houston was placed in a position susceptible to legal and/or financial liability.”</p> |
| <p>25. At least half to three quarters of HCDD inspector’s Field Reports contain notation of “deficiencies” (and in work signed off on by the agency’s inspector) i.e. work not done, unacceptable workmanship, overcharges, sites not returned to original condition.</p> <p>We noted several files with deficiency lists that had a photocopy of later dated “Completion of Warranty Item and/or Punch List Items” sheet signed by contractor, homeowner and agency inspector; there is no evidence that HCDD re-inspected any of these properties.</p> | <p>70) 73)</p> | <p>To maintain consistency, an inspector was assigned at the beginning of a particular project and remained on that project through completion.</p> | <p>A review of 12 SFHRP files indicated one file had punch list items that were signed off by the homeowner, inspector, and contractor on 01/13/05; yet, additional items were still being disputed as of 04/15/05 and no final disposition was in the file.</p> <p>There was a lack of documentation in that two of 12 files reviewed had warranty repair work complaints and no subsequent documentation to resolve the complaint.</p> <p>HCDD did not have a process in place to ensure all warranty issues were resolved.</p> |
| <p>26. In some files documenting inspection work done by HAUL, there</p> | <p>15) 21)</p> | <p>HCDD brought the inspection process in house after March of 2005.</p> | <p>None</p> |

| HCDD REMEDIAL ACTION MATRIX | | | |
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| Gap/Issue Identified in JWI Report Appendix G | JWI Recommendation | HCDD Action Taken | Residual Gap |
| was an unusual cost phenomenon - although the underlying individual repairs varied considerably in nature, over half were for exactly \$7,500, the maximum permissible that HAUL could approve under minor repair program. | 25) | | |
| <p>27. There is infrequent follow-up of aging loan balances or missing financial documentation which Multi-Family Housing developers were contractually obliged to submit.</p> <p>Over 30 loans totaling \$440,000 in principal and a further \$140,000 of accrued interest are still delinquent (as of JWI report date). Also, the Department and its Loan Servicing has generally not actively pursued payment and collection of overdue loans, issued default letters, or sought judgment against the related borrowers, on an estimated \$100 Million plus of affordable housing and economic development related financing provided by the Department using Federal and City of Houston funds.</p> | 43) 48) 57) | <p>We were informed that the RM was responsible for monitoring continual compliance with affordability and information requirements.</p> <p>Loan schedules were provided on 09/16/08 that showed delinquent loans of approximately \$1M, of which \$350k has been reserved. Supporting schedules of balances and payment histories were maintained. Not all loans were in the ledger. This was due to the fact that most loans were forgivable or based on net cash flow from rent and management fees received.</p> <p>One loan of considerable size (Magnolia Hotel - \$9.5 Million) was restructured in 2006.</p> <p>For other loans that were subject to repayment, it was noted that Loan aging is reviewed by the Commercial Division (AD).</p> | <p>We noted approximately \$12M in default or foreclosed Multi-family projects, \$7M of which was in question by HUD.</p> <p>Financial information was not available in one centralized location, causing reconciliation and reporting of all loan information to remain informal and inconsistent. This compounds HCDD's inability to effectively monitor/manage their portfolios.</p> |
| 28. There is currently no formal process to ensure that any related past or current | 25) 28A) | According to the SFHRP AD, 1098s were not applicable. Evidence to the contrary | HCDD had not formalized Policies and Procedures. |

| HCDD REMEDIAL ACTION MATRIX | | | |
|---|---------------------------|---|--|
| Gap/Issue Identified in JWI Report Appendix G | JWI Recommendation | HCDD Action Taken | Residual Gap |
| annual regulatory filings (Form 1098) have been performed and by due dates. | | was not found. | |
| 29. (It was) noted that personnel responsible for reviewing reimbursement requests would reject disallowable items and that Financial Services also performs a secondary review. However, instances were identified where the section management personally overrode such controls to obtain payment for unsubstantiated expenses claimed by a specific agency. | 49) | Note: We could not determine an adequate population to test for this issue. | N/A |
| 30. There is no one single "Project Manager" assigned to oversee each Multi-Family project related to ensure that all requisite activities are coordinated and performed. | 29) | As part of the re-organization, a RM was assigned to all Multi-family projects. The RM position was designed to be a point of contact and person of responsibility and accountability. | None |
| 31. There is no evidence of sub-contractor qualification, which is generally left to either the general contractor or administrating agency. | 15) 54) | It was learned that the general contractor of a commercial project is ultimately responsible for the qualifications of each sub-contractor. Additionally, it was noted through the interview process that each draw request was reviewed and approved by the RM prior to payment. | HCDD had not formalized Policies and Procedures. |
| 32. Although owner's (including board of directors of non-profit agencies) backgrounds are checked for non-payment of city taxes, their status and history on prior and existing loans with the Department are not checked when | 54) | The application process included gathering information on the principals and the entity itself (e.g. status of current and pending projects). | Although HCDD was conducting checks prior to loan approval, they were not coordinating with HPD (for crime incident rates for other loan applicant owned properties,) HFD for Fire Code violations at other loan applicant owned |

