

August 31, 2012



*Parks, Recreation & Neighborhoods Department*

Stanislaus Grand Jury  
1021 I Street, Floor 3  
Modesto, CA 95354

RE: Neighborhood Stabilization 2 Program Response

Dear Members of the Civil Grand Jury;

First off, I would like to thank the members of the Civil Grand Jury for taking the time and energy to respond to the City of Modesto's request for review of the Neighborhoods Stabilization Program (NSP). As the members involved in this review realize, the program is complex, requiring the participating cities to work with local data and housing stock to design and create credible priorities, while working through an ever changing list of federal regulations and very difficult timelines set by the past legislation.

In our response we indicate that most of your recommendations have been implemented. The intent of the Neighborhood Stabilization Program was to stabilize economically depressed neighborhoods and create jobs. It should be noted that the scope of the program was quite extensive and the City of Modesto worked diligently to meet program goals within very tight deadlines set by federal legislation. That being said The Civil Grand Jury's Report, HUD's Office of the Inspector General Report, and HUD-sponsored technical assistance provided excellent recommendations and process reviews to confirm staff's strengths and weaknesses. I believe the City of Modesto has revised program guidelines and procedures, as appropriate based on these reports.

As required, the City of Modesto has attached its response to the findings and recommendations of the Grand Jury report and again, thanks to the members of the Civil Grand Jury for the research and diligence in this process.

Yours truly,

  
Greg Nyhoff, City Manager  
City of Modesto, CA

1010 Tenth Street, Suite 4400, Modesto, CA 95353  
PO Box 642, Modesto, CA 95354  
(209) 577-5344 Fax (209) 571-5825

## FINDINGS ISSUED BY THE CIVIL GRAND JURY

### Finding #1: Modesto City Council and City Manager's Direction and Responsibility.

#### **City of Modesto partially agrees with this finding**

The City agrees that a higher degree of oversight was necessary for the program and prior to the Grand Jury review and release of this report, on March 13, 2012, the City Council adopted new guidelines for the NSP2 program requiring that all major actions and property acquisitions be brought before the full Council, rather than its' designated committee, for approval. In addition to the increased oversight, new program guidelines and program spending caps were put into place to address numerous issues regarding rehabilitation limits.

The City disagrees to an extent with the statement that insufficient interest was expressed by the Mayor, City Council, and City Manager. The Modesto City Council and City Manager have not only shown great interest in the NSP program but have directed and been involved in the NSP program from the very beginning. Due to the aggressive grant timeline requirements the City Council initially delegated review and approval of all transactions to its appointed Committee, the Citizens Housing and Community Development Committee (CH&CDC) whose members were made up of real estate professionals, loan professionals and related professions. In this manner, the CH&CDC was delegated to act on transactions utilizing clear guidelines and loan documents that were reviewed and approved by the Council.

The NSP Program management was assigned to the Park, Recreation and Neighborhood Department (PR&N) by the City Manager. This decision was based on the fact that this department manages the City's HUD-funded grants and has extensive experience with many HUD programs, such as the Community Development Block Grants (CDBG), HOME, and Emergency Solutions Grants (ESG). HUD guidelines for the use of the NSP2 funds were established through the American Recovery and Reinvestment Act of 2009 legislation (ARRA) which closely utilized guidelines from the CDBG and HOME regulations. Based on the Department's experience with HUD-funded programs and their oversight, this Department provided the same level of direct oversight utilized in all other departments throughout the City. Staff from the City Manager's and City Attorney's Offices met regularly with PR&N staff for internal analysis and review in the early stages of the NSP program development and implementation. When issues related to Conflict of Interest and Cost Reasonableness began to surface, the City Manager, the City Attorney and the Mayor held weekly meetings with PR&N staff regarding the management of NSP. Those meetings continued for over a year as we worked with HUD OIG and HUD technical assistance consultants to insure program compliance with HUD requirements.

With the adoption of new guidelines and including the requirement that all transactions under the NSP program come to the City Council for action, the City Council continues to demonstrate its leadership and interest in the program.

### Finding #2: City Staff Administration of the NSP2 Program

### **The City of Modesto partially agrees with this finding**

Per the City's grant agreement, the City outlined a monitoring plan for expenditure of NSP2 funds, which was approved by HUD. This monitoring was to take place quarterly.

