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September 28, 2006

The Honorable Antonio Villaraigosa, Mayor  
The Honorable Rockard J. Delgadillo, City Attorney  
The Honorable Members of the Los Angeles City Council  
City Hall  
200 North Spring Street  
Los Angeles, California 90012

Dear Mayor Villaraigosa, City Attorney Delgadillo and Members of the City Council:

In October of 2004 I released a series of three audits of the Los Angeles Community Redevelopment Agency (CRA). With an annual operating budget of \$430 million, and a loan portfolio of half-a-billion dollars, the CRA is one of the most important pistons in the City's economic engine. The CRA is charged with attracting private investment into economically depressed neighborhoods, creating jobs, eliminating blight, and encouraging development in areas where development is most difficult.

These audits made 92 recommendations for change, signaling a loud SOS for the CRA, a large and rusty ship in distress. With that kind of call for monumental change it was clear that I would need to circle back with a follow-up audit which I release today.

While the CRA is no longer rusty, and the barnacles have been scraped off her hull, the Agency is still fundamentally off-course and needs further redirection. The Agency has moved rapidly to implement 57 of the audits' recommendations. Unfortunately, some of the most fundamental policy issues regarding the fulfillment of the CRA's mission remain unanswered.

One example is how the CRA is missing out in bringing additional dollars back to the City to finance additional CRA projects. The audit showed that the CRA still does not incorporate a profit sharing clause in its market-rate housing projects. If a profit-sharing clause was included in the loan agreements, the CRA could receive a share of the profits along with the developers.



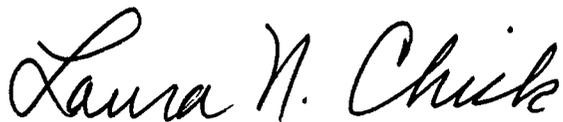
September 28, 2006  
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Another ongoing problem is that a small number of borrowers and developers receive the majority of CRA loans. It is difficult to believe that in a real estate town such as Los Angeles, the CRA's explanation is that they can't find enough interested, qualified developers. An aggressive and effective campaign, reaching out to the building industry, should help attract a significantly larger pool of viable contractors.

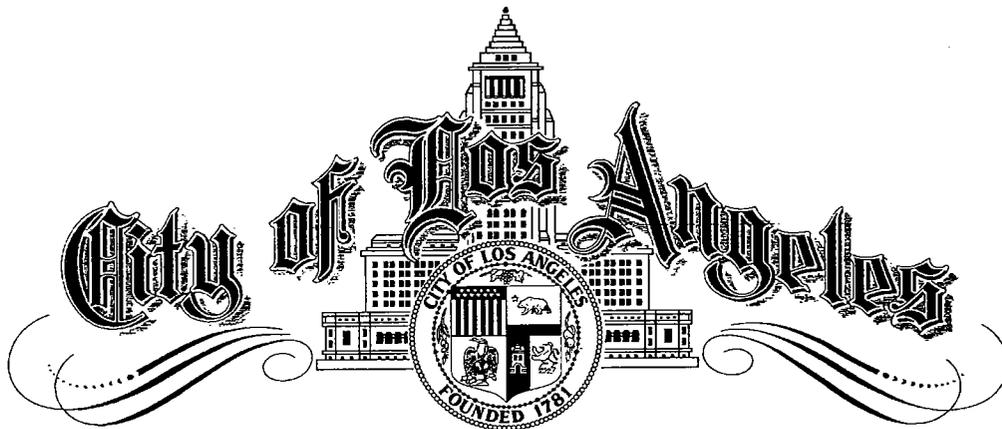
The follow-up audit found once again that the CRA still fails to monitor whether developers are providing affordable housing as promised. One of the key reasons for the existence of the Agency is to encourage development of sorely needed affordable housing. The CRA makes millions of dollars available for that purpose, but does not follow-up to guarantee that the affordable housing units are delivered and maintained.

The purpose and mission of the CRA is far too important to be allowed to get, much less remain, off-course. With the new leadership at the helm of the CRA, and the impetus of a follow-up audit, now is the time for the CRA to realize its full potential.

Sincerely,

A handwritten signature in cursive script that reads "Laura N. Chick".

LAURA N. CHICK  
City Controller



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September 28, 2006

Cecilia V. Estolano, Chief Executive Officer  
Community Redevelopment Agency  
354 South Spring Street, Suite 800  
Los Angeles, CA 90013

Dear Ms. Estolano:

Enclosed is a report entitled, "Follow-Up Audit of the Community Redevelopment Agency (CRA)." A draft of this report was provided to your office on September 21, 2006. Comments provided by your Agency at the September 26, 2006 exit conference were evaluated and considered prior to finalizing this report.

Please review the final report and advise the Controller's Office by October 27, 2006 on planned actions you will take to fully implement the remaining recommendations in the 2004 audits. If you have any questions or comments, please contact me at (213) 978-7392.

Sincerely,

A handwritten signature in black ink, appearing to read 'Farid Saffar'.

FARID SAFFAR, CPA  
Director of Auditing

Enclosure

cc: Robin Kramer, Chief of Staff, Office of the Mayor  
Marcus Allen, Deputy Chief of Staff, Office of the Mayor  
Bud Ovrom, Deputy Mayor, Office of the Mayor  
William H. Jackson III, Chair, CRA Board of Commissioners  
William T Fujioka, City Administrative Officer  
Frank Martinez, City Clerk  
Gerry F. Miller, Acting Chief Legislative Analyst  
Independent City Auditors



# **City of Los Angeles Office of the Controller**

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## **Follow-Up Audit of the Community Redevelopment Agency (CRA)**

**September 28, 2006**

**Laura N. Chick  
City Controller**

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## EXECUTIVE SUMMARY

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The Community Redevelopment Agency of the City of Los Angeles (CRA/LA) is a public Agency established to attract private investment into economically depressed communities and to eliminate slums, abandoned or unsafe properties and blight throughout Los Angeles. It encourages development and promotes revitalization in the City through its various housing, commercial and industrial projects by providing different types of assistance to eligible individuals and developers consistent with its redevelopment goals. The CRA derives its primary funding from property tax increment revenue, tax allocation bond proceeds, grants, and general revenues that include land sale proceeds, rental income, loan repayments, and investment income.

CRA provides assistance in various forms such as acquisition or predevelopment loans, construction or permanent financing gap loans, tax allocation bond financing, selling real estate at less than fair market value, leasing real estate properties for an extended period of time at a below-market rate, etc. As of June 30, 2006, CRA's loan portfolio consisted of 932 loans with a balance of \$535 million.

In October 2004, the City Controller's office issued three audit reports covering CRA's major operations. The audits found that the Agency lacked sound underwriting guidelines, adequate monitoring of its loan portfolio and Agency-wide policies and procedures. The three audits contained 92 recommendations for improvements.

### **Summary of the Follow-Up Audit**

The CRA underwent an organizational restructuring and operational overhaul in response to the 2004 audits. CRA hired key underwriting management personnel. It formed a loan committee to provide independent reviews of loan applications and loan re-structures, contracted with outside consultants to review significant loan accounts, and developed more standardized loan underwriting and monitoring policies. The Agency also developed guidelines for dispositioning real estate, particularly for Disposition and Development Agreements (DDA's) and Owner Participation Agreements (OPA's).

Although the new commercial underwriting guidelines are still in a "draft" stage, staff has already incorporated the elements into their review of loan applications. For example, we noted new loan application files now include evidence of adequate research of the borrower's background such as credit reports, past financial statements, analysis of financial viabilities etc. We also noted that reports to the Agency's Board of Commissioners (Board) now include a section entitled "Community Context Report" where quantifiable goals and objectives of each project (such as the number of housing or jobs) are discussed. The Agency also increased its residual receipt billings and

collections, from \$686,484 in Fiscal Year 2004-05, to approximately \$2 million in Fiscal Year 2005-06, an increase of 194%.

However, a number of our recommendations, affecting CRA's ability to effectively develop and monitor its loan activities, have not been fully implemented despite the ample time available to CRA since our reports were issued in October 2004. Agency management must continue this effort by enhancing and strengthening its oversight of underwriting and monitoring functions to ensure that development activities and loan decisions are prudent, sound and in the public's best interest.

Overall, we determined that the Agency has implemented 57 recommendations and partially implemented 23. CRA has not implemented 10 recommendations and two recommendations no longer apply. Some of the key areas the Agency still needs to address are as follows:

□ **CRA Does Not Consistently Use a Profit-Sharing Arrangement**

The 2004 audit noted five successful developments, some of which the owners were in the process of selling the properties. The audit noted that CRA was not able to share in the potential profits because a profit participation clause was not included in the loan agreements. If a profit-sharing clause was included in the loan agreements, the CRA could receive its share of the profits along with the developers upon the sale or refinance of the market-rate or the commercial/retail units, without impacting the status of the existing low-to-moderate income housing units.

Our follow-up shows that CRA still does not incorporate a profit sharing clause in its market-rate housing projects. On commercial and mixed-use projects, we noted that the commercial underwriting standards address the inclusion of a profit-sharing/participation agreement clause. However, only one of the three proposed agreements since May 2005 included the profit-sharing clause.

