AC2014-0294
Attachment

THE CITY OF
CALGARY
CITY AUDITOR'S OFFICE

Attainable Homes Calgary Corporation - Home Ownership Business Cycle Controls Audit

March 31, 2014

The City Auditor's Office completed this project in conformance with the *International Standards for the Professional Practice of Internal Auditing.*

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Executive Summary

Attainable Homes Calgary Corporation (AHCC) is a wholly owned subsidiary of The City of Calgary. AHCC is a non-profit organization that was incorporated in 2009 to implement and administer attainable housing in Calgary. AHCC's mandate is: "Creating value-driven developments using innovative financing solutions with our partners and communities underpins our success in providing quality entry-level homes at attainable prices". AHCC uses a shared equity model of home ownership to generate future funding to sustain the organization.

The objective of this audit was to review controls over the home ownership business cycle to provide assurance that existing controls were appropriately designed and operating effectively to support the shared equity model. The audit focused on controls designed and/or operating during the home ownership business cycle from October 1, 2012 to September 30, 2013. The unit acquisition and construction phase and the acquisition and development of land phase were not included in the scope of the audit.

There are three phases in the home ownership business cycle: the application process, home ownership and re-sale of homes. AHCC relies on a small number of experienced staff (four with direct involvement) to administer and oversee this business cycle. Processes, practices and controls identified in the audit generally supported compliance with AHCC policies, AHCC's mandate, and AHCC's shared equity model.

However, we noted that AHCC changed eligibility practices in 2013, and no longer required documented confirmation of applicant eligibility from lenders. We raised one recommendation to evaluate this practice as applicant eligibility is a critical aspect of AHCC's ability to fulfill its mandate.

Possessions have increased steadily since 2011 (37 in 2011 to 164 in 2013) and are expected to continue to increase in future years. AHCC will need to implement oversight controls and strengthen practices and procedures, particularly as additional staff will be required to deal with increased activity. We raised three recommendations to further build an effective framework of controls to support future activity. In particular, we recommended that AHCC implement monitoring controls to evaluate the shared equity model variabilities. The long term success of the shared equity model relies on current activity (sales and re-sales) providing future financial support for further attainable properties to be made available. There are a number of variables impacting current activity, some of which can be controlled by AHCC (such as the minimum repayment price), others which are outside their control (such as market price). These variabilities should be periodically evaluated to support future sustainability of the model.

Management has agreed to our recommendations and has indicated in their responses a commitment to implement action plans.

1.0 Background

This audit was undertaken as part of the City Auditor's 2013 approved Audit Plan.

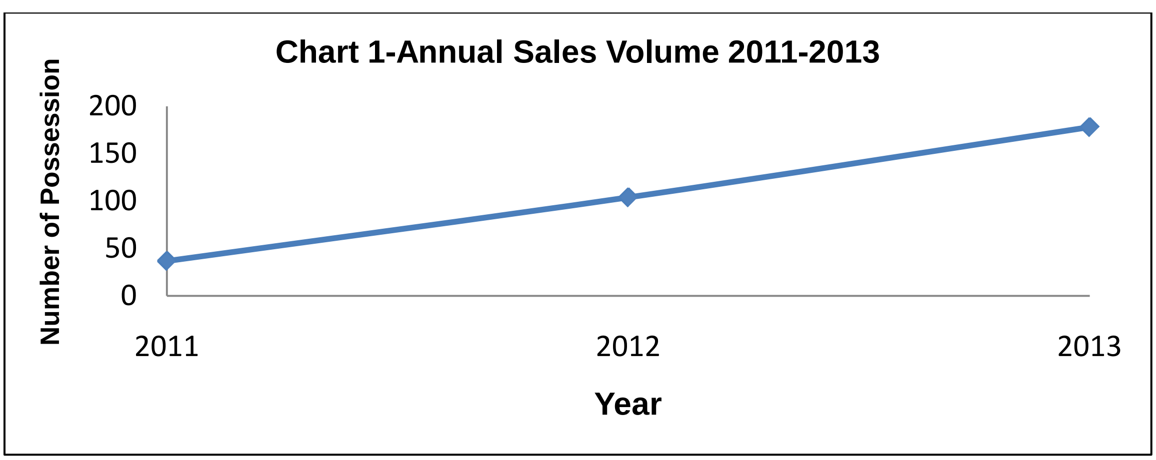
Attainable Homes Calgary Corporation (AHCC) is a wholly owned subsidiary of The City of Calgary. AHCC is a non-profit organization that was incorporated in 2009 to implement and administer attainable housing in Calgary. AHCC is governed by a Board of Directors, who report to City Council. City Council exercises an oversight role over the organization. In 2009, City Council also approved a $10 million loan facility for AHCC.

