



City of New York

OFFICE OF THE COMPTROLLER

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COMPTROLLER



MANAGEMENT AUDIT

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Deputy Comptroller for Audit

Audit Report on the Department of Housing
Preservation and Development's Monitoring
of Building Owners' Compliance with
Affordable Housing Provisions and
Requirements

MG15-118A

June 29, 2016

<http://comptroller.nyc.gov>



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June 29, 2016

To the Residents of the City of New York:

My office has audited the New York City Department of Housing Preservation and Development's (HPD's) monitoring of building owner's compliance with affordable housing provisions and requirements. We audit City entities such as HPD as a means of increasing accountability and ensuring that City programs operate as intended and in the best interest of the public.

The audit found that the controls established by HPD's Tax Credit and Home Compliance (TC&H) unit, part of the Division of Asset Management (Asset Management), are implemented on a consistent basis for the monitoring of building owners' compliance with affordable housing provisions and requirements. However, we found that Asset Management does not maintain a complete list of all rental projects that the TC&H unit oversees. In addition, we found that HPD does not track building owners who consistently fail to comply with affordable housing requirements and does not verify building owners' assertions that deficiencies cited by the agency in inspection reports have been corrected. Finally, HPD does not have an effective tracking mechanism in place that would allow it to review all affordable housing units under its oversight on an aggregate basis.

The audit makes five recommendations to HPD, including that Asset Management should periodically review its asset management portfolio database and update it as needed; establish a watch list to track those building owners who have a history of repeated non-compliant behavior; independently verify that the measures reported by building owners to correct deficiencies were actually made; and create a formal tracking mechanism for projects and units on an aggregate level.

The results of the audit have been discussed with HPD officials, and their comments have been considered in preparing this report. Their complete written response is attached to this report.

If you have any questions concerning this report, please e-mail my Audit Bureau at audit@comptroller.nyc.gov.

Sincerely,

A handwritten signature in blue ink, appearing to read "Scott M. Stringer".

Scott M. Stringer

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THE CITY OF NEW YORK OFFICE OF THE COMPTROLLER MANAGEMENT AUDIT

Audit Report on the Department of Housing Preservation and Development's Monitoring of Building Owners' Compliance with Affordable Housing Provisions and Requirements

MG15-118A

EXECUTIVE SUMMARY

The New York City (the City) Department of Housing Preservation and Development (HPD) is the largest municipal housing preservation and development agency in the nation. The agency is responsible for promoting the construction, rehabilitation and preservation of affordable, high quality housing for low and moderate-income families, for enforcing housing quality standards, financing affordable housing development and preservation, and for ensuring sound management of the City's affordable housing.

HPD's Division of Asset Management (Asset Management) is responsible for monitoring various housing projects' financial health, overseeing the physical condition of buildings that are financially assisted by or through certain City and other government programs, and for ensuring continued compliance with regulatory agreements. HPD's Tax Credit and Home Compliance (TC&H) unit is part of Asset Management and is responsible for overseeing affordable housing projects that receive Low Income Housing Tax Credits, as well as those that are funded through a federal program administered by the U.S. Department of Housing and Urban Development (HUD) called "HOME."

HPD's compliance analysts review an owner certification and rent roll form submitted by building owners to assess whether the owners have fulfilled the terms and conditions of their regulatory agreements. In addition, HPD must visit 20 percent of the units identified by their owners as low-income units and verify the information provided in the annual owners' certifications and rent rolls.¹ Moreover, HPD must physically inspect these affordable housing units to ensure that they are in good physical condition and compliant with the New York City Housing Maintenance Code.²

¹ During these site visits, HPD is required to review the certifications, the documentation supporting the certifications, and the rent records for the tenants in those units.

² Maintaining the premises in good physical condition is required by the U.S. Treasury Regulations, which call for inspections of 20 percent of low-income tax credit units. HUD guidelines similarly mandate that units are to be maintained in good physical condition and call for inspections of between 15 to 20 percent of subsidized units in HOME projects. These inspections are conducted by HPD's code enforcement inspectors.

As of Calendar Year 2015, the TC&H unit monitored 589 affordable housing projects, which consisted of 54 tax-credit projects, 276 HOME projects and 259 projects that received a combination of both tax credits and HOME funds. These 589 are associated with 25,279 affordable units in 1,955 buildings.

The objective of this audit was to determine whether the controls established by HPD's TC&H unit for the monitoring of building owners' compliance with affordable housing provisions and requirements are implemented on a consistent basis to ensure that: 1) tenants residing in affordable housing projects meet eligibility requirements; 2) rents are charged in accordance with affordability requirements; and 3) units are adequately maintained.

Audit Findings and Conclusions

The audit found that the controls established by HPD's TC&H unit are implemented on a consistent basis for the monitoring of building owners' compliance with affordable housing provisions and requirements. However, we found a number of weaknesses that hinder HPD's ability to ensure that building owners consistently comply with requirements. Specifically, we found that Asset Management does not maintain a complete list of all rental projects that the TC&H unit oversees. In addition, we found that HPD does not have a watch list to track building owners who consistently fail to comply with affordable housing requirements, and does not verify building owners' assertions that deficiencies cited by the agency in inspection reports have been corrected. Finally, we found that HPD does not have an effective tracking mechanism in place that would allow it to review all affordable housing units under its oversight on an aggregate basis, including the issues found with the units. This hinders HPD's ability to track building owners' overall compliance status for their affordable housing projects.

