



GARLAND

INTERNAL AUDIT

Single Family Rental Registration Program

Craig Hametner, CPA, CIA, CISA, CMA, CFE
City Auditor

Audit Team Members

Jed Johnson
Sr. Auditor

Marla Hamilton
Staff Auditor

INTERNAL AUDIT DEPARTMENT

August 21, 2012
Report 201208

Table of Contents

	<u>Page</u>
Authorization	1
Objective	1
Scope and Methodology	1
Overall Conclusion	2
Background	2
Management Accomplishments	4
Program Analysis	6
Recommendations	10

Authorization

We have conducted an audit of the Single Family Rental Registration Program. This audit was conducted under the authority of Article VII, Section 5 of the Garland City Charter and in accordance with the Annual Audit Plan approved by the Garland City Council.

Objective

Ensure that the City has a mechanism in place to verify rental properties in Garland are registered with the City and test the effectiveness of the mechanism.

Scope and Methodology

We conducted the audit in accordance with Generally Accepted Government Auditing Standards. Those 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 objective. This included a review of Ordinance 6534 and comparisons between three different databases comprising of the Dallas Central Appraisal District (DCAD) property listing, the City of Garland active rental registry and the active/new utility account database. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

While we report to the Mayor and City Council and present the results of our work to the Audit Committee, we are located organizationally outside the staff or line management functions we are auditing. Therefore, this Audit organization may be considered free of organizational impairments to independence to audit internally and report objectively to those charged with governance.

To adequately address the audit objective we:

- Reviewed City of Garland Ordinance 6534 adopted April 4, 2012, Single-Family Permits.
- Obtained a current list of residential and commercial properties within the City of Garland from DCAD containing over 68,000 records.
- Obtained a current list of active registered rental properties with the Code Compliance Department containing over 8,100 records to match with DCAD.
- Developed a report of new and active utility accounts held with the City of Garland.
- Obtained Multiple Listing Services (MLS) listings of “For Sale” and “For Lease” properties in the City to compare to the active registered rental properties.
- Obtained a list of foreclosures within the City to compare to the above lists.
- Conducted internet research on some properties.
- Interviewed various parties with Code Compliance and the Customer Service Department.

The program analysis can be found on page 4 of this report.

Overall Conclusion

Code Compliance Department has a satisfactory mechanism in place, however improvements can be made.

Background

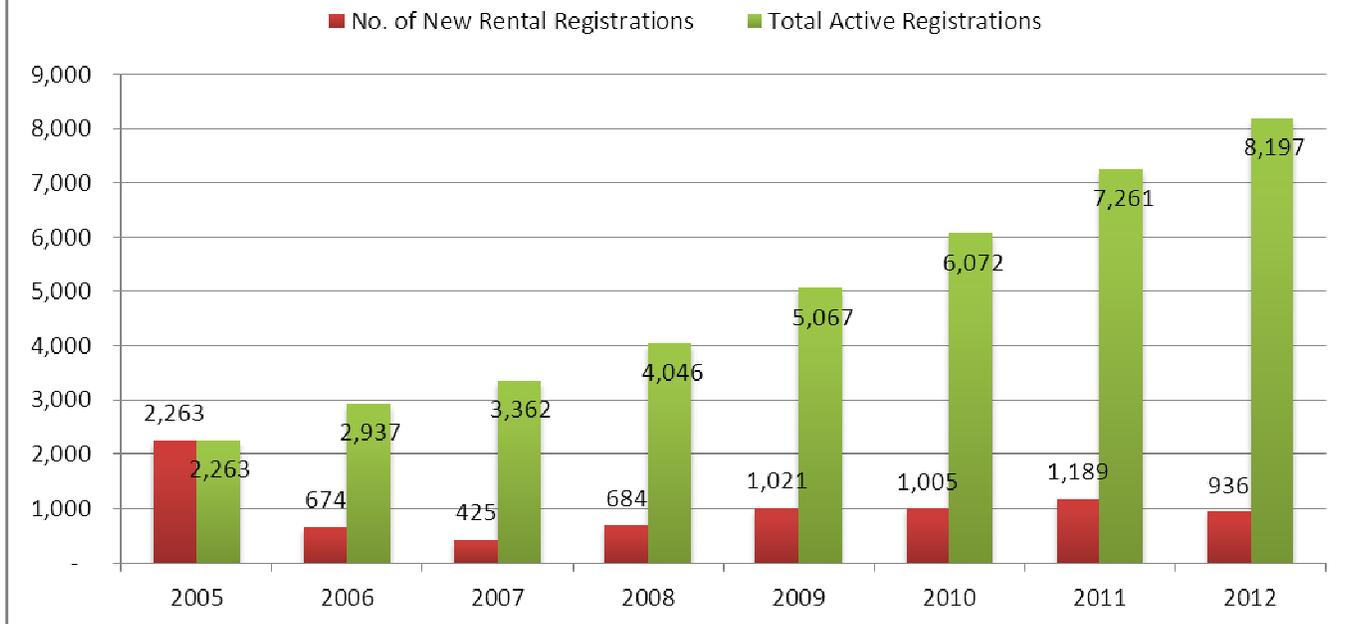
The Code Compliance Department oversees the Single Family Rental Registration Program. Per Ordinance 6534, the City of Garland requires all occupied single family rental properties to be permitted by Code Compliance. The following is required for a property to become permitted as a single family rental property:

- The landlord/manager must submit a completed permit application for each single family dwelling rented or leased, including duplexes.
- The application requires certain information about the owner(s), management company and occupants.
- A yearly fee of \$55.00 must accompany the completed application unless the property is certified at which point the renewal will be extended by two years to every three years.
- A permit will be mailed to the owner or designated party.
- The permit cannot be assigned or transferred.
- A full inspection will be conducted upon each change of tenancy, if the property is not a certified rental property. It is the responsibility of the owner/management company to notify Code Compliance of the vacancy and set up an appointment for a full inspection.
- A copy of the inspection report will be provided to the person in charge (landlord, property manager or designated party).

Sources: City of Garland website

As of July 3, 2012, the department had 8,197 properties registered as rental properties with the City. The chart on page 3 shows the number of properties registered each fiscal year since fiscal 2005.

No. of New Rental Registrations by Fiscal Year (Active as of July 2012)



Source: Active Rental Properties database dated 7/3/2012

Management Accomplishments

On April 19, 2005, the City of Garland became the first city in Texas to conduct routine inspections on the single-family home rental industry. Five Code Inspectors were hired and assigned to diligently search for every single-family home in Garland that was a rental property. Between May 1, 2005 and September 30, 2005, the five single-family housing inspectors visited 3,939 addresses that were identified by database queries as “possible rentals.” This identification initiative was thwarted at its inception by a vigorous federal court challenge by a handful of real estate professionals. In December of 2005, Federal Judge Sam Lindsey ruled that the challenged ordinance was constitutional, and the program was enabled to proceed. However, the perceived unconstitutionality of the program; the continuing outcry from the rental property owners; demands on the newly elected members of the City Council; and an overwhelmed recently appointed Managing Director, all resulted in the inspection programs cessation in 2006. A Blue Ribbon Panel was appointed by Council to assist staff in reworking the single-family inspection program into a fair, non-intrusive inspection program.

The Single-Family Inspection Program reopened for business in 2007 with a new business model: interior inspections of single-family rental properties would be made upon a change-in-tenancy. Permit fees were lowered and a landlord certification training course was added to allow certified owners or property managers an opportunity to extend their operational permits from one year to three. The certification also allowed the subject property to forgo interior inspection during this three-year permit cycle. Inspection protocol and dwelling scoring methodology were dramatically altered. The inspection report’s debited violations were actual, referenced minimum standards adopted through the Code of Ordinances. Inspector standardization on the new procedures were also completed and revisited annually.

Also in 2007, the single-family inspection staff was reduced from five Code Inspectors to enforce the program to two. The Blue Ribbon Panel realizing the dramatic reduction in staff size recommended that rental properties be identified through the Customer Service Department when utility connections were requested by the tenant. It was assumed that all rental properties would eventually be identified through this methodology. It was also understood that the “trickle in” effect would allow the small staff size to be effective and not inundated.