| HCDD REMEDIAL ACTION MATRIX | | | |
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| Gap/Issue Identified in JWI Report Appendix G | JWI Recommendation | HCDD Action Taken | Residual Gap |
| they submit additional projects for consideration. | | | properties,) and PW&E Code Enforcement (for citations issued and construction permits issued at other loan applicant owned properties.) |
| 33. No reconciliation is performed between sub-ledger and General Ledger (City books). | 52) | <p>During fieldwork, we noted the following:</p> <ul style="list-style-type: none"> • IDIS contained project related financial data as it relates to HUD funding for all program sources. • SAP contained all financial data for sources and uses of those funds. • A reconciliation was in process to align the two systems <p>NOTE: Per the AD for Risk Management, the reconciliation process was approximately 90% complete (as of July 2008) for the CDBG program and should be reconciled for all funding programs by 09/30/08.</p> <p>HCDD indentified that approximately 40% of CDBG funds (about \$14 million per year for the last three years) were expended by other City Departments.</p> <p>The Controller's Office Financial Reporting Division reported HCDD had made significant progress in identifying their portion of the SAP grants funds account.</p> | <p>The reconciliation had not been completed for any of the programs.</p> <p>An effective process was not in place to address reconciliation issues attributable to other Department's spending.</p> |
| 34. Several executed legal documents reviewed (primarily loan agreements and | 50) 72) | Commercial loan agreements were signed and countersigned by HCDD, City | In the 12 Good Neighbor Next Door home loan files reviewed, we noted 5 |

| HCDD REMEDIAL ACTION MATRIX | | | |
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| Gap/Issue Identified in JWI Report Appendix G | JWI Recommendation | HCDD Action Taken | Residual Gap |
| notes) contained internal inconsistencies and inaccuracies, which could potentially result in their being unenforceable. | | Legal, and the Mayor with no inconsistencies noted. Homebuyer's Assistance Program loan documents were signed by HCDD's Director. | instances where the affordability period was 5 years and should have been 10, and 2 instances where the affordability period was 30 years and should have been 10. |
| 35. Authorized as well as unauthorized personnel may access or remove documentation without being detected. Historically, there has been no formal sign-out procedure or requirement when personnel borrow files or records from other areas (other than Central Files). | 25) 62) 63) 68) | Per the Administration Manager (AM) overseeing file management and document retention, all project files were to be centralized, stored, monitored, and controlled in the File Room (FR). Project documentation contained in files was to be reviewed in the file room and not allowed to be removed except by project/RMs. | HCDD had not formalized Policies and Procedures over file access and security. The process described by the AM was not fully implemented. We noted that access to the FR was not restricted. HCDD personnel had difficulty locating and/or were unable to locate other files. |
| 36. There is no security over general access to work areas in which potentially sensitive (including confidential applicant / homeowner personal data) records are maintained. | 62) | HCDD recently installed security locks on the 4 th floor and on the 3 rd and 5 th floors within the past year. | The locks on the 4 th floor were physically in place, but had not been activated as of 09-05-08. The doors on other floors where key cards were required, were not locked. |
| 37. Several employees provided their personal log on ID and password to other personnel – generally their immediate manager – who then used their computer, both in their presence and absence, to access and update records. | 64) | HCDD added Policy and Procedure 9-52 - Employee Computer Usage, which instructed users to “handle assets such as passwords, identification codes, city confidential information, and physical system assets in a secure and responsible manner”. | None |
| 38. Several people often had access to the same file(s) and no version control (or electronic edit capture) practices | 65) | Non-integrated systems required the need for spreadsheets and external tracking mechanisms. These resided on | The process that was in place created the opportunity for errors and timing issues, which required additional layers |

| HCDD REMEDIAL ACTION MATRIX | | | |
|---|---------------------------|---|--|
| Gap/Issue Identified in JWI Report Appendix G | JWI Recommendation | HCDD Action Taken | Residual Gap |
| were in place to detect or control changes. | | the responsible party's machine and/or a shared drive. | of reconciliation and other detective controls. Our testing revealed errors in spreadsheets which required additional time to validate the data and review for completeness and accuracy. |
| 39. Owing to workflow being widely dispersed throughout the Department, documentation for a specific project is created and maintained by diverse groups and captured in their respective files. Most multi-family project loan files were incomplete and missing important documentation. | 67) 68) 69) 72) | An Administrative Assistant was hired in the Commercial Division, for multi-family projects who was to ensure that the files were compliant with all relevant requirements. | Implementation of the process was not complete. |