Under the adopted program regulations, the City's process of disbursement of funds was actually required to be conducted at a minimum on a monthly basis and in practice, was frequently conducted on a weekly basis. Funding disbursement is only allowed to take place in two ways, they are as follows:

1. Property Acquisition – Funds are wired directly to an escrow account with all supporting documentation.
2. Property Rehabilitation – Funds are only released on a reimbursement basis and after the following actions have taken place on ALL invoices:
  - a. All receipts supporting the invoice are in hand;
  - b. City Rehabilitation Specialist has visited the project to verify that the presented bill of goods is accurate ;
  - c. City Administrative Staff insures the accuracy of the invoice.

As stated previously, funding disbursement frequently was conducted on a weekly basis. This was due to a couple of factual realities such as the down-turn in the economy and the limited availability of operating credits.. The City's policy required issue payment within 30 days of receipt and verification of invoice. For these reasons the City of Modesto feels that quarterly monitoring regarding fund disbursement for the acquisition and property rehabilitation portion of the NSP program was satisfied.

Additionally, if the Grand Jury's finding in this regard is also addressing monitoring of tenant placement by the developers, the City would like to point to requirements in the NSP agreements with the developers that stipulate that the City of Modesto will monitor developers efforts on tenant screening and placement on no less than an annual basis. However, the City agrees that more frequent monitoring of tenant placement and developer files could be beneficial when developers are struggling with this portion of the NSP program.

### Finding #3: Project Costs

#### **The City of Modesto partially agrees with this finding**

It is very important to remember that the clear purpose of the Neighborhood Stabilization Program, as administered by HUD, is to not only stabilize neighborhoods that have been detrimentally affected by the economic downturn and housing market crash, but also to eliminate the slum and blight that inevitably resulted from this crisis. An important feature of this program was to stabilize neighborhoods by ensuring long term, stable residents that would invest in their neighborhoods.

Additionally, the City extensively utilized HUD mapping tools and census tract information when selecting its' target areas for all three NSP programs and focused on areas of greatest need. These areas are primarily the 14 low income census tracts located within the City of Modesto boundaries. In addition, the established target areas receive the greatest benefit from increasing/stabilizing the property value of properties in

their neighborhoods through the use of more durable building materials. It is the City's position that residents of all neighborhoods within the City of Modesto deserve to live in quality housing equipped with quality components, regardless of the census tract income levels.

Nevertheless, the City understands the need to ensure it gets the best' "bang for its' buck" and has, in fact already made programmatic changes in this area. Specifically, the City Council implanted a spending cap on the total costs of property acquisition and property rehabilitation when it adopted changes to the NSP program guidelines in March of 2012. This specific Council action limits the total acquisition and rehabilitation costs of single family houses to \$165,000 and the price per unit of a multi-family development to \$125,000 per unit.

#### Finding #4: Tenant Eligibility at SCAP: Conflict of Interest and Public Perception of Favoritism

##### **The City of Modesto partially agrees with this finding**

As became plainly evident after investigation by numerous agencies including the City, the practices employed by Stanislaus Community Assistance Project when selecting and screening tenants were against City-established program regulations and resulted in several significant conflicts of interest and ineligible occupants of the NSP properties owned by SCAP. As has been previously noted, the City of Modesto took several actions in regards to these and other SCAP practices. First, the City froze all funding to SCAP while investigating and trying to gain access to files and records that SCAP kept on their premises. The time spent on this endeavor was lengthy due to the lack of cooperation by some of the staff at SCAP. Additionally, the City worked cooperatively with the auditors from the Housing and Urban Development (HUD) Office of the Inspector General (OIG) in its' review of all SCAP files, specifically, those related to SCAP's spending and property rehabilitation costs. Significantly, these projects and the cost reasonableness of the projects did not receive a finding in the final OIG Audit Report – which essentially means that OIG did not find a flaw in the City's oversight of SCAP's property acquisition and rehabilitation costs.

With regard to SCAP's improper tenant screening and placement, once the City had the entire picture regarding SCAP's activity in this regard, the City took specific action to remove any existing conflict of interest situations from the SCAP-owned housing stock, as well required SCAP to outsource their tenant screening and processing of tenant income eligibility to a private property management company. At present, the City Council has frozen any future funding allocations to SCAP from the City's HUD allocations.

The referenced handbook entitled Homebuyer Program: Policies and Procedures is specific to NSP2 projects designated for re-sale/home ownership and does not outline requirements for tenant eligibility, nor does it apply to the Special Needs Program which SCAP was operating under. However, the City of Modesto provided extensive guidance and direction to SCAP staff regarding income certification methods and tenant certifications. Although in hindsight of course we are able to speculate on additional steps that staff could have taken to provide more oversight on this tenant screening process, and in fact this experience with SCAP's abuses has resulted in the

implementation of more stringent oversight. However, at the time these actions took place, we believe that staff was vigilant with respect to the existing guidelines and provided extensive direction to SCAP regarding this issue. City Staff had been engaging SCAP (specifically Mr. Gibbs) for months regarding which method to implement when certifying a tenant. The City staff went as far as requesting HUD's assistance in determining which tenant screening protocol was correct, and HUD confirmed that the Part V form required by the City was the correct documentation by virtue of it being a City mandated requirement that is set forth in each property regulating agreement (as referenced above in the City's response to finding #2 .)

