



Office of the City Auditor
Audit of Housing's Asset Management Program

Report Date: August 5, 2011



Office of the City Auditor

"Promoting Accountability and Integrity in City Operations"

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Office of the City Auditor
Transmittal Letter



Date: August 5, 2011
To: James K. Spore, City Manager
Subject: Audit of Housing's Asset Management Program

I am pleased to present the report of our audit of Housing's Asset Management Program. The results of this audit will be distributed to City Council through the City's Audit Committee.

The objective of our review was to determine whether loans and/or grants made to individual property owners and nonprofit agencies for the purpose of purchasing or rehabilitating housing are administered properly by the Department of Housing and Neighborhood Preservation. This audit was performed at the request of management.

The results of our review are provided in this report. Findings considered to be of insignificant risk were discussed with management during the course of our review. We completed our fieldwork on July 7, 2011.

The Office of the City Auditor reports to City Council through the City's Audit Committee and is organizationally independent of all City departments. This report is intended solely for the information and use of the Audit Committee, City Council, City Manager, and appropriate City management. It is not intended to be, and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

We would like to commend the staff of the Department of Housing and Neighborhood Preservation for the courtesy and cooperation extended to us during the review. We would also like to thank the Clerk of the Circuit Court and her staff for their cooperation and assistance.

If you have any questions about this report or any audit-related issue, I can be reached at 385-5872 or via email at lremias@vbgov.com.

Respectfully submitted,

Lyndon S. Remias, CPA, CIA
City Auditor

c: City Council Members
Audit Committee Members
Steve Herbert, Deputy City Manager, City Manager's Office
Andrew Friedman, Director, Department of Housing and Neighborhood Preservation



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Purpose

To determine whether loans and/or grants made to individual property owners and nonprofit agencies for the purpose of purchasing or rehabilitating housing are administered properly by the Department of Housing and Neighborhood Preservation (DHNP). This audit was performed at the request of management.

Scope

The scope of our review was limited to reviewing the securing and releasing of liens resulting from assistance provided in the form of loans and/or grants through April 1, 2011. We did not review compliance with eligibility requirements for such assistance. We reviewed loan repayments and early payoffs received during the fiscal year ended June 30, 2011.

Methodology

To accomplish our objective, we performed the following procedures:

- Reviewed pertinent laws, regulations and available agreements regarding access and use of protected information.
- Reviewed policies, procedures and internal controls related to securing and releasing of liens associated with assistance to property owners provided in the form of loans and/or grants.
- Met with appropriate staff to discuss current policies and processes related to securing and releasing liens associated with assistance to property owners provided in the form of loans and/or grants.
- Obtained extracts of assistance provided and land records recorded in the City's name for the period under review.
- Reconciled assistance provided in the form of a loan or secured grant to the City's land records to ensure proper recording and/or release of associate liens. Investigated discrepancies.
- Identified liens scheduled for and/or released to ensure timely processing of Certificates of Satisfaction.
- Traced a sample of assistance provided in the form of deferred loans and secured grants to supporting documentation.
- Traced early payoffs and repayments to the City's General Ledger.
- Made recommendations as appropriate to improve processes, increase efficiency and reduce risk to the City.



Standards

Our audit was conducted in accordance with generally accepted government auditing standards. The Office of the City Auditor reports to City Council through the Audit Committee and is organizationally independent of all City Departments. This report will be distributed to the City's Audit Committee, City Council, City Manager, and appropriate management within the City. This report will also be made available to the public.



Background

The Department of Housing and Neighborhood Preservation (DHNP) operates programs that provide financial assistance for the acquisition and/or rehabilitation of property for the benefit of low to moderate income households. These programs are funded with HOME and/or CDBG funds provided by the U.S. Department of Housing and Urban Development (HUD). The DHNP provides financial assistance in the following forms:

- **Unsecured Grants** - funds are unsecured and require no repayment.
- **Secured Grants** - funds are secured by a Deed of Trust and Promissory Note and are generally forgiven over a specified period of time as long as the owner meets all of the terms spelled out in the Deed of Trust. Should the owner default on any/all of the terms, then a percentage of the funds (based on when the default occurred) are due and payable to the City.
- **Amortized Loans** - funds are secured by a Deed of Trust and Promissory Note. Interest is charged and monthly payments are required for a specified period of time. Sun Trust Mortgage Company services all amortized loans on behalf of the City of Virginia Beach.
- **Deferred Loans** - funds are secured by a Deed of Trust and Promissory Note. Funds are due and payable in full to the City either on a specified date, or upon sale, lease, or transfer of the property, or upon the grantor(s) failure to maintain the property as their primary residence, or upon the death of the grantor(s).

