DATE: July 21, 2016

TO: Audit Committee Members, Honorable Mayor and Members of the City Council

FROM: Eduardo Luna, City Auditor

SUBJECT: Performance Audit of the San Diego Housing Commission – Affordable Housing Fund

Results in Brief

In accordance with the City Auditor's FY2016 Work Plan, we conducted a performance audit of the San Diego Housing Commission (SDHC), which included SDHC's financing of affordable housing efforts through the revenue received from the City of San Diego's (City) Affordable Housing Fund (AHF). The Development Services Department (DSD) and the Facilities Financing Section of the Planning Department (Facilities Financing) assess and collect AHF revenues.

The AHF is made up of revenue collected via an inclusionary fee on residential developments and a linkage fee on non-residential developments. For FY2013–2015, collections averaged $10.25 million per year with $8.75 million from inclusionary fees and $1.45 million from linkage fees.

We found some processing errors and process issues that need to be addressed to ensure timely and accurate assessment and collection of affordable housing revenue. Any loss in AHF revenue diminishes the City's efforts to provide affordable housing for its very low- to moderate-income households.

Specifically we found:

- DSD incorrectly assessed the inclusionary housing fee in two residential developments we reviewed, resulting in a potential revenue loss of approximately $22,000. We found one phased-development where an inclusionary fee of $1.9 million was assessed and collected nine months late.
- DSD under assessed one residential development by $1,565 in inclusionary fees as a result of not timely updating the inclusionary rates in DSD's Project Tracking System to reflect the rates in effect after July 1 of FY2016.
- Facilities Financing assesses linkage fees based on the square footage from initial plan submissions and not the square footage on finalized building plans. While the net effect was an overbilling by the City of less than 1 percent of the dollar amount of our sample, the fact remains that some developers paid more than their share of linkage fees while others paid less than their share.
- Facilities Financing incorrectly assessed a commercial linkage fee of $17,000 on a residential development.

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We made eight recommendations to address the issues identified in this memo, and the City Administration, including SDHC, agrees with all recommendations. Our recommendations cover system controls, training, supervisory review, service level agreements, process changes, and department consultation with the City Attorney's Office regarding fee refund or recoupment. The staff responsible for this audit are Megan Garth, Luis Briseño, Chris Kime, and Kyle Elser.

Background

The City of San Diego (City) created the Affordable Housing Fund (AHF) to assist in meeting the housing needs of its low- and moderate-income households. The revenues in this fund are administered by the San Diego Housing Commission (SDHC), a public housing agency governed by the City's Housing Authority.[1] SDHC's mission is to provide affordable, safe, and quality homes for low- and moderate-income families and individuals in the City. To achieve its mission of creating and preserving affordable housing, SDHC uses AHF revenues leveraged with other non-City funds.

The AHF is comprised of two permanent, annually-renewable sources of revenue:

1. The Inclusionary Housing Fund, which is made up of Affordable Housing Fees (also known as **inclusionary fees**) levied on residential developments in the City.
2. The Housing Trust Fund, which is made up of Housing Impact Fees (also known as **linkage fees**) levied on non-residential developments in the City.

Inclusionary Fees

In accordance with the City's Inclusionary Housing Ordinance (Inclusionary Ordinance) enacted on July 3, 2003, all new residential developments must pay an inclusionary fee. Developers of for-sale affordable housing have an option to provide 10 percent of the total housing units at affordable rates in lieu of paying the fee, with a similar option for developers who are converting apartments to condominiums. The Development Services Department (DSD) assesses and collects inclusionary fees on behalf of the City and deposits them into the AHF. The intent of the Inclusionary Ordinance is to ensure that when developing the limited supply of developable land, housing opportunities for persons of all income levels are provided.

Linkage Fees

On April 16, 1990, the San Diego City Council passed the Housing Trust Fund Ordinance (Trust Fund Ordinance) to finance affordable housing for low-income workers whose jobs were created by commercial, industrial, or retail development. The Trust Fund Ordinance requires developers of certain non-residential commercial developments to pay a linkage fee as a way of subsidizing the cost of housing for the low- and very low-income employees who will occupy the jobs related to the commercial development. Facilities Financing, a section of the City's Planning Department, assesses linkage fees on non-residential developments. DSD collects the fees and deposits them into the AHF.

[1] The Housing Authority is composed of the nine members of the San Diego City Council.

Linkage fees establish the 'link' between the construction of new non-residential developments and the need to provide affordable housing for those who cannot afford to buy or rent housing within the City. The Trust Fund Ordinance, San Diego Municipal Code (SDMC) §98.0601, was established to ensure that non-residential developments pay a fair share of the costs of the subsidy necessary to house low-income workers in the City who will occupy jobs within these developments.

