Internal Audit Department

Report 2012 – 4

Housing, Human & Veteran Services

Neighborhood Stabilization Program: Gilchrist Street Rental Properties

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TABLE OF CONTENTS

BACKGROUND 2
SUMMARY 3
SCOPE 3
OBSERVATIONS, RECOMMENDATIONS & MANAGEMENT RESPONSES 4
CONCLUSION 10
ADDITIONAL MANAGEMENT COMMENTS 11

The files and draft versions of audit reports remain confidential and protected from public records requests during an active audit under Nicolai v. Baldwin (Aug. 28, 1998 DCA of FL, 5th District) and Florida Statute 119.0713. Workpapers supporting the observations noted within this report are public record and can be requested upon release of the final audit report.
BACKGROUND

The Neighborhood Stabilization Program (NSP) is a federal program administered by the Department of Housing and Urban Development (HUD), which provides funding to state and local governments that have experienced property foreclosures and abandonment. The program’s purpose is to stabilize communities through government acquisition and rehabilitation of foreclosed homes, with the ultimate goal of selling the homes to income-qualified families. On the recommendation of its Housing, Human, and Veteran Services Department (HHVS), the Collier County Board of County Commissioners (BCC) used $449,460 of NSP funds on September 28, 2010, to purchase six duplexes (units: 5318, 5320, 5322, 5324, 5326, 5328, 5330, 5332, 5334, 5336, 5338, and 5340) on Gilchrist Street (the Property) in unincorporated Naples Manor. The properties were owned by the Bank of Naples at the time of purchase by the County; the Bank of Naples was acquired by Central Bank in July 2012.

The six Gilchrist Street duplexes had rent-paying tenants at the time of purchase by the County and the property management services were being provided by Colonial Square Realty, Inc. (the Manager). The Chairman of the BCC executed a temporary property management agreement on the closing date; among other duties, the agreement obligated the Manager to collect all rents on behalf of Collier County. An escrow agreement was also executed on the day of the closing; that agreement required the escrow agent, Stewart Title Company, to hold security deposits and October 2010 rents until given full direction by Collier County. County staff indicated the original purpose of acquiring the properties was to subsequently transfer ownership to a local non-profit organization within 30-60 days. After the Property was purchased by the County, circumstances arose whereby the non-profit organization could no longer acquire the properties. Transfer of the Property has not taken place as of the issuance of this audit report and the County has retained ownership of the properties since September 2010.

Upon discovering the rent-paying tenants in March 2011, the Clerk’s Finance Department inquired of HHVS staff regarding rent deposits, financial reporting and grant program income ramifications. In December 2011, HHVS provided financial statements for the Gilchrist properties from the Manager; those statements covered the period October 2010 through October 2011. HHVS provided additional statements to Internal Audit for November 2011 through March 2012 in April 2012. On July 25, 2012, the Manager furnished HHVS with their records related to the properties; Internal Audit immediately reviewed the records and withheld issuance of the draft audit report to review all invoice documentation, rather than just a sample of invoices, due to the nature of observations made during the July 18, 2012 meeting with the Manager and HHVS.

Upon request from the county in July 2012, escrowed funds in the amount of $80,119 were provided by Stewart Title to the County, representing that the distribution was the total of all monies related to these properties and the account is now closed. Internal Audit and HHVS are working jointly on a final reconciliation of program income for these properties.
SUMMARY

The following observations were generated during this review:

- HHVS did not follow the NSP Administrative Plan, Purchasing Policy or 24 CFR 85.36 in procuring property management services.
- The BCC did not approve the temporary property management agreement executed by the Chairman.
- The property management contract did not contain provisions for compliance with applicable HUD requirements.
- Funds in the escrow account were maintained in an account outside of the control of the County.
- HHVS allowed the property manager to collect and spend rent revenues rather than deliver them to the Clerk as custodian of County funds.
- Expenditure of certain rental revenues not valid or properly approved by County staff.
- Proper notice to vacate the properties was not given to tenants upon purchase of the property by the County.
- HHVS did not screen or monitor tenants for program eligibility.
- Program Income (PI) was not calculated, monitored nor reported to the grantor agency.

