Office of the City Auditor

Review of Development Services Center Surety Program

Report Date: October 23, 2012
Office of the City Auditor
“Promoting Accountability and Integrity in City Operations”

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Lyndon Remias, CPA, CIA  City Auditor
Timothy Bell, CICA  Senior Auditor
Date: October 23, 2012
To: James K. Spore, City Manager
Subject: Review of Development Services Center Surety Program

I am pleased to present the report of our review of the Development Services Center Surety Program. The results of this review are provided in this report. Findings considered to be of insignificant risk have been discussed with management. We completed our fieldwork on August 15, 2012. The results of this review are provided to City Council through the City’s Audit Committee.

The objective of our review was to determine the causes of sureties going into default status and make recommendations for improvements to ensure adequate City coverage of the liabilities associated with project completion.

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 Developmental Services Center and Public Works-Operations Division for the courtesy and cooperation extended to us during the review. It should also be noted that management agreed with our findings and recommendations.

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

cc: City Council Members
    Audit Committee Members
    Steve Herbert, Deputy City Manager, City Manager’s Office
    David Hansen, Deputy City Manager, City Manager’s Office
    Phil Davenport, Director, Public Works
    Jack Whitney, Director, Department of Planning and Community Development
    Charles Hassen, Development Services Coordinator, Development Services Center
    Mark Gemender, Division Director, Public Works, Operations Division

The Office of the City Auditor is an independent audit function reporting to the Virginia Beach City Council.
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The Office of the City Auditor is an independent audit function reporting to the Virginia Beach City Council.
Purpose

To determine causes of sureties going into default status and make recommendations for process improvements to ensure adequate City coverage of liability for project completions.

Scope and Objectives

The objectives of our agreed-upon-procedures audit with the Development Services Center (DSC) were to determine why projects in the Projects In Default Reports went into default and what is necessary to eradicate the origin; and if there are staffing and/or software issues affecting the surety process.

The audit covered the 24 sureties totaling $4,446,410 in default status as of May 17, 2012. We reviewed the files and documentation related to the administration and correspondence between the DSC, developers and guarantors of the sureties. Our fieldwork concluded on August 15, 2012.

Methodology

To accomplish our objectives, we performed the following procedures:

- Met with appropriate staff to discuss the surety process.
- Obtained a listing of all projects in default status for review.
- Examined the files, documentation and correspondence between the DSC, other City departments, developers and guarantors of all default status sureties.
- Coordinated discussions between the DSC and Public Works/Operations Division to address surety issues between them.
- Performed analysis to identify causes of surety defaults and developed recommendations for improvements.

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 City established the Development Services Center (DSC) in 1990 to provide a more centralized focal point for private development. In 1992, the Planning Department was reorganized to include the DSC as a division. The DSC has 21 full-time positions (FTEs) with a FY13 budget of $1,986,690. The DSC coordinates the review and approval of development plans and subdivision plats to ensure compliance with ordinances, standards, specifications and City Council requirements. Development projects can be either public or private and include plans for commercial sites, subdivision construction, land management for septic systems in poorly drained soils, and Chesapeake Bay Preservation Area single-family sites. The DSC also administers development sureties and coordinates the review and recordation of legal documents and agreements designed to ensure construction of requirements established during the plan review and approval process.

When a construction project, land improvement or any other land disturbing activity is approved by the DSC, the developer is required to post a surety which provides a guarantee that they will complete the work that they have committed to perform. Surety amounts are based on engineering cost estimates to complete a project or a development within the project. The surety guarantees the availability of financial resources to complete the project from start to finish in the event that the developer defaults. This reduces or eliminates the City’s financial liability for required improvements associated with a project in default. Sureties also guarantee that:

- Improvements shown on approved plans, permits and recorded subdivisions are installed;
- The site and improvements are left in a satisfactory and safe condition;
- The contractor/developer is moving forward to the timely completion of the project;
- All aspects of the project and construction are in compliance with City specifications, standards, approved plans, agreements and permits;
- Citizens can expect to continue the safe use of existing systems and all of the improvements to be completed for their use and enjoyment.