Affordable Housing Fund Revenues and Uses

Exhibit 1 below shows the amounts the City collected in each of the funds between FY2013 and FY2015:

Exhibit 1

Linkage and Inclusionary Fees Have Increased Since FY2013

	2013	2014	2015
Linkage Fees	$736,782	$2,266,643	$1,354,624
Inclusionary Fees	$5,979,225	$4,579,103	$15,714,875

Source: Office of the City Auditor generated based on SAP data, FY2013–2015.

AHF revenues are used for affordable housing development, including construction of new housing units and acquisition and rehabilitation of multifamily rental projects, first-time homebuyer assistance, and related programs. SDHC leverages AHF funds with other funding sources—such as federal entitlements, bonds, and tax credits—to further the City's affordable housing efforts.

DSD's Project Tracking System

DSD's Project Tracking System, an in-house software system, is used to both manage and track the City's land development permit processing functions, including the invoicing and collection of inclusionary and linkage fees. In September 2015, the City Council approved DSD's request to purchase Accela, a widely used permitting system. Accela is anticipated to go live in May 2017.

Audit Results

The Development Services Department did not always assess inclusionary fees accurately because it based the rate on the number of units per building rather than the number of all of the units within the development. In addition, an inclusionary fee was not assessed and collected prior to the issuance of the first building permit.

The City's Inclusionary Housing Ordinance (Inclusionary Ordinance) requires all new residential developments with two or more units to pay an inclusionary fee.[2] This fee is based on the product of the square footage of all the units within the development and a pre-determined per-unit rate. The Development Services Department (DSD) incorrectly assessed the inclusionary fee in 2 of the 17 residential developments we reviewed, resulting in a revenue loss of approximately $22,000. In these two developments, each involving separate buildings, DSD erroneously assessed the inclusionary fee based on the number of units per building, rather than the number of all of the units within the development.

Additionally, the Inclusionary Ordinance requires the inclusionary fee to be paid on or before the issuance of the first residential building permit for the development.[3] In our review of building permit issuance reports for residential developments that were completed in FY2013–2016, we found one phased-development where an inclusionary fee of $1.9 million was not assessed and collected on or before the issuance of the first building permit in FY2014. The fee, collected in FY2015, nine months after the issuance of the first building permit, represents a loss in interest earnings. Alternatively, the funds could have been distributed to the San Diego Housing Commission (SDHC) at an earlier date.

DSD's process relies on staff to assess the inclusionary fee correctly for all applicable projects. While DSD has a procedure clearly documenting the assessment as specified in the Inclusionary Ordinance, the absence of controls in its Project Tracking System (PTS) places reliance on staff to correctly apply the fee.

Assessment of Inclusionary Fees Lacks Consistency and Controls

The Inclusionary Ordinance,[4] enacted to encourage diverse and balanced neighborhoods for households of all income levels, applies to all residential developments of two or more units.

To ensure that residential developments are accurately assessed an inclusionary fee, we tested a judgmental sample of 17 residential developments that paid a total of $632,000 in inclusionary fees during FY2014–2015. The inclusionary fee, according to San Diego Municipal Code (SDMC) §142.1304(a), is based on the product of the square footage of all the units within the development

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[2] Developers may elect to reserve at least 10 percent of total units as affordable housing units in-lieu of paying the fee, according to SDMC §142.1303(f).
[3] SDMC §142.1304(c).
[4] SDMC §142.1301 and 143.1304.

and a pre-determined per-unit rate. The inclusionary rates are shown below in **Exhibit 2.** This formula applies regardless of the number of buildings within the development.

Exhibit 2

Inclusionary Rates Have Increased from FY2013–2016

Units within the Development	Inclusionary Affordable Housing Per-Square Foot Rates			
	Effective After December 1, 2012 (FY2013)	Effective After July 1, 2013 (FY2014)	Effective After July 1, 2014 (FY2015)	Effective After July 1, 2015 (FY2016)
2	$1.00	$1.64	$1.72	$1.90
3	$1.49	$2.46	$2.58	$2.85
4	$1.99	$3.28	$3.44	$3.81
5	$2.49	$4.10	$4.31	$4.76
6	$2.99	$4.92	$5.17	$5.71
7	$3.49	$5.74	$6.03	$6.66
8	$3.98	$6.56	$6.89	$7.61
9	$4.48	$7.38	$7.75	$8.56
10 or more	$4.98	$8.20	$8.61	$9.51

Source: Office of the City Auditor generated based on the Development Services Department's Inclusionary Affordable Housing Information Bulletin 532, FY2013–2016.