Irrespective of the initial intent of the County to dispose of this real estate within a short period of time, the funds in escrow and all additional revenues from these properties should have been handled through the County. Revenues and expenditures should be reviewed and approved by HHVS on a timely basis in order to ensure the proper accounting for grant funds and monitoring of program activities.

SCOPE

The review consisted of, but was not limited to the following tasks:

- Reviewing the Purchase and Sale Agreement for the Gilchrist properties between the Bank of Naples (recently acquired by Central Bank) and Collier County;
- Examining the temporary property management agreement and the escrow agreement;
- Reviewing the Purchasing Policy of Collier County (revised 2-09);
- Reviewing applicable BCC agenda records, including county Ordinances and Resolutions;
- Reviewing Property Appraiser’s records applicable to these parcels;
- Reviewing the NSP Administrative Plan and other grantor agency guidelines and regulations;
- Reviewing leases, reconciliations, and other files obtained from HHVS staff, including certain financial records from Colonial Square Realty and Stewart Title;
- Reviewing relevant emails and other communications regarding these properties;
- Meetings with County staff, including conference calls to discuss observations made during the audit;
- Searching records of the Florida Department of State, Division of Corporations and relevant Florida Statutes;
- A site visit to the office of Colonial Square Realty on July 18, 2012 to meet with the property management staff and test a sample of expenditures (cutoff period March 2012); subsequently, Internal Audit reviewed all records provided by Colonial Square Realty due to the nature of observations made at that meeting; and
- A meeting with Colonial Square Realty, Inc. staff on August 6, 2012.

The objectives of the review were to determine whether the Gilchrist rental property purchase and subsequent management and operations are in compliance with federal, state, county and grantor agency laws and regulations; the management contract is legal and valid; services were properly procured; revenue and expenditures are properly tracked, documented, approved and reconciled; program income is properly reported; and, to resolve custody of the escrowed funds.
OBSERVATIONS

1) Services for the properties not competitively procured.

Section 3.2 of the temporary property management agreement defines the compensation to the Manager as 15% of gross rent collections per month with a minimum of $500 per month. HHVS bypassed the procurement of services requirement defined in the 2009 NSP Administrative Plan, section (X)(ii), which states, “all purchases, excluding real property, under the NSP shall be procured in accordable [sic] with the County’s Purchase Policy and the County’s Procurement Administration Procedures.” Financial records from the Manager indicate that fees of $17,193 were collected between October 2010 and July 2012.

HHVS was unable to show that the 2010 procurement of services related to the properties was in compliance with the NSP Administrative Plan, the Purchasing Policy and 24 CFR 85.36(d)(1).

Lawn care and maintenance and handyman services for the properties were not competitively procured or reviewed for reasonableness; the property manager chose lawn and handyman service providers without obtaining bids or quotes for the goods and services. Payments of $5,250 and $11,779 have been made to Valencia Lawn Care and Commercial Handyman, LLC, respectively, for services rendered at the Gilchrist properties for the period October 2010 to July 2012.

Upon discussion of these activities with HUD Technical Assistance (TA) and HHVS in July 2012, the TA suggested that after County staff was aware the transfer of properties was not going to take place in 2010, the property management services should have, at a minimum, followed the procurement requirements of the County and therefore should have been competitively bid. The TA stated that the other services (i.e. lawn care and handyman services) should have been validated by HHVS as being reasonable. Comparing the price paid for the Gilchrist lawn care services to other lawn care companies that had been awarded contracts to maintain other NSP properties could have been performed to satisfy this responsibility.

24 CFR 85.36 (d) Methods of Procurement to be followed (1) Procurement by small purchase procedures: are those relatively simple and informal procurement methods for securing services, supplies, or other property that do not cost more than the simplified acquisition threshold fixed at 41 U.S.C. 403(11) (currently $100,000). If small purchase procedures are used, price or rate quotations shall be obtained from an adequate number of qualified sources.

Recommendations:

- The Purchasing Policy should be followed for all applicable activities, as stated in the 2009 NSP Administrative Plan section (X)(ii) approved by the BCC on October 27, 2009 (item 16D8).