□ **CRA Needs to Increase Participation in its Redevelopment and Loan Activities**

The 2004 audit revealed that CRA made a substantial amount of loans to a limited number of borrowers and developers. The result of this practice led to a high concentration of risks associated with these borrowers and developers. The audit recommended that the CRA establish a maximum number and dollar amount of loans that could be made to the same developer.

CRA did not implement this recommendation. CRA stated that it makes real estate loans based on its value of contribution to communities. The Agency stated that only a handful of developers are willing to do business in certain communities within the City and that it does not have a high number of qualified developers for its projects. However, the Agency management agreed with the intent of the recommendation and indicated that it is working on simplifying procedures/processes, and expanding its outreach efforts to increase the pool of qualified developers. As part of its efforts to increase its pool of developers, the Agency should also coordinate its efforts with other

City departments such as the Building and Safety and Planning to identify other developers who already conduct business in the City in order to increase its pool of qualified developers.

□ **Loan Receivable and Project Management Systems Still Need To Be Finalized**

The 2004 audits found many weaknesses in the system tools used for loan monitoring and project management. For instance, the Loan Receivable system did not have the capability to accurately calculate and report loan interest accrual. The Chartering System used for project monitoring was cumbersome and not user-friendly. As of the date of this report, these systems have not yet been implemented. The lack of adequate project management and loan receivable systems continues to hinder the CRA's ability to efficiently manage its projects and loan activities.

□ **Loan Monitoring Efforts Are Still Inadequate**

The 2004 audits found that CRA failed to pursue all available options relative to delinquent borrowers. For example, CRA had not established policies to prohibit borrowers and developers under "technical default" from applying for a loan within two years, did not file default notices, and did not report delinquent borrowers to credit reporting agencies. The 2004 audits also noted that CRA had not made any effort to share default information with other City agencies, to protect the City against defalcations. Although CRA now files and shares default notices with other City departments and conducts necessary appraisals of properties, it still does not report delinquent borrowers to credit reporting agencies.

We also found that once a loan is approved, neither CRA nor its loan-monitoring consultant verifies that the borrowers continue to comply with non-monetary terms of the loan agreements such as the insurance requirements. A listing of insurance policies provided by the CRA shows many policies have expired. Additional monitoring efforts are still needed to ensure borrowers' compliance with non-monetary loan agreement terms.

□ **CRA Needs to Perform a More In-depth Review of its Borrowers' Financial Statements**

The residual receipt loan agreements require borrowers to submit annual financial statements to the CRA. The financial statements are used to determine any residual receipts due from borrowers. The 2004 audit found that CRA had underbilled various residual receipt borrowers because of limited oversight of its loan servicers and inadequate review of financial statements submitted by borrowers.

Subsequent to the audits, the Agency engaged a Certified Public Accountant (CPA) firm to review four borrowers identified as high-risk. In addition, since the CRA assumed the responsibility for reviewing financial analyses in-house, it added two additional financial staff. As a result of its efforts, the Agency increased its residual receipt billings and collections, from \$686,484 in Fiscal Year 2004-05, to approximately \$2 million in Fiscal Year 2005-06, an increase of 194%.

However, the reviews performed by CRA lacked thorough analyses and quality. For example, staff does not analyze and question upward trends in expenses nor do they review property management contracts and amendments, especially in cases where the expenses appear to be more than stipulated in the agreements. We believe the Agency can further increase its collections by performing a more in-depth review of financial statements received.

□ **Monitoring of Affordability Covenants and Performance of Physical Inspections Require Additional Efforts**

Section 33418 of the California Health and Safety Code requires redevelopment agencies to obtain annual reports from property owners or managers to certify compliance with the affordability covenant. For rental units, the report must include the rental rate, income, and family size of the occupants. For each owner-occupied unit, the report must include information as to whether there was an ownership change from the prior year and, if so, the income and family size of the new owners. In addition, State and federal guidelines require CRA to ensure that physical inspections are performed to determine compliance with property standards.

The 2004 audits reported that CRA did not monitor compliance with the affordability covenant. Specifically, we noted that CRA had not been obtaining the annual reports from borrowers. The audit also revealed that CRA failed to conduct physical inspections of properties required by applicable laws. We noted during this follow-up that CRA started monitoring for affordability covenants but does not currently perform physical inspections. The CRA indicated it plans to utilize the inspection reports issued by the Los Angeles Housing Department (LAHD) on its properties. If CRA utilizes LAHD inspections, it should ensure that the inspections are performed within the timeframe required by the funding agencies.

**Review of Report**

A draft report was provided to CRA management on September 21, 2006. We met with CRA representatives on September 26, 2006 to discuss the contents of the report. The Agency indicated general concurrence with the findings. We would like to thank the Agency management and staff for their cooperation and assistance during the audit.

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## Introduction and Background

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The Community Redevelopment Agency (CRA) is a public agency, established by a resolution in 1948. It has been the City of Los Angeles' public partner in housing, commercial, neighborhood and economic development. The CRA has a goal of revitalizing, refurbishing, and renewing economically underserved areas of Los Angeles for the purpose of eliminating blight, providing low and moderate income housing and encouraging economic development. CRA provides financial assistance in the form of loans and grants to residents, local businesses, and developers.

The CRA is governed by State regulations but takes its direction from the Mayor and the City Council. It is overseen by a board of seven commissioners, appointed by the Mayor and confirmed by the City Council. According to a city ordinance adopted in 1991, all actions taken by CRA are subject to City Council approval.

The CRA currently operates in 32 redevelopment project areas and three revitalization areas in seven regions throughout Los Angeles. Redevelopment project areas are designated as blighted by the CRA Board, the Mayor and the City Council, and are for which redevelopment plans have been approved as required by California Community Redevelopment Law. CRA provides assistance in various forms such as acquisition or predevelopment loans, construction or permanent financing gap loans, tax allocation bond financing, selling real estate at less than fair market value, leasing real estate properties for an extended period of time at a below-market rate, etc. As of June 30, 2006, CRA's loan portfolio consisted of 932 loans with a balance of \$535 million.

CRA derives most of its revenue from the following four sources: (1) property tax increments generated from redevelopment project areas, (2) tax allocation bond proceeds, (3) grants, and (4) other general revenues, including the proceeds from certain land sales, developer payments, rental income, loan repayments and investment income. The Agency is required, by law, to set aside a minimum of 20% of the revenues it accrues for the purpose of maintaining and expanding the supply of housing for low and moderate income households. CRA's operating budget for Fiscal Year 2005-06 was \$430 million.

In October 2004, the Controller's Office issued three audit reports covering CRA's major operations. The audits found a lack of Agency-wide policies and procedures, and non-standardized loan underwriting and monitoring practices. The three audits contained 92 recommendations to improve controls over loan underwriting and collections, developer subsidies, and disposition of real estate. The following is the breakdown of the recommendations in the three audit reports:

- Review of the Loan Underwriting Practices at the CRA – this audit examined the underwriting process and practices. The audit contained 59 recommendations.

- Financial and Compliance Audit of the CRA's Development Loans and Developers' Subsidies – this audit evaluated at CRA' monitoring efforts of its loan programs. The audit contained 20 recommendations.
- Financial and Compliance Audit of the CRA's Disposition of Real Estate – this audit examined the Agency's process for dispositioning its real estate properties. The audit contained 13 recommendations.

### **Scope, Objective and Methodology**

The objective of this follow-up was to evaluate the adequacy, effectiveness, and timeliness of actions taken by management on findings and recommendations contained in the three 2004 audits. Our follow-up audit was performed in accordance with Generally Accepted Government Auditing Standards and covered the period from January 2005 through June 2006. To meet our audit objective, we performed the following procedures:

- Verified and corroborated the CRA's specific actions and plans on recommendations that the Agency considered implemented.
- Interviewed CRA's staff involved in loan underwriting, loan monitoring, and disposition of real estate.
- Reviewed CRA's Board minutes and reports.
- Reviewed the new loan monitoring policies and procedures, and guidelines for disposition of real-estate properties.
- Reviewed the new underwriting guidelines for housing and commercial/industrial loans.
- Tested new loan application files to determine whether each file includes evidence of adequate background research on prospective borrowers such as credit reports, tax returns and evidence of financial capabilities.
- Reviewed a sample of borrowers' financial statements and residual analyses performed by Agency staff for accuracy, timeliness and proper disposition in accordance with Agency policies.
- Tested sample loan files for evidence of compliance with the affordability covenants, physical inspection requirements and other loan agreement terms.

For the three audits, we determined that CRA has implemented 57 recommendations. Of the remaining 35 recommendations, 23 are partially implemented, 10 have not been implemented, and two no longer apply. The following three sections discuss each audit report and recommendations that are yet to be fully implemented. Attachments I through III provide a listing of each of the 92 recommendations contained in the three 2004 audits, along with the status of each recommendation.

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## Section I. Loan Underwriting Practices

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As noted earlier, to accomplish its redevelopment goals, the Agency provides financial assistance in the form of loans and grants to individuals and developers. The CRA offers developers and homeowners a variety of loan options with unique repayment terms and below market interest rates. CRA's goal is to provide incentives or developer subsidies to ensure the delivery of critically needed projects to Los Angeles communities. The following is a description of the different loan types offered by the CRA.

