City of New York

OFFICE OF THE COMPTROLLER

John C. Liu
COMPTROLLER

FINANCIAL AUDIT

Tina Kim

Deputy Comptroller for Audit

Audit Report on the Housing Development Corporation's Administration of the Mitchell-Lama Repair Loan Program

7E12-139A

May 29, 2013

http://comptroller.nyc.gov

THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
1 CENTRE STREET
NEW YORK, N.Y. 10007-2341

John C. Liu
COMPTROLLER

May 29, 2013

To the Residents of the City of New York:

My office has audited the Housing Development Corporation (Corporation) to determine whether the Corporation is approving property repairs to be financed by the Mitchell-Lama Repair Loan Program and ensuring that the repairs funded by the program loans are carried out effectively. We audit agencies such as the Corporation to verify that the City is properly administering programs that focus on the preservation and maintenance of affordable housing.

The audit found that the Corporation has been approving property repairs to be financed by the Repair Loan Program, and these approvals are being made by Credit Committee vote prior to the loan closing date. Also, the repairs/improvements funded by the Repair Loans were performed in a satisfactory manner. However, Repair Loan funds totaling more than $10 million were not used in accordance with the program criteria; they were used to reduce accounts payable, to pay off principal and/or interest of loans obtained from private entities, and to pay liens. Additionally, the audit found some problems with the controls over the program resulting in issues including the inconsistent presentation of cost estimates, a lack of formal procedures for changes in work scope, and data reliability issues.

The audit recommends that the Corporation ensure that Repair Loan Funds are only used for new capital repair/improvement work or system modernization as per the program's criteria, develop guidelines as to how estimates should be presented, develop formal procedures for reviewing and approving changes in project work scopes and/or funding, ensure that loan closing memos are prepared in a timely manner, develop guidelines to explain how to count superintendent-occupied units in specific situations, and ensure that closing dates associated with Repair Loans are correct in its database system.

The results of the audit have been discussed with the Corporation 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,

John C. Liu

TABLE OF CONTENTS

THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
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AUDIT REPORT IN BRIEF

The Mitchell-Lama program was enacted by New York State to encourage the construction and continued operation of affordable rental and cooperative housing. The City Housing Development Corporation (Corporation) holds first mortgages on approximately 75 Mitchell-Lama rental and cooperative housing developments. In 2004, the Mitchell-Lama Preservation Program was created by the Corporation to encourage owners to keep their properties within the Mitchell-Lama program and thereby protect the tenants living in these developments. As part of the Preservation Program, the Repair Loan Program makes financing available to owners and cooperative corporations for making necessary capital improvements on buildings in disrepair. Upon entering the Repair Loan Program, a building must remain in the Mitchell-Lama program for the duration of the term of the loan or a minimum of 10 years. The repairs must be approved by the Corporation in advance of making the loan.

The Corporation's Asset Management division is responsible for administering the Mitchell-Lama Repair Loan Program. Its Engineering group is responsible for monitoring the work and approving the release of loan funds. Information about the Repair Loan Program (repair loan dollar amounts, project/property identifying information, and a brief description of the capital work) is recorded in an Oracle database.

A May 2006 policy report by the New York City Office of the Comptroller entitled "Affordable No More: An Update" stated that as of November 2005, 4,112 rental units and 8,959 cooperative units citywide were preserved by the Mitchell-Lama Preservation Program. As of the commencement of this audit, the Corporation had provided $72,782,134 in Repair Loan funding to 18 Mitchell-Lama properties. (See Appendix I for a list of the projects.)

Audit Findings and Conclusion

The Corporation has been approving property repairs to be financed by the Repair Loan Program, and these approvals are being made by Credit Committee vote prior to the loan closing date. Also, the repairs/improvements funded by the Repair Loans were performed in a satisfactory manner.

However, we found that Repair Loan funds totaling more than $10 million are not being used in accordance with the program criteria. The audit found that Repair Loan funds are being used to reduce accounts payable, to pay off principal and/or interest of loans obtained from private entities, and to pay liens.

- $2,369,717 was used to pay off non-repair accounts payable or accounts payable of an unidentified nature.
- $7,900,849 (which is 10.9 percent of all Repair Loan funding) was used to pay off private loans and accounts payable for prior repair work.