Audit Recommendations

To address the issues raised by this audit, we make the following five recommendations:

- Asset Management should periodically review its Asset Management portfolio database and update it as needed to ensure that applicable buildings and units from the TC&H compliance data are included into the portfolio database.
- HPD should establish a watch list to track those building owners who have a history of repeated non-compliant behavior.
- HPD should enforce its contractual authority to institute legal proceedings for the repayment of funds obtained from HPD for HOME projects and take steps to prevent these owners from future business dealings with the City.
- HPD should independently verify that the measures reported by building owners to correct deficiencies were actually made.
- HPD should create a formal tracking mechanism that would allow it to clearly identify the number of projects and units that it is responsible for overseeing on an aggregate level.

Agency Response

In its response, HPD agreed with one recommendation and agreed in principle with two others. HPD disagreed with our recommendation that it independently verify that the measures reported by building owners to correct deficiencies were actually made and did not directly address our

recommendation that it create a formal tracking mechanism for all of the projects and units that it oversees. HPD also disagreed with a number of the audit's findings. After carefully reviewing HPD's arguments, however, we find no basis to alter any of the audit's findings and conclusions.

AUDIT REPORT

Background

HPD is the largest municipal housing preservation and development agency in the nation. The agency is responsible for promoting the construction, rehabilitation and preservation of affordable, high quality housing for low and moderate-income families, for enforcing housing quality standards, financing affordable housing development and preservation, and for ensuring sound management of the City's affordable housing. HPD's Asset Management is responsible for monitoring various housing projects' financial health, overseeing the physical condition of buildings that are financially assisted by or through certain City and other government programs, and for ensuring continued compliance with regulatory agreements.

HPD's TC&H unit is part of Asset Management and is responsible for overseeing affordable housing projects that receive Low Income Housing Tax Credits, as well as those that are funded through a federal program administered by the U.S. Department of Housing and Urban Development (HUD) called "HOME." HOME funds are forgivable loans provided by HUD through HPD to help subsidize the construction or rehabilitation of affordable rental housing and homeownership. Building owners receiving HOME funds must comply with HUD rules. The Low Income Housing Tax Credits program provides tax credits intended to reduce affordable housing investors' corporate federal income tax bill. It is monitored by the Internal Revenue Services (IRS). U.S. Treasury Regulation §1.42-5(c)(2)(ii)(A) sets forth the conditions with which building owners receiving these tax credits must comply. The TC&H unit is responsible for monitoring building owners' compliance with the federal requirements of both programs.

Owners of affordable housing projects that have received HOME funds or Low Income Housing Tax Credits must adhere to federal regulations that require certain units to be affordable and/or rented to tenants within specific income ranges and the buildings to maintain a certain levels of habitability. These regulations include HUD's Compliance in HOME Rental Projects – A Guide for Property Owners; HUD's HOME and the Low-Income Housing Tax Credit Guidebook; and U.S. Treasury Regulation §1.42-5(c)(2)(ii)(A).

At the beginning of each calendar year, staff from the TC&H unit send owners of affordable housing units in housing projects that have received HOME funds or Low Income Housing Tax Credits certification and rent roll forms. These must be completed and submitted to HPD by March 1st of that year. HPD's compliance analysts review the information submitted to assess whether the owners have fulfilled the terms and conditions of their regulatory agreements. Such conditions include: maintenance of the necessary number of low-income and very low-income affordable housing units within a project; rental to tenants within appropriate income limits; and charging allowable rents. In addition, HPD must visit 20 percent of the units identified by the owners as low-income units and verify the information provided in the annual owners' certifications and rent rolls. Moreover, HPD must physically inspect these affordable housing units to ensure that they are in good physical condition and compliant with the New York City Housing Maintenance Code.

In instances of non-compliance with the Low Income Housing Tax Credit requirements, HPD must notify the Internal Revenue Service (IRS) so that it can take action, including seeking recovery of the tax credit claimed during the period of non-compliance. HPD notifies the IRS of non-compliance by submitting Form 8823 - Low-Income Housing Credit Agencies Report of

Noncompliance or Building Disposition. This form does not apply to projects that receive HOME funds, which are monitored by HUD.

HPD maintains an Asset Management portfolio database that contains all of the projects that Asset Management monitors for compliance with applicable regulatory agreements, including projects that receive HOME funds and Low Income Housing Tax Credits. For projects under its purview, the TC&H unit maintains a compliance data system to record activities as they relate to projects receiving federal tax credits and HOME funds. As of Calendar Year 2015, the TC&H unit monitored 589 affordable housing projects, which consisted of 54 tax-credit projects, 276 HOME projects and 259 projects that received a combination of both tax credits and HOME funds. These 589 are associated with 25,279 affordable units in 1,955 buildings.

Objective

The objective of this audit was to determine whether the controls established by HPD's TC&H unit for the monitoring of building owners' compliance with affordable housing provisions and requirements are implemented on a consistent basis to ensure that: 1) tenants residing in affordable housing projects meet eligibility requirements; 2) rents are charged in accordance with affordability requirements; and 3) units are adequately maintained.

Scope and Methodology Statement

We conducted this performance 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. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. This audit was conducted in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

The primary scope of this audit was the period covering Calendar Years 2013 through 2015. Please refer to the Detailed Scope and Methodology at the end of this report for the specific procedures and tests that were conducted.

Discussion of Audit Results with HPD

The matters covered in this report were discussed with HPD officials during and at the conclusion of this audit. A preliminary draft report was sent to HPD and discussed at an exit conference held on June 3, 2016. We submitted a draft report to HPD on June 9, 2016, with a request for comments. We received a written response from HPD on June 23, 2016.