Program income derived from the payoff of grants and/or loans plays a crucial role in funding the DHNP's programs. Therefore, the importance of protecting these assets (Deeds of Trust) is vital to the long term financial success of the DHNP's rehabilitation and acquisition programs for low to moderate income households. During FY11, the DHNP received approximately \$170,568 in program income from early payoffs, repayments and interest. All program income must be deposited back into the CDBG and/or HOME accounts and spent on eligible activities in accordance with HUD regulations. The DHNP currently has a portfolio of over \$4.8 million¹ in recorded liens (Deeds of Trust). This amount *does not* include liens for the non-profit organizations which have received financial assistance from the DNHP.

Due to changes in the economy, the increase in foreclosures, both locally and nationally, and revisions to applicable regulations, Housing's policies and procedures were revised in FY10 to protect the City's interests in these assets. Additionally, management designated a staff member to serve as the Asset Manager for the department's portfolio of liens. The Asset Manager is responsible for ensuring liens are recorded accurately and in a timely manner, that customers/borrowers are in compliance with the terms of the DHNP's Deed of Trust, calculating payoffs, evaluating and approving all requests for the subordination of liens, foreclosure and bankruptcy matters, and the timely release of liens.

¹ Value of outstanding deferred loans as of June 30, 2011.



Findings and Recommendations

Continue diligence in securing and releasing of liens resulting from financial assistance provided in the form of loans and/or grants

Deeds of Trust and Promissory Notes are prepared and sent to the Clerk of Circuit Court to be recorded to secure the City's interests when property owners receive financial assistance in the form of amortized loans, deferred loans and/or forgivable grants from the Department of Housing and Preservation (DHNP).

The recovery of funds in the event of a property transfer, foreclosure or noncompliance is dependent upon the accuracy and completeness of information contained in these legal documents. For example, if the amount on the Deed of Trust and Promissory Note do not match, then the lower dollar amount takes precedent in the recovery of the funds, which can result in a financial loss to the city. Also, in order to protect these assets it is crucial that the Deeds of Trust are sent to the Clerk of Circuit Court for recordation in a timely manner. Delay in getting the DHNP's Deed of Trust recorded could potentially result in the customer taking on additional secured debt, and that new debt being recorded in a superior position to DHNP's Deed of Trust, which could then result in the DHNP's lien not being covered by the equity in the property (which is a requirement of the rehabilitation programs).

The safekeeping of the original documents is also vital to the recovery of funds, particularly in the event of a default when legal action (judgment) is pursued through the courts, as the original documents must be produced.

Section 55-66.3 of the Code of Virginia requires the release of the lien to be reflected on a Certificate of Satisfaction submitted for recordation within 90 days of receipt of payment and/or satisfaction. Failure to do so could result in potential fines levied against the City.

In order to ensure the completeness and accuracy of the lien data in Housing's database, we reconciled the lien data in the City's land records maintained by the Clerk of the Circuit Court. We also traced a sample of funding records to the original supporting documentation. The results of review are provided in Table 1.

| Table 1. Results of Audit Tests | # | % of Total |
|--|----------|-------------------|
| Traced to Land Records | 1,969 | 98.3% |
| Liens not recorded/not found in Land Records | 20 | 1.0% |
| Issues with documentation (i.e., missing or incorrect data and/or documents) | 21 | 1.0% |
| Liens not released | 7 | 0.3% |
| Lien release not recorded in Housing database | 40 | 2.0% |
| Incorrect funding type in Housing database | 281 | 14.0% |
| Repayments and early payoffs posted to City's General Ledger | n/a | 100.0% |



Recommendations

- 1.1 Housing should continue their diligence in ensuring accurate, complete and timely information and recording and release of liens securing the city's interest.
- 1.2 Housing should correct the errors identified during our review.

Ensure the accuracy and completeness of data

The Housing Development Division maintains an Access database to assist with tracking, managing and reporting on assistance provided through its rehabilitation and property acquisition programs.