AHCC was created to address the housing affordability gap in Calgary and contribute to Calgary's 10-Year Plan to End Homelessness. AHCC's mandate is: "Creating value-driven developments using innovative financing solutions with our partners and communities underpins our success in providing quality entry-level homes at attainable prices".

AHCC created the Attainable Home Ownership Program (AHOP) to provide 1,000 quality entry-level homes at attainable prices to eligible middle income Calgarians. This would be achieved by partnering with reputable, community-minded builders and establishing savings that were directly passed onto customers. The three key elements to the AHOP are attractive home prices, forgivable equity loans and a shared appreciation plan that provides customers with a financial stake in the equity of their new home. The longer homeowners stay in their home, the larger their share of equity (e.g. a maximum of 75% after 3 years).

AHCC is using the shared equity model to ensure the sustainability of the organization. Under this model, AHCC shares in the appreciation of value when properties are resold. The expectation is that AHCC will generate sufficient revenues to repay the City of Calgary loan, and the mortgages payable on lands purchased from The City, as well as reinvest to provide homeownership opportunities to other Calgarians.

AHCC has experienced a rapid increase in activity levels over the last three years, which is shown in the following chart:



There are four staff members directly involved in the home ownership business cycle that consists of the following steps:

- Application Process:
    - Eligibility confirmation
    - Application approval
    - Home transfer

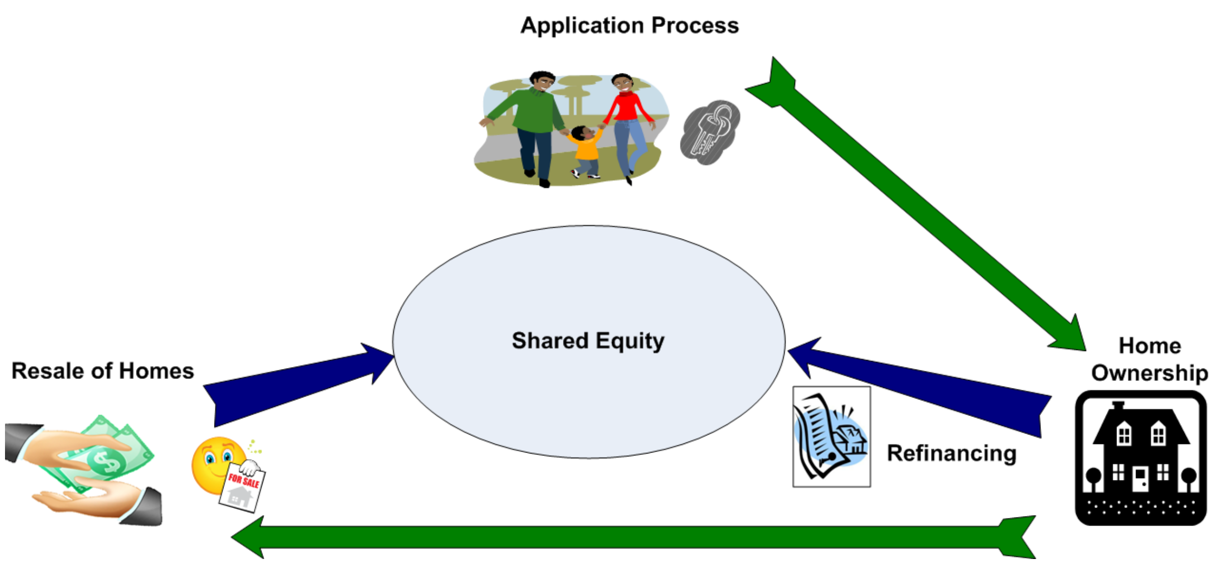
- Home Ownership:
    - Compliance with AHCC policies by owners
    - Refinancing (e.g. an owner wants to secure more favourable financing)

- Resale of Homes
    - Appraisal of home for re-sale
    - Shared equity payment calculation following sale

The following diagram illustrates the Home Ownership Business Cycle:

Home Ownership Business Cycle

Diagram 1



Attainable housing is an important part of a city's social and economic development. AHCC's 2013 Risk Register (presented to The City of Calgary's Audit Committee on 25 July 2013 as part of the AHCC annual presentation to the Audit Committee) acknowledges that: "AHCC's long term sustainability is depending on the success of the shared equity model in 5 – 10 years' time. Sufficient future long-term cash streams must be generated to fund the acquisition of land and the construction or acquisition of program inventory once short and medium term finite financing sources have been exhausted''.

2.0 Audit Objectives, Scope & Approach

2.1 Audit Objectives

The objective of this audit was to review controls over Attainable Homes Calgary Corporation's (AHCC) home ownership business cycle to provide assurance that existing controls were appropriately designed and operating effectively to support the shared equity model.