In its response, HPD explicitly agreed with Recommendation 1 and agreed in principle with Recommendations 2 and 3. HPD officials disagreed with Recommendation 4, that it verify that the measures reported by building owners to correct deficiencies were actually made, and did not directly address Recommendation 5, that it create a tracking mechanism that would allow it to identify the number of projects and units it is responsible for overseeing.

HPD's response contains a number of arguments against the audit findings that we address in detail in the body of this report. Among these are several arguments that unfortunately reflect a misunderstanding of the audit findings.

After carefully reviewing HPD's arguments, we find no basis to alter any of the audit's findings and conclusions.

The full text of HPD's response is included as an addendum to this report.

FINDINGS AND RECOMMENDATIONS

The controls established by HPD's TC&H unit are implemented on a consistent basis for the monitoring of building owners' compliance with affordable housing provisions and requirements. However, we found a number of weaknesses that hinder HPD's ability to ensure that building owners consistently comply with program requirements. Specifically, we found that Asset Management does not maintain a complete list of all rental projects that the agency oversees. In addition, HPD does not have a watch list to track building owners who consistently fail to comply with affordable housing requirements and does not verify building owners' assertions that deficiencies cited by the agency in inspection reports have been corrected.

We also found that HPD reviews owners' tenant files for 20 percent of the projects that are monitored by the TC&H unit, and that it conducts housing quality standard inspections in accordance with federal guidelines for the projects monitored by the TC&H unit. In addition, our review of 25 randomly selected projects that failed to comply with various requirements during Calendar Year 2013 found that HPD sent notification letters to building owners that informed them of non-compliant conditions as well as the deadlines to correct the conditions cited, and stated the consequences that could result from a failure to do so.³ For projects involving federal tax credits, we also found that HPD submitted Form 8823 to the IRS, informing them when building owners did not resolve non-compliance issues within mandated deadlines, reviewed building owners' self-reported corrections, notified the IRS when non-compliant conditions were remedied and sent semi-annual notice to building owners with unresolved issues.

However, these positives are mitigated by the weaknesses noted above and discussed in greater detail in later sections of the report. Further, while our review of 589 projects in HPD's tax-credit compliance database found that, for the most part, HPD reviewed the annual owner certification and rent rolls submitted to ensure that tenants who qualify to participate in the program are charged rents within the mandated limits, we found that 24 of the 589 projects did not have annual owner certifications or rent rolls. Moreover, six of the 24 projects did not submit the required documents for two consecutive years and another four of the 24 projects did not submit the documents for three consecutive years. In addition, as discussed in the Other Matters section of this report, HPD does not have an effective tracking mechanism in place that would allow it to review all affordable housing units under its oversight on an aggregate level, including the issues found with the units. This hinders HPD's ability to track building owners' overall compliance status for their affordable housing projects. As a result, non-compliant owners can have the benefit of receiving tax credits or governmental funding while not adhering to regulations, which ultimately has a negative impact on the tenants for which these affordable housing projects were intended to serve.

The details of these findings are discussed in the following sections of this report.

HPD's Tracking of Projects and Building Owners' Compliance Needs Improvement

HPD has not established an adequate tracking mechanism to monitor the number of affordable housing projects under its oversight. In addition, HPD currently lacks a tracking mechanism that

³ The required correction period is within 30 days for non-compliance identified during the review of annual owner certification and rent roll reports and within 90 days for non-compliance identified during housing quality standards inspections.

would allow it to monitor those building owners who have a consistent pattern of non-compliant behavior.

These issues are discussed in more detail below.

Asset Management Does Not Maintain an Accurate Aggregate List of All Rental Units Overseen by TC&H

Currently, Asset Management uses its Asset Management portfolio database to track the number of affordable housing rental units that the agency oversees, but we found that database to be incomplete. We compared information in the Asset Management portfolio database, which purportedly identifies all of the units overseen by HPD, including rental units that are monitored by the TC&H unit, with information in the TC&H compliance data system. Our review identified 7,813 additional rental units associated with 388 different buildings currently monitored by the TC&H unit that should have been included in the Asset Management portfolio database but were not.

After repeated requests for an explanation of the discrepancy, HPD acknowledged that an additional 192 buildings should have been monitored by Asset Management. The agency stated that 42 of those buildings were in the process of being added to the Asset Management portfolio and the remaining 150 buildings will be added after the appropriate documents are reviewed. HPD cited various reasons for excluding the remaining 196 buildings (of the 388 we found that were missing) from the Asset Management portfolio. However, since HPD did not provide us with the criteria used by the agency for including buildings in the Asset Management portfolio, we could not confirm whether their reasons for the exclusions were applicable. These discrepancies raise questions as to whether HPD management has an accurate aggregate list of all of the projects and units that the agency is responsible for overseeing and as a result, whether HPD adequately oversees all of the properties it is responsible for.

HPD Does Not Have an Effective Mechanism to Identify Consistently Non-Compliant Building Owners

HPD has no structured mechanism in place to track building owners who receive tax credits or HOME funds but who have unacceptable or questionable rates of compliance with those programs' requirements. As a result of this deficiency, HPD's ability to adequately monitor and enforce compliance with regulatory agreements is hindered. HPD's contracts with building owners receiving tax credits and HOME funds mandate that "[i]n the event of a breach of any of the covenants and agreements contained herein, the City shall have the right to...institute and prosecute any proceeding for an injunction or for specific performance of Owner's obligation hereunder."