During our reconciliation of Housing's lien records to the City's land records, we identified:

- Incorrect funding types entered for 281 records in the Housing database (6%). These records indicated funding by an unsecured grant, when Deeds of Trust had been recorded for the assistance provided. Of the 281 records, 141 were for assistance provided to non-profit agencies; 98 indicated that Certificates of Satisfaction had been issued. Incorrect funding types can result in the City's failure to properly secure or release our interest in a property.
- Multiple Deeds of Trust where the property owner's name entered in the database differed from that on the deed due to spelling errors and the use of middle or nicknames. Incorrect/inconsistent use of names can lead to title issues and failure to receive proper notification in the event of a foreclosure or transfer of ownership.
- Several instances where pertinent data was missing or incorrect (i.e., due dates) in Deeds of Trust. In one instance, the expiration date provided was prior to the effective date.
- Inconsistencies in the entering of property addresses that could lead to errors in future funding. For example, the same street name: West Hastings Arch, was entered five different ways (i.e., Hastings; Hastings Arch; W Hastings Arch; W Hastings Arch Court; W. Hastings Arch Court). Such inconsistencies could result in inaccurate or incomplete results when searching by property address.

Additionally, of the 175 records related to assistance provided to non-profit agencies for property acquisition and rehabilitation, 169 were missing key data elements such as the lien date and the lien release date.



We offer the following recommendations to ensure the accuracy and completeness of documents and data:

Recommendations

- 2.1 Housing should correct the errors identified and ensure key data elements are present.
- 2.2 Housing should develop data entry standards for address related fields and consider having street names selected through a drop down menu to ensure consistency.
- 2.3 Housing should consider scrubbing the existing address data to correct the inconsistencies and ensure consistency for future assistance applications.
- 2.4 Housing should require use of the applicant's full legal name when entering the applications.
- 2.5 Housing should consider having the database application generate the Promissory Notes, Deeds of Trust and Certificates of Satisfaction to ensure their accuracy and completeness.

Manage the lien process for assistance to non-profit agencies in the same manner as for individual property owners

Assistance to non-profit agencies for procurement and rehabilitation of housing is coordinated by Housing's Strategy Policy and Resources (SPR) Division. The process for recording and releasing Deeds of Trust for assistance provided to non-profit agencies differs from that for assistance provided to individuals in that the non-profits agencies are responsible for preparing, recording and releasing their own Deeds of Trust. There is no formal review of the documents prior to recording with the Clerk of the Circuit Court. Please see Table 2, below, for the results of our review related to the 175 liens associated with assistance provided to non-profit agencies.

| Table 2. Results of Audit Tests (Non-Profit Funding Only) | # |
|--|----------|
| Traced to Land Records | 159 |
| Liens not recorded/not found in Land Records | 16 |
| Issues with documentation (i.e., missing or incorrect data and/or documents) | 6 |
| Liens not recorded in Housing database | 9 |
| Liens not released | 1 |
| Incorrect funding type in Housing database | 126 |



We offer the following recommendations to strengthen the lien process as it relates to assistance provided to non-profit agencies to protect the City's interest:

Recommendations

- 3.1 Housing should manage the lien process for assistance to non-profit agencies in the same manner as for individuals, including ensuring pertinent information is accurate and complete in the Housing database as well as on the Deeds of Trust.
- 3.2 Identified errors should be corrected and the corrections, when applicable, recorded in the City's land records.



Conclusion

The Department of Housing and Neighborhood Preservation has made considerable progress toward ensuring loans and/or grants made to individual property owners and non-profit agencies for purchasing or rehabilitating housing are administered properly with its implementation of revised policies and procedures and the appointment of an Asset Manager to coordinate and monitor these activities. However, there is still opportunity to further minimize the risks of loss and noncompliance through continued diligence, implementing standards and system controls to ensure the accuracy and completeness of information and documentation and by managing the lien process for assistance to non-profit agencies in the same manner as for individual property owners.

Acknowledgments

We would like to thank Housing staff for their responsiveness to our requests during the review and their receptiveness to questions and comments. We would also like to thank the Clerk of the Circuit Court and her staff for their cooperation and assistance. Additionally, we offer our assistance should concerns regarding implementation of these recommendations or other audit issues arise.



