

Stanislaus County Civil Grand Jury
Cases 12-03C and 12-04C
City of Modesto Neighborhood Stabilization Program

The Neighborhood Stabilization Program² (NSP²) was authorized by Title XII of Division A of the American Recovery and Reinvestment Act of 2009. The program provided grants to states, local governments, and nonprofits to stabilize residential neighborhoods damaged by foreclosed, abandoned, and blighted properties. In January 2010, the U.S. Housing and Urban Development Department (HUD) awarded \$1.93 billion in NSP² grants to 56 grantees nationwide, including \$25 million to the City of Modesto. Grantees were selected on the basis of foreclosure needs in their selected target areas, recent past experience, program design and compliance with NSP² rules.¹ The City of Modesto had previous experience with successfully implementing the Neighborhood Stabilization Program¹ (NSP¹, Division B, Title III of the Housing and Economic Recovery Act of 2008). NSP¹ provided over \$8 million for rehabilitating approximately two-dozen rental properties.

The NSP² program attempted to fairly quickly inject several million dollars into local economies to mitigate neighborhood deterioration in the wake of the 2008 financial crisis and collapse of the housing market. The HUD NSP² program provided some guidance to grantees (such as a guide to completing income certification), but by and large HUD encouraged grantees to propose and implement their own individual program structures, policies, and procedures that they deemed would meet the general needs of their respective communities within the program goals.

The principal author of Modesto's NSP² grant application was a Stanislaus Community Assistance Project (SCAP) staff member. SCAP is a non-profit, non-governmental, agency that provides low-cost housing, food, and health education services to about 200 special-needs clients.² Until the NSP program, government and charitable grants provided about a \$2.5 million operating budget to SCAP.

The \$25 million NSP² grant had four components: (1) Acquisition and rehabilitation of 100 housing units, \$10.5 million; (2) SCAP acquisition and rehabilitation of 35 housing units, \$6.0 million (nearly tripling its operating budget); (3) Stanislaus County Housing Authority acquisition and rehabilitation of 40 housing units for emancipated foster/homeless youth, \$6 million; (4) Administration and planning, \$2.5 million.

The city's plan called for identifying and qualifying "developers" who, in addition to SCAP, would locate foreclosed or abandoned residential housing units, distributed across the city—specifically targeting areas having high numbers of residential foreclosures and abandonment, including approximately forty properties to provide permanent housing for special needs

¹ U.S. Department of Housing and Urban Development, Neighborhood Stabilization Program², http://portal.hud.gov/hudportal/HUD?src=/program_offices/comm_planning/communitydevelopment/programs/neighborhoodspg/arrafactsheet

² A special need includes mental or physical disability, HIV/AIDS, low-income, or elderly. SCAP changed its name to Community Impact Central Valley (CICV) on April 2, 2012.

households—acquire and rehabilitate these units, and then sell or lease these units to qualified buyers or tenants. All projects were to benefit households whose income is less than 120 percent of area median income, with 25 percent of the funds for projects to be occupied by low-income households (less than 50 percent area median income). (Median household income in the City of Modesto in 2009 was \$46,316.) Overall, the program goal was to serve an estimated 200 households within three years while economically stabilizing the property values in targeted residential areas.

The city's principal role was to be general contract administrator, overseeing, but not itself rehabilitating, housing units—monitoring and auditing the developers to ensure that HUD monies were properly expended. The private sector or nonprofit developers would do the actual rehabilitation work.

Because the NSP2 grant was authored and submitted under the auspices of the city's Parks, Recreation and Neighborhoods (PRN) department, the City Manager assigned administration of the NSP2 grant to that department. The City Council assigned responsibility for reviewing and selecting properties to the City of Modesto's Citizens Housing and Community Development (CHCD) Committee working in concert with city staff. This 13-member committee, appointed by the City Council, is charged with overall review of the city's HUD funds including the HUD Community Development Block Grant (CDBG), Emergency Shelter Grant, HOME Investment Partnership Grant programs, and the Neighborhood Stabilization Programs. Members tend to be selected more on the basis of community service than expertise in housing/development or finance. The CHCD committee assigned specific responsibility for NSP2 to a three-person subcommittee (CHCD-NSP). The CHCD-NSP subcommittee in concert with city staff had complete authority to make decisions regarding NSP2 properties to be acquired and developed without further reporting to the full CHCD committee or the City Council. Members of the CHCD-NSP subcommittee did not have extensive program management and housing/development experience.

By Spring 2011, the city was working through seventeen developers, including SCAP. Rehabilitation work was well underway with many units completed. It is important to note that the NSP2 program did not allow demolition of a property deemed too deteriorated.

In April 2011, a member of the SCAP Board of Directors informed a Modesto city councilmember of possible improprieties in SCAP's implementation of the NSP2 grant. The councilmember met with the complainant and contacted the city manager. City of Modesto staff administering the NSP2 grant were not brought in at this point. Shortly afterward the councilmember informed reporters and editors of the *Modesto Bee* about the allegations. The councilmember did not bring this matter to the attention of the city council.