Finding # 5: Cost of Acquisition and Rehabilitation of Properties

**The City of Modesto agrees with this finding**

The City of Modesto would like to ensure that the Civil Grand Jury, as well as citizens of Modesto understand that the six month audit completed by the Housing and Urban Development (HUD) Office of the Inspector General (OIG), requested by the City, did indeed address the reasonableness of the property acquisition and rehabilitation costs and issued no findings on these matters. To illustrate this point, we are attaching a letter from the Inspector General of HUD which clearly makes this point (see attachment 1) Accordingly, the City agrees that that the OIG HUD audit did not address the screening and approval of prospective buyers or tenants of the NSP2 housing units.

Finding #6: Councilmember Acting Alone

The City of Modesto understands the Grand Jury's opinion on this matter. The Grand Jury's recommendations in this regard properly fall within the purview of the City Council for future determination as to whether any follow up action is necessary.

Finding #7: Councilmember Conflict of Interest

The City of Modesto considers this matter resolved and would refer the Grand Jury to the OIG Audit Report as to its findings in this regard.

**RECOMMENDATIONS STATED BY THE CIVIL GRAND JURY**

Recommendation #1:

**This recommendation was implemented by City Council on March 13, 2012.**

All NSP2 documents, property acquisition and pertinent information are now required to go through City Council for approval. In addition there are now two (2) City Council members sitting on the CH&CDC Committee where they receive monthly reports and updates. Both Council members have also volunteered to sit on the NSP2 CH&CDC Property Sub-Review Committee to evaluate the feasibility of the properties before they go to the full Council for approval.

Recommendation #2:

As stated above, the City Council will determine if any action is necessary.

Recommendation #3:

**The recommendation requires further analysis.**

On March 13, 2012 the City Council approved a resolution amending NSP2 guidelines to the following:

- Set a \$165,000 limit for the acquisition and rehabilitation for single family homes.
- Set a \$125,000 limit for the acquisition and rehabilitation per unit for multi-family units.
- Property subsidy has been capped at 30% for re-sales
- New standards for procurement of contractors and bids were adopted

The City of Modesto has also made additional efforts to ensure that all NSP projects adhere to HUD's standards of "cost reasonableness".

Further analysis will be required to determine if the structure outlined in this recommendation from the Grand Jury will be more effective than the new standards adopted by the City Council. The Grand Jury recommendation does not place a cap on total spending, as do the current guidelines adopted by the City Council in March 2012. Furthermore, at first glance, when the recommended 75% of purchase price threshold is applied to the current stock of NSP2 properties it appears the City would have spent an additional \$1,574,621.38 over what was actually expended in total for the rehabilitation of these properties.

Recommendation: #4

**The City has implemented this recommendation**

City staff has become more hands-on with the oversight of their developers, primarily SCAP/CICV. Examples include overseeing the establishment of new bid processes for contractors, routine walk-throughs of all projects still undergoing rehabilitation, weekly updates with the financial officer, and a set monthly meeting with representatives of SCAP/CICV and their property management firm to ensure that all tenant issues are being properly monitored and addressed.

Recommendation: #5

**The City implemented this recommendation**

Steps have already been made to include Demolition as a stand alone eligible use in NSP3

Recommendation: #6

**The City has implemented this recommendation**

City Staff has acquired the services of an outside legal firm recommended by HUD to draft all future NSP2 and NSP3 legal documents. Among the new changes being incorporated are several recommendations from recent HUD monitoring aimed at ensuring that the documents are more enforceable and have clear deadlines and benchmarks.

Recommendation: #7

The City will begin to post which City Council members received the AB1234 Ethics Training on the City's web-site in order to provide this information to the public.



U.S. Department of Housing and Urban Development

**Office of Inspector General**

451 7<sup>th</sup> St., S.W.

Washington, D.C. 20410

**JAN 26 2012**

Mr. Jim Ridenour, Mayor  
City of Modesto  
1010 10<sup>th</sup> Street Place  
Modesto, CA 95353

Dear Mayor Ridenour:

This letter serves as confirmation that the U.S. Department of Housing and Urban Development (HUD) Office of the Inspector General (OIG) conducted an audit of the Neighborhood Stabilization Program 2 (NSP2) grant that the City of Modesto (City) received. This audit started in May 2011 and ended with the issuance of a final report, dated December 22, 2011.