Specifically the audit assessed whether AHCC has effective processes to:

- Accept only eligible applications;
- Treat applicants equitably and consistently;
- Prevent misappropriation of cash received in the application process;
- Protect AHCC's interest in the shared appreciation of homes during home ownership; and
- Ensure that funds received through shared appreciation distribution are correctly calculated and accounted for.

2.2 Audit Scope and Approach

The audit focused on activity within the home ownership business cycle from October 1, 2012 to September 30, 2013. The unit acquisition and construction phase and the acquisition and development of land phase were not included in the scope of the audit.

Our audit approach included the following:

- Conducting interviews with management and staff at AHCC;
- Reviewing documentation of the home ownership business cycle;
- Reviewing relevant policies, procedures and guidelines;
- Testing a representative sample of 32 sales out of 130 sales during the audit period covered (25%);
- Testing 100% of re-sale transactions; and
- Reviewing other files and documents as required.

3.0 Results

AHCC is a new organization which has experienced recent growth in home purchases, and expects this growth in activity to continue. A strong framework of controls is required to ensure effectiveness and sustainability of the shared equity model. In particular, controls over the home ownership business cycle are critical to manage the risks regarding:

- Fulfilment of AHCC's mandate
- Long term funding and sustainment
- AHCC reputation and integrity

Our audit work confirmed that activities throughout the cycle were performed by a small number of experienced staff. The following processes and controls were in place in the home ownership business cycle:

- All deposits and application fees were properly collected, deposited and supported with receipts. We provided management with opportunities to strengthen cash controls during meetings to discuss preliminary audit findings (e.g. using pre-numbered feature in the receipt book and issuing receipts when payment is received).

- All sales contracts included key legal aspects of the program, such as AHCC's encumbrance on the land title, equity loan and liability insurance.

- All steps in the re-sale process were completed accurately (e.g. calculation and review of shared appreciation, verification of lawyer's payout to calculation and journal entry preparation). The re-sale process has not been documented due to low volumes. As resale volumes increase management should consider documenting the process to ensure that key steps are completed and reviewed for accuracy.

However, we identified the following improvements to key controls and processes, which will allow AHCC to better manage the home ownership business cycle as sales continue to increase:

- As activity has increased, changes have been made to policies, practices, and procedures over the time period we reviewed. In particular, we identified that confirmation of application eligibility is no longer documented. We raised a recommendation (Section 4.1) as this is a critical aspect of AHCC's ability to fulfill its mandate.

- The long term success of the shared equity model relies on current activity (sales and re-sales) providing future financial support for further attainable properties to be made available. There are a number of variables impacting current activity, some of which can be controlled by AHCC (such as the minimum repayment price), others which are outside their control (such as market price). As activity increases, AHCC needs to implement monitoring controls to support future sustainability (Section 4.2).

- AHCC should create file checklists and review current wait list practices to better support the effectiveness of the home ownership business cycle (Sections 4.3 and 4.4).

We would like to thank the staff of AHCC for their assistance and support throughout this audit.

4.0 Observations and Recommendations

4.1 Eligibility Confirmation

We reviewed a representative sample of 32 sales files and noted there was no evidence of eligibility confirmation by lending institutions for 28 of 32 sales files examined. During the audit, we were able to perform additional procedures to confirm the eligibility of 11 of the 28 sales files with the lender. There was a legal contract in all sales files signed by the applicant stating they met eligibility criteria.

AHCC's Eligibility Policy states that an application must be accompanied by "confirmation by lender that applicant meets the criteria of the Attainable Home Ownership Program". The criteria of the AHOP are as follows:

- Maximum family income $80,000 per annum for singles and couples without dependent children
- Maximum family income $90,000 per annum for single and dual parent families with dependent children
- Assets not exceeding $100,000

In September 2013, AHCC changed the application form, and in that change, excluded confirmation of eligibility by lenders. Current practice does not conform to AHCC policy. There is a risk that, without documentary evidence, AHCC is accepting ineligible applicants into the program. As a result, AHCC may not be able to fulfill their mandate to provide attainable homes for middle income Calgarians.

<u>Recommendation 1</u>

AHCC Management:

a) Evaluate current eligibility confirmation practices and work with legal counsel to ensure adequate documentation is obtained and retained confirming that applicants meet the eligibility criteria for the AHOP; and
b) Ensure that policies and practices are reviewed and updated accordingly.

