

Internal Audit Department
NeighborWorks® America

**Audit Review of the
National Community
Stabilization Trust, LLC
(NCST)**

Project Number: NWA.EBR.2014

**Audit Review of the National Community Stabilization Trust, LLC
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April 18, 2014

To: NeighborWorks America Audit Committee

Subject: Audit Review of the National Community Stabilization Trust. LLC (NCST)

Please find enclosed the final audit report of the National Community Stabilization Trust. Please contact me with any questions you might have.

Thank you.

Frederick Udochi
Chief Audit Executive

Attachment

cc: C. Wehrwein
J. Bryson
J. Fekade-Sellassie
T. Deyo

Function Responsibility and Internal Control Assessment
Audit Review of the National Community Stabilization Trust, LLC (NCST)

| Business Function Responsibility | Report Date | Period Covered |
|---|--|---------------------|
| National Initiatives | April 18, 2014 | as of December 2013 |
| Assessment of Internal Control Structure | | |
| Effectiveness and Efficiency of Operations | Generally Effective¹ | |
| Reliability of Financial Reporting | Not Applicable | |
| Compliance with Applicable Laws and Regulations | Not Applicable | |

This report was conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing*.

¹ **Legend for Assessment of Internal Control Structure:** **1. Generally Effective:** The level and quality of the process is satisfactory. Some areas still need improvement. **2. Inadequate:** Level and quality of the process is insufficient for the processes or functions examined, and require improvement in several areas. **3. Significant Weakness:** Level and quality of internal controls for the processes and functions reviewed are very low. Significant internal control improvements need to be made.

Executive Summary of Observations, Recommendations, and Management Responses

| Summarized Observation; Risk Rating | Management Agreement with Observation (Yes/ No) | Internal Audit Recommendation Summary | Accept IA Recommendation (Yes/ No) | Management's Response to IA Recommendation | Estimated Date of Implementation (Month/Year) | Internal Audit Comments on Management Response |
|--|--|--|---|---|--|---|
| No observations were noted as a result of this review. | | | | | | |

Risk Rating Legend:

Risk Rating: HIGH

A serious weakness which significantly impacts the Corporation from achieving its corporate objectives, financial results, statutory obligations or that may otherwise impair the Corporation's reputation.

Risk Rating: Moderate

A control weakness which could potentially undermine the effectiveness of the existing system of internal controls and/or operational efficiency, integrity of reporting and should therefore be addressed.

Risk Rating: Low

A weakness identified which does not seriously detract from the system of internal control and or operational effectiveness/efficiency, integrity of reporting but which should nonetheless be addressed by management.

| Management Response to Audit Review of the National Community Stabilization Trust, LLC | | |
|---|---|-------------------------|
| # Of Responses | Response | Recommendation # |
| N/A | Agreement with the recommendation(s) | N/A |
| N/A | Disagreement with the recommendation(s) | N/A |

Background

As part of the Internal Audit objective to conduct a continuous review of significant third party business relationships with NeighborWorks America a review was undertaken of the business relationship with the National Community Stabilization Trust, LLC (NCST/the Trust) one of a number of third party relationships.

In December 2008, the following six nonprofit organizations – NeighborWorks America, the National Urban League, Enterprise Community Partners, Inc., Housing Partnership Network, Inc., Local Initiatives Support Corporation, and National Council of La Raza - joined together to form the National Community Stabilization Trust, LLC (NCST/the Trust). The purpose and mission of the Trust is to provide supporting services to state and local Neighborhood Stabilization Programs (NSP) to ensure the transfer of foreclosed and abandoned properties from financial institutions in order to promote productive property reuse and neighborhood revitalization. The Trust was designed to streamline this process and reduce duplication of efforts with REO properties between servicers, nonprofit, and state/local government agencies.

NCST is organized as a tax exempt organization under section 501(c) (3) of the Internal Revenue Code. Membership into the Trust is segmented as economic (Class A) and non-economic (Class B). Class A members contributed funds in form of a capital contribution and are entitled to cumulative preferred dividends pursuant to the Operating Agreement and the right to vote². Class B members contributed funds in the form of a grant and are entitled to vote. NeighborWorks made an initial investment of \$100,000 grant, which secured its Class B membership within the Trust. NeighborWorks has also contributed free office space (June 2008 – June 2009) and grant funds totaling \$335,000³.

NCST's Board of Managers is comprised of ten members, which includes the President and CEO of the original six member organizations (all with voting rights) and four At-Large Members from the following organizations – National Association of Hispanic Real Estate Professionals, NHS of Chicago, University of Southern California, and Purpose Built Communities. The President and CEO of NeighborWorks America was the current board chair at the initiation of this review⁴. NCST has established a Steering Committee that is responsible for carrying out the governance responsibilities of and provide guidance to NCST's President in the execution of his/her duties. The Steering Committee consists of alternates identified by the initial managing members and at large members.

² Class A members are entitled to a distribution from net cash flow (b) (4) however, no distributions have been made to date.