- Agreements should clearly outline procurement rules to ensure vendors are aware of their obligations to comply with grantor agency requirements; County staff should closely monitor activities associated with grant programs to ensure compliance with those requirements.

Management Response:

Agree with recommendations. In 2010 HHVS did not intend for the agreement to remain in effect for more than 60 days, however as a result of the action of DLC it became necessary for HHVS to continue to maintain the property. It has been determined that the cost of some services performed by the Manager were reasonable as compared to other NSP services competitively procured. All current NSP agreements have been modified to identify grantor requirements and reporting. In addition, HHVS is in the process of developing monitoring standards for the NSP
program under the direction of the HUD TA to enhance HHVS ability to monitor recipients for compliance with program rules. Also, all new agreements do address routine monitoring of expenditures by HHVS on a regular basis. Finally, all procurement documents are now reviewed for grant compliance by the Grants Compliance Office (GCO) of the Collier County Office of Management and Budget.

2) Temporary property management agreement not approved by the BCC.
Although the signature of the BCC Chairman is on the temporary property management agreement with the Manager, there is no record of the BCC approving the contract. The BCC approved the amended NSP Administrative Plan on October 27, 2009. Plan section VIII.B. Acquisition of Real Property, paragraph xvii., authorizes the BCC Chairman to execute Agreements for Sale and Purchase for the acquisition of residential properties. However, that section of Plan does not appear to authorize the Chairman to execute property management service contracts for acquired properties. Section VIII.G. Transfer of Property, paragraph xiii. authorizes the BCC Chairman to execute “any and all other documents necessary for the transfer of residential properties,” but this section is devoted entirely to dispositions of NSP properties, and does not address the procurement of separate contracted services. BCC contracts executed by the Chairman are required to be approved by the BCC.

Recommendations:
- Contracts for services should be properly approved by the BCC and follow applicable state, grantor agency and county regulations.
- Only properly approved contracts should be signed/executed by the BCC Chairman.

Management Response: (Note: This response was prepared by the County Attorney’s Office)
Agree with recommendations. The best practice is to always have agreements such as the Temporary Property Management Agreement considered by the BCC. In this case, it was erroneously believed that the limited duration of the services would not trigger competitive procurement and therefore did not trigger Board approval. There was also erroneous reliance on the Administrative Plan and/or Ordinance No. 09-63 to secure the Board Chairman’s signature on the Temporary Property Management Agreement. Competitive procurement and Board approval should have taken place pursuant to the Administrative Plan before execution of the Temporary Property Management Agreement. In the future, there will be strict compliance with the Administrative Plan, or its successor.

3) Contract with property manager did not clearly define program compliance requirements.
The agreement between the BCC and the property manager did not specify that the project was funded by the Neighborhood Stabilization Program nor did it contain provisions for the management company to comply with HUD NSP requirements. Sample agreements for rental housing property management were available in the NSP Toolkit resources to assist grant recipients in drafting comprehensive contracts that include budgeting, procurement, reporting and various other requirements so that the responsibilities of all parties are well defined. In 2010, County staff did not make clear the activities of the rental properties are related to a grant program and did not monitor the revenues or expenditures, as such, certain expenses made against rental income have subsequently been found to be ineligible.
Recommendation:

- Agreements should be drafted in a manner that clearly defines the responsibilities of all parties. When available, grantor agency templates should be referenced to ensure agreements contain the minimum provisions required to comply with grant program guidelines.

Management Response:

Agree with recommendations; HHVS has been awarded technical assistance (TA) from the US Department of Housing and Urban Development. As part of this technical assistance, HHVS has made it a standard operating practice to utilize HUD approved templates as well as adding a second layer of review from HUD TA, and reviews by the GCO, the County Attorney’s office, and, when possible or appropriate, the Clerk of Courts Finance staff to assure full compliance and adherence to policy. In fact, HHVS has utilized HUD templates for its last three NSP related agreements in an effort to improve compliance and clearly define program parameters.

4) Funds related to the properties maintained outside of County controls.