While a project is ongoing, the DSC schedules inspections and notifies the responsible party of issues found, expected resolution and re-inspection date. If the developer meets all inspection requirements and satisfactorily completes the project, then the surety is released. If a developer does not meet expectations and/or is progressing toward default status, the DSC starts the process to draw on the surety. If the developer defaults, then either the guarantor (bank or bond/insurance company), a contractor for the guarantor, or the City will complete the project.
There are 23 different purposes that require sureties to be issued with right-of-way, subdivision, subdivision defect and stormwater maintenance facility sureties being the largest. There were $26,139,187 in sureties as of April 5, 2012 in cash, bonds or letters of credit.

<table>
<thead>
<tr>
<th>Type of Surety</th>
<th>#</th>
<th>Amount</th>
<th>Percent of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>114</td>
<td>$1,653,753</td>
<td>6.3%</td>
</tr>
<tr>
<td>Bonds</td>
<td>206</td>
<td>$18,608,274</td>
<td>71.2%</td>
</tr>
<tr>
<td>Letters of Credit</td>
<td>87</td>
<td>$5,877,160</td>
<td>22.5%</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>407</strong></td>
<td><strong>$26,139,187</strong></td>
<td><strong>100.0%</strong></td>
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</tbody>
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DSC reviews over 2,200 plans and permits submitted each year and releases over 200 sureties each year. Over the past 22 years, DSC has administered 9,812 sureties worth approximately $235,238,115. In addition, DSC coordinates the ongoing administration of current sureties with the following departments and divisions:

<table>
<thead>
<tr>
<th>Other City Departments/Divisions Involved in Surety Process</th>
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<td>Public Utilities/Inspections</td>
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<tr>
<td>City Attorney's Office</td>
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<tr>
<td>Parks and Recreation/Landscape Services</td>
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<tr>
<td>Public Works/City Surveyor</td>
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<td>Public Works/Traffic Engineering</td>
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<td>Public Works/Operations</td>
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<td>City Treasurer's Office</td>
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<tr>
<td>Planning/Permits and Inspections</td>
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Findings and Recommendations

Finding 1: Sureties Insufficient to Cover City Liability

As of May 17, 2012, per DSC, there were 24 sureties in 11 projects in default status representing those sureties in danger of actual default. These sureties were in default status due to the developer not completing the project(s) in a timely manner. However, seven (7) sureties have been released and the five (5) projects associated with them were completed but one surety was insufficient in the amount of $2,875 due to the cost had risen between the time the surety was issued to the time the City drew on the surety. The City incurred no liability in this case as it was covered by an additional cash surety on the project. Two (2) more sureties were released on two (2) ongoing projects for completion of developments within those projects with no further issues. In actuality, only 15 of the 24 sureties were in default status as of May 17, 2012. Of the 15 sureties, five (5) did not sufficiently cover the City’s liability:

- Three (3) were due to a bank default (Bank of the Commonwealth). The total value of the sureties being held was $22,264.55. The actual loss to the City may be approximately $8,285. Each affected department must take over the responsibility of the item identified as being incomplete. All of the items appear to be minor maintenance issues.
- One (1) for $179,823 had lapsed past renewal date due to oversight by the DSC. The bond company did not honor the City’s draw on the surety bond as the bond expired two years prior. However, this project is still ongoing and the developer is completing some of the work and has taken legal action against another developer involved in the project.
- One (1) was insufficient, short $35,297, due to the actual costs to complete exceeding the original estimates. Costs had risen between the time the surety was issued to the time of the draw by the City. However, the City has incurred no liability to date.

The remaining ten (10) sureties are associated with ongoing projects and the DSC is working with the developers and/or the banks and surety companies to complete these projects.