As stated in the audit report, the purpose of the audit was to “determine whether the City administered its NSP2 grant in accordance with HUD requirements.” Specifically, we focused on “whether the City administered the program to ensure that developers used program funds for eligible acquisition and rehabilitation costs. The audit scope did not include tenant or homeowner eligibility and occupancy.”

As described in the audit report, in order to accomplish the HUD OIG audit objectives, our audit staff reviewed the following items:

- applicable HUD requirements;
- relevant background information related to the City and its NSP2 grant;
- the City’s policies and procedures for administering NSP2;
- samples of the City’s records pertaining to property acquisition, rehabilitations, and expenditures and disbursements; and
- samples of escrow files.

In addition, the audit staff also conducted the following actions:

- visited a sample of properties purchased and rehabilitated under NSP2 and
- interviewed HUD staff, City staff, developers, and real estate agents, as appropriate.

As clarification, in the first step of our process, the survey phase, our staff reviewed a nonstatistical survey sample from a universe of 66 properties with more than \$10.3 million in



NSP2 funds drawn down and attributed to four activities as of March 31, 2011. The survey sample totaled more than \$5 million for 12 property acquisitions and 8 rehabilitations. In addition, during the audit phase of the process, we expanded the nonstatistical sample to include an additional 22 property acquisitions with purchase prices that totaled more than \$2.1 million and 19 property rehabilitations with rehabilitation budgets that totaled more than \$1.2 million (see appendix E in the audit report for a summary of property information).

As you know, any material violations of HUD regulations or City procedures would be cited as a finding or concern in the audit report. The audit revealed three separate findings in the audit report, in summary, these findings were:

- Finding 1: The City approved ineligible and unsupported costs during rehabilitation that resulted in the overpayment of \$56,130 of NSP expenditures
- Finding 2: One NSP2 developer and a City Council member violated the conflict of interest requirements in an NSP2 property purchase transaction. The amount of this violation was \$62,500.
- Finding 3: The City approved ineligible real estate commissions, in the amount of \$51,936.

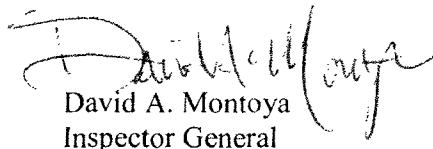
The audit report also notes that the audit “determined that the following internal controls were relevant to our audit objective:

- policies and procedures implemented to reasonably ensure that program activities comply with applicable laws and regulations.
- policies and procedures implemented to reasonably ensure that program funds are used for eligible activities.”

In closing, it is important to note that based on our sampling of files and transactions the three findings called out in the OIG audit report were the only material violations found during our audit.

I hope this letter helps to clarify the scope of the OIG audit and the information reviewed by our audit staff.

Sincerely,



David A. Montoya  
Inspector General

**MODESTO CITY COUNCIL  
RESOLUTION NO. 2012-374**

**RESOLUTION ACCEPTING THE RESPONSE TO THE STANISLAUS CIVIL  
GRAND JURY REPORTS 12-03C AND 12-04C**

WHEREAS, in August 2011 the Modesto City Council requested the Stanislaus Civil Grand Jury to review the Neighborhood Stabilization Program 2 (NSP2), and

WHEREAS, the Civil Grand Jury decided to review the program, and

WHEREAS, on June 28, 2012 the Stanislaus County Civil Grand Jury issued reports 12-03C and 12-04C focusing on the overall management of NSP2, and

WHEREAS, one of the requirements of the Grand Jury report is a written response from the jurisdiction regarding the 'Findings'.

NOW, THEREFORE, BE IT RESOLVED by the Council of the City of Modesto that it hereby accepts the response to the Stanislaus County Civil Grand Jury Reports 12-03C and 12-04C and authorizes the City Manager or his designee to submit the response.

The foregoing resolution was introduced at a regular meeting of the Council of the City of Modesto held on the 11<sup>th</sup> day of September, 2012, by Councilmember Cogdill, who moved its adoption, which motion being duly seconded by Councilmember Burnside, was upon roll call carried and the resolution adopted by the following vote:

AYES: Councilmembers: Burnside, Cogdill, Geer, Gunderson, Lopez, Mayor Marsh

NOES: Councilmembers: None

ABSENT: Councilmembers: Muratore

ATTEST:   
STEPHANIE LOPEZ, City Clerk

(SEAL)

APPROVED AS TO FORM:

By:   
SUSANA ALCALA WOOD, City Attorney