### Residual Receipt Loans

Residual receipt loans (RRL) are loans that share in the residual income of the mortgaged property after all operating expenses are paid. These loans accrue interest and any residual income goes first to pay current interest and then accrued interest and principal. These loans have deferral periods during which payments from residual income is limited in the early years to current interest only. RRLs constitute the bulk of CRA's portfolio.

### Deferred Loans

Deferred loans are loans that permit the borrower to defer all principal payments until the end of the loan term. At the end of the term, the borrower is required to pay off the principal in full. The average term of a deferred loan is 25 years.

### Amortized Loans

Amortized loans have fixed periodic payments. The principal balance is recovered at the end of a designated term or when the title to the collateral property is sold, transferred, or encumbered.

### Home Ownership Loans

Home ownership loans are made to owners of single-family residential properties for initial purchases and are secured by second trust deeds. The principal is due upon the 30<sup>th</sup> anniversary of the loan origination date or upon sale of the property, the failure of the borrower to maintain the property as the primary residence, and/or the default on the first trust deed.

### Forgivable Loans (Conditional Grants)

Forgivable loans are loans that have no fixed monetary payment but are repaid by the provision of a specific service. The loan may be forgiven if specific conditions are met. Examples of forgivable loans include child care loans which are "repaid" by providing child care to low and moderate income households or loans to AIDS hospices that are repaid by providing AIDS residential services to the community.

As of June 30, 2006, the Agency had a loan portfolio of 932 loans with a principal balance of \$535 million. The distribution of the loan portfolio is shown in the figure below:

**Allocation of Loan Funds By Loan Type, As of June 30, 2006**  
**(balance is in thousands)**

Loan Type	# of Loans	Balance	% of Total
Residual Receipts	302	\$ 412,395	77.0
Deferred	180	48,076	9.0
Amortized	207	35,678	6.7
Conditional Grants	152	35,300	6.6
Home Ownership & Subsidy	91	3,787	0.7
<i>Total</i>	<b>932</b>	<b>535,236</b>	<b>100</b>

*Source: CRA's Records*

The Controller's 2004 audit of loan underwriting practices found that the Agency lacked comprehensive and sound underwriting policies and procedures. Key findings of the audit included the following:

- Lack of Agency-wide underwriting standards.
- Lack of adequate oversight over underwriting staff.
- High concentration of risk among few borrowers/developers and their affiliates.
- Lack of adequate research of each developer's background to ensure each is free from credit or financial problems.
- Deficient information provided to the Board of Commissioners.
- Lack of measurable goals and a sustainable loan underwriting operational plan.

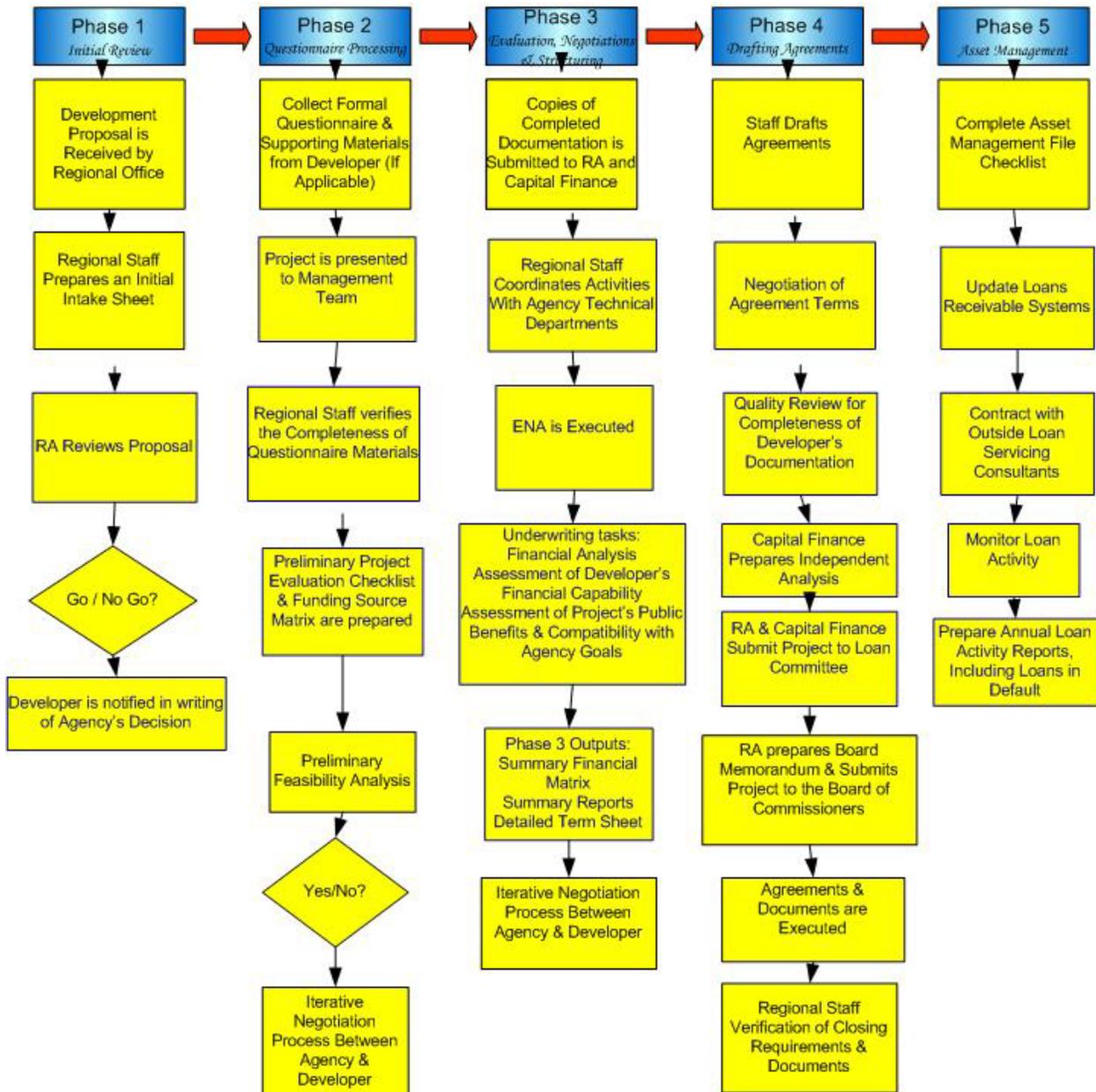
CRA has taken a number of steps to address the key underwriting issues raised in the 2004 audit. Subsequent to the audit, the Agency hired a consultant, Keyser Marston Associates, Inc., to conduct a study of underwriting industry standards and best practices. The CRA also sent out surveys to other redevelopment agencies and its external consultants to solicit ideas about their procedures and guidelines. CRA staff, working with the consultant, and incorporating the recommendations in the 2004 audit report, developed Agency-wide housing policies, and loan monitoring and administrative policies. The Agency's Board approved these policies in 2005. In its attempt to educate its stakeholders and increase transparency, the CRA published its procedures and policy manuals on its website. In July 2006, the staff completed commercial

underwriting policies and guidelines. These guidelines provide a framework for staff and borrowers to follow for creating new loans and modifying existing loans. CRA plans to train its staff on the new completed guidelines.

In 2005, the CRA established and filled a Manager of Capital Finance position to oversee the technical underwriting efforts of commercial loans. CRA also hired a new Director of Housing to oversee technical underwritings of housing loans. The two individuals provided appropriate input and helped the Agency to develop the underwriting guidelines. The CRA also established a loan committee comprised of three CRA staff (the Manager of Capital Finance, the Housing Director and a Regional Administrator), a staff from the Community Development Department and a staff from the Los Angeles Housing Department. The loan committee reviews all loans over \$250,000 and all loan restructures before the loans are presented to the CRA Board.

Although, at the time of this report, the commercial underwriting guidelines are still in a "draft" stage, staff has already incorporated the elements of the guidelines into their review of loan applications. For example, we noted new application files now include evidence of adequate research of the borrower's background such as credit reports, past financial statements, analysis of financial viabilities, etc. We also noted that Board reports now include a section entitled "Community Context Report" where quantifiable goals and objectives of each project (such as the number of housing or jobs) are discussed. New loan files also include evidence that loans over \$250,000 are submitted to the loan committee for review and comments before they are presented to the Board. The following page shows CRA's new commercial loan review and monitoring process.

## The CRA's new loan underwriting and monitoring process



Source: CRA draft underwriting policies

The underwriting audit contained 59 recommendations to improve controls. We determined that CRA has implemented 41, partially implemented 11, and has not yet implemented

seven. While we recognize that CRA has made progress, the following issues still need to be addressed.

### **CRA Still Needs to Increase Participation in its Redevelopment and Loan Activities**

The 2004 audit revealed that CRA made a substantial amount of loans to a limited number of borrowers and developers. The audit noted that 37 out of 339, or 10% of the borrowers/developers, received 73.6% of the total funds awarded. The result of this practice led to a high concentration of risks associated with these borrowers and developers. Furthermore, this practice may exclude qualified and competent developers from participating in the redevelopment process. The audit recommended that CRA establish a maximum number and dollar amount of loans that can be made to the same developer.

CRA does not believe that a maximum dollar amount should be established and therefore did not implement this recommendation. CRA stated that it makes real estate loans based on its value of contribution to communities. It believes that loans should be underwritten on a case-by-case basis. It also believes that only a handful of developers are willing to do business in certain communities within the City.