The wisdom of the Blue Ribbon Panel has been realized and is verified by this audit. Since 2009, over 1,000 properties have been added to the inspection program each year and the vast majorities were identified by the utility application process.

The program’s success has been measured objectively by departmental assessments. At inception, the exterior violation total was three times greater for a rental home than an owner-occupied property. In 2012, that difference in violation totals has evaporated, with 1.06 average violations per rental property and 0.96 average violations per owner-

occupied home. Furthermore, interior life safety and critical violations discovered at time of change-in-tenancy inspection have dropped seventy-five percent (75%) in just the last three years.

These improvements in home livability and appearance have greatly supported the Code Compliance Department and the community in combating declining property tax values and further prove the worth of the single-family inspection program.

Program Analysis

Our review of the Single Family Rental program revealed three methods the department uses to identify rental properties:

- Customer Service Department (main method).
- Homeowners' associations.
- Concerned homeowners.

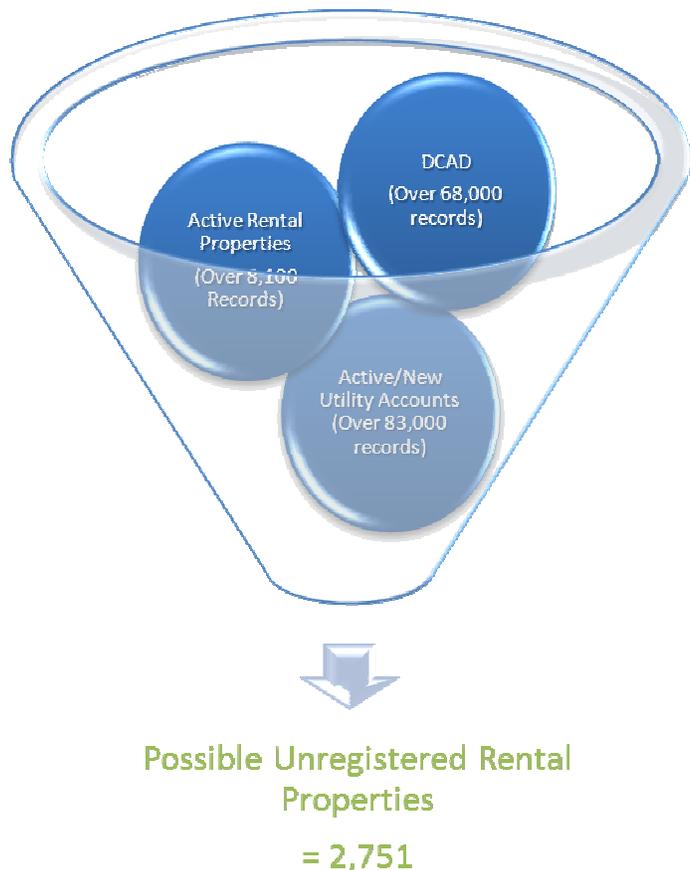
However, Internal Audit was unable to test the effectiveness due to a lack of tracking of the mechanisms in place. Instead, Internal Audit used several different mechanisms to identify possible unregistered rental properties. The results are as follows:

A. Data Mining for Possible Unregistered Rental Properties

Using the lists that Internal Audit obtained from DCAD, Code Compliance and Customer Service, we performed the following:

Used data mining software to:

- Key off the property address.
- Compare DCAD and Active Rental Properties to eliminate already registered rental properties.
- Eliminate:
 - Commercial properties.
 - All exemptions.
 - Apartment complexes.
 - Bank-owned.
 - Trust/Estate Owner properties.
 - Possible Lease-to-Own properties.
 - Church-owned.
- Eliminate all properties if property address matched with property owner's mailing address.
- Match remaining properties to the Active/New Utility Account list.



Source: Internal Audit

Upon completion of this filtering process, we identified 2,751 possible unregistered rental properties.