Collier County entered into an escrow agreement with Stewart Title Company, the escrow agent, and the Bank of Naples, the seller of the six Gilchrist Street duplexes. This agreement was dated September 28, 2010, the same date that the County acquired the duplexes. The escrow agreement addressed $3,000 of tenant security deposits “to be held in escrow for the benefit of Buyer and Buyer’s successors and assigns, to be disbursed at the direction of Buyer.” In addition to the tenant security deposits, according to a Stewart Title ledger dated August 2, 2012, the Manager has made deposits totaling $80,119 to the escrow account since October 2010. Internal Audit requested the bank statements from HHVS to verify the current balance of the funds, but HHVS and property management staff stated that the escrow agent would not provide the documentation to the County due to the funds being commingled with other unrelated escrow accounts; the escrow agent did not maintain a separate account for these transactions, the balance was reconciled to the financial records for distributions made to the account by the Manager.

The money in the Stewart Title escrow account is Collier County revenue, yet it was not being accounted for properly in the records of the County or reconciled and reported as program income. The escrow agreement bypassed the obligation of the County to manage the funds. On numerous occasions upon becoming aware of the escrow agreement (in March 2011), Clerk staff requested that HHVS recover the funds from Stewart Title; the new HHVS Federal/State Grants Manager took action on this request in July 2012 and the escrow account with Stewart Title was closed in August 2012.

Recommendation:

- Contractual agreements should ensure proper custody and control of County funds.

Management Response:

Agree with recommendations. HHVS would concur that several discussions regarding collection of the income occurred between the Clerk and HHVS over several months. Due to the issues with the Neighborhood Stabilization Program, there was management turnover. During this period, HHVS and Grants Compliance Office staff were applying effort to understand the adjustments, the financial status and evaluating the best course of action to address the concerns. Management appreciates the patience and involvement of the Clerk staff in this highly unusual transaction. The goal was to be methodical and assure proper transition, and that was achieved.
HHVS has utilized HUD templates and prepared new agreements that strictly prohibit any program income from being retained outside of the county control. It should be noted that County funds are not considered program income until such time as gross funds are collected and all expenditures are accounted for and any remaining balance is program income thus county funds and shall be returned to the county.

5) Certain expenditures not valid or approved by County staff.
From October 2010 through July 2012, the Manager reported direct expenses for the properties of $20,202, not including management fees. Article III, Section 3.2 of the agreement between the BCC and the property manager states that, “All costs disbursed against the Budget and as otherwise approved by Owner, shall be for the benefit of the Property and expenses of the Owner. Owner agrees to reimburse Colonial Square Realty for any approved expenditure paid by Colonial Square Realty.” Invoices and other supporting documentation for expenditures were not reviewed by HHVS; therefore the accuracy and eligibility of the expenses were not validated or monitored by HHVS. Examples found to be ineligible include:

- Gift cards were purchased for tenants and classified as Office Supplies
- Credits against rent were given to tenants for repairs stated to be performed by the tenant, without sufficient invoice documentation
- Reduction to monthly rent given to one tenant for miscellaneous services

Section 2.1 of the management agreement states that the scope of allowable expenditures is limited to maintenance and repair of the Property, specifically “including, without limitation thereof, interior and exterior cleaning, painting and decorating, plumbing, carpentry, elevators, heating, air conditioning, landscaping, and such normal maintenance, preventative maintenance and repair work as may be prudent, subject to limitations imposed by Owner’s Representative in addition to those contained herein.” Office expenses were reimbursed to the Manager in addition to the management fee, which does not appear to be allowed according to the agreement.

Sales tax was erroneously charged to the Manager on handyman services provided by Commercial Handyman, LLC (reference F.S. 212.05). This was discovered and discussed with property management staff during the July 18, 2012 meeting. Upon inspection of certain records provided to HHVS on July 25, 2012 by the Manager, a credit memo issued by Commercial Handyman Services, LLC dated July 19, 2012 in the amount of $614.37 was observed. Sales tax charged by Commercial Handyman Services has not been refunded by the Manager to the County at this time.

It was also noted that the management fee collected by the Manager was not consistently 15% of total gross rents collected. Some months exceeded the amount, while other months were less. Property management staff confirmed that the fee is calculated on the cash basis and therefore inconsistencies should not exist. Internal Audit reviewed all fees calculated and collected by the Manager and determined that a balance due for management fees is outstanding as of August 2012.