However, the Agency management agreed with the intent of the recommendation and indicated that it is working on simplifying procedures/processes, and expanding its outreach efforts to increase the pool of qualified developers. As part of its efforts to increase its pool of developers, the Agency should coordinate its efforts with other City departments such as the Building and Safety and Planning to identify other developers who already conduct business in the City in order to increase its pool of qualified developers.

Once the Agency increases its pool of qualified developers, the Agency should consider establishing a maximum number and dollar amount that can be awarded to the same developers. This should help increase participation in its redevelopment activities and help minimize the concentration of its loan risks.

### **CRA Does Not Consistently Use a Profit-Sharing Strategy**

The CRA participates in developments that consist of a combination of market-rate residential for-sale and rental units, as well as retail/commercial elements. These types of developments can represent substantial potential profit for both the developers and the CRA, in terms of equity, if the development is eventually sold. The 2004 audit noted the Agency's loan agreements did not contain a profit sharing clause. As a result, CRA did not put itself in a position to take advantage of any potential increase in the value of the developments.

Our follow-up shows that CRA still does not incorporate the profit sharing clause in its market-rate housing agreements. The CRA staff indicated that the Agency does not intend to have any more market-rate housing projects. Nevertheless, the staff stated that the Agency will consider including an equity/profit-sharing clause when structuring projects with a market rate component. As for the commercial and mixed-use projects, the newly commercial underwriting guidelines address the inclusion of a profit-sharing clause/participation agreement in future loan agreements. However, only one of the three

proposed agreements since May 2005 included a profit-sharing clause. CRA should incorporate a profit sharing clause in all its market-rate and commercial agreements. This will help generate additional income that can be used to help further CRA's mission.

### **Loan Receivable and Project Management Systems Still Need To Be Finalized**

The 2004 audits found many weaknesses in the system tools used for loan monitoring and project management. The system related findings in the 2004 audits included:

- The mainframe system used by Asset Management did not have the capability to compound, accrue and accurately report interest relative to each loan. Consequently, the loan information maintained was inaccurate.
- The Chartering System used as a project management tool was cumbersome and not user-friendly. Consequently, the staff did not always update the Chartering System with critical changes on various projects' status.

To address these issues, the CRA hired an Information Technology consultant to develop system specifications for a new loan receivable system. The Agency indicated that it intends to use Microsoft Project as a standard tool for managing projects. The new project management tool has yet to be implemented, and there is no specific timeframe on its implementation. With respect to the Loan Receivable System used by the Asset Management, the Agency stated that it encountered several delays in its implementation and now anticipates its upgrade to be completed by November 2006. The lack of adequate project management and loan receivable systems continues to hinder the CRA's ability to efficiently manage its projects and loan activities.

### **The Internal Audit Department Should be Independent of Finance and Operations**

The 2004 audit noted that the internal audit efforts were insufficient relative to the size of the Agency. Many recommendations made by consultants, external auditors were not followed-up on, and many of the monitoring and underwriting issues identified during the audits should have been detected and brought to management's attention. The audit recommended that the CRA establish an independent Audit Committee to oversee the Agency's audit activities. The audit also recommended that CRA ensure that the internal audit department reports directly to the Administrator or the Audit Committee to increase its independence of finance operations.

Based on our review of CRA's current organization chart, the internal audit department stills reports to the Chief Financial Officer, and thus is not independent of finance operations. CRA executive management indicated that it recently created a Finance, Audit and Budget Committee to oversee audit activities.

In addition, the 2004 audit recommended that the CRA establish a clear line of supervision and direction from the Finance Department to the loan underwriting staff so that the underwriting staff are not supervised or evaluated by the Operations Department. The current organization chart also shows that the housing underwriters still work directly under the Operations Department (the regional offices).

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## Section II. Loan Monitoring

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The 2004 audit of developer loans and subsidies examined CRA's loan monitoring efforts. The audit found that the CRA: 1) did not review residual receipt analyses for accuracy, 2) lacked stringent collection measures, 3) did not strictly enforce compliance by borrowers with the loan contract terms, 4) lacked reliable, timely and useful loan information, 5) did not monitor compliance with the Affordability Covenant as required by the State, and 6) did not perform necessary property inspections to comply with the required property standards.

The audit contained 20 recommendations to improve controls over loan monitoring and collection efforts. We determined that CRA has implemented seven, partially implemented nine, and has not yet implemented two. Two recommendations no longer apply. The following discusses the areas where we believe CRA still needs additional efforts to fully implement all recommendations.

### **Loan Monitoring Efforts Are Still Inadequate**

The 2004 audit report found that CRA failed to pursue all available options relative to delinquent borrowers. For example, CRA had not established policies to prohibit borrowers and developers under "technical default" from applying for a loan within two years, did not file default notices, and did not report delinquent borrowers to credit reporting agencies. The audit also noted that CRA had not made any effort to share default information with other City agencies, to protect the City against defalcations.

The 2004 audit recommended that CRA allow its loan-monitoring consultant to declare in technical default, all borrowers who are non-compliant with contract terms as to non-monetary loan agreement provisions, such as insurance requirements and financial reporting requirements. The audit also recommended that the CRA report delinquent borrowers to credit reporting agencies, file default notices and conduct appraisals of properties with delinquent loans to determine if foreclosure proceedings should be implemented.

Although the CRA now files and shares default notices with other City departments and conducts the necessary appraisals of properties, it still does not report delinquent borrowers to credit reporting agencies. The Agency also does not currently monitor changes in legal entity status, as was previously recommended. The CRA stated that they plan to develop a mechanism to report delinquencies to credit agencies in the future.

In addition, we found that once a loan is approved, neither CRA nor its loan-monitoring consultant verifies that the borrowers continue to comply with non-monetary terms of their loan agreements such as the insurance requirements. A listing of insurance policies provided by the CRA shows many policies have expired.

The CRA indicated that it relies on its loan monitoring consultant, AmeriNational, to monitor insurance requirements. The Agency indicated that it has been having problems with AmeriNational for about a year and a half. The CRA stated that it intends to issue a Request for Proposal (RFP) in November 2006.

### **CRA Needs to Perform a More In-depth Review of its Borrowers' Financial Statements**

The loan agreement requires residual receipt borrowers to submit annual financial statements to the CRA. The financial statements are used to determine any residual receipts due from borrowers. The 2004 audit found that CRA had underbilled various residual receipt borrowers by approximately \$213,000 because of (1) limited oversight of its loan servicers, (2) lack of staff resources adept in financial statement analysis, and (3) lack of necessary internal controls to ensure the accuracy of billings and collections. The audit also found \$387,000 in uncollected residual receipts. The audit recommended a thorough review of all analyses to identify any underbillings.

Subsequent to the audits, the Agency engaged a Certified Public Accountant (CPA) firm, Vasquez and Company, in 2005, to review four borrowers identified as high-risk. Vasquez identified a total of \$607,000 due to the Agency from the four borrowers. In addition, CRA assumed the responsibility for reviewing 100% of the financial analyses in-house because it believes it can do a better job of reviewing the financial statements<sup>1</sup>. As a result of its efforts, the Agency increased its residual receipt billings and collections, from \$686,484 in Fiscal Year 2004-05, to approximately \$2 million in Fiscal Year 2005-06 an increase of 194%.

However, we believe CRA can further increase its collections by performing a more thorough and in-depth review of the financial statements. We reviewed a sample of residual analyses completed by the Agency staff and questioned the quality of the reviews performed. Specifically, we noted the following:

- No evidence of a review of the borrowers' annual operating budgets as required by the Housing and Urban Development Agency.
- No evidence of a review of property management contracts and/or amendments, especially in cases where expenses appear to be greater than allowed in the agreements.
- Staff does not review transactions/transfers between affiliates to ensure that they are valid and are not made to inappropriately reduce residual receipts due to the Agency.
- Financial statements reviewed did not include notes and detailed information that are needed to accurately determine residual receipts due to CRA.

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<sup>1</sup> Prior to 2004 audits, CRA contracted with outside consultants to review borrowers' financial statements.

- Increases and upward trends in operational and administrative expenses are not thoroughly analyzed or explained.

Without reviewing these items closely, CRA cannot ensure the accuracy of the residual receipts processed. In addition, we noted that the financial statements analyzed for four of the five residual receipt loans we sampled were not prepared or audited by a CPA as required by the loan agreements.

**Oversight over Borrowers' Compliance with the Provisions of the Forgivable Loan Agreements Needs to be Increased**

The forgivable/conditional loan agreements require borrowers to show proof of compliance with the specific conditions of the loans. One of the conditions that must be satisfied is the submission of an annual report. The annual report typically includes documentation such as the level of service provided during the previous year to support the borrower's compliance with the loan conditions and provide the basis for CRA to forgive portions of the loan. If a borrower fails to submit an annual report, the loan goes into default and the CRA should initiate collection efforts.