<u>Management Response</u>

Action Plan	Responsibility
Agreed; AHCC will check with legal counsel to ascertain whether clients legally representing and warranting their eligibility can be more defined. AHCC will manage adequate documentation as per outcome of the legal advice. The Corporate Performance and Governance Committee of the Board of Directors will be reviewing this policy, amongst others, in 2014.	<u>Lead:</u> Tara Cooney, Sales and Marketing Manager <u>Completion Date:</u> June 30, 2014

4.2 Shared Equity Model

Home owners get a financial stake in the equity of their new home. When home owners sell their home or refinance[1] they are entitled to a share of the equity based on the length of ownership (0% to 75%)[2]. The equity is determined using a standard formula where the principal amount of the mortgage and a $2,000 deposit are deducted from the selling price. The formula includes a minimum amount payable to AHCC to protect their interest where market value has declined or the property has not sufficiently appreciated. AHCC policy sets the minimum repayment between 50% and 60% of the forgivable equity loan.

Before homes are made available to customers, the purchase price is determined through AHCC analysis that includes a profit margin to AHCC to cover operating costs. The amount of the forgivable equity loan helps customers with the down payment and is set at an amount that assists prospective home owners with mortgage qualification. AHCC will recognize a loss on the forgiveness of the equity loan whenever the shared appreciation received is less than the equity loan (e.g. minimum amount). However, this is not a net loss given profit recognized at the beginning of the cycle.

To date, AHCC have evaluated equity loans and minimum repayments on an ad hoc basis. AHCC did adjust the equity loan amount from an average of 10% of selling price on an early project to 5% on future projects to protect future cash flows. We reviewed one re-sale from this early project and noted that although the home appreciated in value, the shared appreciation paid to AHCC was less than the equity loan and resulted in a loss.

The determination of the forgivable equity loan, the minimum repayment and the percentage of shared equity payable to AHCC based on the length of ownership have a significant impact on the amount AHCC will receive on re-sale and be reinvested in the program. Fluctuations in market prices also have an impact.

As sale and re-sale activity increases, it is important that AHCC periodically evaluate changes to market prices and amounts received from recent re-sales. AHCC should also assess the impact the minimum amount, the forgivable loan and the percentage share of equity have on future cash flows. Adjustments can then be made to these variables as required. This will allow AHCC to better manage the risk that future cash flows are not sufficient to ensure sustainability.

Recommendation 2

AHCC Management implement a monitoring control to periodically evaluate the change in market prices, amounts received from recent sales, and the variables in the shared equity model and make required adjustments to ensure sufficient future returns.

[1] Homeowners may also choose to repay AHCC's equity share.
[2] The amount is 0% up to and including the first anniversary from the closing date and increases to a maximum of 75% after three years plus one day from the closing date and is specified in AHCC Policy #2.

Management Response

Action Plan	Responsibility
Agreed; more sales are required to establish a pattern and confirm a process. Less than 2% of the properties have completed the entire cycle. Historical market prices, appraisals, amounts received from re-sales and the variables in the shared equity model are tracked. However, with five re-sales, there is insufficient data to draw conclusions. AHCC will monitor this on a yearly basis with a report to AHCC Board of Directors on 2014 prepared in Q1 2015, to determine if amendments should be made to the model.	Lead: Marion Shill, Finance Manager Completion Date: March 31, 2015

4.3 File Check List

We reviewed a sample of 32 sales files and noticed that documentation was not consistently obtained and/or retained within applicant files. Specifically:

- 20/32 sample files had certificate of title
- 26/32 sample files had application forms
- 14/32 sample files had pre-approval letters
- Training records were available for 24/32 sample files

Documentation provides evidence to support that staff and lenders are fulfilling their roles and responsibilities and complying with standard processes and practices. In particular, the certificate of title provides evidence of encumbrance on the title, which protects AHCC's interest in the shared appreciation. File checklists can be an effective tool to ensure that key documents are obtained.

Recommendation 3

AHCC Management should consider creation of a file checklist or other tools to ensure receipt of key documentation, and provide staff training on usage.

Management Response

Action Plan	Responsibility
Agreed; AHCC has begun the process of changing the current checklist to be more inclusive. In addition, AHCC has established a new administrative position that will be responsible to check the files for completion.	Lead: Tara Cooney/Marion Shill Completion Date: March 31, 2014

4.4 Wait List Process

Current practice to manage wait lists is not consistent with information on AHCC's website or internal policy. We reviewed the application process and noted current practice allocates priority based on completion of paperwork, rather than applicants listed first on these wait lists.

The AHCC Eligibility Policy and information on the AHCC website refer to the use of a wait list and taking applicants on a first come first served basis. However, there is no mention of additional criteria such as completion of required paperwork.

To improve the transparency of the home acquisition process the use of the wait list to support a fair priority should be more clearly defined. It is also important to document and communicate the process.

Recommendation 4

AHCC Management should review current wait list practices to ensure they reflect the intended customer priority and update documentation and communication accordingly.

Management Response

Action Plan	Responsibility
Agreed; AHCC has determined that keeping waitlists is a practice that should be discontinued. AHCC will be honoring those currently on waitlists, but not build any new ones.	Lead: Tara Cooney Completion Date: December 31, 2013