HPD officials stated that failure to correct non-compliant conditions could result in various penalties. These include compelling delinquent building owners to repay funds obtained from HPD for affordable housing development; requiring payment to the IRS for tax credits determined to have been improperly granted; instituting legal proceedings against owners for their failure to comply with contractual agreements; and prohibiting building owners from doing business with HPD for a period of not less than three years from the date of violation. During our scope period, HPD identified 292 projects that had some areas of non-compliance. These projects involved 1,622 units associated with 805 buildings. Of the 1,622 units that had issues during our scope

period, 289 units had issues with rent exceeding the allowable amount or ineligible tenants residing.

With regard to those units identified by HPD as non-compliant with all relevant program requirements, including rent and income level violations, we found that the agency took the steps required by the federal government. Specifically, for the non-compliant units that receive tax-credits, HPD notifies the IRS as is required. In such cases, if the IRS takes enforcement action, it removes the portion of the credit related to the non-compliant unit for the period of non-compliance. For the HOME funds, as per HUD requirements, HPD is required to send notices to the owner informing them of the non-compliance.

However, while HPD has taken all of the federally required follow-up actions upon findings of non-compliance, it does not specifically have a watch list to track those housing projects that have been found consistently non-compliant or the owners associated with them. As a result, HPD has a limited ability to identify persistently troubled projects and owners within their programs and across program lines, which would potentially increase the effectiveness of its compliance enforcement efforts.

HPD provided limited evidence of any additional punitive measures the agency took against building owners who consistently fail to comply with HOME program or tax credit requirements, such as barring a building owner from participation in future projects. This is of even greater concern with the HOME projects, since HPD is not required to inform HUD of ongoing issues of non-compliance or take any action other than sending out reminder notices. If HPD takes no further action, there is a greatly increased risk that the non-compliance will be able to continue.

If the agency had a tracking mechanism, such as a watch list, to identify persistently non-compliant building owners, it would enable HPD to determine when more aggressive efforts such as legal action may be warranted, a form of action that is all the more imperative for HOME projects. The absence of such a mechanism increases the risk that projects could receive benefits for longer than they should, owners with a history of non-compliance could be allowed to receive future benefits, and tenants could be at increased risk for being overcharged, living in substandard conditions, or denied housing they are entitled to altogether.

Recommendations

1. Asset Management should periodically review its Asset Management portfolio database and update it as needed to ensure that applicable buildings and units from the TC&H compliance data are included into the portfolio database.

HPD Response: “HPD agrees with the auditor’s that the Agency can better capture and manage data to make faster, more accurate and better-informed business decisions, in particular as these efforts relate to asset management functions. The Agency recently completed a Request for Information (RFI) and is finalizing a negotiated acquisition for a software system specifically designed to assist with the asset management of affordable housing. . . . We anticipate that the Asset Management unit will have this new software system fully in place by next summer.”

2. HPD should establish a watch list to track those building owners who have a history of consistent non-compliant behavior.

HPD Response: “We disagree. The compliance rate for the TC&H was 99.5% during the period covered by the audit: during the three-year period, the TC&H unit performed 89,153 compliance checks, with only 413 findings of non-compliance. . . . The exceptionally low rate of non-compliance, and the procedures already in place to address non-compliance, make a public ‘watch list’ unnecessary.

TC&H non-compliance is included in the Asset Management unit’s monthly report. Further, TC&H compliance and other data points are now weighted to create a risk rating analysis and report to identify affordable housing that is at the greatest risk. The risk rating report is being piloted this summer and will identify owners and buildings that require more active and regular engagement from the Asset Management unit.”

Auditor Comment: HPD’s disagreement appears to be primarily based on a mistaken belief that we are recommending that the watch list be made public. We make no such argument. Rather, our recommendation is intended for HPD internal monitoring purposes only. It is based on the fact that HPD has no structured mechanism in place to track building owners with unacceptable or questionable rates of compliance. Indeed, by its description, it appears that the risk rating report being piloted by HPD this summer would potentially serve as such a mechanism. Therefore, rather than disagree, HPD appears to agree—at least in principle—with this recommendation. With regard to the 99.5 compliance rate claimed by HPD, we do not know the source for its figures and so cannot comment on it.

3. HPD should enforce its contractual authority to institute legal proceedings for the repayment of funds obtained from HPD for HOME projects and take steps to prevent these owners from future business dealings with the City.

HPD Response: “HPD takes appropriate steps to enforce its HOME compliance monitoring responsibilities, using the enforcement actions and remedies allowed to us by law. Such remedies can, but seldom should, include legal proceedings for the repayment of funds through foreclosure because those proceedings take many years, often result in owner neglect during the process, and provide no guarantee that the affordable housing will be held by a responsible owner at the end of the process. For those reasons, we only start the foreclosure process when there are very significant that cannot be corrected through other means.

Long before foreclosure is an appropriate remedy, HPD usually finds other leverage points (such as the exit of investors in LIHTC projects at the end of the initial compliance period) to compel owners to address compliance problems, agree to professional third party management, or to give up ownership or control of a building.”

Auditor Comment: From its response, it appears that HPD erroneously believes that we are recommending that it specifically initiate foreclosure proceedings to compel building owners to repay HOME funds. Rather, we recommend that HPD avail itself of its full contractual authority, for which foreclosure is merely one option. Nevertheless, we are pleased that HPD appears to agree, in principle, with the need for instituting proceedings to enforce its compliance and monitoring responsibilities allowed by law.