In two developments within our sample, each involving two buildings (with two units each), DSD incorrectly assessed the inclusionary fee based on the number of units per building, rather than all of the units within the development. For one of these developments, DSD incorrectly assessed the buildings using the two-unit rate instead of the four-unit rate. In the second development, also with two buildings, DSD incorrectly assessed the inclusionary fee using the two-unit rate for only one building, failing to charge the other building entirely.[5] Combined, these errors resulted in nearly $22,000 in lost revenue for FY2014–2015.

In a separate instance, we found a phased-development with two building permits for which DSD did not assess and collect the inclusionary fee of $1.9 million on or before the issuance of the first building permit in March of FY2014, as required by the SDMC. Rather, the fee was assessed and collected nine months later in January of FY2015 with the issuance of the second building permit. As a result, the City lost approximately $7,500 in interest earnings that would have been collected if the $1.9 million had been collected prior to the issuance of the first building permit. Alternatively, these funds could have been distributed sooner to SDHC.

[5] After the Office of the City Auditor notified the Development Services Department (DSD) of this error, DSD immediately issued a new invoice to the developer to recoup $16,287; the invoice was subsequently paid in FY2016. The net loss remains $5,960.

DSD's Development Review Procedure 9.22 aligns with the Inclusionary Ordinance's requirement for the inclusionary fee to be based on all the units within the development and for staff to add the inclusionary fee at the time of the building permit application. However, DSD's PTS, which is scheduled to be replaced by Accela in May 2017, lacks controls to ensure that staff apply the procedure correctly. As a result, DSD staff must recall their procedure to select the fee for the development, correctly apply the total number of units within the development at each building level, and ensure that the inclusionary fee is calculated accurately.

Recommendations

1. We recommend that the Development Services Department conduct ongoing training to ensure that inclusionary fees are accurately assessed on developments with multiple buildings and inclusionary fees are assessed and collected prior to the issuance of the first building permit (Priority 2).
2. We recommend that the Development Services Department (DSD) implement controls within Accela, such as a default to the total number of units within the development to calculate the inclusionary fee. Additionally, we recommend DSD initiate a control within Accela to ensure that the inclusionary fee will be assessed and collected within the first building permit phase of all future phased developments (Priority 2).
3. We recommend that the Development Services Department consult with the City Attorney's Office to determine if inclusionary fees not assessed (totaling $5,960) should be recouped (Priority 2).

Inclusionary rates were not updated in PTS in a timely manner.

We found one residential development that was under assessed a total of $1,565 in inclusionary fees as a result of the Development Services Department (DSD) not updating the inclusionary rates in the Project Tracking System (PTS) by July 1 of FY2016. The City of San Diego (City)—and by extension, San Diego Housing Commission (SDHC)—risks losing inclusionary fee revenues if rates increase or risks overcharging developers if rates decrease.

Through a City-approved and San Diego Municipal Code (SDMC)-mandated process, SDHC provides DSD with new inclusionary rates near the end of each fiscal year. The rates are to take effect at the beginning of each fiscal year, according to the SDMC, and are to be based on the date on which the building permit application is filed. Without updated rates, PTS automatically applies the inclusionary rates in effect for the prior fiscal year.

Process issues have likely contributed to DSD not updating PTS in a timely manner. DSD officials noted that in recent years, SDHC has provided them with the updated rates rather late in the fiscal year—June 11, June 6, and June 9 for FY2014, 2015, and 2016, respectively—creating a small window of time in which to update PTS prior to the beginning of the next fiscal year. Additionally, DSD staff stated that updating PTS is a time-consuming process that needs to be performed when the system is not in high demand, such as on a Saturday or Sunday.

