
RECOMMENDATION:
That Report CM07023 respecting the follow up of Audit Report 2005-07, Downtown Renewal Division – Financial Assistance Programs, be received.

Ann Pekaruk
Director, Audit Services
City Manager's Office

EXECUTIVE SUMMARY:
Audit report 2005-07, Downtown Renewal Division – Financial Assistance Programs, was originally issued in September, 2005 and management action plans with implementation dates were included in the report. In May, 2007, Internal Audit followed up the report to determine that appropriate and timely actions had been taken. Regarding the implementation of the sixteen (16) recommendations made in the original report, thirteen (13) are completed and three (3) are in progress.

BACKGROUND:
Audit report 2005-07, Downtown Renewal Division – Financial Assistance Programs, was originally issued in September, 2005. The report indicated several recommendations which dealt with: (i) the segregation of duties within the division’s personnel in charge of the loan program and within Finance where loan advances and repayments are handled; and (ii) the collection and retention of necessary documentation and support for compliance and verification work carried out by staff and outside counsel.
BACKGROUND (Continued):

It is normal practice for Internal Audit to conduct follow up reviews within a 12-18 month period following issuance of the original report in order to determine whether actions plans committed to by departmental management have been implemented. In May, 2007, Internal Audit followed up the report to confirm appropriate and timely actions had been taken.

ANALYSIS/RATIONALE:

The report attached as Appendix “A” to Report CM07023 contains the first three (3) columns as originally reported in Audit Report 2005-07 along with an added fourth column indicating Internal Audit’s follow up comments.

Due to the efforts of staff, there has been significant improvement in the controls and processes for the Downtown Residential Loans program. Thirteen (13) of the sixteen (16) recommendations have been fully implemented. Among the implemented recommendations are included detailed application and approval processes, file administration, and pertinent documents and recordkeeping.

The remaining three (3) recommendations are in progress and expect to be implemented by the third quarter of 2007.

ALTERNATIVES FOR CONSIDERATION:

Not applicable.

FINANCIAL/STAFFING/LEGAL IMPLICATIONS:

Financial
None.

Staffing
None.

Legal
None.

POLICIES AFFECTING PROPOSAL:

None.
RELEVANT CONSULTATION:

The results of the follow up were discussed with the staff responsible for the administration of the financial assistance programs (Downtown Renewal Division, Planning and Economic Development Department and Taxation Division of the Corporate Services Department).

CITY STRATEGIC COMMITMENT:

By evaluating the “Triple Bottom Line”, (community, environment, economic implications) we can make choices that create value across all three bottom lines, moving us closer to our vision for a sustainable community, and Provincial interests.

Community Well-Being is enhanced. ☑ Yes ☐ No

City Council’s goal of “A Great City in Which to Live” and its commitment to providing quality community services through its support of economic development in the downtown area are upheld by the provision of services through the area audited and reported upon.

Environmental Well-Being is enhanced. ☐ Yes ☑ No

Economic Well-Being is enhanced. ☑ Yes ☐ No

City Council’s strategic commitment to “Best Practices – Best Value” under “A City That Spends Wisely and Invests Strategically” is addressed through audits and reviews and their subsequent follow up to ensure controls are in place to protect the assets of the City and promote efficient, effective and economic services and programs.

Does the option you are recommending create value across all three bottom lines? ☑ Yes ☐ No

Do the options you are recommending make Hamilton a City of choice for high performance public servants? ☑ Yes ☐ No

:dt
Attachment
# OBSERVATIONS OF EXISTING SYSTEM | RECOMMENDATION FOR STRENGTHENING SYSTEM | MANAGEMENT ACTION PLAN | FOLLOW UP (May 2007)

**Downtown Residential Loans***

1. **Application and Approval Process**

   Before recommending loans for Council’s approval, the Division does not carry out a formalized risk assessment of applicants and their proposed projects. Also, project viability is not formally evaluated through financial projections to assess the borrower’s ability to repay the City and the bank’s mortgages. There is often insufficient information on loan files to support the basis for loan approval or denial decisions. This is despite the fact that as much as 20% of loan qualification criteria relate to project risk evaluation, requiring that staff review the applicant’s business plans and track record.