HPD Does Not Independently Verify that Housing Quality Deficiencies Are Corrected

Building owners participating in affordable housing developments are obligated to maintain the premises in a habitable condition. Inspectors from HPD's Code Enforcement unit conduct physical inspections to ensure compliance with these requirements and the results of their inspections are noted in the housing quality inspection report. However, HPD has no policy or procedure in place to verify that deficiencies cited in these reports are corrected. Deficiencies can include electrical hazards, broken windows, cracked or peeling ceilings, walls and floors, lead paint, poor ventilation, broken or lack of smoke detectors, poor building exterior conditions, faulty heating and plumbing, and general health and safety such as an inability to access units and fire exits.

According to HPD's current policy, when a building owner corrects a non-compliant housing condition cited in an inspection report, the owner must submit a Certification of Repairs signed by the tenant. This serves as evidence that the condition has been corrected. However, HPD's inspectors do not obtain any independent verification that the condition has actually been corrected, such as sending inspectors out to visit the premises. Further, HPD takes no action to verify that the purported tenant signatures are authentic, which hinders the effectiveness of the oversight efforts of the TC&H unit.

This risk is even more prevalent with HUD-funded HOME projects. These only require that HPD send a letter to building owners to alert them when non-compliant conditions are found; HUD does not require that it also receive notice. Thus, there are fewer potential consequences for owners of non-compliant HOME projects. For instance, the owners run less of a risk that they will be compelled to return federal funds received for affordable housing development. Therefore, owners of these projects may have less incentives to correct the non-compliant condition. Independent verification through re-inspection, even if only on a sample basis, helps ensure that conditions are corrected.

Recommendation

4. HPD should independently verify that the measures reported by building owners to correct deficiencies were actually made.

HPD Response: "We disagree. We believe HPD's certification process conforms to the applicable federal regulations and is an efficient and effective process for ensuring compliance. Indeed, our process has never been found lacking by any of the many independent auditors who have reviewed the program through the annual Single Audit review process. The HOME Final Rule that HUD published in 2013 made clear that an agency can accept third party verification that non-hazardous deficiencies have been corrected.... [HPD's] process is consistent with the HOME Final Rule, because the tenant is providing third-party verification by affirming the repairs have been completed."

Auditor Comment: HPD's argument appears to be based on a presumption that the tenant signature on the Certificate of Repair qualifies as third-party verification. However, HPD takes no action to verify the authenticity of those signatures, increasing the risk that building owners may present fraudulent affirmations that go undetected and allow deficient conditions to remain. Consequently, we urge HPD to implement our recommendation.

Other Matters

HPD has not established a structured tracking mechanism that would allow it to monitor, on an aggregate level, building owners' compliance for the various affordable housing projects under its oversight. Monitoring of project (or program) types on an aggregate level allows management to assess compliance rates and program effectiveness, identifying those that have higher success rates than others. Aggregate monitoring also helps management identify building owners who have unacceptable or questionable rates of compliance among various programs. As noted above, this type of identification does not occur for projects receiving Low Income Housing Tax Credits and HOME funds.

In addition to HOME funds and Low Income Housing Tax Credits, affordable housing projects overseen by HPD may receive other tax incentives. For example, owners might also receive a 421-a tax exemption, a partial tax exemption afforded by New York State for new multiple dwellings or an owner could receive a tax exemption for rehabilitation or new construction of housing in an Urban Development Action Area Project area. Unlike the HOME projects and other projects that received Low Income Housing Tax Credits monitored by the TC&H unit, HPD officials could not identify any other affordable housing project categories that are monitored for compliance on an aggregate level. Instead, these projects are assigned to different HPD units and different project managers, who monitor for compliance on a case-by-case basis.

Moreover, as stated earlier, HPD's Asset Management unit is responsible for monitoring the financial health of the projects, checking the physical condition of the buildings, and ensuring project compliance with regulatory agreements. Though the Asset Management unit analyzes data to identify projects that may need HPD's attention and intervention, HPD officials acknowledged that the agency does not have a structured and centralized tracking mechanism that would allow it to track the follow-up efforts taken for these projects. The lack of such a comprehensive list limits HPD's ability to effectively manage its programs by with a clear overview of the number of projects that require attention at any given time.⁴ HPD officials stated that the agency is in the process of acquiring a more robust system that would allow them to keep track of the workflow and the monitoring efforts. However, we cannot determine the effectiveness of the new measure until it is fully implemented.

Without monitoring non-compliance overall, HPD is limited in its ability to identify those programs (and building owners) for which more in-depth monitoring is needed to ensure that these programs are operating as intended for the public's benefit.

Recommendation

5. HPD should create a formal tracking mechanism that would allow it to clearly identify the number of projects and units that it is responsible for overseeing on an aggregate level.

HPD Response: "TC&H has an adequate formal tracking mechanism and the audit found no fault with the TC&H database, which includes on-demand reporting provided to Agency senior management on the number of projects and units that are subject to monitoring.

⁴ Data analyzed by the Asset Management unit includes HPD code violations, outstanding Emergency Repair Program fees, and municipal tax arrears from the Department of Finance and the Department of Environmental Protection.

The auditors identified a group of buildings that were in the TC&H portfolio that were not also in the Asset Management portfolio. We believe that this recommendation relates to that concern and we agree that our data management and reporting capabilities for the Asset Management portfolio can be improved. As discussed above, that is why we are in the process of procuring an asset management database that will greatly improve our ability to track, manage, and report on the projects and units that we oversee.

In the interim, we are reviewing the buildings identified by the auditors as not in both the TC&H and Asset Management portfolios. We expect up to 192 of those buildings may be added to the Asset Management unit.”