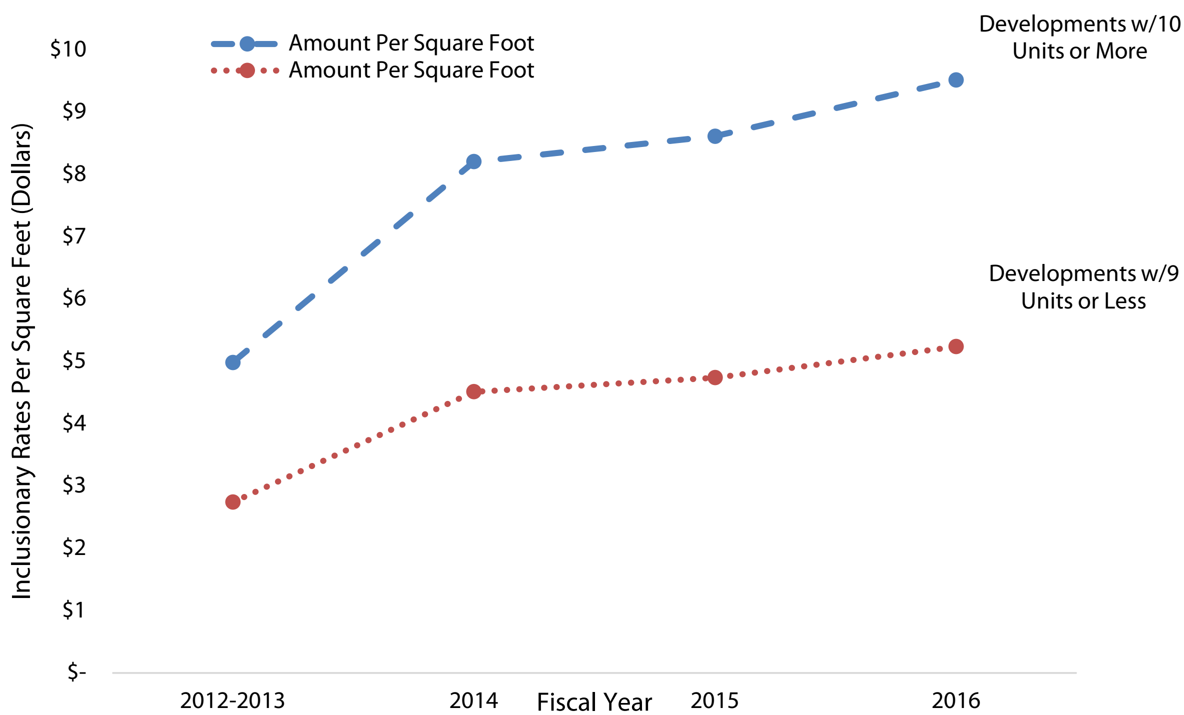
Timely Implementation of Inclusionary Housing Rates is Necessary to Ensure the City Properly Assesses Inclusionary Fees to Support its Affordable Housing Efforts

In our review of building permit issuance reports for residential developments that were completed in FY2013–2016, we found one residential development that was incorrectly assessed its inclusionary fee based on the FY2015 rate although the building permit application was deemed complete in FY2016.

The Inclusionary Housing Ordinance (Inclusionary Ordinance), SDMC §142.1304(b), requires SDHC to annually determine applicable per square foot rates that are used to calculate the inclusionary fee on residential developments. The City Council-approved Inclusionary Affordable Housing Implementation and Monitoring Procedures Manual (Procedures Manual) sets a formula that SDHC must use to calculate the annual rates. Each year, SDHC hires a consultant to determine the new rates using real estate and median income data for the City from the prior year. Rates have increased annually from FY2013–2016 as shown below in **Exhibit 3**.

Exhibit 3

Inclusionary Rates Nearly Doubled for Residential Developments During FY2013–2016



Note: The inclusionary rates for developments with nine units or less are averaged.

Source: Office of the City Auditor generated based on the Development Services Department's Inclusionary Affordable Housing Information Bulletin 532, FY2013–2016.

Currently, SDHC provides the new rates to City officials, including DSD, towards the end of each fiscal year via a formal memo. The new rates take effect after July 1 of each fiscal year,[6] according to DSD's Inclusionary Affordable Housing Information Bulletin 532 (Bulletin 532). Under the Building Permit Applications section, Bulletin 532 states that the rate of the fee shall be the rate in effect at the time the application for the building permit is deemed complete and the fees shall be paid on or before issuance of construction permits.

DSD must update its PTS to ensure accurate calculation of inclusionary fees using rates for the appropriate fiscal year. Because the inclusionary fee uses the rate in effect at the time City staff determine a building permit application has all required information, timely implementation of the new rates is important to ensure that developers pay the inclusionary fee based on the correct rate.

The lack of a formalized process with specific deadlines for delivery likely contributed to late updates within PTS. DSD officials noted that in recent years, SDHC has provided them with the updated rates rather late in the fiscal year, creating a small window of time in which to update PTS prior to the beginning of the next fiscal year. Going forward, both SDHC and DSD officials acknowledged that a formalized delivery process with specific deadlines will help to ensure that PTS is updated timely so that the new rates will take effect after July 1 of each fiscal year.

Recommendations

4. We recommend the Development Services Department (DSD) and the San Diego Housing Commission (SDHC) establish a written service level agreement to determine mutual timelines as to when SDHC should provide the updated inclusionary rates to DSD, and when DSD will update the rates in the system so they will take effect after July 1 of each fiscal year (Priority 2).
5. We recommend that the Development Services Department consult with the City Attorney's Office to determine if the under-assessed inclusionary fees (totaling $1,565) should be recouped (Priority 2).