HOUSING & COMMUNITY DEVELOPMENT PERFORMANCE DIAGNOSTIC REVIEW
JWI REPORT RECOMMENDATIONS

Departmental Culture and Tone at the Top

- 1) Management should work to ensure both the appearance and reality of open communications through weekly management meetings, periodic staff meetings / communications, an open door policy, and cross-sectional collaboration.
- 2) Management should implement a formal Conflict of Interest policy and require annual signed agreement of compliance by all employees, including the full disclosure of any potential conflicts.
- 3) Personnel should be hired, assigned, recognized and rewarded solely on the basis of personal (and team) merit and such practices should be transparent.
- 4) Establish a Project Team to review and prioritize all potential project applications immediately upon receipt and make recommendations (to the Project Review Committee)
 - a) Include representatives from all key sections of the Department
 - b) Establish and publish formal and consistent criteria for the selection and approval of a project, including funding guidelines.
- 5) Re-establish a Project Review Committee as an oversight body to review and approve any projects and the subsequent RCA of those selected.
 - a) Consider including independent external members from areas such as the Mayor's Office and local industry experts.
 - b) Ensure the reasons for selecting or rejecting each proposed project are clearly documented in the formal minutes of regular meetings.

Organizational Structure

- 6) Management should perform a needs assessment for each program including all critical functions, and minimum and ideal technical skills, formal qualifications and experience required to perform each function.
- 7) Perform a risk assessment of each program to ascertain which required functions are most critical and to determine which functions to perform in-house, which to outsource, and which to manage with a hybrid model.
- 8) Determine Department's current and planned core competencies.
- 9) Perform a documented skills assessment of all current employees to facilitate optimal assignments and training needs.
- 10) Ensure all required internal functions are staffed with appropriately qualified personnel through hiring and continuous training.
- 11) Management should ensure that it has the requisite minimum degree of technical talent on board to perform a sufficient level of control and oversight.

- 12) When the specific technical skills required are in short supply in the market place or are unique to the Department's operations, management should consider bringing the function in-house to ensure the resources are readily available.
- 13) Where the specific skills sets required are widely available such that the Department will not need to pay a premium or may even be able to leverage other organizations' economies of scale and specialization, management should consider an outsourced model.
- 14) If the Department's need fluctuates, management should consider a hybrid model: a base level of in-house personnel supplemented by a pool of pre-qualified external specialists leveraged on an as needed basis.
- 15) Management should establish specific documented criteria for the selection of external service providers for each outsourced function, including key deliverables and performance metrics and ensure that they are applied consistently. Their eligibility should be re-verified regularly, ideally annually, including through communication with other City or neighboring County departments.
- 16) For those functions to be performed in-house, management should evaluate existing resources and re/train and assign existing personnel and hire new personnel as appropriate based on the specific skills identified. 16a) Subsequent advancement should be based on merit.
- 17) Implement a formal annual training plan at Department and individual employee levels.
- 18) Have the designated in-house Federal fund subject matter experts publish periodic (monthly) highlights to in-house file or web site of any regulatory changes including impacts on specific current programs, compliance activities, data capture for related reporting, etc.
- 19) Invite HUD and other City Departments (identified by HUD or others as having best in class practices) to provide related classes and seminars.
- 20) Cross train personnel, implement a formal program to train a back-up for each position and implement successor planning.
- 21) The Department should implement a formal Code of Conduct / Conflict of Interest policy for which every employee, contractor and agency is required to sign and reaffirm regularly. This compliance document should be placed in the respective employee, contractor, or agency file. This process should be performed annually to remind employees, contractor, and agencies of the policy.
- 22) Program Managers should not be appointed to programs where they have any close personal relationships with key management of Agencies that the program oversees – or be precluded from sole oversight of those specific Agencies.
- 23) Program Managers should be rotated on a periodic basis not only to provide cross training and for possible advancement purposes, but also to avoid any appearance of potential personal conflicts of interest.
- 24) The current Monitoring & Evaluation Section should be set up as a separate section from all other operating sections and be renamed "*Monitoring & Compliance.*" It should only contain monitoring and compliance functions, not any regular program / project execution ones. The head of *Monitoring & Compliance* should report directly to the HCDD Director – and if the Department has external members on

the Project Review Committee, then on a dotted line basis to those members (ideally the Committee Chair if s/he is an external member.