The 2004 audit disclosed that CRA failed to monitor the submission of the required annual reports and other conditional loan provisions. We sampled five forgivable loans to determine whether CRA monitors the receipt of annual reports. We also determined if the Department processes the annual forgiveness amount accurately, timely and consistently in accordance with its policies. The loans had a combined balance of approximately \$4.4 million. Our testwork revealed that CRA still does not adequately monitor the receipt of these reports and does not initiate collection efforts for non-compliance. Specifically, for the five forgivable loan files we reviewed, we noted the following:

- One borrower's forgiveness was processed properly.
- One borrower has not submitted the required annual reports since 1999. No forgiveness has been recorded and no action has been taken to enforce the provision.
- For one borrower, although the CRA staff signed-off that the borrower is entitled to the amount forgiven, we did not see any evidence of verification to show that the services were actually provided.
- For the remaining two borrowers, staff has not yet reviewed the annual reports and/or recorded the annual forgiveness amounts. The annual forgiveness amount has not been processed for one borrower since 1999.

CRA staff indicated that inadequate monitoring was due to personnel constraints. The staff explained that due to the higher likelihood of generating a positive cash flow, the Asset Management Department had prioritized monitoring of residual receipt loans over other loans. While we understand the importance of emphasizing residual receipt loans because they comprise the bulk of the Agency's portfolio, CRA should not neglect borrowers of other loans who are non-compliant with their loan terms.

### **Monitoring of Affordability Covenant And Performance of Physical Inspections Require Additional Efforts**

Section 33418 of the California Health and Safety Code requires redevelopment agencies to obtain annual reports from property owners or managers to certify compliance with the affordability covenant. For rentals, this report must include the rental rate, income, and family size of the occupants. For each owner-occupied unit, the report must include information as to whether there was an ownership change from the prior year and, if so, the income and family size of the new owners. The income information shall be supplied by the tenant in a certified statement on a form provided by the Agency. In addition, state and federal guidelines require the CRA to ensure periodic physical inspections to be performed to determine compliance with property standards.

The 2004 audit reported that the CRA did not monitor compliance with the affordability covenant. Specifically, the audit noted that CRA had not been obtaining the annual reports from borrowers. The audit also revealed that CRA failed to conduct on-site physical inspections of properties required by applicable laws.

The first five sample files we reviewed did not have the required annual reports. However, CRA stated that in response to the 2004 recommendation, it had selected and prioritized 82 properties or projects for monitoring. Our test of an additional five samples (out of the 82 properties) found that the required reports were received and reviewed. In this regard, CRA has shown efforts to monitor the affordability covenant compliance by the property owners. However, since CRA has over 1,400 properties, at its current rate, it would take the Agency over 18 years to complete a review of all properties. The Agency indicated that it recently added three additional staff to this function to help increase the number of reviews completed annually.

With respect to “physical inspections”, other than the Section 8 housing units, staff do not perform physical inspections to ensure decent, safe, and sanitary conditions of the properties, in compliance with the property standards set forth in loan agreements. According to the CRA housing staff, the Agency is working with the Los Angeles Housing Department (LAHD) to access and utilize their reports on physical inspections performed on CRA properties. If CRA utilizes LAHD inspections, it must ensure the inspections are performed within the timeframe required by the funding agencies. For example, Chapter 24 of Code of Federal Regulations, Section 92.504d, requires that during the period of affordability for the Home Investment Fund (HOME) assisted program, the participating jurisdiction must perform on-site inspections to determine compliance with property standards no less than (a) every three years for projects containing one to four units, (b) every two years for projects containing five to 25 units, and (c) every year for projects containing 26 or more units.

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## Section III. Disposition of Real Estate

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The CRA disposes of real estate properties in redevelopment areas through the execution of a document called the Disposition and Development Agreement (DDA). A disposition may include selecting a developer and entering into an exclusive negotiation for a DDA. The CRA Board approves all transactions, subject to the review and approval by the City Council. The CRA may dispose of property for less than its acquisition costs and/or fair market value. If it does, the CRA is required to provide an explanation for the reason(s).

The 2004 audit found issues relating to adequate tracking of disposed properties and inadequate disclosure of transaction details to the CRA Board. Of the 13 recommendations, the Agency has implemented nine recommendations and partially implemented three recommendations. Although the Agency has not implemented the recommendation to train staff on the application of the new policies and procedures, the Agency indicated that training of Agency personnel would commence immediately upon the implementation of the new administrative policies and procedures.

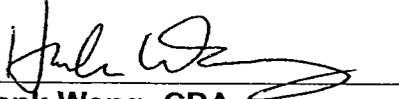
### **The New Real Estate Acquisition and Disposition Tracking System is Ineffective.**

The 2004 audit found that CRA did not track the disposition of its real estate properties, making it difficult to verify or confirm the appropriateness of the transactions and identify trends that may require management attention.

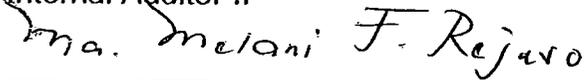
Subsequent to the 2004 audit, CRA implemented its Property and Land Inventory System to track and record acquisitions and disposition of properties. However, based on our current testwork, CRA's system for tracking acquisitions and disposals appears to be ineffective. In order to test whether CRA's new system captures all transactions, we requested a report of all disposals executed between January 1, 2005 and April 30, 2006. The report shows that the Agency disposed 14 parcels for a total of \$5.2 million during the period.

In order to verify whether the listing from the property system is complete, we reviewed the development and disposition agreements approved by the Agency's Board during the same period. We identified three transactions approved by the Board that were not included in the report generated from the tracking system. CRA's tracking system did not include the acquisitions and/or dispositions of the parcels related to the Yale Terrace, the County Administration Office, and the Encore Hall projects. In addition, the Agency's ledgers did not accurately reflect the transactions. Asset Management staff indicated that the tracking system was not updated because staff involved in the disposition of the three projects did not forward the required documents (e.g., memo of closing, grant deed, etc.) to them. As an ongoing control to ensure it receives documentation for all disposals, Asset Management staff should periodically review Board reports and compare the disposal agreements approved by the CRA Board to the documents it received.

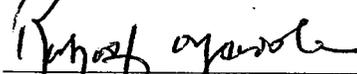
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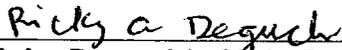
**Hank Wang, CPA**  
Internal Auditor II



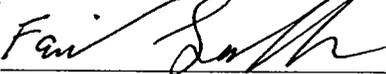
**Maria Melani Rejuso**  
Internal Auditor III



**Rahoof Oyewole, CPA, CIA, CISA**  
Internal Auditor IV



**Ricky Deguchi, CPA, CIA, CISA**  
Chief Internal Auditor



**Farid Saffar, CPA**  
Director of Auditing

August 31, 2006

**ATTACHMENT I  
REVIEW OF THE UNDERWRITING PRACTICES AT CRA  
RECOMMENDATION IMPLEMENTATION STATUS**

No.	2004 Recommendation	Summary of CRA's Actions	Recommendation Implemented?
1	The CRA management should develop standard and sound loan underwriting criteria, policies, and procedures.	CRA management has developed housing and commercial underwriting guidelines. The commercial underwriting guidelines were presented to the Board in July 2006.	Implemented
2	The standard loan underwriting criteria should include basic requirements, such as 1) a standard CRA application form, 2) developers' credit reports, 3) background database search, 4) all projects costs be carefully developed, and 5) three years' financial statements and tax returns.	The criteria are incorporated in the new underwriting guidelines.	Implemented
3	Once standard loan underwriting policies and procedures are adopted, CRA's management should conduct extensive training of its loan underwriting staff.	CRA stated that staff training would take place within 30 days after implementation of underwriting administrative policies and procedures.	Partially Implemented. CRA scheduled training of staff to begin in September 2006.
4	The CRA management should develop criteria that is comparable with other City agencies.	Many of CRA's loans are not comparable to those of CDD and LAHD. However, when a project is jointly funded, CRA uses complimentary underwriting guidelines. These procedures are outlined in the Agency's new	Implemented

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No.	2004 Recommendation	Summary of CRA's Actions	Recommendation Implemented?
		administrative policies' manual.	
5	The CRA management should review the differences between the CRA's loan underwriting practices and the criteria followed by other CRA agencies, to assist the CRA in developing its best practices.	CRA hired a consultant to review various loan underwriting practices of other CRA agencies, to assist the CRA to develop its new policies.	Implemented
6	The CRA management must establish a clear line of supervision and direction from the Finance Department to the loan underwriting staff. The CRA's loan underwriting staff must not be supervised or evaluated by the Operations Department.	Although CRA created a new position, Manager of Capital Finance, that underwrites commercial loans and reports directly to the Finance Department, the Housing underwriters still work directly under the Operations Department.	Partially Implemented
7	The CRA management should implement the six suggestions provided by the consultants to the auditors, which are the following: 1) use of highly qualified consultants to conduct negotiations on its behalf, 2) strengthen the language of loan agreements, 3) provide instructions to the consultants, who review the RRL financial statements as part of a restructuring request by the borrower, 4) increase the implementation of profit participation clauses in market rate developments, 5) negotiate with senior lenders for terms	CRA stated it implemented the recommendations as follows: 1) Use consultants but lead all negotiations, 2) Already seek City Attorney's assistance to strengthen the loan agreements, 3) all RRL financial statements are now reviewed by CRA staff, 4) new policies include the use of profit participation when applicable, 5) will actively negotiate with senior lenders when	Partially Implemented because of #4. See discussion of the use of profit sharing clause on page 12