Facilities Financing assesses linkage fees based on the square footage from initial building plan submission, which can differ from final building plans. In one instance, Facilities Financing applied the linkage fee to a residential development.

Facilities Financing does not account for the square footage on finalized building plans and, in one instance, applied the linkage fee to a residential development. As a result, there was payment inequity among developers and a potential loss in revenue to support the City's affordable housing efforts.

The linkage fee is based on the product of the square footage of the non-residential portion of the building and the rate of the applicable development category. In some cases, the assessed square footage and the final square footage differed by as much as 10 percent. We found differences in the square footage for 11 of the 26 sample developments we reviewed. While the net effect was an

[6] DSD management stated that the new rates for FY2017 have been implemented July 3, 2016.

overbilling by the City of less than 1 percent of the dollar amount of our sample, the fact remains that some developers paid more than their share of linkage fees while others paid less than their share.

Facilities Financing attributed differences between initial and final square footage to the building plan review process. During plan review, staff within the Development Services Department (DSD) and Facilities Financing concurrently review building plans to ensure compliance with City standards, existing property entitlements, and to assess various City fees. This process may result in the alteration of plans to ensure compliance with City standards, especially after structural review. However, staff within Facilities Financing assess the linkage fee based on their review of the initial submission of the building plans.

Additionally, Facilities Financing incorrectly assessed a linkage fee of $17,000 on a residential development.

Differences between Initial Square Footage and Final Square Footage Result in Fee Discrepancies

The Housing Trust Fund Ordinance (Trust Fund Ordinance) established a linkage fee to be assessed on all non-residential developments in the categories of office, retail, research and development, and hotel. With each category assigned a per square foot rate, the San Diego Municipal Code (SDMC) §98.0610 states that the fee is calculated based on the applicable gross square footage of the non-residential space multiplied by the category rate.

Non-residential developments seeking a building permit for the construction, addition, or interior remodeling of a structure, must submit building plans to the City for review prior to building permit issuance. Plan review, conducted concurrently by City staff of various expertise/disciplines, ensures that developments meet City standards and regulations. Facilities Financing, a section of the City's Planning Department, assesses and collects various impact fees as part of the costs of land development within the City during the plan review process, including linkage fees.

To ensure Facilities Financing accurately assessed linkage fees in accordance with the SDMC, we tested a judgmental sample of 26 non-residential developments that paid a total of $428,000 in linkage fees during FY2014-2015. We identified discrepancies between the square footage used to assess the fee and the square footage noted on the final building plans in almost half of our sample, as shown below in **Exhibit 4**. In some cases, the square footage used by Facilities Financing and the final square footage on the plans differed by as much as 10 percent. While the overall result has a small net effect of less than 1 percent of the dollar amount of our sample,[7] some developments paid more while others paid less, resulting in payment inequities among developers.

[7]The net effect of the over/under-assessed linkage fees was an overbilling by the City of $3,079 (as shown in **Exhibit 4**), which is less than 1 percent of the total $428,000 in linkage fees collected for our sample developments during FY2014–2015.

Exhibit 4

Discrepancies in Fee Calculations Based on Differences in Square Footage

	Facilities Financing Assessments		City Auditor Estimates		Difference		
Development	Square Footage (Initial)	Total Fee	Square Footage (Final)	Total Fee	Square Footage	Total Fee	
*1	27,280	$ 17,459	23,910	$ 15,302	-3,370	$(2,157)	
2	29,745	$ 19,037	28,510	$ 18,246	-1,235	$ (790)	
3	1,568	$ 1,333	1,115	$ 948	-453	$ (385)	
4	7,268	$ 4,652	6,879	$ 4,403	-389	$ (249)	
5	3,638	$ 2,328	3,308	$ 2,117	-330	$ (211)	
6	6,836	$ 5,811	6,550	$ 5,568	-286	$ (243)	
7	13,536	$ 8,663	13,330	$ 8,531	-206	$ (132)	
						$(4,167)	**Total Over Assessed**
8	56,610	$ 36,230	56,750	$ 36,320	140	$ 90	
9	2,105	$ 1,684	2,278	$ 1,822	173	$ 138	
10	3,025	$ 2,571	3,345	$ 2,843	320	$ 272	
11	275,527	$ 176,337	276,446	$ 176,925	919	$ 588	
						$ 1,088	**Total Under Assessed**
						$(3,079)	**Net Effect**

Source: Office of the City Auditor generated based on review of SAP data from FY2014–2015, building plans, and assessments provided by Facilities Financing Section.