Policies and Procedures

25) Establish written policies and procedures for all compliance and oversight activities and ensure that the functional groups responsible for each are clearly identified and held accountable. Ensure that this information is maintained in a format and location accessible to all employees.

26) Provide all employees with initial and periodic refresher training on the Department's Policy and Procedures.

27) All entities subject to any periodic i.e. annual compliance verification should be clearly identified and included in a documented annual compliance plan and schedule.

a) Continuing compliance confirmation, which form an integral element of a program should be scheduled and performed as part of that program's regular operations

b) Such activities should be clearly differentiated from monitoring reviews designed to ensure that both the internal sections and any external Agencies responsible for operating the program are actually performing such activities and in accordance with related Departmental and regulatory policies.

28A) Management should address Federal and other regulations non compliance issues immediately.

Program and Project Management

28) Management should establish written policies and procedures for processing applications, including the use of requisite checklists and turnaround within a stated time of receipt.

a) Where applicable, such checklists should be incorporated into informational documentation and application forms furnished to potential applicants. Applicants should be required to complete the checklists and include with their submission, enabling the Department to verify quickly if all required documentation has been submitted and received with the application.

b) Such checklists should be fully inclusive of all possible requirements and contain a "not applicable" check option. Where particularly lengthy or complex requirements must be met, especially ones only applicable to specific types of programs or applications, these should have their own secondary checklist and be incorporated by reference in the primary checklist.

29) Establish a Project Evaluation Team (PET) with qualified representation from each requisite group to review and prioritize all potential project applications immediately upon receipt. All communications requesting Department assistance should be routed through the Project Evaluation Team and date/time logged.

a) The PET should process all requests in accordance with a prescribed workflow and will document all actions and decisions taken in a single dedicated Application / Project Evaluation File that remains with Project until conclusion.

b) A team member will be assigned as the Application / Project Coordinator on each application. This individual will be responsible for the overall coordination of the application, and subsequently as a project, if approved, until its final conclusion.

c) The Application / Project Evaluation Coordinator will act as the primary interface on the application between the Project Evaluation Team and the Project Review Committee upon its submission for approval or rejection.

30) Ideally, applications should be captured electronically in a database, allowing compilation and report generation of:

- a) A Status Log
- b) A dedicated Application File (upon approval, Project File) accessible by log-in ID and password by any Team member / authorized employee
- c) Existence and location of key documents, internal checklists

31) Establish and publish general roles and responsibilities for each section (possibly electronically on a secure central site.)

32) Hold periodic “lunch and learn” sessions where representatives of sections can speak to their individual / section tasks and their critical intra-Departmental interactions / dependencies. This forum can also be used to share “best practices” and recent learning from processing applications or executing related projects and programs.

33) Where feasible, combine similar functionality / tasks into common group e.g. inspections. This will allow more efficient delivery of similar activities either concurrently or at specific phases during project’s lifecycle.

34) Management should designate primary and secondary contact Subject Matter Experts for each major Program. These personnel should also be responsible for ensuring the education, coordination, and collaboration of all Sections / Functions that support that Program.

35) Management should designate primary and secondary contact Subject Matter Experts for managing each major source of funding. These personnel should also be responsible for ensuring the contemporaneous intra-Departmental communication of each Source’s most current regulations and requirements, especially as they apply to each individual Program.

36) Management should introduce a single Project Evaluation and Tracking Form which comprises a checklist sub-divided by activities and requirements common to all projects / funding sources and additional sections for each funding source with its specific requirements.

37) Establish a set of criteria and related metrics, which can be applied consistently for the evaluation of all applications, projects.

38) Management should consider use of an annual closed RFP process for some projects in order to limit the potential impact of unexpected fluctuations in timing and magnitude of applications.

39) Representatives from each respective section or area in the Departments that is affected by a given application should meet with that applicant in a formalized pre-construction / commencement meeting to explain clearly all the commitments which the applicant must fulfill, including any reporting requirements, associated with the funding requested / offered. The Department should ensure that all recipients of funding confirm their agreement with all funding related conditions and that conditions include immediate access by Department personnel or assigned representatives to all properties for any and all inspection or compliance review purposes.