Note: Internal Audit is working with HHVS to determine the final amounts due to/from the Manager and the County as of August 2012. The Manager has indicated to Internal Audit willingness to repay amounts determined to be ineligible expenditures as a result of the audit.

Recommendations:

- HHVS should properly monitor the expenditure of grant funds by reviewing supporting documentation prior to approving payments to vendors.
- Fees paid to vendors should reflect the amount as permitted by the agreement and should be validated by County staff for accuracy.

**Management Response:**

Agree with recommendation: HHVS has implemented a process to routinely monitor all expenditures and supporting documentation to ensure compliant payments.

The HUD approved template for property management services does not require a prescribed review of expenditures prior to reimbursement. Thus the HUD property management template allows for the property manager to collect gross rents and make necessary expenditures and maintain a capital reserve and any remaining funds are to be accounted and tracked as program income. Before the County took back the property management of the properties, it had been the intent to enter into a new property management agreement that would have been more restrictive than the approved HUD guidance. However, management has now made a decision to competitively procure a developer for the property.

HHVS has implemented numerous changes and has modified agreements to require routine submission of documentation and quarterly monitoring requirements that include reconciliation and review of all expenditures.

HHVS agrees with the finding that office supplies are expressly not allowable and should be repaid by the Manager along with all other non-eligible expenses. Clerk staff has drafted a final reconciliation and HHVS, along with the Clerk’s Office have reached consensus on a final repayment amount from the Manager. HHVS will be requesting payment forthwith.

6) **Proper notice to vacate the properties not given to tenants.**

The Uniform Relocation Act (URA) requirements are triggered when using grant funds to acquire a rental property with existing tenants. To be in compliance with the URA, proper notice in the form of a General Information Notice (GIN) should be given to all tenants before acquiring such a property, regardless of whether they are or are not scheduled to be displaced by the acquisition (49 CFR 24.203(a)).

HHVS stated to Internal Audit that upon acquisition of the properties proper notice was not given to the tenants by the County. Upon review of records provided by the Manager, URA notifications were observed to be on file for several tenants; URA notices were given by the David Lawrence Center in 2009 when the non-profit was planning to acquire the Gilchrist properties. HUD Technical Assistance confirmed that the notice provided at that time was sufficient to meet URA requirements, however proof of notice to all established tenants was not found on file. HHVS should have confirmed that notice was given to all tenants at the time the properties were purchased with NSP funds.

**Recommendations:**

- Proper notice must be provided to all established tenants upon acquisition of a rental property where grant funds are utilized to conform to URA requirements.

- HHVS should establish advisory services and a plan to accommodate tenants that will be displaced by a potential sale, transfer or demolition of the property.
Management Response:

Agree with recommendations. A General Information Notice per URA guidelines was disbursed to a majority of the tenants who resided at the property by DLC at the time that acquisition of the properties was being considered; management at the time did not ensure all tenants were notified. Current HHVS management has consulted with HUD TA regarding the content of the notice and it was determined that the notice was properly drafted with all necessary information at the time that the properties were selected to acquire. Upon acquiring the properties the Manager was given explicit instructions from HHVS not to proceed with filling empty units with additional residents. By allowing new tenants to move into the vacant units the Manager was in breach of the directive given to them by HHVS. It is the opinion of HHVS that the Manager should be held liable for any URA costs associated with their filling vacant units in conflict with HHVS and URA procedures. Regarding establishing advisory services and a plan as noted above, this recommendation is accepted as a future action should this circumstance present itself in the future.

7) Tenants were not screened for program eligibility.
HHVS did not validate the eligibility of the Gilchrist property tenants at the time the properties were purchased in 2010. In addition, new tenants were allowed to move into the units without being screened for program eligibility. HHVS staff stated that the new tenants had moved into the units without their prior knowledge or approval, and requested they be removed from the units. Both new tenants vacated within three months; however, allowing the tenants to occupy the units did not comply with the Housing and Economic Recovery Act of 2008 (HERA) Section 2301(f)(3)(A)(i) requiring that “all funds appropriated or otherwise made available under this section shall be used with respect to individuals and families whose income does not exceed 120% of area median income.” HUD has further determined that “tenant incomes must be certified as meeting the applicable income limits at initial occupancy and at any time a new tenant occupies a unit.”