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Attachment A

City of Virginia Beach

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INTER-OFFICE MEMORANDUM

DATE: July 29, 2010

TO: Lyndon Remias, City Auditor

FROM: Andrew M. Friedman, Director, Housing & Neighborhood Preservation

SUBJECT: DHNP Response to draft Audit of Asset Management Program

Thank you for the opportunity to respond to the draft version of the audit of our Asset Management Program. We appreciate the responsiveness of Gretchen Hudome in regard to our questions about the report, and the overall way in which the audit was conducted.

In summary, our responses are as follows:

1. We will continue and enhance our diligence in recording, tracking and releasing liens that secure assets of the city.
2. We will correct all material errors that could affect our ability to track liens or insure collection of the liens in the future.
3. We will seek to make database improvements as recommended, to the extent feasible and cost-feasible.
4. We will begin to manage non-profit liens in the same manner as individual loans to homeowners.
5. We will correct all material errors in the city land records, to the extent that they affect our ability to collect on liens in the future.

A detailed response to specific issues is attached. Please let me know if you have any questions or need additional information.

Attachment:

Cc: R. Steve Herbert, Deputy City Manager
Sharon Prescott, Bill Dore', Cheryl Smith, Minta Walker (DHNP)

Response to Findings and Recommendations of the Office of the City Auditor
Regarding the Department of Housing and Neighborhood Preservation's
Asset Management Program – July 29, 2011

In July 2011, the Office of the City Auditor completed an audit of the Department of Housing and Neighborhood Preservation's (DHNP) Asset Management Program. The audit was requested by the DHNP as a result of the efforts of the DHNP to put policies and procedures in place to safeguard the City's assets and to ensure that funds provided to citizens and non-profit organizations for the acquisition and/or rehabilitation of property are repaid to the City, and that the liens (Deeds of Trust) recorded against said property get released in a timely manner as required by law. Many of these policies and procedures were put into effect after consulting with the City Attorney's Office in 2009 concerning issues with some of our loans that are serviced by SunTrust Mortgage.

Before addressing the findings and recommendations from the audit, it is important to note that the majority of the liens at issue originated in the 1990's, prior to the Housing Development Division making multiple upgrades to the existing database, or are attributed to assistance provided to non-profit organizations rather than individual households.

In 1991-1992 the DHNP developed a database to track our loan and grant activity. However, it has only been within the last 4 – 5 years that modifications were made to this database to record information that allows us to better safeguard the assets held by the City. Also, as of this date the Housing database is being analyzed by an outside consultant in order to convert the database to a currently supported format. As part of this conversion, we will try to incorporate the audit recommendations.

The following are the audit issues and our responses:

1. Incorrect Funding Types in the Housing Database – as noted in the Background section of the report, the DHNP provides financial assistance in the form of unsecured grants, secured grants, amortized loans, and deferred loans (known as the funding type). The audit revealed that an incorrect funding type was entered for 281 records in the Housing database. In each of these instances, the funding type was listed as an unsecured grant when it should have been listed as a secured grant. Of these 281 records, 155 relate to liens for individual households while 126 relate to liens for non-profit organizations.

Of the 155 recorded liens for individual households, 99 have been released and the date of the Certificate of Satisfaction is appropriately recorded in the database. The original database did not utilize funding types. Because all of these 99 liens have been appropriately released, the DHNP feels it is not necessary at this time to change the funding type code from an unsecured grant to a secured grant, **as no assets are at risk**, and there would be a significant amount of work involved in making the required changes to the database.

The other 56 records of the 155 are listed as being coded incorrectly and not having a Certificate of Satisfaction date recorded in the database. **All 56 of these records have been researched and corrected.**

Response to Findings and Recommendations of the Office of the City Auditor
Regarding the Department of Housing and Neighborhood Preservation's
Asset Management Program – July 29, 2011

Concerning the 126 liens for non-profit organizations it is important to explain that when assistance is provided to an individual household for the rehabilitation of their home, a Deed of Trust is recorded prior to the work commencing. However, when assistance is provided to a non-profit organization for the acquisition and/or rehabilitation of rental property, the Deed of Trust is not recorded until after the property is acquired and rehabilitated. HUD imposes a period of affordability on rental projects (the non-profit projects are rental projects) that does not begin until after the property has been rehabilitated and passes inspection. HUD does not impose a period of affordability for owner-occupied rehabilitation activities.