*Note: This development was incorrectly assessed a linkage fee on a residential development.

Facilities Financing attributed differences between the square footage on which the fee was assessed and the final square footage to the building plan review process. During plan review, reviewers in various disciplines may require plan alteration to bring the building plans into compliance with City standards, especially after structural review. Staff at Facilities Financing stated that other reviewers often fail to communicate later plan changes (especially those with changes in square footage) back to them for a secondary assessment of linkage fees to account for the new changes.[8]

During our review, we also found that Facilities Financing incorrectly assessed a linkage fee of $17,000 on a residential development. Facilities Financing does not have an internal supervisory review process to ensure that staff properly assess linkage fees only on non-residential developments in accordance with the SDMC. Facilities Financing stated that supervisors do not review staff's assessments on a regular or periodic basis to ensure accuracy.

[8] The net effect of the differences in square footage may have an effect on other impact fees such as Facilities Benefit Assessments (FBA) and Development Impact Fees (DIF) in those communities where non-residential projects are assessed based on square footage.

Recommendations

6. We recommend Facilities Financing assess the linkage fees after the building plans are finalized (Priority 3).
7. We recommend Facilities Financing implement a supervisory review of staff's assessments on a periodic basis to ensure accuracy of linkage fee assessments (Priority 2).
8. We recommend Facilities Financing consult with the City Attorney's Office to determine if the over/under-assessed linkage fees identified should be refunded or recouped (Priority 2).

Conclusion

The City of San Diego (City) prioritizes affordable housing and affordable housing services as essential to the City's long term economic growth and prosperity. In recognition of this priority, the City created the Affordable Housing Fund (AHF) as a permanent and annually renewable source of revenue to meet, in part, the housing needs of its very low-, low-, and moderate-income households. The AHF, comprised of the revenues of inclusionary and linkage fees, serves as the City's main contribution to its affordable housing efforts. Therefore, accurate assessment and collection of these revenues by the City is essential to:

- Meet the intent of AHF;
- Ensure that developers pay their fair share of costs; and
- Provide the San Diego Housing Commission (SDHC) with City funds to leverage non-City funds.

We found the City can improve its assessment of the AHF revenues through:

- Staff training and better system controls in the Development Services Department's (DSD) Project Tracking System and/or Accela;
- A written service level agreement between DSD and SDHC;
- An enhanced process for Facilities Financing to assess linkage fees based on finalized building plans; and
- An internal review process within Facilities Financing to ensure that linkage fees are properly assessed.

Our recommendations underscore the need to maximize affordable housing revenues. These revenues are a vital part of the City and SDHC's efforts to create diverse and balanced neighborhoods and housing opportunities for persons of all income levels. Ultimately, housing affordability is key to retaining and attracting a talented workforce at all income levels, which contributes to the City's long-term economic growth and prosperity.

Respectfully submitted,

Eduardo Luna
City Auditor

cc: Jan Goldsmith, City Attorney
Scott Chadwick, Chief Operating Officer
Stacey LoMedico, Assistant Chief Operating Officer
Mary Lewis, Chief Financial Officer
Andrea Tevlin, Independent Budget Analyst
Mike Hansen, Deputy Chief of Staff & Chief of Policy, Office of the Mayor
Marshall Anderson, Director of Council Affairs, Office of the Mayor
Rolando Charvel, City Comptroller, Office of the City Comptroller
David Graham, Deputy Chief Operating Officer, Neighborhood Services
Bob Vacchi, Director, Development Services Department
Jeff Murphy, Director, Planning Department
Richard Gentry, President and Chief Executive Officer, San Diego Housing Commission
Debbie Ruane, Senior Vice President, San Diego Housing Commission
Tracy McCraner, Director, Financial Management Department
Ken So, Deputy City Attorney

Recommendations

1. We recommend that the Development Services Department conduct ongoing training to ensure that inclusionary fees are accurately assessed on developments with multiple buildings and inclusionary fees are assessed and collected prior to the issuance of the first building permit (Priority 2).

2. We recommend that the Development Services Department (DSD) implement controls within Accela, such as a default to the total number of units within the development to calculate the inclusionary fee. Additionally, we recommend DSD initiate a control within Accela to ensure that the inclusionary fee will be assessed and collected within the first building permit phase of all future phased developments (Priority 2).

3. We recommend that the Development Services Department consult with the City Attorney's Office to determine if inclusionary fees not assessed (totaling $5,960) should be recouped (Priority 2).