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No.	2004 Recommendation	Summary of CRA's Actions	Recommendation Implemented?
	more favorable to the CRA, and 6) develop cooperation with tax collection agencies.	applicable and 6) develop cooperative links with tax collection agencies.	
8	The CRA management should develop a survey form asking suggestions for improvement to be completed by each consultant after each assignment.	CRA now solicits feedback by requesting its consultant to complete a survey form upon completion of each assignment.	Implemented
9	A loan committee should be in place to review the loan underwriting and other project files prior to the Board's approval of the loan award.	CRA established a loan committee to evaluate loans greater than \$250,000 in value and loan restructuring requests. The loan committee will review loan applications and communicate its recommendations to the Board.	Implemented
10	After Board approval, and before the loans are made, a loan committee should review the contents of the loan agreement and ensure that the Recorded Deeds of Trust are in the file prior to providing confirmation to the Board.	Deed of Trusts are recorded and placed in the files after loans are approved.	Implemented
11	A - CRA management ensure that all delinquent accounts, including technical defaults and delinquent loans where collection efforts have not commenced, are reported to the Board.	A - CRA reports technical default and delinquent loans to its Board on a quarterly basis.  B - CRA reconciles its	Implemented

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No.	2004 Recommendation	Summary of CRA's Actions	Recommendation Implemented?
	B- CRA management reconcile its loan receivable balances to AmeriNational's records on a regular basis.	loan receivable balance to AmeriNational's balance on a monthly basis.	
12	The CRA management must resolve the discrepancies in the amounts reported to the Board as in default as of December 31, 2003, with the information on AmeriNational's Delinquent Aging Report and the CRA's own Cumulative Loan List for the same period.	The CRA resolved and reported the discrepancies to its Board in a January 19, 2006 default report.	Implemented
13	The CRA management should develop a policy establishing the maximum number and dollar amount of loans that can be made to the same developer and its affiliates or related entities.	CRA did not develop a policy to establish a maximum number or dollar amount of loans that can be made to the same developer.	Not Implemented  See Page 12
14	The CRA management should develop a wider pool of potential borrowers/developers through outreach, advertising, etc.	CRA's Contracts & Purchasing has taken steps such as attending workshops and sharing information with other public entities. CRA also mails RFP's to numerous outreach organizations. RFP's are also posted in the CRA's and the City of LA's websites. In addition, the Regional Offices conduct periodic meetings with their communities to communicate CRA's development	Partially Implemented  See Page 12

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No.	2004 Recommendation	Summary of CRA's Actions	Recommendation Implemented?
		opportunities to the public.	
15	The CRA management should verify that potential borrowers do not have any outstanding tax liens or legal entity status problems, prior to approving each developer's loan.	CRA has established procedures to verify that new borrowers do not have any outstanding tax liens. The recommendation is incorporated into the underwriting administrative policies and procedures.	Implemented
16	Develop and include a profit-sharing clause in all market-rate residential housing and commercial/retail development loan agreements that will require the CRA share in the profits with the developers, without impacting the status of low to moderate income units.	CRA has incorporated profit-sharing considerations in its commercial underwriting guidelines.	Partially Implemented
17	The Chartering System should be improved or replaced to ensure that critical loan underwriting information is concurrently updated, and to make it more user-friendly, efficient, and effective.	CRA is currently working towards implementing a new project management system that will replace the Chartering System.	Not Implemented  See Page 13
18	The CRA management should develop an all-inclusive list of loans, including work-in-progress, rejected loans, approved loans waiting to be funded (reflecting their current status) and active funded loans, and written off loans, for its use in monitoring the work of the Agency's staff.	CRA has developed an all inclusive list of loans. The list is provided to the Board as part of the Agency's quarterly report.	Implemented
19	The CRA management should	CRA established a	Implemented

**ATTACHMENT I**  
**REVIEW OF THE UNDERWRITING PRACTICES AT CRA**  
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No.	2004 Recommendation	Summary of CRA's Actions	Recommendation Implemented?
	establish a truly independent and formal loan committee.	loan committee that consists of three internal CRA staff (including a regional administrator), one staff from CDD and one from LAHD. The loan committee reviews all loans over \$250,000 and all requests for loan restructures. The Bylaws provide for committee member to abstain from voting when the member is not independent.	
20	The loan committee should be comprised of the CRA's loan underwriters who have been trying to develop agency-wide standards and one senior external bank loan underwriter.	CRA's Manager of Capital Finance and Housing Director are members of the loan committee. The Manager of Capital Finance provides technical commercial underwriting expertise. The Loan Committee also includes a member from the Housing Department who has bank loan underwriting experience.	Implemented
21	The CRA's management should require the planners to always quantify the goals and objectives for each development, in its Budget and Strategic Plan.	CRA reports the number of housing units, jobs created, and other quantifiable objectives in projects approved by the Board of Commissioners. A community context	Implemented

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No.	2004 Recommendation	Summary of CRA's Actions	Recommendation Implemented?
		report stating the goals and objectives of each project are included in the Board memo when a loan is presented to the Board for approval.	
22	The CRA's management should implement an annual monitoring program, to ensure that it monitors its compliance with the measurable goals established by the CRA for each development.	CRA now reports compliance with goals established for each project.	Implemented
23	The CRA's management should develop a sustainable model that defines how the loan underwriting function is to operate, regardless of changes in administrators.	The new underwriting policies and procedures achieve the definition of a sustainable policy.	Implemented
24	The CRA should hire a loan underwriting director to develop sound standard loan underwriting policies and procedures to be followed uniformly by all the CRA loan underwriters and be responsible for monitoring and ensuring compliance.	CRA hired a Manager of Capital Finance to provide technical underwriting expertise. CRA has developed new commercial underwriting and housing underwriting guidelines.	Implemented
25	The CRA should develop and implement policies and procedures to ensure that it monitors, through a combination of reporting and site visits, all borrowers' compliance with the loan covenants.	CRA has a plan to conduct all of the necessary on-site inspections over a three-year period.	Partially Implemented  See Page 17
26	If the CRA continues to use redevelopment funds to give loans, it must exert every effort to enforce all loan terms, and	CRA improved its review of the residual receipt loans. Additional monitoring	Partially Implemented  See Page 15 - 16

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No.	2004 Recommendation	Summary of CRA's Actions	Recommendation Implemented?
	exert adequate loan monitoring and collection efforts to adequately protect the CRA's interests.	efforts are still needed.	
27	The CRA's management should ensure that adequate staff is allocated to the loan portfolio management to expedite and enforce loan collection actions and loans reported by AmeriNational as requiring collection efforts.	CRA conducted a staffing analysis of its Asset Management Section and created new positions within its Section. CRA improved on its review of the residual receipt loans. Additional monitoring efforts are still needed.	Partially Implemented  See Page 14 - 16
28	The CRA's management should a) audit the financial statements for loans which a re-structure has been requested, and b) institute a system where high-dollar amount loans are audited if information developed by CRA and AmeriNational, indicates that residual receipts should be paid to the CRA.	CRA currently reviews 100% of the financial statements obtained from its residual receipt loans. In addition, loans considered to be higher risk were referred to the CRA's Internal Audit Section. An audit of these loans was conducted by a contractor and completed in 2005.	Implemented
29	The CRA should monitor tax liens and legal entity status problems on all loans and take action to prevent losses due to tax sales and legal entity problems.	CRA's independent loan servicer, AmeriNational, subscribes to a property tax monitoring service. CRA does not feel that the borrower/developer's legal entity status creates a high risk of loss as its loans are secured by real estate.	Partially Implemented  See Page 14
30	The CRA should declare in technical default all borrowers who are non-compliant with	CRA's new Loan Underwriting Procedures prohibit	Not Implemented  See Page 14 - 15

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REVIEW OF THE UNDERWRITING PRACTICES AT CRA  
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No.	2004 Recommendation	Summary of CRA's Actions	Recommendation Implemented?
	contract terms as to non-monetary loan agreement provisions, so as to preclude Developers/borrowers in default from borrowing for at least two years in order to provide an incentive for compliance.	borrowers and developers with material defaults from obtaining new financing within two years. Non-monetary defaults are reported to the Board on a quarterly basis.	
31	Developers/borrowers who are in technical default should be precluded from processing loan re-structuring requests.	CRA may consider restructuring requests if it can benefit the Agency. CRA requires disclosure of previous defaults for all loan financing requests. CRA's policy does not allow developers with material defaults to obtain new financing within two years of the default.	Implemented
32	The CRA should maintain a history of technical and other defaults relative to each borrower/developer to preclude borrowers in default from applying for any new loans for a period of two years.	CRA presents technical default information to the loan committee for consideration. CRA plans to implement a mechanism to track and monitor default history.	Partially Implemented.  CRA has yet to complete all of its system upgrades.
33	The CRA should share the technical default information with other City agencies.	CRA now shares delinquency contact information with CDD and LAHD.	Implemented
34	The CRA should report delinquent borrowers to credit reporting agencies, should file Default Notices and should conduct appraisals of properties with delinquent loans to determine if foreclosure proceedings should be	CRA now files and shares default notices with other City departments and conducts appraisals of properties. However, it still does not report delinquent borrowers to	Partially Implemented  See Page 14