The *Modesto Bee* soon began a year-long investigation into the administration of the NSP2 program. In early June 2011, questions arose regarding the fees and salary owed by SCAP to its staff member who wrote the NSP2 grant. This was not an obligation of the city. Later that month and into early July 2011, information surfaced that relatives of SCAP staff as well as SCAP staff were occupying 6 of the 20 housing units that had been rehabilitated to date by SCAP under the NSP2 program. City staff froze SCAP's CDBG and NSP2 funds pending an audit.

Shortly after taking office in July 2011, the 2011-2012 Stanislaus County Civil Grand Jury (SCCGJ) was asked to review the NSP2 program. The SCCGJ focused its attention on the overall management of the program by City of Modesto including relations with developers. It did not review management issues by or within the organization of SCAP or the other developers. Nor did it examine the rationale and efficacy of HUD's NSP2 grant program as part of national economic recovery.

Questions arose about the appraisal practices, purchase price, and cost of improvements of certain NSP2 properties.

SCCGJ members reviewed the appraisal of the SCAP-developed Coolidge Avenue property including comparable properties and the credentials of the Santa Cruz appraiser. The appraisal in relation to comparable properties was realistic. Regarding the cost of upgrading the individual units, city staff did not calculate their figures by the individual unit. They looked at the expenses for the entire project (acquisition and rehabilitation) and then figured the cost per square foot per unit. The per-unit cost (estimated at about \$70,000 per unit) was reasonable and not excessive. In addition to the costs in general of fixing the entire property up, the city had to honor HUD requirements for accessibility by the disabled population. These upgrades can be costly.

SCCGJ members also reviewed SCAP-developed Bonita Circle and Weston Way properties. In general, the costs looked within reason. In visiting the properties handled by the Housing Authority of the County of Stanislaus for comparison, SCCGJ members were impressed with workmanship, process, and general procedures. They are excellent at bidding out work and getting the best price. One person oversees all of the rehabilitation process.

SCCGJ members examined the records of three properties (Redbud Court, Dartmouth Lane, and Lassen Avenue), developed by Mission Development of San Francisco, that seemed to have higher rehabilitation costs in relationship to the cost of the acquisition of the property. The acquisition price of the Rosebud Court property was \$79,389 and the rehabilitation cost was \$97,982 (total: \$177,371). It has not sold as yet. Redbud Court is in a generally run down area neighborhood off of Lincoln Avenue and Yosemite Avenue.

In reviewing some of the invoices SCCGJ members believe that some of the expenses for landscaping were high. However, developers often have to redo a sprinkler system, remove trees, and put in new fences.

City staff came to view more than one developer as less than competent to do the job of rehabilitation. These developers had to be helped by the city staff to accomplish their task. Because the city was in contract with these developers they could not sever the relationship.

City staff requested that HUD initiate an audit. In early August 2011, *Modesto Bee* articles raised questions about the cost of several specific NSP2 rehabilitation expenditures.

Then the city staff discovered that a Modesto city councilmember was a partner in a "doing-business-as" (DBA) firm that had an undisclosed business relationship with one of the approved NSP2 developers. This firm received a sales commission on one of the properties to be rehabilitated by this developer under the NSP2 program. By the time that this information was reported in the *Modesto Bee*, the councilmember's firm had returned the questioned fee, and HUD was asked to add this matter to its audit investigation. This conflict of interest was not

readily apparent to city staff because government forms declaring potential conflicts of interest, that all councilmembers must complete, seem to only require naming primary business entities—not names of individuals as principals, partners, or DBA affiliates. The distinction between an actual person’s name and a “fictitious” business name is important because business fictitious names give no obvious indication of the persons or entity that is legally responsible for their operation. California’s Fair Political Practices Commission found that the councilmember violated Government Code Section 87100 (Political Reform Act) and issued a written warning.

In October 2011, a letter from the City Manager to SCAP formally charged SCAP with “egregious management and performance deficiencies,” listing several serious problems and requesting corrective actions. Within the next few weeks key SCAP staff were first suspended, and then fired. The City Manager hired new “consultants” to administer the NSP2 program. Key city staff resigned or expressed their intention to resign.

In January 2012, the HUD Office of Inspector General released a report about city’s administration of NSP2 funds. It faulted the city councilmember for conflict of interest and found malfeasance. The HUD audit found that the “...councilmember and one of the developers violated conflict-of-interest requirements of both HUD and the City in one multifamily property acquisition.” The HUD audit did not address the reasonableness of property acquisition and rehabilitation costs or the screening and approval of prospective buyers or tenants of NSP2 rehabilitated housing units.