- 40) Management should compile a “real time” list of all active projects subject to periodic compliance reviews and prepare a rolling 15 month (past quarter, future year) schedule. On at least a quarterly basis management should ensure that all requisite reviews and visits for the current calendar / fiscal year have been performed or are scheduled with the necessary (internal or independent external) resources assigned.
- 41) The Department should identify all key control and oversight activities, including those required by Federal, i.e. HUD, and other regulatory bodies and determine and assign responsibility and accountability to specific Department sections / personnel. Management may wish to use a more detailed version of the matrices we used and as attached.
- 42) The respective section responsible for oversight activities should coordinate their activities and communicate the results, especially of any adverse findings or concerns. Whenever the latter are identified, management should ensure that a follow up review / visit is performed within ideally 3 months. The disposition of all findings or concerns should be addressed in the next successive review and report.
- 43) An aged report of all (multi-family, single-family, economic development, etc.) loans should be generated on at least a quarterly if not (ideally) a monthly basis. Management should institute formal policies and procedures to pursue collection of aged and non-performing loans, including work-outs and foreclosure as appropriate.
- 44) Annual reviews should verify continuous owner occupancy of all single family housing benefitting from any Department funding and ensure that such funding is spent in accordance with the related loan / funding terms and conditions.
- 45) The Department, and any agencies to which it out-sources the approval of such services, should each check all applicants against shared databases of individuals and addresses receiving assistance before approving the provision of any repair.
- 46) Any identified or repeat offenders should be recorded in a separate list disseminated to all potential approvers for possible exclusion from any further or future funding or use by the Department.
- 47) Management should review all duplicated records of assistance provided for potential overpayments and their related recovery from appropriate party / parties.
- 48) All loans to single-family homeowners should be secured by promptly executed liens.
- 49) All overrides by Management should be clearly and separately documented, including reasons for override. In any situation where the respective manager may be perceived, even indirectly, to have a personal or conflicting interest in the matter’s outcome, a secondary level of written approval should be obtained from his / her supervisor. Such documentation should be readily available on demand for any periodic review by Monitoring & Compliance, Management and appropriate 3rd parties.
- 50) The Loan Origination Department should obtain original certificates as outlined in the Loan Agreement.
- 51) The Inter-creditor Agreement should provide the City the right to check the first lien note balance as well as for continuing proof of insurance and taxes. Management should review the Agreement on at least an annual basis.
- 52) The Department’s sub-ledgers should be reconciled to the City’s general ledger and a quarterly, if not (ideally) monthly reconciliation should be performed going forward.

53) The Department should contractually require all applicable borrowers to provide audited financial statements and should ensure that these are received. The Department should also reserve and exercise the right to perform its own audits, either directly or via third parties of its choosing.

54) The Department should contractually require and verify all borrowers', agencies', contractors', and sub-contractors' – both the entity's and its individual named principals' – conditions. The Department should require all "approved" agencies or contractors to confirm their eligibility on an annual basis.

55) On at least an annual basis, management should ensure that reviews of project costs and cash flows are performed and formally documented and compared to both the original, approved application and the annual budgets, and that the results of such reviews are taken into consideration when evaluating future or additional request for funding from the same or related parties.

56)) Management should compile a "real time" list of all active projects subject to periodic compliance reviews and prepare a rolling 15 month (past quarter, future year) schedule. On at least a quarterly basis management should ensure that all requisite reviews and visits for the current calendar / fiscal year have been performed or are scheduled with the necessary (internal or independent external) resources assigned.

57) An aged report of all (multi-family, single-family, etc.) loans should be generated on at least a quarterly if not (ideally) a monthly basis. Management should institute formal policies and procedures to pursue collection of aged and non-performing loans, including work-outs. (Repeat of #43)

58) The Department should explore options to increase its leverage to enforce participants' compliance with respective Program terms, especially post funding and during extended affordability periods.

59) The Department should consider performing a review of all multi-family reconstruction projects which it funded under the previous Director's jurisdiction to identify any displaced tenants which it may have overlooked and to whom the Department (and owner) may owe relocation related compensation, including moving expenses and up to 42 months of rent differentials.

60) The Department should also review its pipeline of related projects to ascertain the need to increase its available relocation resources. At a minimum, management should train a backup for its sole current relocation personnel.

61) The Department should review all relevant project files for any potential non-compliance with Uniform Relocation Act and exposure to related fiscal penalties. Department should staff up a trained relocation section or identify external resources as appropriate to cover current and future needs and as back up to sole current in-house relocation specialist.

Documentation

62) Management should consider implementing an electronic card (e.g. smart ID badge) operated secured access system for all non-public areas.

63) Section Management should determine need and implement a sign out procedure for removing any critical documentation from that section or even from those individuals responsible for its safekeeping.

64) Management should issue and require compliance with a Department Policy that log-in IDs and passwords are not shared between employees, including with their management.