   Management have indicated that, being a facilitator of downtown revitalization, and not a primary lender, the Division places reliance on the first mortgagee’s more rigorous and formalized processes. There is however no evidence that staff do receive and review documents on which the first mortgagee’s decisions are based.

   If projects are not formally evaluated before approval, the City could advance loans to risky applicants who may not be able to repay. The City’s ability to advance loans under this program could be affected by cash flow problems thereby, possibly affecting the attainment of Council’s strategic goals regarding downtown revitalization.

   That loan applications be formally evaluated in accordance with established loan approval criteria and that results of such evaluations be documented as a basis for recommendations to Council.

   Agreed. In the past we have used a two-step process but have not documented same to the appropriate extent. Accordingly, we will formalize our current practice and place the information on file. That process includes:

   a. Using preliminary plans, costs and financing to ascertain the worthiness of applications being presented to Council for funding commitment.

   b. Undertaking detailed assessments satisfying all City lending criteria before executing the loan commitment and agreement.

   Agreed. Given that the City is not the primary lender, we have evaluated applications based on the extensive due diligence undertaken by the first mortgage lender, thereby lowering the overall cost to the City. However, we will document the findings from our assessments for our files.

   Completed. An Evaluation Committee, consisting of two groups – Financial and Planning and Development – now review all applications using precise and detailed criteria. The scores of these two groups are combined for the final evaluation score.

   There was evidence on file of scored evaluation sheets initialed by members of the committee. However, there is opportunity for more detailed documentation. Many of the evaluation forms did not have any comments to give some indication as to the basis of the score granted.

   Completed. In addition to the financial evaluation undertaken by the Committee as noted above, the Co-ordinator of Downtown Municipal Incentives also may review mortgage documents, property appraisals, leases and tenant information and income and expense statements in evaluating the applicant’s ability to pay back the loan.