Auditor Comment: HPD’s argument does not directly address the recommendation and related finding, which relate to the fact that HPD does not have a structured or centralized tracking system that would allow the agency to identify non-complaint owners, projects or units on an aggregate basis. Instead, HPD is focusing on the discrepancy between the buildings we identified in its TC&H database compared to the ones that were identified in its Asset Management portfolio – a finding that pertains to the first recommendation in the report. We urge HPD to more carefully review and consider this recommendation and implement it as stated.

DETAILED SCOPE AND METHODOLOGY

We conducted this performance 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. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. This audit was conducted in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

The scope of this audit was Calendar Years 2013 – 2015.

To gain an understanding of the overall affordable housing development process, we met with HPD officials from various offices, divisions, and units to discuss the following: 1) Division of Planning, the process of project site selection; 2) Office of Development, the process of developer selection; 3) Division of Building and Land Development Services, the process of monitoring projects during the construction phase; 4) Division of Housing Incentives, the administration of tax benefit programs and allocation of tax credits; 5) Division of Finance for New Construction, funding and subsidies provided to the development of affordable housing projects; 6) Marketing Unit, the affordable housing unit rent-up process; and 7) Division of Asset Management, the monitoring of the financial health of affordable housing projects and oversight of the physical condition of the buildings.

To obtain an understanding of HPD's monitoring process over the building owners' compliance with affordable housing provisions for tax credits and HOME funds projects, we met with HPD officials from the TC&H unit and reviewed the process pertaining to the annual owner certification and the rent roll reports, as well as the tracking system used (TC&H Compliance Data) to keep track of each project's compliance status. In addition, to determine the number of rental units overseen by HPD, we reviewed the Asset Management portfolio. We assessed the reliability of the TC&H compliance data and the Asset Management portfolio by comparing the two datasets to determine whether all projects overseen by the TC&H unit were included in the Asset Management portfolio, and vice versa—whether all tax credits and Home funds projects in the Asset Management portfolio were included in the TC&H compliance data. Moreover, to further assess the accuracy of the data, we randomly selected 25 projects with issues identified in Calendar Year 2013, and traced supporting documentation maintained in the case files to the TC&H compliance data.

To assess the adequacy of HPD's internal controls as they relate to our audit objective, we evaluated information obtained from the agency's website, walkthroughs, and interviews conducted with HPD officials responsible for various aspects of the monitoring process. We used the following materials as audit criteria:

- HPD's HOME Program Owner's Guide – Year 2013;
- HPD's Low Income Housing Tax Credit Program Compliance Manual (November 2008);
- HUD's Compliance in HOME Rental Projects – A Guide for Property Owners;
- HUD's HOME and the Low-Income Housing Tax Credit Guidebook;
- U.S. Treasury Regulation §1.42-5(c)(2)(ii)(A); and
- IRS's Guide for Completing Form 8823, Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition.

To ascertain HPD's monitoring efforts, as well as compliance with HUD and Treasury Regulation §1.42-5(c)(2)(ii)(A), we analyzed the TC&H compliance data for Calendar Years 2013-2015. We reviewed the entire population of 589 projects monitored by HPD's TC&H unit as of December 31, 2015, to determine whether HPD: (1) Reviewed the annual certification and rent rolls; (2) Conducted site visits to review tenant files in compliance with the 20 percent requirement mandated by the Treasury Regulations, (3) Inspected units for compliance with housing quality standards.

To determine whether HPD took follow-up action for those projects that required some form of action, we randomly selected a sample of 25 projects out of 200 projects that HPD determined had areas of noncompliance during Calendar Year 2013. These 25 projects consist of 116 buildings and 1,343 affordable housing units. We identified 91 units within 56 buildings associated with the 25 projects that had areas of non-compliance and in each of these instances, we reviewed the case file for evidence that HPD sent a Notification Letter to each of the building owners informing them of the non-compliant condition; submitted Form 8823 to the IRS informing them of the building owners' non-compliance; reviewed the proof of correction submitted by the building owners, and submitted bi-annual reminders to those building owners with unresolved issues.

The results of the above test, while not statistically projected to their respective populations, provided a reasonable basis for us to assess the consistency of HPD's controls implementation for the monitoring of building owners' compliance with affordable housing provisions and requirements for projects that receive low-income housing credits and HOME funds.



VICKI BEEN
Commissioner

Office of the Commissioner
100 Gold Street
New York, N.Y. 10038

DON SHACKNAI
First Deputy Commissioner

June 23, 2016

Marjorie Landa
Deputy Comptroller
Office of the New York City Comptroller
One Centre Street
New York, New York 10007

Re: Response to Audit Report on the Department of Housing Preservation and Development's Monitoring on Building Owner's Compliance with Affordable Housing Provisions and Requirements MG15-118A

Dear Deputy Comptroller Landa,

I write to thank you for the "Audit Report on the Department of Housing Preservation and Development's Monitoring on Building Owner's Compliance with Affordable Housing Provisions and Requirements" (the "Audit Report") and for the opportunity to provide HPD's response to the report. I appreciate that your staff sought genuinely to understand the agency's operations in the areas of Tax Credit and HOME (TC&H) compliance.

My HPD team has carefully considered the findings and recommendations presented in the Audit Report. We are pleased that the auditors identified significant areas of strength in HPD's compliance efforts, concluding that the agency's TC&H controls are "implemented on a consistent basis for the monitoring of building owners' compliance with affordable housing provisions and requirements." *Audit Report, p. 2.*

The Audit Report identifies opportunities for improvement in HPD's tracking systems and processes. While we agree with some audit findings and recommendations, we disagree with the findings that TC&H does not maintain an accurate listing of its portfolio and that HPD lacks a mechanism to identify non-compliant owners. There were no findings regarding the completeness of HPD's TC&H tracking system and the compliance rate for the TC&H program during the period covered by the audit was a near perfect 99.5%.