FINDINGS

F1. Modesto City Council and City Manager Direction and Responsibility

The Modesto City Council did not exercise sufficient oversight responsibility in setting goals for the NSP2 program, developing a blueprint for management of the program, setting an appropriate timeline for staff to monitor the program, and then report back to the City Council in a timely fashion. Insufficient interest was expressed by the Mayor, City Council and the City Manager in the NSP2 program. Program implementation was delegated to a subunit within the city’s PRN department. Oversight was delegated to the city’s CHCD committee, which in turn delegated complete approval authority to the CHCD-NSP subcommittee. Delegation was one-way. There was little reporting back until problems began to become public and inquiries initiated by the *Modesto Bee*.

F2. City Staff Administration of the NSP2 Program

The city staff responsible for the NSP2 program have been very helpful in providing their time and records. They have been open and honest with information and describing the problems that they faced. The city staff in the PRN department did a good job in developing a management plan and rational guidelines and procedures for the implementation of this program. They monitored detailed rehabilitation expenditures but did not adequately foresee or address issues with respect to the purchase of properties, identification and qualification of potential buyers and tenants, and purported overall objective of the program—neighborhood improvement and property value stabilization. The city staff did not implement HUD guidelines and set up quarterly monitoring to

ensure that the parties involved were following practices appropriately. No quarterly meetings were held for a year. Quarterly monitoring of the developers as required by HUD may have forestalled or mitigated some of the problems early on.

F3. Project Costs

In severely blighted neighborhoods, some properties were overly rehabilitated in relation to the condition of the neighborhood. When a property is purchased in a run-down neighborhood and there is more rehabilitation to do because the property may have been trashed, which happens a lot, or it is just in poor condition, a cap should be placed on rehabilitation costs, so that the taxpayer gets a reasonable return on investment. If the property does sell, those costs will more than likely never be recouped because of the neighborhood and conditions of the market. If the property is rented, there is a better chance that the investment was a better use of taxpayer money. Demolishing the structure might be the best alternative. Another decision might be to not consider that property for rehabilitation and move on.

F4. Tenant Eligibility at SCAP: Conflict of Interest and Public Perception of Favoritism

The handling of tenant eligibility at the SCAP program was inappropriate, egregious, and showed favoritism to family members and staff. The city had guidelines for applicants to the housing program for rental and homeownership in the NSP2 program. The handbook entitled Homebuyer Program: Policies and Procedures specifies owner or tenant requirements. It details policies and procedures for the review and determination of the applicant's program eligibility. City staff were not vigilant with respect to these guidelines and were lax in their monitoring of this element of the program by SCAP, the nonprofit developer.

F5. Cost of Acquisition and Rehabilitation of Properties

The Coolidge Avenue property was rehabilitated within reasonable cost parameters. Costs overall were in reasonable bounds and the craftsmanship at the properties was satisfactory.

F6. Councilmember Acting Alone

The councilmember who was first informed about potential SCAP problems did not appropriately brief, and express his findings and concerns, to the Mayor and fellow councilmembers before contacting the *Modesto Bee*. This action denied elected city officials the opportunity to proactively address a pending problem.

F7. Councilmember Conflict of Interest

The councilmember who had a conflict of interest in the acquisition and rehabilitation of NSP2 properties, and who at first participated in the occasional City Council discussions of NSP2, and who at first accepted a substantial sales commission—only later recusing himself and returning the commission—was on some level deceitful and dissembling in not fully disclosing relevant business affiliations and associates.

RECOMMENDATIONS

- R1. The City Manager and City Council have the responsibility to oversee the management (policies, procedures, and structure) of the program implementation. That oversight was deficient. Periodic, at least quarterly and possibly monthly, detailed performance and financial reports should be submitted to the full CHDC, the City Manager, and the City Council.
- R2. Elected and appointed officials should refrain from acting alone and not following appropriate councilmember protocol when a problem comes to light. They should provide the Mayor, City Council, and city staff the opportunity to address problems and be proactive in their solution.
- R3. With respect to rehabilitation costs, the SCCGJ recommends that a percentage of the price of the property (such as 75%) be designated as the ceiling for rehabilitation costs for a property located in a severely blighted neighborhood. In the case of the Redbud Court property, the acquisition price was \$79,000 and 75% of that would be \$59,000. That seems a reasonable cost for rehabilitation of that property. HUD does not give explicit direction on this but there is an implied direction to spend the money judiciously while getting the houses rehabilitated.
- R4. City staff should meet regularly with appropriate board members of a non-profit developer (SCAP) and other individual developers, or their financial officers to oversee their processes for screening prospective tenants or potential buyers and insure that the guidelines for tenant selection are being handled effectively.
- R5. The city should make sure that future NSP, or similar, grants provide options for structure demolition.
- R6. Contracts should provide that if a developer defaults or is not able to perform satisfactorily their contract could be immediately terminated and the developer quickly replaced.
- R7. Elected officials should complete AB 1234 Ethics Training as soon as possible after they are seated. The status of this training should be posted on the city's web site.

REQUEST FOR RESPONSE

City of Modesto, City Council
City Manager, City of Modesto

This report of cases 12-03c and 12-04c is issued by the 2011-2012 Stanislaus County Civil Grand Jury. No members of the grand jury recused themselves due to a perceived conflict of interest.