- 65) In addition, access to mission critical systems of record e.g. loan servicing spreadsheets should be restricted to a single responsible owner and designated back-up. Any changes, even manager initiated, should only be input into the master by that owner. All other personnel should work off a copy suitably identified as a copy, including read-only versions.
- 66) Secure back-up copies should be maintained in a separate physical location of all critical spreadsheets.
- 67) A checklist should be created and maintained in a Master File within Central Records for each individual project. This should include such details as status and location of all critical documentation required. Ideally this should be in an electronic format within a database file allowing all relevant parties throughout the Department to enter current status for there are (on some mandatory, regular basis e.g. monthly). In addition:
- a) The file should contain a checklist of all documentation, which HUD and other regulatory bodies require to be maintained with a notation of the latest version and where it is physically filed. Wherever possible, a scanned copy of these documents should also be kept in the electronic file.
 - b) The dedicated Application / Project Coordinator for each project should be responsible for ensuring that the checklist is updated accurately and on a timely basis.
 - c) This will allow management or regulatory inspectors to readily generate and review reports of documents on hand and their location for any given project and to quantify the existence of specific documentation across categories (Programs, Department, etc.)
 - d) The physical Master File should contain a hard copy of such a checklist if an electronic version is unavailable.
- 68) Management should consider limiting who may physically (sign for and) remove a Master File from Records.
- 69) Section management should evaluate which working files may be centrally filed in between reviews for projects subject to such annual review.
- 70) Maintain and archive all documentation of inspection and other test work performed.
- 71) We recommend only two people from Loan Servicing be authorized and accountable to enter or edit spreadsheet data and that all others who have a need to know should have read only access.
- 72) The Department should implement a version control policy for all legal and regulatory filing documentation generated, including a requirement that before they are executed or issued all final documents are signed off by the appropriate management, including the Legal Department where applicable, as having been reviewed against supporting data for accuracy and internal consistency.
- 73) A regular systematic physical inspection schedule should be developed for all assets owned and funded by the Department, including those in recipients' location and control throughout any period of affordability or potential reversion of ownership.

EXHIBIT III



CITY OF HOUSTON

Housing and Community Development Department

Interoffice

2009 APR -3 PM 2: 59

Correspondence

CONTROLLER'S

To: Annise D. Parker
City Controller

From: Richard Celli
Director

Date: March 30, 2009

Attn: Steve Schoonover
City Auditor

Subject: RESPONSE - DIAGNOSTIC REVIEW
PERFORMED BY CITY CONTROLLER'S
OFFICE

A great deal has changed in the Housing and Community Development Department (HCDD) since the Controller's Office began their review in June of 2008. As you know, we reorganized along product lines shortly after my joining the Department and have expanded capacity in critical areas including underwriting and accounting. We are continuing to re-engineer the department as reflected in several of our responses to the Residual Gaps Noted in the HCDD Follow-Up 2005 Performance Diagnostic Review performed by the City of Houston's Controller's Office Audit Division. Below are the responses.

Culture, Climate, and Tone at the Top

- Independent evaluation of projects was not performed as the Project Evaluation Team and Project Review Committee had been dissolved, and the HUD Liaison was not included.

HCDD Response: Shortly after the current Director was appointed, HCDD disbanded the Project Evaluation / Review Committee. This was done after a thorough review of the process determined that it did not add value and it consumed many employees' time. By the time of disbandment, the expanded Underwriting Staff was in place and initial project review was set under the Underwriters' purview with Grants Management providing assistance with the preparation of the Activity Eligibility Checklist and signoff as to its correctness. Subsequent to the 2004 HUD findings, HOME project eligibility has been evaluated by Grants Management or a combination of the Product Area and Grants Management. This including the period when the Committee was in place but excluded a brief time during FY 2009 when the HUD Liaison reported directly to the Planning and Risk Management Assistant Director and was responsible together with the Product Area for eligibility reviews. Both the HUD liaison and eligibility review functions were returned to Grants Management when the prior HUD Liaison left City employment.

- The first installment of the \$15.5M minimum HUD payback was not made and part of the support for the other \$7M in question had not been provided to HUD.

HCDD Response: Although letters between HUD and the City had been exchanged during the time period that the auditors were performing their fieldwork, negotiations regarding the payback continued until after the audit concluded. The first installment of the HUD payback was made on November 25, 2008. The final settlement amount is pending HUD's response regarding the land use restriction documentation that HCDD submitted requesting substitution of non-federally funded projects for certain of those disallowed by HUD.

Views of Responsible Officials

EXHIBIT III

Page 2

Internal Organizational Structure

- Review of high level operating results across all product lines was not documented.

HCDD Response: The HOME Compliance Deadline and PR27 reports, as well as the CDBG Timeliness Reports are routinely produced and provide the HCDD managers with information needed to assess committing and spending within the mandated timeframes which is a primary objective of HCDD. However, HCDD is in the process of creating additional management reports that will provide Division Managers, Assistant Directors and the Director other qualitative and quantitative feedback on the operation of the Department. These reports will be phased in over the next year as we continue to re-engineer the Department.