4. We recommend the Development Services Department (DSD) and the San Diego Housing Commission (SDHC) establish a written service level agreement to determine mutual timelines as to when SDHC should provide the updated inclusionary rates to DSD, and when DSD will update the rates in the system so they will take effect after July 1st of each fiscal year (Priority 2).

5. We recommend that the Development Services Department consult with the City Attorney's Office to determine if the under-assessed inclusionary fees (totaling $1,565) should be recouped (Priority 2).

6. We recommend Facilities Financing assess the linkage fees after the building plans are finalized (Priority 3).

7. We recommend Facilities Financing implement a supervisory review of staff's assessments on a periodic basis to ensure accuracy of linkage fee assessments (Priority 2).

8. We recommend Facilities Financing consult with the City Attorney's Office to determine if the over/under-assessed linkage fees identified should be refunded or recouped (Priority 2).

Appendix A: Definition of Audit Recommendation Priorities

DEFINITIONS OF PRIORITY 1, 2, AND 3
AUDIT RECOMMENDATIONS

The Office of the City Auditor maintains a priority classification scheme for audit recommendations based on the importance of each recommendation to the City, as described in the table below. While the City Auditor is responsible for providing a priority classification for recommendations, it is the City Administration's responsibility to establish a target date to implement each recommendation taking into considerations its priority. The City Auditor requests that target dates be included in the Administration's official response to the audit findings and recommendations.

Priority Class[9]	Description
1	Fraud or serious violations are being committed. Significant fiscal and/or equivalent non-fiscal losses are occurring. Costly and/or detrimental operational inefficiencies are taking place. A significant internal control weakness has been identified.
2	The potential for incurring significant fiscal and/or equivalent non-fiscal losses exists. The potential for costly and/or detrimental operational inefficiencies exists. The potential for strengthening or improving internal controls.
3	Operation or administrative process will be improved.

[9] The City Auditor is responsible for assigning audit recommendation priority class numbers. A recommendation which clearly fits the description for more than one priority class shall be assigned the higher priority.

Appendix B: Objective, Scope, and Methodology

Objective

In accordance with the City Auditor's FY2016 Work Plan, we conducted a performance audit of the San Diego Housing Commission (SDHC). Based on the results of our risk assessment, we identified financing of affordable housing efforts through the City of San Diego's (City) Affordable Housing Fund (AHF) as a risk area due to the risk of revenue loss for SDHC. Specifically, our objective was to: Determine if the City's assessment of inclusionary and linkage fees is accurate.

Scope and Methodology

The audit team reviewed documentation such as the San Diego Municipal Code, Information Bulletins, audit reports, policies and procedures, invoices, and building plans. We also interviewed Development Services Department (DSD), Facilities Financing, and San Diego Housing Commission staff. In addition, we spoke with City stakeholders such as the Building Industry Association, Affordable Housing Coalition, and the Chamber of Commerce. Our period of evaluation included FY2013–2016.

To answer our objective, we selected a judgmental sample of 17 residential developments that paid the City an inclusionary fee and 26 non-residential developments that paid the City a linkage fee during FY2014–2015 to test. Using FY2014–2015 data from SAP, the City's financial management system, we selected our sample based on a random selection of daily cash receipts from SAP showing inclusionary and linkage fees collected during our period of review. Using the available reports from DSD's Project Tracking System, we identified the individual transactions and invoices pertaining to the daily cash receipts and our sample developments.

To ensure the accuracy of inclusionary and linkage fee assessment of our sample developments, we reviewed City invoices, final building plans, the San Diego Municipal Code, and DSD's policies and procedures. For the 17 inclusionary developments in our sample, we compared the assessed square footage and number of residential units noted on the invoices with the same information noted on the final building plans. Additionally, we ensured that the correct inclusionary rate was applied at the time of invoice by comparing the effective date of each rate to the date the City determined each building permit application as deemed complete.

For the 26 linkage fee developments in our sample, we compared the assessed square footage and category of use noted on invoices and/or fee estimation sheets provided by Facilities Financing with the same information noted on the final building plans.

We expanded our test of the applicable rates for inclusionary fees when we found an instance where the fee tables had not been updated in a timely manner by reviewing construction permit reports for residential developments with building permit applications recorded in July and August for FY2013–FY2016.

We also conducted a "completeness" test by verifying linkage fee assessment for 17 developments pulled from the San Diego Business Journal. We traced the developments to the linkage fee assessments and verified 6 as applicable for the fee. The others were governmental institutions not subject to the linkage fee.

We conducted this performance audit in accordance with generally accepted government auditing standards. These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on the audit objectives.