We estimate that approximately 51% of Active Rental Properties registered with the City are certified rental properties. Because these are certified rental properties, they are only required to renew every three years. Approximately 49% of Active Rental properties are not certified and therefore are required to renew on an annual basis. The following table illustrates possible registration revenue for the next five years as follows:

Pro Forma Analysis

	2013	2014	2015	2016	2017	Total Potential Revenue ⁽⁴⁾
Certified Rental Properties ⁽¹⁾	\$ 77,082	\$ -	\$ -	\$ 77,082	\$ -	\$ 154,164
Uncertified Rental Properties ⁽²⁾	\$ 74,223	\$ 74,223	\$ 74,223	\$ 74,223	\$ 74,223	\$ 371,115
Total Potential Annual Revenue⁽³⁾⁽⁵⁾	\$151,305	\$ 74,223	\$ 74,223	\$151,305	\$ 74,223	\$ 533,341

(1) Assumed Certified Rental Properties were approximately 51%.

(2) Assumed Uncertified Rental Properties were approximately 49%

(3) Assumed Total Potential Annual Revenue based on the total calculation of possible unregistered rental properties identified.

(4) Assumed properties would remain registered for all five years.

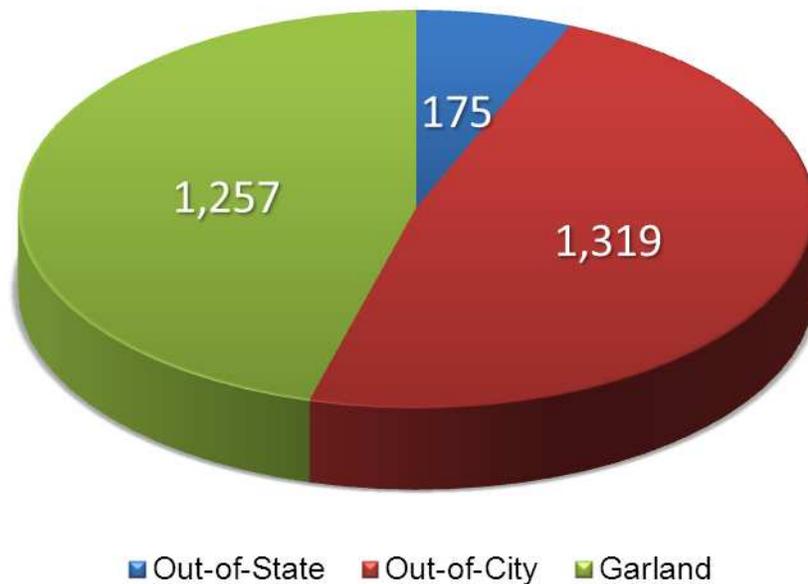
(5) Assumed Rental Registration Permit fee would remain constant at \$55 per registration.

Source: Internal Audit

We classified the possible unregistered rental properties into three different categories based on the property owner's mailing address:

1. Owners with Out-of-State mailing addresses.
2. Owners with Out-of-City mailing addresses.
3. Owners with Garland mailing addresses.

Possible Unregistered Rental Properties



Source: Internal Audit

Internal Audit believes that the higher probability of unregistered rental properties fall within the categories of owners with Out-of-State and Out-of-City mailing addresses and that 100% of identified properties may not ALL be rentals.

Please note that Internal Audit also considered the following aspects of possible unregistered rental properties during our filtering process:

- Some properties may have the utility in the same name as the owner, yet could not be eliminated because we could find no exemptions.
- Address formatting may not be 100% similar between databases.
- Some properties could be in transition between sellers and buyers.

In addition, we identified potential indicators that may suggest a possible rental property as follows:

- Property owners list a PO Box address versus a physical address. For instance, when a search under the owner's name shows several properties, the owner's mailing address for each property may be a PO Box rather than a physical address.
- Owners have properties listed under different names. For example, a property may be listed under "Smith, John Jacob" as well as list a different mailing address for the property owner. A search using the property owner's mailing address may list the owner as "Smith, Jacob Jr."
- Owners have multiple properties listed in DCAD in and around the City. For example, John Smith has 17 properties listed in various cities such as Mesquite, Garland and Dallas.
- Properties list multiple owners in DCAD. For example, John Smith – 67%, James Baker – 33%.
- Rental properties are advertised on Craigslist.com.