- Contracts for Services were monitored by the functional group that awarded the contract.

HCDD Response: When HCDD restructured its monitoring section, the functions were rolled into the product divisions. Some former Monitors became Relationship Managers, others remained Monitors. However, none of these employees perform two roles with respect to the same contract. This approach was taken and is still supported to hold the product managers fully accountable and because familiarity with the product is essential to accurate monitoring.

Policies and Procedures

- Policies and Procedures still needed to be updated; several had not been updated since 1983.

HCDD Response: It is our intent to prioritize and review all policies and procedures within the Department and address any issues in those that are found to be deficient over the next eighteen months as we continue to re-engineer the Department operation.

- Topics such as the following were either not included or not adequately addressed in the Policy and Procedures Manual:
 - Program monitoring procedures
 - Procedures for current organization structure
 - Home Quality Standards inspection program procedures
 - Life Safety Issue procedures
 - Code of Conduct
 - Conflict of Interest Policy
 - File access and security.

HCDD Response: See response to previous item.

- HCDD lacked a Comprehensive Training Program.

HCDD Response: In some cases, HCDD mandates that certain employees attend HUD training if their position requires regulatory knowledge that they do not bring to the job. Assuring this training is the responsibility of the managers. HCDD also encourages employees to attend technical training sessions that are pertinent to the employee's current position or their next reasonable position. HUD training seminars, City of Houston training classes and on-the-job training are provided to help the growth of Department employees. Because of the specialized nature of most jobs in HCDD, on-the-job training is considered the most effective training to compliment that previously described.

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- HCDD lacked a Succession Plan.

HCDD Response: HCDD has a delegation of authority listing that provides for coverage during the absence of key managers. This list is maintained regularly. HCDD has also created a succession plan for the executives on the HCDD Management Team. We believe this is sufficient detail for a department our size.

Program and Program Management

- Existing inspection practices placed the City in a position susceptible to legal and/or financial liability.

HCDD Response: The owner/manager of the multi-family housing complex is primarily responsible for what occurs on the premises. In addition, the borrower must obtain insurance on the property per their contract with the City of Houston. HCDD inspectors complete Housing Quality Standards Inspections of the apartment complexes in accordance with HUD regulations.

- HCDD was not in compliance with HUD requirements as they relate to inspections of multi-family housing, Housing Quality Standards (HQS), and Life Safety issues.

HCDD Response: HCDD inspectors are well trained in and follow HQS standards in their work. At the time of the audit, the inspectors were not carrying the HQS checklists on site, but were documenting issues with photos and on note paper while viewing the apartments. The inspectors were then returning to the office to complete the actual checklists. HCDD inspectors are now taking HQS Checklists on inspections of multi-family housing. HCDD has implemented a policy regarding identification of Life Safety Issues and if a Life Safety Issue is now noted during the inspection, the issue is dealt with before the inspector leaves the site. The property manager or designee is given notice that the issue must be resolved within twenty-four hours and an HCDD inspector returns to the property the following business day. If the issue has not been resolved, HCDD coordinates with the other City department who handles dangerous situations at apartment complexes and can issue citations or take further action if deemed necessary. Additionally, HCDD management now requires that after each multi-family housing inspection report is prepared, the Division Manager meets with the appropriate Relationship Manager to discuss findings after which the Relationship Manager becomes responsible for follow-up until full resolution.

- Reconciliations between the Integrated Disbursement and Information System (IDIS) and SAP amounts had not been fully completed.

HCDD Response: For the first time in many years, HCDD has undertaken reconciliations between the IDIS and SAP/AFMS amounts, including revalidation of the SAP conversion. The project is a work-in-progress that will significantly improve the control environment once completed, including having an ongoing process to keep the systems synchronized. Our goal is to have the reconciliation between the two systems completed by the end of fiscal year 2009.

- Approximately \$12M was in default or foreclosure on Multi-family projects, \$7M of which had been questioned by HUD.

HCDD Response: The multi-family projects referenced were all prior to 2004. All foreclosed and defaulted projects are fully reserved in the City's financial statements. The \$7M questioned related to HOME investment partnerships. HCDD has submitted to HUD new land use restriction agreements on several non-federally funded properties and is seeking HUD's approval to substitute these properties for disallowed

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HOME investment partnerships funded properties. The final settlement amount relating to the \$7M questioned by HUD is pending their response regarding the land use restriction documentation.

- Although HCDD was conducting background checks prior to loan approval, they were not coordinating with Houston Police Department (for crime incident rates for other loan applicant owned properties,) Houston Fire Department (for Fire Code violations at other loan applicant owned properties,) and Public Works & Engineering Code Enforcement (for citations issued and construction permits issued at other loan applicant owned properties.)