Recommendations

1.1 Ensure sufficient solvency of surety grantors through use of bank and insurance company rating services.

1.2 Incorporate a contingency amount in the cost estimates to ensure surety amounts keep up with inflation factors, damages and administrative costs.

1.3 Perform periodic reviews of existing sureties to ensure inflation does not overtake the surety amounts.
Finding 2: Enhance Inspection Procedures

Currently, several major factors are contributing to delays in the closing of projects and the subsequent release of sureties to developers. One key factor appears to be the timeliness of completing the Closed Circuit TV (CCTV) inspection of public storm water pipelines. City regulations require that a “finish inspection” of stormwater pipelines is performed to show that pipes meet all City requirements and are clear of sediment before the infrastructure is taken over by the City for maintenance. CCTV is part of this inspection process. Delays in performing the CCTV inspection can vary and delays are often attributed to finding stormwater pipes that contain erosion sediment and other blockage caused by inadequate stormwater erosion and sediment control. The CCTV may also uncover non-conforming materials or methods utilized during the construction phase. Improper installation and non-conforming material can lead to future costly repairs and maintenance and affect the expected life of the pipe.

Recommendations

We recommend that Planning/Permits and Inspections (Civil Inspections) and Public Works Operations, in collaboration with developers and builders, develop procedures to enhance the inspection process to ensure all scheduled inspections are timely performed. The following procedures should be considered:

2.1 Require developers to perform inspections during construction:
   a. Street and stormwater infrastructure inspections should be routinely performed and thoroughly documented during construction to confirm conformance to construction standards. These inspections should be performed and any issues addressed before the developer is allowed to backfill excavations or pave.
   b. Daily records of these inspections with substantive comments/photographs, copies of material delivery tickets etc., should be maintained by the developer and made available to City inspectors to validate construction methods prior to backfill.
   c. Non-conforming construction practices need to be identified, rejected and corrected expeditiously.

2.2 Contractor submittals for changes to materials specified in the approved construction plan should be received and approved by the DSC review engineer to verify proper materials are being used for City-maintained infrastructure.

2.3 As a long-term alternative to Recommendations 2.1 and 2.2 above, develop a third-party contractor quality control process to provide inspection reports of ongoing construction and certification that construction standards have been met before backfilling around
stormwater structures and paving of streets. Inspection reports should include digital photographs, material testing and submittal approval.

2.4 Daily reports of the Permits & Inspections’ inspector should validate that manufacturer recommendations are followed during construction.

2.5 Require the contractor/developer to pay a penalty for mobilization of CCTV assessment contractor when the system is not ready due to erosion sedimentation in the stormwater pipe.

2.6 Perform only one CCTV assessment, prior to release of surety, at the developer’s scheduling and cost.

Finding 3: DSC Relies on Outdated Software

The DSC currently relies on software developed during the 1990’s to administer the financial and surety processes. There is no integrated computer system/database for reporting, tracking and monitoring development plans, fees and sureties. Given the broad array of DSC responsibilities and duties and the DSC’s impact upon other departments, an integrated system of sureties, permits, financial and project tracking is needed to eliminate time-consuming duplicate data-entry and prevent workload issues. Recently, Planning /Permits and Inspections implemented the Accela Automation System, which integrates and automates business activities that include those found in the DSC. Online payment of fees and electronic plan submittal and review are other enhancements in this application that would benefit DSC. The DSC is requesting Accela Automation System implementation in the FY14 Capital Investment Project budget. This request was also made during the FY13 budget but was not funded.

Recommendation

3.1 We support the planned Capital Investment Project funding in FY14 of Accela Automation System and expansion into the DSC for better efficiency and coordination of business activities between City departments and developers.
Conclusion

In our opinion, the surety process can be enhanced by implementation of the recommendations above to ensure that the City’s liability associated with project defaults is minimized or eliminated.

Acknowledgements

We would like to thank the Development Services Center and Public Works/Operations for their responsiveness to our requests during the review and their receptiveness to questions and comments. We offer our assistance should concerns regarding implementation of these recommendations or other audit issues arise.
DATE: October 11, 2012

TO: Lyndon S. Remias

FROM: William J. Whitney, Jr.