³ The most recent grant award in the amount of \$30,000 was an expendable grant for the Trust to provide specialized support to NWOs that are purchasing REO property, assisting them one-on-one to purchase property from the Trust and training them on the Trust's new property transfer technology system.

⁴ In May 2014, the Board of Directors accepted Eileen Fitzgerald's resignation as Chief Executive Officer of NeighborWorks America and Chuck Wehrwein was announced as the Acting Chief Executive Officer of NeighborWorks America. The Acting CEO of NeighborWorks America currently serves as a board member on the NCST Board.

Major programs and services of the trust include a focus on REO Property Acquisition, REOMatch and the REO Capital Fund. The REO Property Acquisition Program is the nation's only scalable program that has established a transparent and cost-effective method of transferring REO properties directly from REO sellers directly to community-based housing organizations via the following transfer medium including, First Look, Listed/Aged Inventory, or Donation Properties. REOMatch is used by cities and housing agencies to manage local stabilization programs and make more strategic decisions about distressed properties. The REO Capital Fund helps community-based organizations finance the acquisition, rehabilitation and interim holding of distressed properties to maximize community revitalization efforts in neighborhoods hit hard by the foreclosure crisis.

In efforts to support the major programs and services, NCST formed the following three wholly owned subsidiaries:

- **Stabilization Trust REO Capital Fund, LLC** –The fund acts as the financing agent to facilitate the cost-effective transfer of foreclosed and abandoned properties to localities by providing various financing options to support local and state efforts.
- **NCST Housing Services, LLC /Housing Services Corporation** - Facilitates the transfer of foreclosed and abandoned properties from financial institutions to local housing providers engaged in neighborhood stabilization.
- **NCST Mortgage Resolution, LLC** – Provides services to NCST affiliates that acquire nonperforming mortgage loans from financial institutions with the intent of focusing services and resources to remediate the current borrower or properties in a manner that emphasizes occupancy and neighborhood stability.

In addition to the wholly owned subsidiaries, NCST partnered with several nonprofit organizations to create the following non-consolidated affiliates⁵ to further supplement the mission of NCST by preserving, stabilizing, and revitalizing communities:

- **Community Restoration Corporation, LLC (CRC)** – A national non-profit established in 2011 by NCST LLC, Housing Partnership Network, and Enterprise Community Partners. CRC helps local nonprofit organizations and governments reclaim low value distressed real properties in areas badly impacted by foreclosure/abandonment. CRC is currently active in 35 states.
- **Mortgage Resolution Fund, LLC (MRF)** – A national non-profit established in 2011 by NCST, LLC, Mercy Housing, Enterprise Community Partners, and Housing Partnership Network. MRF has partnered with the Illinois Housing Development Authority (IHDA) and the Ohio Housing Finance Agency (OHFA) using hardest hit funds and other financing medium to purchase mortgages from lenders struggling to make payments and works with the eligible homeowners to modify the loan or identify options/resources for affordable housing. MRF options to homeowners may include – trial/permanent loan modification, short sale, and/or Deed-in-Lieu of Foreclosure.

⁵ NCST does not have a controlling interest in either of the affiliates. NCST holds two seats on the CRC Board and one seat on the Board and 25% interest in MRF.

Currently approximately 60 NeighborWorks network organizations are active buyers with NCST.

Objectives

The objective of the audit was:

- To evaluate the business relationship between NeighborWorks America and the National Community Stabilization Trust and any related business entities.
- To obtain assurance that the business relationship does not present a conflict of interest and that NCST activities do not pose a risk to the NeighborWorks reputation.
- To obtain assurance that obligations from any MOU/Grant Awards entered into have been satisfied.

Scope & Methodology

Internal Audit obtained and reviewed the following documentation to better understand the NCST profile, its products and services, in order to identify any potential major risk as a result of the business relationship and board participation:

- Consolidated Financial Statement Audit Report for the FY 2012 and FY 2011;
- Operating Agreement for National Community Stabilization Trust LLC;
- Operating Agreement for the Mortgage Resolution Fund, LLC;
- By Laws for the following entities – Community Restoration Corporation, LLC.; NCST Housing Services Corporation; Stabilization Trust REO Capital Fund;
- Utilized external resources to identify external risks/threats to the NCST and its members;
- Minutes of the Steering Committee Meeting;
- Minutes of the Board Committee Meeting; and
- Grant Awards to NCST.