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No.	2004 Recommendation	Summary of CRA's Actions	Recommendation Implemented?
	implemented.	credit reporting agencies.	
35	The CRA's management should develop an accurate profile of the activities performed by Asset Management to be distributed throughout the organization, to ensure that other departments have an accurate understanding of what Asset Management does and does not do.	The Agency's new policies include an adequate description of the duties and responsibilities of the Asset Management Department.	Implemented
36	The CRA should refer to the loan-monitoring consultant for its review of the recommended number (125) of RRLs, to ensure that the CRA is reviewing at least 10% of the financial statements each year.	CRA now reviews 100% of the financial statements related to residual receipts loans.	Implemented
37	The CRA needs to develop a system that provides a code number for each type of delinquency that will allow both AmeriNational and the CRA to print a list of loans in technical default, by loan type, as well as loans that have been restructured.	CRA reports loan default information, delineated by loan type and type of delinquency, to the Board on a quarterly basis.	Implemented
38	The CRA's management should develop written procedures, whereby loans lost to senior lender foreclosures, tax sales, bankruptcies, etc., would be reported to the Board for write-off authorization.	CRA developed procedures within the Asset Management function for the handling of delinquent loans.	Implemented
39	The CRA's management should provide to the Asset Management whatever equipment or system upgrade it needs, to ensure that the most	CRA is currently working on system upgrades. The new system has yet to be	Not Implemented  See Page 13

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No.	2004 Recommendation	Summary of CRA's Actions	Recommendation Implemented?
	accurate, and up-to-date information is readily available to all users of this information at the CRA.	completed.	
40	The CRA should allow the loan monitoring consultant to perform services authorized under its current contract, in order to ensure that the CRA properly protects its interests in the delinquency loans.	CRA's loan procedures define the services that are to be provided by its loan servicing consultant.	Implemented
41	The CRA needs to resolve the discrepancies that exist between its Cumulative Loan List and AmeriNational's list to ensure that its loan monitoring function will be efficient and effective.	CRA's Asset Management has reconciled its loan list with AmeriNational's records.	Implemented
42	The CRA's Internal Audit Department should be reviewing a substantial number of RRL financial statements each year.	CRA has reviewed 100% of the RRL financial statements that it received last year.	Implemented
43	The CRA's Internal Audit Department should be following up on the 2002 Risk Assessment report's recommendation that discrepancies between the CRA's Cumulative Loan Balances and the AmeriNational's loan balances should be resolved.	CRA reconciled its Cumulative Loan Balances with AmeriNational's balances and has reported the discrepancies to the Board.	Implemented
44	The Internal Audit Department should review the adequacy of the CRA's loan monitoring efforts, to ensure that the CRA aggressively enforces the payment due to it by the terms of the loan agreements and should evaluate its RRL loan portfolio for delinquencies.	CRA has reviewed 100% of the RRL financial statements it received during 2005. Non-submittals of financial statements are considered defaults and have been reported to the Board.	Implemented

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REVIEW OF THE UNDERWRITING PRACTICES AT CRA  
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No.	2004 Recommendation	Summary of CRA's Actions	Recommendation Implemented?
45	The CRA's management should ensure that the Internal Audit Department prepares an analysis of each loan submitted for audit by Asset Management.	Internal Audit hired a CPA firm to review the loans related to the four borrower/developers referred by Asset Management. The CPA firm has completed the reviews and issued the reports.	Implemented  See Page 13
46	The CRA's management should ensure that the Internal Audit Department follows up, reviews, and documents the effort and result of the reviews, on the results of any preliminary evaluations and written reports of financial statements performed by AmeriNational each year.	The reviews of financial statements are conducted by CRA's Asset Management section.	Implemented
47	The CRA management should establish an independent Audit Committee to review the CRA's compliance and adequate follow-up of audit report recommendations, review the Internal Audit Department's compliance with Asset Management's requests for reviews/audits of financial statements, and review reports from the CRA's consultants.	CRA management is working on establishing a Finance, Audit and Budget Committee to oversee audit activities.	Not Implemented  See Page 13
48	The CRA management should establish policies for referring developers' financial statements for audit to the Internal Audit Department.	The CRA Board of Commissioners or a designated Board committee will review Internal Audit's work plan for the year. This includes any activity that relates to financial	Implemented

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REVIEW OF THE UNDERWRITING PRACTICES AT CRA  
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No.	2004 Recommendation	Summary of CRA's Actions	Recommendation Implemented?
		statement referrals.	
49	The CRA management should ensure that the Internal Audit Department is strengthened to ensure that it proactively investigates and reports of potential financial irregularities, fraud or abuse.	CRA plans to have Internal Audit report to the CRA Board or a designated Board Committee on its audit activities, including an audit work plan and efforts to investigate financial irregularities, fraud, or abuse.	Not Implemented
50	The CRA management should ensure that the Internal Audit Department always maintains written records and reports of all of its efforts.	The Internal Audit Division maintains written records for all financial statement reviews.	Implemented
51	The CRA management should ensure that the Internal Audit Department develops a plan for reviewing loan underwriting and monitoring functions over the next three years, and should prioritize the conduct of said audits by order of importance.	The Internal Audit Department has been directed to review loan underwriting and monitoring functions over the next three years.	Implemented
52	The CRA's management should ensure that the Internal Audit Department investigates and conclusively resolves, in cooperation with the Asset Management Department, the discrepancies between all of the lists prepared and maintained by the CRA, including the December 31, 2003 Loans in Default List attached to the March 4, 2004 Board report, AmeriNational's December 31, 2003 Delinquency Aging Report, and the CRA's own December 31, 2003 Cumulative Loan List.	CRA reconciled its AmeriNational's loan balance with CRA's Loan Receivable System.	Implemented

**ATTACHMENT I  
REVIEW OF THE UNDERWRITING PRACTICES AT CRA  
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<b>No.</b>	<b>2004 Recommendation</b>	<b>Summary of CRA's Actions</b>	<b>Recommendation Implemented?</b>
53	The CRA management should ensure that the Internal Audit Department is sufficiently independent of the finance and operations functions to act as a watchdog of their activities. Furthermore, it should ensure that the internal audit function reports directly to the Administrator, and not to any other department, relative to its activities.	The Internal Audit Department still reports to CRA's Finance Division. Thus, the Internal Audit is not independent.	Not Implemented
54	The CRA management should develop and implement a better filing and document retention system that will ensure that the documents are readily available for use by its staff and auditors. An inventory should be created of all existing files and their respective locations.	The retention schedule is complete. CRA has issued policies on the filing and document retention system. Asset Management maintains an inventory of its loan files and locks the room where the loan files are kept.	Implemented
55	The CRA's management should implement the use of indexes in all files. It should also implement the use of a required documents/equity/collateral list. Furthermore, the CRA's management should also require staff to prepare a brief of each loan agreement, to include all terms and conditions.	The new Asset Management loan files are required to include a transmittal Checklist that includes a list of required documents. A Loan Summary Report is included for each loan that describes the key provisions of the loan. These procedures are included in CRA's underwriting administrative procedures.	Implemented
56	The CRA's management should develop and implement improvements to its loan monitoring files, to ensure that critical documents are	CRA's stores its loan monitoring files in a locked room. Original Recorded Deeds of Trusts and Promissory	Implemented

**ATTACHMENT I  
REVIEW OF THE UNDERWRITING PRACTICES AT CRA  
RECOMMENDATION IMPLEMENTATION STATUS**

No.	2004 Recommendation	Summary of CRA's Actions	Recommendation Implemented?
	maintained in a safe deposit box or other safe location.	Notes are currently stored separate from other loan documents in six locked 4-drawer fireproof cabinets.	
57	The CRA management should ensure that its loan agreement undergoes substantial overhaul to ensure that the organization, requirements, and language of the agreements are clear, definitive, and free of conflicting information.	The City Attorney and outside counsel reviewed and updated various standard loan agreements. Standard documents are finalized and posted in CRA's intranet for use.	Implemented
58	The CRA management should ensure that the language in future loan agreements is revised to ensure that only the costs originally reported in the financial statements can be considered allowable expenses for the calculation of residual receipts due to the CRA.	CRA's policy now defines a model for calculating residual receipts. New loans now include provisions that state that only costs reported in the financial statements can be considered allowable expenses for the calculation of residual receipts due CRA.	Implemented
59	The CRA management should ensure that its loan agreements are prepared and reviewed by the best available real estate attorneys, to include all necessary requirements to protect the CRA's interests and the public funds.	City Attorney and outside counsel reviewed and updated various standard loan agreements. The CRA Board also includes many of the best real estate attorneys.	Implemented

**ATTACHMENT II**  
**FINANCIAL AND COMPLIANCE AUDIT OF THE CRA'S LOAN SUBSIDIES**  
**RECOMMENDATION IMPLEMENTATION STATUS**

<b>No.</b>	<b>2004 Recommendation</b>	<b>Summary of CRA's Actions</b>	<b>Recommendation Implemented?</b>
1	Review all the residual receipts analyses for accuracy and determine if any underbillings occurred.	CRA hired Vasquez and Company to review 4 significant loan accounts and found a total of \$607,000 underbilled residual receipts. However, we questioned the quality of the reviews performed by Agency staff.	Partially Implemented  See Page 15
2	Provide adequate oversight over loan servicers' submitted analyses and reports.	The agency has taken over the responsibility for reviewing (in-house) all borrowers' financial statements and preparing corresponding analyses for residual receipts due to CRA.	No longer applicable
3	Provide necessary training to staff on financial statement analysis.	Although according to the Asset Management Director, training was provided, we did not consider this recommendation implemented because of the quality review issues discussed on page 15.	Partially Implemented  See Page 15
4	CRA management be proactive and take measures to improve and maximize loan collections.	Although the CRA increased its collections from in 2005-06, the issues brought up on the quality of reviews undermine the implementation of this recommendation.	Partially Implemented  See Page 15
5	CRA management evaluate loan servicers collection	The CRA management has provided	Implemented