Department: City Auditor

Department: Planning

RE: Response on Review of Development Services Center (DSC) Surety Process

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Thank you for the effort and hard work you and your staff invested in studying and providing a report on the Development Services Center (DSC) surety process. Some of the recommendations are already in place while others are being reviewed. We understand that, while not within the original scope of the report, Finding #2 is provided as information that you discovered during the audit. The Permits and Inspection Division of the Planning Department will continue to work closely with Public Works Operations and the development community to address the suggestions. Public Works has already initiated discussions with Hampton Roads Utility and Heavy Equipment Contractors Association (HRUCA).

The Planning Department’s detail comments on the findings and recommendations are provided below:

**Finding #1: Sureties Insufficient to Cover City Liability**

1.1 The DSC staff has started using the two financial rating services. Banks are checked through Weiss Bank Ratings and bond companies are checked through Insure.com. This will provide staff with a good indication of the institution’s current rating so we may avoid those with poor ratings. It should be noted that some sureties are held for several years during the construction of the project. It is possible that a bank’s rating could be lowered during the construction period.

1.2 The State Code (Section 15.2-851.1 and 15.2-2241) allows “a reasonable allowance for estimated administrative costs, inflation, and potential damage to existing roads or utilities, which shall not exceed 10 percent of the estimated construction costs.” In order for the City to require the additional amount of surety, several sections the City Code must be amended to give staff the authority to make the requirement.
1.3 The surety staff currently has yearly reminders for all sureties. When a surety has been dormant for three years, an inspection is requested to determine if any progress has been made since the last inspection. The permittee is contacted when the project is not active. If appropriate, the inspectors are asked to provide the cost to complete the public infrastructure or a private infrastructure, e.g., stormwater management facility. If the value of the surety is equal to or less than the estimates, the principal/permittee is contacted to increase the surety. If the surety is not increased, a draft will be placed on the surety. The drawback to increasing the frequency of this process will be pulling inspectors from other projects to work on cost estimates. The DSC staff will work with inspections agencies to identify a reasonable periods of time between cost estimate reevaluations.

Finding #2: Enhance Inspections Procedures

At the beginning of the audit, we were asked for any concerns we may have regarding the surety program. One of the concerns provided by the DSC identified delays being experienced by Civil Inspection in receiving the closed circuit TV (CCTV) final report. These delays can result in postponing the release of several sureties. The inspectors use the CCTV as a part of their final inspection of the stormwater system for the release of the performance sureties and defect surety. If the final performance inspection is not delivered to the DSC in a timely manner, the developer must renew his/her surety and pay for the additional coverage. If the final defect inspection is not delivered to the DSC prior to the end of the defect period, the surety must be extended or the DSC must call the surety. The extension would be an additional cost to the developer. Drafting or calling a surety is not in the best interest of the individual posting the surety and the action requires staff resources. It could also have an effect on the developer’s credit rating.

The DSC is not responsible for the inspection of the infrastructure nor is it directly involved in the CCTV process. The information gathered during the inspector’s field inspections and review of the CCTV video is provided to the DSC in the form of an inspection report listing all outstanding discrepancies. The discrepancies are passed on to the developer/contractor for corrective action. If the improvements pass inspection, the developer/contractor is notified.

Several of the suggestions provided were discussed in a City facilitated Process Improvement Team process in 2011. Team members were selected from Public Works Operations, DSC, Civil Inspections, and Public Works Engineering. The following responses to the recommendations are provided by Permits and Inspections:

2.1 A responsible Land Disturber (RLD) is required to be assigned for each construction project. One of the responsibilities of a RLD is to make periodic site inspections and take needed action to control erosion and sediment. Recent changes to erosion and sediment control and stormwater laws and audits by State and Federal agencies have resulted in more onsite inspections and documentation by both the City and the contractor. Routine inspections are being performed and are being thoroughly documented by staff. The new
stormwater permitting program, scheduled to be transferred from the State the City on July 1, 2014, will also require additional inspections with a wider range of authority at the local level. This stormwater permit requires heavy documentations on the part of the developer/contractor and city staff. Many current policies and procedures are being reviewed to address changes required by the new stormwater law and permit requirements. The permit does not address the actual installation of infrastructure, per se.