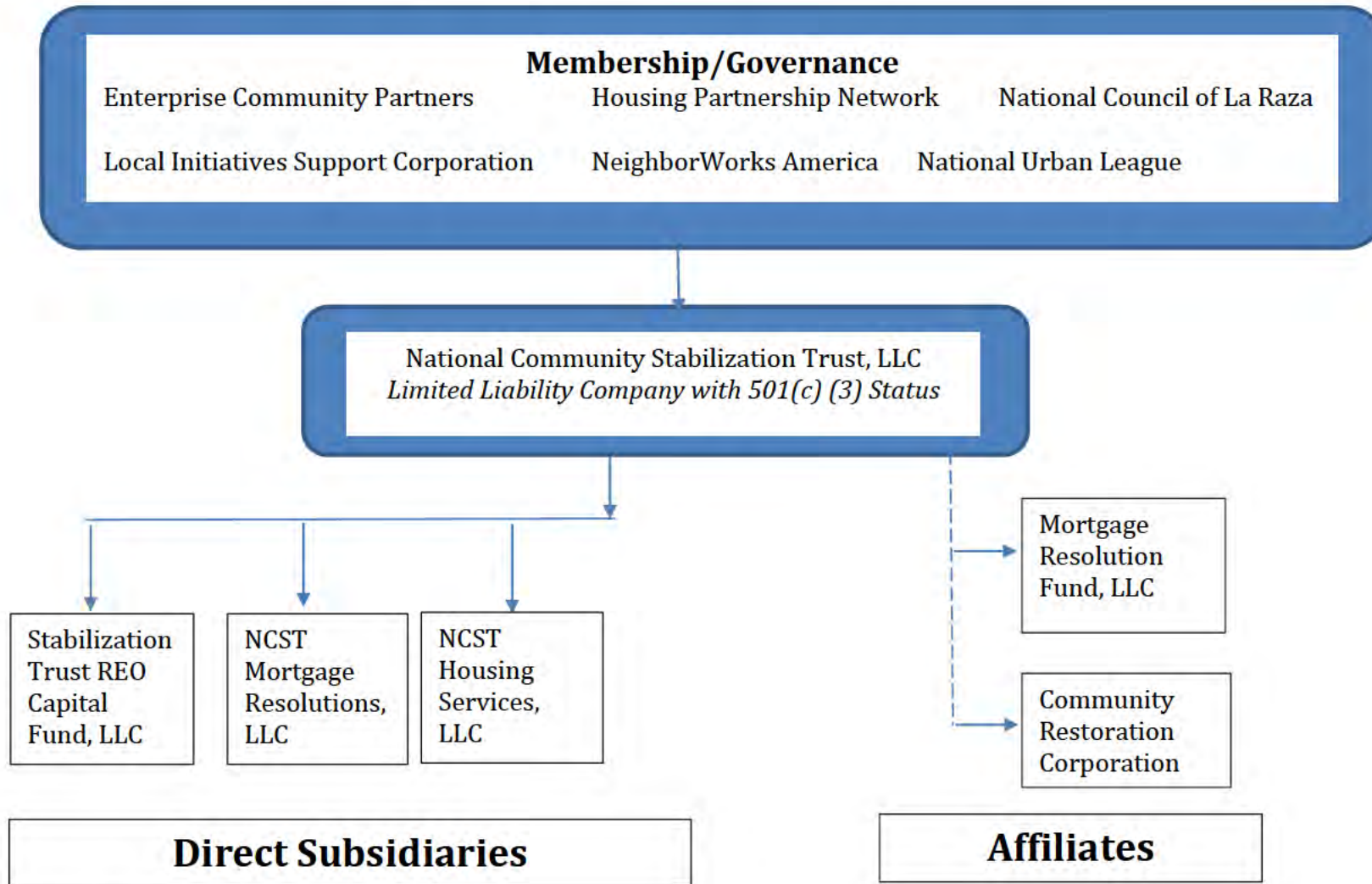
Observations and Recommendations

Based on our review, Internal Audit is of the opinion that there is adequate management oversight to manage the NeighborWorks and NCST relationship, and sufficient controls in place to mitigate any conflict of interest to NeighborWorks America. In addition no significantly emerging risks were identified in relation to the NeighborWorks relationship and involvement in the National Community Stabilization Trust.

Conclusion

Based on the audit performed, Internal Audit concludes that there is sufficient assurance that the business relationship with NeighborWorks America and the National Community Stabilization Trust is appropriately aligned with the objectives of NeighborWorks and potential external threats and risks are mitigated throughout the governance protocols instituted by the organization.

APPENDIX A – National Community Stabilization Trust Entity Structure



APPENDIX B – National Community Stabilization Trust Board of Managers

The Board of Managers of NCST is comprised of the leadership of its six sponsor organizations and other leading professionals in the housing and community development industry, see below:

Eileen Fitzgerald (*Board Chair*)

President and CEO
NeighborWorks America

Thomas A. Bledsoe

President & CEO Housing
Housing Partnership Network

Terri Ludwig

President and CEO
Enterprise Community Partners

Marc Morial

President and CEO
National Urban League

Janet Murguia

President and CEO
National Council of La Raza

Michael Rubinger

President and CEO
Local Initiatives Support Corporation

Gerado (Jerry) Ascencio

President
National Association of Hispanic Real Estate Professionals

Ed Jacob

Executive Director
NHS of Chicago

Dr. Rapheal Bostic

Professor and Bedrosian Chair in Governance and the Public Enterprise
Sol Prince School of Public Policy, University of Southern California

Shirley Franklin

CEO
Purpose Built Communities and Former Mayor of Atlanta