---

* The Commercial Property Improvement Grants and the Enterprise Zone Realty Tax Grants programs were also reviewed. They appear to be in compliance with applicable policies and procedures and noted controls are adequate. As a result of the audit, there are no recommendations made in regard to these two programs.
<table>
<thead>
<tr>
<th>#</th>
<th>OBSERVATIONS OF EXISTING SYSTEM</th>
<th>RECOMMENDATION FOR STRENGTHENING SYSTEM</th>
<th>MANAGEMENT ACTION PLAN</th>
<th>FOLLOW UP (May 2007)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.</td>
<td>A multi-disciplinary staff committee set up to evaluate loan applications only meets when short-listed applicants' proposals exceed funds available in the line of credit, whereupon applications are ranked according to weighted criteria. As funds have so far been available, this committee has not met. Applications are, to a very large extent, received, evaluated and recommended for Council approval by one member of the Downtown Renewal staff without a peer review of the basis of judgments made. Further, internal financial expertise from the Budgets and Finance Division is not utilized. Staff from this Division are not members of the committee referred to above nor are they called upon to review the financial content of applications before recommendations for approval are presented to Council. Compliance with program requirements and attainment of the program's strategic objectives cannot be guaranteed if critical processes are not adequately overseen. Significant risks could be overlooked if financial information is not comprehensively reviewed.</td>
<td>That the Downtown Renewal Division consider appointing a person with a financial background to its loan evaluation committee. That, in addition to its current responsibilities, this committee be tasked with reviewing the Division's recommendations to Council to ensure transparency and compliance with the loan program's requirements. (Also see recommendation #12.)</td>
<td>Agreed. The Finance Division will appoint the City's Chief Investment Officer who is a member of the Institute of Chartered Financial Analysts (CFA). We will implement immediately. Agreed. See response under #12.</td>
<td>Completed. As per point 1 above, the evaluation Committee consists of a financial group responsible for sixty (60) per cent of the final score assessed. The Financial group consists of the Manager of Tax Accounting, the Chief Investment Officer and the Co-ordinator of Downtown Municipal Incentives. Completed. The staff report to the Economic Development and Planning Committee is circulated to the staff committee members to ensure they concur with the report recommendations.</td>
</tr>
<tr>
<td>3.</td>
<td>Loan applications are not logged and date-stamped on arrival nor are receipts issued for received applications. Also, applicants do not receive letters of acknowledgement as proof that their applications have been received. Lack of proof that applications were received within the deadline specified in the Request for Applications undermines the transparency that is vital in the administration of a public loan fund.</td>
<td>That a system of date-stamping and logging applications on arrival be established and that receipts be issued in duplicate with one copy retained in the applicant's file.</td>
<td>Agreed. Since June, 2005, the Division has begun issuing formal receipts. We will send formal letters acknowledging receipt of the applications upon closure of the Request for Applications and placing copies of them in the individual files.</td>
<td>Completed. Receipts are issued when applications are received. The receipt indicates date received, from whom, time and staff initials. Also, letters acknowledging receipt of the applications are sent once the Request for Application has closed. Copies are retained in the applicants' files.</td>
</tr>
<tr>
<td>#</td>
<td>OBSERVATIONS OF EXISTING SYSTEM</td>
<td>RECOMMENDATION FOR STRENGTHENING SYSTEM</td>
<td>MANAGEMENT ACTION PLAN</td>
<td>FOLLOW UP (May 2007)</td>
</tr>
<tr>
<td>---</td>
<td>---------------------------------</td>
<td>----------------------------------------</td>
<td>------------------------</td>
<td>---------------------</td>
</tr>
<tr>
<td>4.</td>
<td>Downtown Renewal staff frequently meets with developers before and after Council’s approval of loans. Such meetings are informal, with no record of the nature of discussions engaged in or decisions taken. There have been several instances where, after Council had approved a loan, the developer has either withdrawn their application or abandoned the project. There is no documentation on file to record such withdrawal or abandonment and Internal Audit had to rely on verbal explanations from a staff member for reasons why approved loans had not subsequently been advanced. The ability for the City to defend itself in the event of litigation could be compromised by a lack of written evidence.</td>
<td>That all verbal and telephone discussions be summarized and placed on file. Developers should be advised to communicate all major project decisions (i.e. withdrawing from the loan program) in writing.</td>
<td>Agreed. Notwithstanding the fact that there has been no difficulty arising from current practices, we will immediately commence the practice of preparing minutes of relevant meetings where significant administrative decisions are made. Developers will be requested to communicate major project decisions in writing.</td>
<td>Completed. Significant administrative decisions are documented via minutes taken at meetings with the borrowers. Copies are retained in the applicant's file. Also, letters are retained on file from the Co-ordinator of Municipal Incentives to applicants of projects that have had their funding commitment cancelled due to failure of the applicant to confirm their intentions to proceed with development.</td>
</tr>
<tr>
<td>5.</td>
<td>Loan Advances</td>
<td>That loan files contain evidence that staff verified the property tax and work order status of projects prior to advancing funds. Property tax certificates should be attached to loan advance documents and be placed in loan files as proof of such verification. Property reports from the Building Department should be attached to the Request for Payment Memorandum as proof that the work order status has been checked.</td>
<td>Agreed. The current practice on loan advances is to have the Finance Department verify that taxes are in good standing. The lawyer administering the loan agreement on behalf of the City checks to see if there are any liens on the property and that check is made on the same day of the advance. The payment is not released by the Finance Department unless all elements are in a satisfactory state. However, formal verification was not placed in the file of the applicant. We will create a check list to be filled out by the Division before each advance and the evidence will be placed in the files of the Downtown Renewal Division including status of property taxes and a property check on the Amanda System to verify no outstanding Work Orders from the Building Division.</td>
<td>Completed. The Manager of Tax Accounting performs a review to ensure that taxes are not in arrears prior to the advancement of funds. Screen prints are placed in the applicant's file. The Amanda system is also reviewed to verify that there are no outstanding work orders. Documentation is retained in the applicant's file.</td>
</tr>
<tr>
<td>#</td>
<td>OBSERVATIONS OF EXISTING SYSTEM</td>
<td>RECOMMENDATION FOR STRENGTHENING SYSTEM</td>
<td>MANAGEMENT ACTION PLAN</td>
<td>FOLLOW UP (May 2007)</td>
</tr>
<tr>
<td>---</td>
<td>---------------------------------</td>
<td>-----------------------------------------</td>
<td>-----------------------</td>
<td>----------------------</td>
</tr>
<tr>
<td>6.</td>
<td>To safeguard the City’s interest, loan terms require that a minimum owner’s equity of 25% be maintained throughout the term of the loan. As a second mortgagee, whose interests are subordinated to the first mortgagee, it is important to enforce the 25% equity requirement in case of foreclosure or financial problems and maintain adequate documentation to indicate the monitoring of a loan-to-value rate not exceeding 75%.</td>
<td>That, upon initialization and on each loan installment draw, staff satisfy themselves that the loan-to-value ratio has not exceeded 75%. Such computations should be placed in the borrower’s file.</td>
<td>Agreed. We will implement immediately and do computations on each draw and place on borrower’s file.</td>
<td>Completed. Memos to the file, from the Co-ordinator of Municipal Incentives, are placed in the applicant’s file on each installment draw. The memos provide confirmation that the loan-to-value ratios have not been exceeded.</td>
</tr>
</tbody>
</table>
| 7. | **Recordkeeping** Several documents, important for the effective administration of the loans program, could not be found in files maintained by the Downtown Renewal Division. These included completed application forms, borrowers’ financial statements, incorporation documents, appraisal reports, project financial projections and commitment letters. The residential loan program’s policies and procedures require that the above-noted documents be submitted with each application in order that a proper assessment of eligibility can be made. Taxation and Legal Services also keep loan files of their own. Attempts to locate some of the missing documents in these areas were also unsuccessful in several instances. Without such documents, borrowers’ compliance with the program’s policies and procedures can be called into question. Such dispersion of important file documentation can result in missing information or inefficient document retrieval. | That the management of the Downtown Renewal Division implement a system that ensures that applicants have submitted requisite documents:  
• prior to recommending projects for Council’s approval; and  
• prior to processing borrowers’ progress draw requests.  | Agreed. To address the recordkeeping and administration we will be hiring a support person to replace a vacant Senior Planner position.  
It is important to acknowledge that in all cases the loan is secured via a second mortgage registered on title which includes a loan agreement identifying responsibilities of the parties. | Completed. The position of Business Analyst was created and filled in May 2006. This position is to administer program details through file administration, communications and administrative policy implementation. Applicant files reviewed had evidence of the required documentation with the exception of the Evaluation Committee score sheets that were stored in a secondary file. |