Non-profit projects are intentionally set-up with the funding type of GU (unsecured grant). This is due to how the database rules are set up and the way in which non-profit projects are processed. Because it is staff in another division, without access to the database, with responsibility for securing and releasing liens for the non-profit projects, the non-profit projects in the database do not reflect the proper code (GS – secured grant). Based on the recommendations of the Office of the City Auditor, the non-profit projects will be handled in the same manner as projects for individuals to ensure pertinent information is accurate and complete in the Housing Development Division database. **Access has already been granted to staff responsible for the non-profit liens, and the process of correcting the errors is currently underway.**

Multiple Deeds of Trust Where Owner's Name Entered in Database Differed From Name on the Deed of Trust – those instances of the name in the database not matching the name on the Deed of Trust are older cases (most dating back to the 1990's). During fiscal year 2009-2010, based on the recommendation from the City Attorney's Office, staff were instructed that the current legal name of the homeowner, along with their name on the deed to the property verifying their ownership, must be listed on the Deed of Trust, and that no nicknames are permitted. In 2010, written policies and procedures were put in place whereby the Asset Manager will begin checking to ensure that the name(s) on the Deeds of Trust match the name(s) in the database.

2. Data Missing or Incorrect in Deeds of Trust – the DHNP is aware that there have been instances where the expiration date on some Deeds of Trust was missing or incorrect. In 2010, written policies and procedures were put in place to reduce the possibility of this occurring by providing an internal review prior to submission.
3. Data Incomplete – the audit revealed multiple instances where a Certificate of Satisfaction was found in the Land Records but the date of the Certificate of Satisfaction was not recorded in the database. These records have all been corrected to reflect the missing data. Again, these are older cases (most dating back to the 1990's) or non-profit projects. In 2005, written policies and procedures were put into place regarding the releasing of liens which has resulted in the date of the Certificate of Satisfaction consistently being entered in the database. Furthermore, based on recommendations of

Response to Findings and Recommendations of the Office of the City Auditor
Regarding the Department of Housing and Neighborhood Preservation's
Asset Management Program – July 29, 2011

the Office of the City Auditor, non-profit projects are now being processed in the same manner as projects for individual households.

4. Liens Not Recorded – the audit revealed that 20 liens did not get recorded. Four of these liens are for individual households and 16 are for non-profit organizations. We are unable to account for the missing Deeds of Trust for 3 of the 4 liens for individual households as one of them dates back to 1988, and the file has since been destroyed. The other two did not get recorded for reasons we cannot explain, and at this time, **there is no need to get them recorded because the expiration date on both of them has passed.** We have documentation to verify that the fourth lien was sent to the Clerk of Circuit Court (via inter-office mail) for recordation, but the Clerk of Circuit Court has no record of receiving the document. **Because this particular project is still under construction, we will have the customer sign another Deed of Trust for recordation.**
5. In regard to the missing deeds for non-profit projects, these will be researched and we expect to be able to record all deeds with correct information with the cooperation of the non-profit owners.
6. Liens Not Released – the audit revealed that there were 7 liens that should have been released between 1995 and 1998 but were not. **All 7 of these liens have now been sent to the City Attorney's Office for release.** . These liens were part of a program that did not have fully adequate tracking procedures, and therefore these 7 did not get released. In 2005, written policies and procedures were put into place regarding the releasing of liens which has resulted in liens being released in a timely manner.
7. Inconsistencies in Entering Property Addresses – the addresses in question are for older records (from the 1990's and very early 2000's). Since that time, one of the modifications we made to the database was to list each component of the address as a separate field (as opposed the there being only one field for the street direction, name and type). As part of the current database conversion, we will clean up the incorrect addresses for these old projects as recommended in the audit report. We will also discuss with our consultant staff being able to select street addresses through a drop down table as recommended in the audit report. Budget permitting, we will incorporate this as part of the conversion.

In conclusion, the DHNP has made significant upgrades to the database to allow for more accurate tracking of liens, and to ensure the timely release of said liens. Furthermore, between 2005 and 2010, written policies and procedures have been put into place which have resulted in errors of the type noted in the audit report being virtually eliminated. In 2010, a current staff member with the DHNP was assigned as the Asset Manager for the DHNP's lien portfolio. An Asset Management Manual was developed incorporating existing, as well as newly developed policies and procedures. In April 2010, a copy of the manual was provided to the City Attorney's Office for review and comment, as well as to the City Manager's Office.