HCDD Response: HCDD was coordinating background checks prior to multi-family development loan approval. These checks historically were made through reputable resources, but had not encompassed broad coordination with other City departments (HPD, Fire, and Public Works). In early 2008, HCDD partnered with the Public Works Department to plan a new unit and process that would coordinate efforts among various City Departments when the City closes apartment complexes that do not comply with habitability standards. This unit is headed by Andy Icken, and mid-year 2008 was joined by Douglas Anders, a Houston Police Officer. In addition to apartment complex closing, the new process coordinates background checks on multi-family loan applicants through various City department records. The first multi-family RFP since the establishment of the new unit/process is currently posted.

- An effective process was not in place to address reconciliation issues attributable to other Department's spending.

HCDD Response: A more effective on-going process to address reconciliation issues attributable to other Department's spending will be implemented with the changes in the ongoing reconciliation process referenced earlier. This will improve efficiency and hold other Departments more accountable for spending timeliness.

- Access to the File Room was not restricted and there was no procedure to track the location of the files.

HCDD Response: HCDD Record's Management policies and procedures were updated effective November 24, 2008. HCDD staff is allowed to enter the file room. However all files are to be viewed within the file room only and HCDD staff may not check out files for any reason. Staff is only allowed to enter the file room as long as Record's Management personnel are present; if not, the file room is locked to all Department employees.

- Program checklists were not clear regarding HUD requirements.

HCDD Response: HCDD is in the process of evaluating program checklists and those found to be deficient will be updated. Responsibility for checklists resides with the Assistant Directors and Division Managers. Follow-up on this item has been assigned to the HUD Liaison and Grants Management.

- Financial information was not available in a centralized location.

HCDD Response: All Commercial Division related financial information and loan servicing information is centralized in the Assistant Director's office. All other financial information for the Department is centralized in the office of the Assistant Director over Finance & Administration.

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- Two of 12 SFHRP files reviewed had warranty repair work complaints and no subsequent documentation to resolve the complaint.

HCDD Response: The two files in question have been reviewed. For the first file, after the repairs were completed the homeowner called the Contractor and HCDD inspector regarding four issues with the work that had been done. The Contractor and the HCDD Inspector returned to the property to view these warranty items and the contractor did make the necessary repairs. Upon completion of these repairs the HCDD inspector returned and verified that the repairs were made and there are pictures that document this event in the file. A field report was created at this time but was not present in the master file when audited. The field report has since been placed in the file. For the second file, the Contractor refused to complete the items that were unsatisfactory so these items were removed from the final payment to the contractor. During the process of rebidding the remaining scope of work, the assigned inspector was notified by a family member that the homeowner passed away. The HCDD inspector was instructed to close the case.

- HCDD did not have a process in place to ensure all home repair warranty issues were resolved.

HCDD Response: A warranty follow-up process has been implemented so that HCDD can track and complete the repairs in a timely manner. Our Single Family Home Repair Program database now contains a field for the warranty call in date and the warranty completion date so that we can better track the timeframe for addressing issues and assure that the issues are closed. Workflow diagrams are being made for the Single Family Home Repair processes and will be used to draft new procedures after decisions are made regarding process changes that will improve the product. These are expected to be completed by the end of calendar year 2009.

- HCDD personnel had difficulty locating and/or were unable to locate certain requested files during our fieldwork.

HCDD Response: All Single Family Home Repair files are now located in a centralized, secured file room until the repair process is finished. Once the repairs have been completed, files are sent to the main file room for storage. In addition, HCDD Record's Management policies and procedures were updated effective November 24, 2008.

- Unsecured spreadsheets used in Program Management allowed for data corruption and required additional layers of reconciliation and other detective controls.

HCDD Response: We believe that spreadsheets are sufficiently controlled by those that have access. The Commercial Division has password protected all essential spreadsheets. See response below regarding single family activities.

- HCDD lacked a comprehensive database containing the entire universe of single family home assistance recipients.

HCDD Response: HCDD is currently developing a Microsoft Access database with security protocols to warehouse all Single Family Home Repair recipients' data in one consolidated database. The Access database has a target completion and roll-out date of May 31, 2009. This new data base will be used to produce customer data validation and management reporting metrics reports. A staged roll-out will begin with the Single Family Home Repair program with the Down Payment Assistance program to follow at a later date.

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I want to thank you and ask that you thank your staff for the professionalism exhibited by them during their review of HCDD. If you have any questions regarding this response, I may be contacted at 713-868-8305 or you may contact Derek Sellers at 713-868-8428.

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