Importantly, the Audit Report notes that HPD is in the process of acquiring technology designed to improve overall tracking and management. As the auditors learned during this process, there was insufficient investment in technology for HPD prior to this administration. Since 2014, however, significant investments have been made in upgrading the systems we use to track HPD's development and asset management activities.

For example, this fall we will roll out the first release of HPD Works. HPD Works will provide our development staff with a custom-designed application to automate and track their work and, ultimately, will enable our development team to seamlessly (and paperlessly) hand off completed projects to our asset management staff. In addition, asset management will benefit from the acquisition underway of a sophisticated, industry-specific computerized tracking system that will dramatically enhance HPD's ability to manage projects in our asset management portfolio.

While implementing these crucial new tracking technologies, HPD is increasing staffing, optimizing how we structure our resources, providing needed training, and creating standardized procedures and risk metrics for asset managers to ensure consistency in how staff assess and attempt to improve distressed buildings.

I am confident that all of this good work will further enhance HPD's effectiveness in TC&H compliance and asset management more broadly.

Once again, we value the audit report and this opportunity to comment upon it. I would be happy to discuss our response with you if that would be helpful.

Very truly yours,



Don Shacknai

**NYC Comptroller Audit Report on HPD's Monitoring of Building Owner's Compliance
MG15-118A
June 23, 2016**

The objective of this audit “was to determine whether the controls established by HPD’s Tax Credit and Home (TC&H) unit for the monitoring of building owners’ compliance with affordable housing provisions and requirements are implemented on a consistent basis to ensure that: 1) tenants residing in affordable housing projects meet eligibility requirements; 2) rents are charged in accordance with affordability requirements; and 3) units are adequately maintained.”

The audit’s primary finding is “that the controls established by HPD’s TC&H unit are implemented on a consistent basis for the monitoring of building owners’ compliance with affordable housing provisions and requirements.” See Audit Report, page 2. We are pleased that the audit acknowledges the fairness and efficiency of our monitoring processes.

Many of the audit’s recommendations for improvement are already in progress as mentioned below. While we always seek to further strengthen our oversight of the affordable housing we have financed, we disagree with several other recommendations.

HPD (or, “the Agency”) maintains an accurate listing of buildings in its TC&H portfolio. The Agency has a database with a complete listing of the projects we oversee, with ongoing tracking and monitoring mechanisms that allow us to quickly identify non-compliant owners and track that compliance over time. TC&H non-compliance is reported on a monthly basis and provided to Agency senior management on demand for any owner, project or building. Moreover, the status of TC&H non-compliance is shared with HPD’s Asset Management unit and other parts of the Agency, including the Office of Development and senior staff. Further clarification of how we manage the TC&H program is included in our responses to the Audit Recommendations below.

Audit Recommendations

- 1. Asset Management should periodically review its asset management portfolio database and update it as needed to ensure that applicable buildings and units from the TC&H compliance data is included into the portfolio database.**

Agency Response to Recommendation 1

HPD agrees with the auditors that the Agency can better capture and manage data to make faster, more accurate and better-informed business decisions, in particular as these efforts relate to asset management functions. The Agency recently completed a Request for Information (RFI) and is finalizing a negotiated acquisition for a software system specifically designed to assist with the asset management of affordable housing. That system will electronically capture critical data from other parts of the Agency and documents submitted by owners, track communication, automate certain business functions, provide reporting capabilities, and improve document

management. We anticipate that the Asset Management unit will have this new software system fully in place by next summer. Additionally, over the last several years the Agency has developed business intelligence tools that aggregate and make housing production data easily available for daily operations and analytics. Those tools are making it possible for Asset Management staff to more efficiently identify projects that will be subject to monitoring by the Asset Management unit.

2. HPD should establish a watch list to track those building owners who have a history of consistent non-compliant behavior.

Agency Response to Recommendation 2

We disagree. The compliance rate for TC&H was 99.5% during the period covered by the audit: during the three-year period, the TC&H unit performed 89,153 compliance checks, with only 413 findings of non-compliance. When TC&H reports identify consistent owner non-compliance, the agency intervenes as needed and in proportion to the scope and scale of the non-compliance. The exceptionally low rate of non-compliance, and the procedures already in place to address non-compliance, make a public “watch list” unnecessary.

TC&H non-compliance is included in the Asset Management unit’s monthly reports. Further, TC&H compliance and other data points are now weighted to create a risk rating analysis and report to identify affordable housing that is at the greatest risk. The risk rating report is being piloted this summer and will identify owners and buildings that require more active and regular engagement from the Asset Management unit.

Further, depending upon the degree and nature of the non-compliance, correction is often a prerequisite to the owner receiving any additional HPD assistance in the form of development opportunities, tax benefits or City financing. Owners applying for competitive allocations of Low Income Housing Tax Credits (LIHTC) lose points on their applications because of TC&H non-compliance.

When owners partner with HPD on new affordable housing projects, HPD conducts a comprehensive Sponsor Review process that includes a report on all the properties they own, manage, and control directly or indirectly. That report includes all instances of TC&H non-compliance and, along with other considerations, determines whether the owner will be approved for the project. In addition to Sponsor Review, HPD’s Credit Committee approves or disapproves of funding for potential development projects. As part of that review, the Committee considers the capacity and compliance record of the owners involved, including TC&H non-compliance.