Recommendations:

- Procedures should be implemented for HHVS to ensure that tenants are income qualified to live in the rental units to be in compliance with grantor agency guidelines.

- Processes should be established to monitor changes in tenants to ensure all new occupants are properly screened for program eligibility.

Management Response:

Agree with recommendations. HHVS assumed full responsibility of the property management in August 2012. Tenant eligibility activities occurred throughout the month of August. HHVS has followed the procedures set forth by HUD for the NSP program. Those tenants that have not income qualified will be provided eviction notices in accordance with NSP policy and under the direction of the NSP HUD TA. It is the policy of the county to not rent any vacant units to new tenants therefore future eligibility will not be an area of non compliance. However, once the property is assumed by a developer it will be the responsibility of the developer to ensure income eligibility in addition to oversight provided by HHVS. The developer agreement also shall contain income qualifying requirements to further ensure compliance and this will be monitored by HHVS.
8) **Program Income (PI) not reported to the grantor agency.**

Net operating income (revenue from rent collections less allowed expenditures) from rent collections is considered NSP PI according to 24 CFR 570.500(a)(1), and is required to be reported to the grantor agency, HUD, with the Quarterly Performance Reports (QPRs); HHVS staff confirmed that the reporting has not been done. Deposits of net income were made by the Manager to the escrow account with Stewart Title without being validated and captured as PI.

Note: Internal Audit is working with HHVS to determine the final amount of program income generated by the rental activity as of August 2012.

**Recommendation:**

- HHVS should compile all records necessary to validate the amount of PI required to be returned to the county and submit the proper information in the next QPR to the grantor agency.

**Management Response:**

Agree with recommendations. Program Income was received and accounted for, however, not reported. On September 11, 2012 all program income was recognized and will be reported in the fourth quarter QPR on January 31, 2013 to HUD. HHVS is in the process of adopting internal policies to address accurate reporting to grantor agencies. HHVS has also initiated new sub recipient agreements that require quarterly monitoring and reporting of any earned program income.

**CONCLUSION**

HHVS made Internal Audit aware that the original intent for these properties was an immediate subsequent transaction with a non-profit organization to assume the ownership and management of the Gilchrist units (dating back to late 2010). That transaction was not and still has not been executed; the County retained the responsibility of overseeing the activities of the property manager and as of August 2012, the County has assumed full management of the Gilchrist properties. The audit results indicate a lack of prior management oversight and compliance in several areas, showing that immediate action was required to remedy the remaining audit observations.

During the invoice review portion of this audit, ineligible program expenditures were noted; all were paid prior to any review or approval by HHVS. The practice of “netting” expenses against revenues was addressed in Attorney General Opinion 79-78, which stipulates, “…the board of county commissioners, in the absence of statutory authority, cannot delegate by contract its authority to approve, compromise, and pay claims against the county…” The *Alachua County v. Powers* case also established that the pre-auditing responsibility is shared by the clerk and the board of county commissioners. HUD does allow eligible program expenditures to be netted against revenues for NSP rental properties; however, this does not preclude the recipient of the NSP grant funds from performing the proper oversight of the use of the funds.
The audit observations related to the expenditure of grant funds may have been avoided with the proper control mechanisms in place: a legal and valid contract, review and approval of expenditures by County staff, and appropriate grant monitoring and oversight by HHVS.

It is the responsibility of County management to understand and implement the proper procedural controls in order to limit the risk of fraud, error, and misappropriation of county assets. Internal Audit may recommend improvements in audit reports, but ultimately it is the duty and decision of County management to formulate processes that ensure compliance with federal, state and county laws and policies.

Additional Management Comments:

Management appreciates the opportunity to review and provide comment to this report. The current HHVS management team and staff have worked in concert with the Finance and Audit teams to understand and seek resolution on all identified issues, and we are pleased to be able to report many of recommended actions are completed and the others are well underway. We remain committed to identifying and resolving control and compliance issues and we appreciate the input and guidance of the Clerk Internal Audit and Finance department staff members toward that end.