Each quarter, an account analysis form is prepared by the Manager of Tax Accounting detailing the amount of the loan and balance owing. This form is sent to the Downtown Renewal Division.
<table>
<thead>
<tr>
<th>#</th>
<th>OBSERVATIONS OF EXISTING SYSTEM</th>
<th>RECOMMENDATION FOR STRENGTHENING SYSTEM</th>
<th>MANAGEMENT ACTION PLAN</th>
<th>FOLLOW UP (May 2007)</th>
</tr>
</thead>
<tbody>
<tr>
<td>8.</td>
<td>Outside lawyers retained by the City to carry out various tasks associated with the loan program do not forward documents to the Downtown Renewal Division on a timely basis, hence the inadequacies in recordkeeping noted above. Of late, one of the two City designated lawyers has been forwarding a “Record Binder” containing all documents relating to the borrower but this occurs only on closing.</td>
<td>That outside lawyers be asked to forward copies of legal documents to the Downtown Renewal Division at the conclusion of each process with which they are charged.</td>
<td>Agreed. The materials produced by the lawyers are held in their offices until the full advance of the loan, at which time an entire package of documents is forwarded to the Downtown Renewal Division. In all cases where a critical piece of information has been required by the Division, we have managed to receive same within one working day. We will amend our processes to secure the information upon completion of the individual processes and place same within the individual loan files.</td>
<td>Completed. A comprehensive documentation package is provided by the Solicitor retained by the City once the file is closed. In the interim, the Business Analyst requests copies of documentation upon completion of individual processes for inclusion in the applicant’s file.</td>
</tr>
</tbody>
</table>
| 9. | Loan Repayments Loan terms require that repayments for re-sale condominiums be based on a rate of $25 for every square foot sold. To this end, the borrower is required to submit detailed monthly sales statements stating the purchaser’s name and address, units sold, date of sale, unit number, selling price and square footage. It was observed that:  
  - the Division does not independently verify the accuracy of square footage provided by the borrower. The borrower could understate square footage sold, resulting in underpayments that could affect the City’s ability to get full payment on time.  
  - information provided was lacking in detail, only showing units and square footage sold and is, therefore, not in compliance with loan terms. | That sales information provided by the borrower, in particular regarding the accuracy of square footage sold and the dates of sale, be independently verified by the Division. | Agreed. Currently the City is lending the money at $20 per square foot but upon sales it is receiving the money back at $25 per square foot until our loan is paid back. To verify the amount of square footage being sold, we will initiate a process immediately where the said sales information will be confirmed through Building Department plans submitted for construction and, if necessary, site visits. | Completed. One of the City’s Senior Landscape Architects reviews external architect’s drawings and confirms square footage via a memo to the division. This memo is filed in the applicant’s file. |
### Observations of Existing System