There are only seven civil inspectors for the entire city. The inspectors cannot always be on the site during the installation of the pipe. Staff is looking into the suggestion of photo documentation of the pipe installation. When staff finds construction problems, the developer/contractor is notified immediately to take appropriate action. In order to require additional documentation from the developer, a change to the Public Works Design Standards Manual or amendments to the City Code may be necessary.

2.2 Field changes are typically sent to the DSC for review and approval. The inspector makes sure the materials being installed conform to the approved plans, which are in conformance with the Public Works Design Standards Manual. Pipe that is installed and covered on the weekend or when the inspector is not on the site is hard to verify. The CCTV may discover major problems with pipe connections and pipe integrity. CCTV does not identify poor installation practices, e.g., materials used for bedding and cover or voids beneath the pipe, which might result in future failure.

2.3 This is a good recommendation; however, there are several aspects that would need to be completely studied. Some questions that would need to be answered are: How will the development community react to the added cost of a third party inspection report? Will the third party report only apply to stormwater pipe? Should the inspection fees be reduced? What certifications would be necessary for the third-party to be qualified to perform the inspections?

2.4 Reporting and documenting are easier with the new Accela application. Making sure the installation is in conformance with the details shown on the plan is part of any routine inspection. Reports are filed when the inspector visits the site. Inspectors respond to all requests for inspections and follow up as needed. Due to limited staff, inspectors are unable to visit all of their projects daily. Please keep in mind that the time spent on documentation results in less time allowed for actual visits to and inspection of sites.

2.5 The charge for mobilization may be an item that will require a City Code amendment. A draft form was prepared for the developer/contractor to sign stating that the pipes were clean and ready for inspection. If the pipes are found to be not clean enough to perform the CCTV process, the developer/contractor would be responsible for a mobilization fee of a stated amount. This form should be reviewed further and discussed with the City Attorney. The City Code and/or the Public Works Design Standards Manual may need to be amended.

2.6 This recommendation will also increase the cost of construction to the development community. The Tidewater Builders Association, HRUCA, and others in the development
community will be very vocal on transferring the cost of CCTV to the developer. If they are required to have the inspection at their cost, they will probably want to shop for the lowest bid. There should be standards governing the product (report) provided to the City. There are companies equipped to perform the CCTV other than the contractor being used by the City. This finding and recommendation will take a great deal of resources to study and develop policies, practices, and amendments. The study will require participation by the development community, Public Works Operations, and Permits and Inspections.

Finding #3: DSC Relies on Outdated Software
3.1 The update of the DSC’s business system is being requested again in the FY 2013-14 budget proposal. The Accela application should provide the needed technology to improve the DSC’s business systems. Online payment of fees and the electronic submittal of plans will be two of the new services available for our customers and staff.

Summary
Once again thank you for your investment in one aspect of the land development process in the City. We felt our surety processes were reliable, consistent, and in line with the City’s mission. As with any process or system, a third-party review helps to identify areas that may need to be improved and confirm the areas that are operating as they should. The recommendations in Finding #1 are already in place. We look forward to expanding our services to our customers through new technology identified in Finding #3. Our Permits and Inspections staff will continue to work with Public Works Operations to improve the delivery of the CCTV reports. They will continue to use the resources available to them to make sure the public improvements, installed by developers, meet all City requirements and are installed correctly.

c: Phil Davenport
Charles Hassen
Sue Hollingsworth
Candace Slade
Tony Tolentino
Timothy J. Bell
Adam Swan
Kay Wilson