B. MLS Property Research

We obtained property listings of "For Sale" and "For Lease" properties from MLS and a list of foreclosed properties from the City Budget Department. We compared the three lists to the Possible Unregistered Rental Properties list as well as the current Active Rental Registration list. We identified 60 properties listed as "For Lease" on the MLS list and we matched 38 of these properties to properties listed on the current Active Rental Registration. We ensured that any unmatched properties were included in the Possible Unregistered Rental Properties list. Our comparison of the foreclosure did not result in any exceptions.

Recommendations

Internal Audit believes that Code Compliance can expand its Single-Family Rental Registration Program by implementing the following recommendations:

- 1) Develop a tracking mechanism to measure the effectiveness of the methods used. For example, track the number of referrals from Customer Service, Homeowners' Associations and citizen reports.

Management Response: Management concurs, with reservations as to the real need for such measurement.

Action Plan: Without any Internal Audit analysis or Code Compliance tracking mechanism, it is obvious that the most effective method of referral is through the Customer Service Department, in that 100 percent of the referrals are rental properties. As to the other sources of referral, from the Code Compliance Department's perspective, the origin of the complaint is irrelevant in regards to enforcement. All incoming complaints are investigated to validate the property as a suspected rental property.

During the audit it did become apparent to departmental management that Code Compliance needed an improved method to track all suspected rental cases. Preliminary thoughts are to create an aging report that will efficiently incorporate these type of complaints into the monthly enforcement matrix. The complaints could be tagged as to their origin and then mined at a later date to track the source and test the effectiveness of each, if so needed.

Implementation Date: December 1, 2012, contingent upon the resources and support of the Information Technology Department.

Auditor's Comment: According to Government Auditing Standards 7.35, "Auditors should also include in the report an evaluation of the comments, as appropriate."

As mentioned previously in this analysis, 2,751 possible unregistered rental properties were identified by this audit. We believe measuring the effectiveness of the methods utilized will provide the following benefits to the department:

- Identifying potential strengths and weaknesses of the current mechanisms.
- Applying corrective actions, if needed
- Developing new mechanisms, if needed
- Utilizing resources more effectively.

- 2) Conduct internet research upon acceptance of an application such as using DCAD's website to find owner's with multiple properties.

Management Response: Management concurs.

Action Plan: The application for a single-family rental permit has been expanded to request if an owner has multiple properties. If ownership of multiple properties is checked on the application, staff will check DCAD during data entry. In addition, a random number of all the applications will be verified through DCAD as to the owner's status. Particular attention will be paid to owner's that do not reside in Garland.

Implementation Date: October 1, 2012

- 3) Standardize current data entry formatting to match DCAD for conducting periodic data mining.

Management Response: Management concurs. Such a simple task would make property and/or owner identification much more efficient. The Code Compliance Department has attempted this assignment in the past.

Action Plan: CRM is the Code Compliance software used in the single-family rental program. According to the Information Technology Department, the primary keys used by DCAD for defining addresses do not match the primary keys used by Garland GIS. The templates do not match and they have seen the CRM data corrupted when the two formats are merged as there is no direct correlation between address fields or owner information.

Implementation Date: Unknown. The Information Technology Department and the CRM vendor will be consulted again to explore the possibility of implementing this recommendation.

- 4) Obtain and compare MLS listings on a monthly basis.

Management Response: Management concurs.

Action Plan: As the audit found, sixty-three percent (63%) of the identified properties through MLS were already permitted. A large portion of the remainder will revert back to home ownership or, if leased, will be captured through the Customer Service application process.

Code Compliance will attempt to secure a MLS license and track the listings. MLS access is limited to real estate agents and licensed brokers. There are some similar subscriptions that may be available to the Code Compliance Department. If available and resources allow, after 120 days, a listed, non-permitted property will be compared to the single family rental database and

DCAD. If status unknown after this period, the property will be placed in the enforcement matrix mentioned in the response to recommendation #1.

Implementation Date: December 1, 2012, if MLS or a substitute subscription is available and staffing resources allow.

Auditor's Comment: According to Government Auditing Standards 7.35, "Auditors should also include in the report an evaluation of the comments, as appropriate."

IA believes obtaining and providing MLS lists to the Customer Service department will enhance their ability in identifying rental properties quickly. During the utility account set up process, this list can be utilized to verify the rental status with the account holder. We also believe the Code Compliance Inspectors can utilize the MLS listings in performing field verifications.