**Management Issues**

10. There is no satisfactory separation of responsibilities in the handling of payments from borrowers. The Manager of Tax Accounting requests payments from borrowers, receives, stores and records cheques and reconciles loan accounts.

   Concentration of the above duties in one individual weakens controls over the receipt and recording of repayments.

   Further, as these tasks are performed at the managerial level, there is no review of work performed. Lack of a review mechanism could result in errors and other improprieties going undiscovered for a considerable period of time.

   **Recommendation for Strengthening System**

   That consideration be given to separating the custodial, recording and reconciliation functions of loan payments.

   For example, a staff person could record payments and reconcile general ledger accounts. The Manager of Tax Accounting, in addition to requests for repayment and having custody of borrowers’ post-dated cheques, could supervise and review the employee’s work.

   **Management Action Plan**

   Agreed. The Manager of Accounting currently provides this service. He will move the custodial, recording and reconciliation functions to one of his staff and provide a supervisory role only.

   **Follow Up**

   In progress. Postdated cheques from borrowers are now retained by the Intermediate Tax Accountant. Payments are processed through the tax counter and receipts are given to the Manager for his records. The Manager of Tax Accounting still prepares the reconciliation of loan accounts on a quarterly basis. Starting in the 3rd quarter of 2007, the Tax Accountant will prepare the reconciliations and they will be reviewed by the Manager. Corresponding spreadsheet summaries will continue to be prepared by the Manager and sent to the Downtown Renewal division quarterly.

   Although the Manager is responsible for requesting postdated payments/late payments, the above process (when fully implemented) will provide an adequate separation of duties.

11. The first two loan agreements drawn up for this program (prior to formalization of procedures) included a set of conditions under which repayments were expected to begin, sometimes based on length of time that had transpired since the start of the project rather than the 100% completion certification. The above stipulation, in addition to the lowering of the loan term from 10 to 5 years, was meant to provide established cash flows to the program fund.

   One comparatively small project of 12 units (loan approved post formalization of procedures) has taken more than two years to complete. Although there are several reasons for this delay, City funds have been tied up in the project for much longer than anticipated.

   The City relies on the monies from repayments to replenish the funds made available for new projects. Delayed repayment may impair the City’s ability to satisfy its strategic objectives for the downtown.

   **Recommendation for Strengthening System**

   That management consider the incorporation of a matrix of deadlines for the commencement of repayments (the lesser of one of several conditions) into the terms of the loan agreements. This would serve as an incentive for timely completion of projects and would ensure more consistent cash inflows.