Findings of non-compliance surface in only a tiny fraction of our portfolio. This rare occurrence already triggers HPD review, is factored into the risk analysis that guides our monitoring efforts, and is considered, as appropriate, in the Agency’s tax credit allocation and financing decisions. Therefore, publishing a “watch list” and responding to the inquiries it would generate would not add value to our already rigorous use of non-compliance data, and would be an inefficient use of HPD’s resources.

3. HPD should enforce its contractual authority of instituting legal proceedings for the repayment of funds obtained from HPD for HOME projects and take steps to prevent these owners from future business dealings with the City.

Agency Response to Recommendation 3

HPD takes appropriate steps to enforce its HOME compliance monitoring responsibilities, using the enforcement actions and remedies allowed to us by law. Such remedies can, but seldom should, include legal proceedings for the repayment of funds through foreclosure because those proceedings take many years, often result in owner neglect during the process, and provide no guarantee that the affordable housing will be held by a responsible owner at the end of the process. For those reasons, we only start the foreclosure process when there are very significant problems that cannot be corrected through other means.

Long before foreclosure is an appropriate remedy, HPD usually finds other leverage points (such as the exit of investors in LIHTC projects at the end of the initial compliance period) to compel owners to address compliance problems, agree to professional third party management, or to give up ownership or control of a building.

To demonstrate how HPD is able to use leverage to encourage compliance, we shared a recent example with the auditors of an owner who had failed to submit required TC&H compliance related documents for three years. The building was behind in payments to a private lender and it was clear the owner was not able to manage the building on his own. The owner needed a new mortgage against the property but could not get a mortgage without HPD permission. We used that opportunity to compel the owner to fully satisfy the private lender and HPD mortgage arrears, sign a new regulatory agreement with HPD, agree to the creation of a reserve of funds for critical repairs, and to accept professional third-party property management for the building going forward.

As discussed above, HPD's Sponsor Review already uses an owner's record of compliance as a significant factor in determining what future business dealings will be permitted with the Agency, if any.

4. HPD should independently verify that the measures reported by building owners to correct deficiencies were actually made.

Agency Response to Recommendation 4

We disagree. We believe HPD's certification process conforms to the applicable federal regulations,¹ and is an efficient and effective process for ensuring compliance. Indeed, our

¹ 24 CFR 92.251 and federal Department of Housing and Urban Development rules as described in as described in 24 CFR 5.703

process has never been found lacking by any of the many independent auditors who have reviewed the program through the annual Single Audit² review process.

As required by federal rules, HPD conducts on-site physical inspections of apartments to determine if they are decent, safe, sanitary and in good condition. The most frequently cited deficiencies revealed by such inspections include leaky faucets, broken window balances and missing smoke detector batteries, although a failure could also be for a more significant problem.

The HOME Final Rule that HUD published in 2013 made clear that an agency can accept third party verification that non-hazardous deficiencies have been corrected. HPD permits owners to certify non-hazardous deficiencies have been corrected if an owner: 1) completes the appropriate HPD form, 2) provides a written description that the appropriate repairs have been completed, and 3) the tenant signs the form affirming that the repairs have been completed. Upon receipt of the form HPD checks if the form is complete, if the repairs as reported by the owner are appropriate to the deficiency identified, and that the tenant has signed the form. HPD then notifies the owner if the certification has been accepted. That process is consistent with the HOME Final Rule, because the tenant is providing third-party verification by affirming the repairs have been completed.

Moreover, physical inspections of apartments are conducted by HPD Housing Maintenance Code (HMC) inspectors who, in addition to identifying physical condition deficiencies, also issue applicable HMC violations when necessary. The HMC violations are corrected through a separate process. Tenants are encouraged to call 311 at any time to report maintenance problems in their apartments or building. HPD responds to housing quality complaints and, if warranted, a Housing Maintenance Code violation is issued. If the owner does not immediately repair a hazardous condition, HPD will correct the problem through the Emergency Repair Program and bill the owner. If those bills are not paid by the owner they become liens on the property.

5. HPD should create a formal tracking mechanism that would allow it to clearly identify the number of projects and units that it is responsible for overseeing on an aggregate level.

Agency Response to Recommendation 5

TC&H has an adequate formal tracking mechanism and the audit found no fault with the TC&H database, which includes on-demand reporting provided to Agency senior management on the number of projects and units that are subject to monitoring.

The auditors identified a group of buildings that were in the TC&H portfolio that were not also in the Asset Management portfolio. We believe that this recommendation relates to that concern and we agree that our data management and reporting capabilities for the Asset Management portfolio can be improved. As discussed above, that is why we are in the process of procuring an asset management database that will greatly improve our ability to track, manage, and report on projects and units that we oversee.

² The Single Audit, also known as the OMB A-133 audit, is an organization-wide audit or examination of recipients of Federal assistance (commonly known as Federal funds, Federal grants, or Federal awards).

In the interim, we are reviewing the buildings identified by the auditors as not in both the TC&H and Asset Management portfolios. We expect up to 192 of those buildings may be added to the Asset Management unit. Of the 192 buildings, 42 were previously identified as needing to be added and are moving through that process. If appropriate, the remaining 150 will be added after the appropriate documents are assembled and reviewed.

The other buildings that are in the TC&H portfolio but not the Asset Management portfolio are not appropriate for inclusion in Asset Management. Asset Management monitors buildings that have a regulatory agreement and are not already asset managed at the New York City Housing Development Corporation, the State Division of Housing and Community Renewal, or another government agency. Projects enter Asset Management only after completion, or lease-up. Mitchell Lama buildings are monitored by HPD's Housing Supervision unit. Additionally, some types of projects are not appropriate for Asset Management depending upon the nature of the financing and other project attributes.