**ATTACHMENT II  
FINANCIAL AND COMPLIANCE AUDIT OF THE CRA'S LOAN SUBSIDIES  
RECOMMENDATION IMPLEMENTATION STATUS**

<b>No.</b>	<b>2004 Recommendation</b>	<b>Summary of CRA's Actions</b>	<b>Recommendation Implemented?</b>
	procedures to identify areas that need improvements.	guidelines to its loan servicer, AmeriNational, to ensure that CRA's expectations are communicated and met.	
6	CRA management ensure residual receipts due from borrowers are properly recorded in the CRA's books to reflect any subsequent arrangements that may have been worked out between the CRA and its borrowers.	Test of samples showed that residual receipts identified were properly billed and recorded in the CRA's books.	Implemented
7	CRA should ensure all collections are immediately deposited in the bank.	Our review of a sample of 30 residual receipt collections for the period of July 1, 2005 to May 31, 2006 found that all collections were deposited accurately and timely.	Implemented
8	Conduct a thorough investigation for the eight subsidy loans where the recipients sold the properties subsidized either through direct sales or foreclosures, and assess actions that may be taken to recover or write-off uncollected subsidy loans in the CRA's books.	CRA has taken actions to either recover or write-off the questioned subsidy loans in the 2004 audit.	Implemented
9	Establish internal controls within their policies and procedures to reflect the terms and conditions set forth in the loan agreements.	Although CRA has conducted a thorough investigation of the eight subsidy loans, the Agency does not have any controls or written procedures for monitoring current	Partially Implemented

**ATTACHMENT II  
FINANCIAL AND COMPLIANCE AUDIT OF THE CRA'S LOAN SUBSIDIES  
RECOMMENDATION IMPLEMENTATION STATUS**

No.	2004 Recommendation	Summary of CRA's Actions	Recommendation Implemented?
		subsidy loans.	
10	CRA management establish control mechanisms to effectively monitor submission of the required annual financial statements from borrowers.	CRA developed a framework to track and monitor borrowers' submission of the required financial statements.	No longer applicable
11	CRA management conduct an in-depth and timely review of the financial statements submitted by the borrowers.	Although CRA's records showed improvement on the number of reviewed financial statements, we considered this recommendation partially implemented because of the issues noted about the quality of reviews being rendered by the CRA on the borrowers' submitted financial statements.	Partially Implemented
12	CRA management provide adequate oversight over borrowers' compliance with the provisions of the loan agreement.	We concluded that CRA needs additional oversight to ensure borrowers' compliance with the provisions of the loan agreements.	Partially Implemented  See Page 16
13	CRA management prioritize upgrading its Loan Receivable System.	As of August 31, 2006, the CRA has not completed its upgrade of the Loan Receivable System.	Not Implemented  See Page 13
14	CRA management ensure the Loan Receivable System data accurately reflect and agree with information in the loan agreements and its amendments.	CRA indicated that the new Loan Receivable System would address this issue. The system is yet to be completed.	Not Implemented
15	CRA management ensure that	CRA now reconciles	Implemented

**ATTACHMENT II  
FINANCIAL AND COMPLIANCE AUDIT OF THE CRA'S LOAN SUBSIDIES  
RECOMMENDATION IMPLEMENTATION STATUS**

<b>No.</b>	<b>2004 Recommendation</b>	<b>Summary of CRA's Actions</b>	<b>Recommendation Implemented?</b>
	information from Loan Receivable System is fully reconciled with the loan servicers' monthly reports.	loan servicers' reports with the subsidiary records (loan receivable system) monthly.	
16	CRA management ensure that information from the Loan Receivable System is reconciled with the general ledger on a regular and timely basis.	CRA now performs this reconciliation monthly.	Implemented
17	CRA management monitor to ensure borrowers submit required annual reports.	CRA still needs additional effort in this area.	Partially Implemented  See Page 17
18	Conduct on-site inspections of properties to ensure property standards are met and any code violations are immediately abated.	The CRA does not currently conduct on-site inspections to ensure property standards are met	Partially Implemented  See Page 17
19	Maintain records and sufficient documentation for all inspections conducted.	CRA maintained sufficient documentation for all inspections conducted.	Implemented
20	Update the list of properties for inspection on a regular and timely basis.	The CRA is still updating its housing database.	Partially Implemented

**ATTACHMENT III  
FINANCIAL AND COMPLIANCE AUDIT OF THE CRA'S DISPOSITION OF REAL ESTATE  
RECOMMENDATION IMPLEMENTATION STATUS**

<b>No.</b>	<b>2004 Recommendation</b>	<b>Summary of CRA's Actions</b>	<b>Recommendation Implemented?</b>
1.1	CRA management develop written policies and procedures for the disposition of real estate properties.	CRA developed updated administrative policies and procedures to replace the previous manual that governed the disposition of real estate.	Implemented
1.2	CRA management train staff on the application of the written procedures above and monitor their compliance.	CRA indicated that training of Agency personnel would commence immediately upon implementation of the new administrative policies and procedures.	Not Implemented. Training has not yet been conducted.
2.1	CRA management implement a tracking system to record the disposition of real estate properties.	CRA accounts for its disposed properties through its new land inventory system. The land inventory reports are reconciled to the accounting records. CRA will track the issuance of DDA's and OPA's through a new contract database.	Partially Implemented  CRA failed to include three disposal transactions in its land inventory system.  See Page 18
3.1	CRA management implement written procedures that require staff involved in the disposition of real estate properties to forward required documents to the Asset Management Division in a timely manner.	CRA developed updated administrative policies and procedures to replace the previous manual that governed the disposition of real estate. The new procedures require staff involved in the disposition of real estate properties to	Partially Implemented. Although CRA developed the policies, as discussed on page 18, it appears staff involved in disposals still do not always forward the required documents to Asset Management staff.

**ATTACHMENT III  
FINANCIAL AND COMPLIANCE AUDIT OF THE CRA'S DISPOSITION OF REAL ESTATE  
RECOMMENDATION IMPLEMENTATION STATUS**

<b>No.</b>	<b>2004 Recommendation</b>	<b>Summary of CRA's Actions</b>	<b>Recommendation Implemented?</b>
		forward required documents to Asset Management.	
3.2	CRA management ensure real estate acquisitions and sales are recorded in the land inventory subsidiary and general ledgers in a timely manner.	CRA attempts to reconcile the information from its land inventory system to the general ledger on a monthly basis.	Partially Implemented. CRA failed to include three disposal transactions in its land inventory system.  See Page 18
4.1	CRA management submit all proposed projects to the Project Review Committee for review.	CRA established a Management Team to assume the functions of the former Project Committee. Proposed projects that include loans are also reviewed by the new loan committee.	Implemented
4.2	CRA management ensure property owners within a redevelopment area have an opportunity to participate in redevelopment project.	CRA's new procedures include the process of selecting developers. The new policy includes procedures to inform property owners of ongoing redevelopment projects – such as the use of community context reports and statements of interest. Regional offices also conduct public meetings to discuss future projects.	Implemented
4.3	CRA management ensure DDA's reflect complete and accurate requirements on redevelopment projects.	All CRA agreements are reviewed and approved by the City Attorney. The DDAs are also reviewed by the Board of Commissioners and City Council.	Implemented

**ATTACHMENT III  
FINANCIAL AND COMPLIANCE AUDIT OF THE CRA'S DISPOSITION OF REAL ESTATE  
RECOMMENDATION IMPLEMENTATION STATUS**

<b>No.</b>	<b>2004 Recommendation</b>	<b>Summary of CRA's Actions</b>	<b>Recommendation Implemented?</b>
4.4	CRA management ensure that documentation is maintained to support the acquisition costs associated with redevelopment projects submitted to the CRA Board and the City Council.	CRA incorporates procedures and checklists to ensure that Environmental Reviews are included in the project file and referenced in related board memos.	Implemented
5.1	CRA management ensure that documentation is maintained to support the acquisition costs associated with redevelopment projects submitted to the CRA Board and the City Council.	CRA's submitted project reports to the CRA Board and the City Council now include appropriate documentation to support acquisition costs.	Implemented
5.2	The CRA Board require CRA management to explain the \$2.5 million difference in the acquisition cost for the Metropolitan Loft project.	CRA provided a report to its Board on December 17, 2004 explaining that the \$2.5 million variance was attributed to an error contained in the previous board report.	Implemented
6.1	CRA management ensure that contractors comply with DDA's insurance requirements.	CRA established a contract database to monitor DDA insurance requirements.	Implemented
7.1	CRA management ensure that the sale of homes to first-time homebuyers is advertised in a newspaper of general circulation.	CRA advertised its homes in the Valley in the West Valley Times. Although it is questionable whether West Valley Times is a newspaper of general circulation, since homes available were in the Valley area, we considered the recommendation implemented.	Implemented