   **Management Action Plan**

   Agreed. In September of 2002, program details were amended by Council through a report which defined the terms and conditions of the program. Of significance is the fact that staff recommended that the term of the loan be reduced from 10 years to 5 years; that the risk be limited to up to $20 per square foot of loan; and, most importantly, unlike a typical second mortgage, the City’s money would only flow upon 60% completion of the project. These steps significantly reduced the risk to the City.

   Nonetheless, the program could be enhanced. We will provide a matrix for construction start, completion and payback deadlines which will be put forward for Council’s consideration for future applications.

   **Follow Up**

   In progress. The Manager of Tax Accounting has developed a listing of all approved projects identifying loan cash flow requirements. The matrix for construction start, completion and payback deadlines has yet to be completed. All information is available but has not been condensed into one summary sheet. The expected completion of the matrix is the 3rd quarter of 2007.
<table>
<thead>
<tr>
<th>#</th>
<th>OBSERVATIONS OF EXISTING SYSTEM</th>
<th>RECOMMENDATION FOR STRENGTHENING SYSTEM</th>
<th>MANAGEMENT ACTION PLAN</th>
<th>FOLLOW UP (May 2007)</th>
</tr>
</thead>
<tbody>
<tr>
<td>12.</td>
<td>There is not an adequate separation of duties in the process of promoting the loan program, providing consultancy services to developers, evaluating received applications and recommending projects for Council’s approval. These duties are performed by one individual who is also responsible for project monitoring. This concentration of responsibilities, together with lack of important documentation noted above, raises the risk and perception that projects might not be objectively evaluated and result in projects that do not meet criteria being approved.</td>
<td>That consideration be given to separating the marketing, consultancy and monitoring responsibilities of the program from the application evaluation and approval processes. The use of the staff committee as mentioned in recommendation #2 to evaluate applications and propose projects for Council approval would alleviate the concentration of duties in one staff member.</td>
<td>Agreed. The Hamilton Downtown Residential Loan Program in its current version was approved in 2002 and, as required, we have made the requisite adjustments along the way. The Downtown Renewal Division has a staff complement of 7 involved in Downtown Renewal in which one position, Senior Planner, has been vacant since March 2003, despite attempts to recruit on numerous occasions. In light of the Internal Auditor’s comments, we have made plans to replace that position with a position to assist the Co-ordinator of Downtown Municipal Incentives. We would expect that this position would take care of the administrative challenges identified in the auditor’s report. The staff committee will be utilized to evaluate applications and propose projects for Council’s considerations.</td>
<td>In progress. Letters from the Director of Downtown Renewal are sent to borrowers to submit statements within the deadlines and further reminder letters are sent if statements are not submitted. While the monitoring function has improved as per the procedures above, not all borrowers have submitted their statements as required by the loan agreement. In some instances, statements were not requested from borrowers who have yet to receive their full funding amount. The Division will begin to request statements as soon as funds are advanced. The matrix referenced in point #11 above will also be used to track financial statement submissions. When received from borrowers, the accountant prepared financial statements are reviewed by Downtown Renewal staff and retained in the applicant’s file. Copies are also forwarded to the Manager of Tax Accounting for review.</td>
</tr>
<tr>
<td>13.</td>
<td>A review of all six borrowers’ files with outstanding balances revealed that none had submitted signed accountant prepared financial statements to the City as part of their annual reporting obligations. The loan agreement’s requires that until all debts and liabilities are fully discharged, borrowers should provide duly signed, accountant prepared financial statements within 180 days of the borrower’s year end. Three of the six outstanding loans have been outstanding for more than two years.</td>
<td>That management puts in place an effective project monitoring system to ensure that borrowers fully comply with terms of the program.</td>
<td>Agreed. This is a requirement of the loan agreement and is a monitoring function. Downtown Renewal staff in conjunction with Finance staff will review procedures and have said procedures in place by the year-end.</td>
<td>Completed. The new position of Business Analyst has taken over the responsibilities related to administration and file documentation. Staff prepare a report with recommendations to Council of projects for funding only after the Evaluation Committee has reviewed and approved applicants.</td>
</tr>
</tbody>
</table>