THE CITY OF SAN DIEGO

MEMORANDUM

DATE:	July 21, 2016
TO:	Eduardo Luna, City Auditor
FROM:	Robert A. Vacchi, Director, Development Services Department Jeff Murphy, Director, Planning Department via David Graham, Deputy Chief Operating Officer
SUBJECT:	Management Response to the San Diego Housing Commission Audit – Affordable Housing Fund Department Correspondence

The City of San Diego (Management) acknowledges the Office of the City Auditor San Diego Housing Commission Performance Audit – Affordable Housing Fund (Audit). The following summarizes the recommendations contained in the Audit and the response from Management to the recommendations.

Recommendation 1: The Development Services Department conduct ongoing training to ensure that inclusionary fees are accurately assessed on developments with multiple buildings and inclusionary housing fees are assessed and collected prior to the first building permit issuance (Priority 2).

Management Response: Agree with recommendation
Management will initiate ongoing training to ensure that inclusionary fees are accurately assessed on developments with multiple buildings and inclusionary housing fees are assessed and collected prior to the first building permit issuance.

Date to be completed: August 1, 2016

Recommendation 2: The Development Services Department implement controls within Accela such as a default to the total number of units within the development to calculate the inclusionary fee. Additionally, we recommend DSD initiate a control within Accela to ensure that the Inclusionary Affordable Housing Fee will be assessed and collected within the first building permit phase of all future phased developments (Priority 2).

Management Response: Agree with recommendation
Management will work with the provider to implement controls within Accela that will include measures to ensure the calculation of the inclusionary fee is appropriately assessed which may include a default to the total number of units within the development. Additionally, controls will be put in place to ensure that the Inclusionary Affordable Housing Fee is assessed and collected within the first building permit phase of all future phased developments. If these controls cannot be effectively implemented, DSD will establish

appropriate procedures to ensure the recommendation is appropriately addressed and the appropriate fee is assessed at the required time.

Date to be completed: May 31, 2017

Recommendation 3: The Development Services Department consult with the City Attorney's Office to determine if inclusionary fees not assessed totaling $5,960 should be recouped (Priority 2).

Management Response: Agree with recommendation
Management will consult with the City Attorney's Office to determine if inclusionary fees not assessed totaling $5,960 should be recouped.

Date to be completed: November 1, 2016

Recommendation 4: The Development Services Department and the San Diego Housing Commission establish a written service level agreement to determine mutual timelines as to when SDHC should provide the updated inclusionary rates to DSD, and when DSD will update the rates in the system so they will take effect after July 1st of each fiscal year (Priority 2).

Management Response: Agree with recommendation
Management will enter into a Service Level Agreement (SLA) with the San Diego Housing Commission to establish appropriate timelines to ensure that updated inclusionary rates are reflected on permit invoices no later than July 1st of each fiscal year.

Date to be completed: January 1, 2017

Recommendation 5: The Development Services Department consult with the City Attorney's Office to determine if the under-assessed inclusionary fees totaling $1,565 should be recouped (Priority 2).

Management Response: Agree with recommendation
The Development Services Department will consult with the City Attorney's Office to determine if the under-assessed inclusionary fees totaling $1,565 should be recouped.

Date to be completed November 1, 2016

Recommendation 6: Facilities Financing assess the linkage fees after the building plans are finalized (Priority 3)

Management Response: Agree with recommendation
Management will review building permit plans at the time of initial submittal to inform the customer of their potential Housing Impact Fee (HIF) obligations which allows the customer to budget accordingly. We will revise the review and assessment procedure to require that staff also review the plan set that is approved by DSD Structural staff in order to assess the final HIF. The revised procedure will require additional staff time and may extend the overall building permit processing time in order to accommodate this secondary review procedure. The additional use of staff time for this purpose may impact the other programs such as updating facility financing plans and processing reimbursement agreements.

Date to be completed: August 31, 2016

Recommendation 7: Facilities Financing implement a supervisory review of staff's assessments on a periodic basis to ensure accuracy of linkage fee assessments. (Priority 2)

Management Response: Agree with recommendation
Management will implement a supervisory review of the staff assessment of linkage fee assessments on a periodic basis to ensure accuracy.

Date to be completed August 31, 2016

Recommendation 8: Facilities Financing consult with the City Attorney's Office to determine if the over/under-assessed linkage fees identified should be refunded/recouped. (Priority 2)

Management Response: Agree with recommendation
Management will consult with the City Attorney's Office to determine any exposure the City may have for the over/under assessed HIF identified in the audit sampling. In addition, staff will make themselves available to respond to any valid refund requests.

Date to be completed November 1, 2016

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