The audit also identified a number of areas where controls and procedures could be strengthened. Additionally, for six of 18 cases (33 percent), discrepancies were found between the loan closing dates shown in the listing extracted by Corporation officials from its database and those stated in the Loan Closing Memos.

Audit Recommendations

This report makes a total of six recommendations, including that the Corporation:

- Ensure that Repair Loan Funds are only used for new capital repair/improvement work or system modernization as per the program's criteria; other uses should be denied.
- Develop guidelines as to how estimates should be presented. These guidelines should address soft costs, contingencies, funding sources, and work item breakouts.
- Develop formal procedures for reviewing and approving changes in project work scopes and/or funding.
- Ensure that loan closing memos are prepared in a timely manner.
- Develop guidelines to explain how to count superintendent-occupied units in specific situations.
- Ensure that closing dates associated with Repair Loans are correct in its database system.

Corporation Response

In its response, the Corporation agreed with five recommendations and disagreed with one recommendation. HDC stated, "Under the terms of the Board's approval, the President of the Corporation is authorized to make repair loans subject to HDC Credit Committee approval . . . As stated in your report, all Mitchell Lama Repair Loans were made with Credit Committee Approval. HDC therefore does not agree with your finding that funds were not used in accordance with program criteria."

INTRODUCTION

Background

The City Housing Development Corporation (Corporation) was created by the New York State Legislature in 1971 as a means of providing financing for affordable housing independent from New York City's capital budget. The Corporation issues bonds and provides subsidies and low-cost loans to develop and preserve a variety of housing. The Corporation is currently the leading local housing finance agency in the nation and outperforms some of the nation's largest banks in the volume and dollar amount of bonds issued.

The Mitchell-Lama program was enacted by New York State in the mid-1950's to encourage the construction and continued operation of affordable rental and cooperative housing. However, after being in the Mitchell-Lama program for 20 years, a mortgagor can repay its mortgage and be released from the Mitchell-Lama program and its affordable housing protections; thereafter, rental and cooperative housing market rates may be charged.

The Corporation holds first mortgages on approximately 75 Mitchell-Lama rental and cooperative housing developments. In 2004, the Mitchell-Lama Preservation Program was created by the Corporation to encourage owners to keep their properties within the Mitchell-Lama program and thereby protect the tenants living in these developments. The Preservation Program has two financing options: the Repair Loan Program and the Mortgage Restructuring Program.

The Repair Loan Program makes financing available to owners and cooperative corporations for making necessary capital improvements on buildings in disrepair. Upon entering the Repair Loan Program, a building must remain in the Mitchell-Lama program for the duration of the term of the loan or a minimum of 10 years. The minimum loan amount is $100,000 and the maximum loan amount is $10,000,000. The repairs must be approved by the Corporation in advance of making the loan.

The Mortgage Restructuring Program (which is not addressed by this audit) offers debt relief through the refinancing of first and second mortgages. The savings from reduced payments may be granted to the development to perform capital improvements.

The Corporation's Asset Management division is responsible for administering the Mitchell-Lama Repair Loan Program. When a property seeks funding from the Repair Loan Program, a scope of work is prepared with bids and/or estimates for each work item. The work scope is presented to the Corporation's Credit Committee for a vote. If approved, legal documents for the loan are prepared and signed, and construction can begin. The Engineering group (part of Asset Management) is responsible for monitoring the work and approving the release of loan funds. There are five inspectors in the Engineering group who provide input on the project from scoping through completion and final payment.

Information about the Repair Loan Program (repair loan dollar amounts, project/property identifying information, and a brief description of the capital work) is recorded in an Oracle database. The information is input after a loan agreement is signed and updated as necessary by the Loan Servicing group in the Accounting Division. The Engineering group has read-only access of the database. Documents associated with the repair loans, such as authorizations to release loan funds, are scanned into Oracle Markview.

A May 2006 policy report by the New York City Office of the Comptroller entitled “Affordable No More: An Update” stated that as of November 2005, 4,112 rental units and 8,959 cooperative units citywide were preserved by the Mitchell-Lama Preservation Program. As of the commencement of this audit, the Corporation had provided $72,782,134 in Repair Loan funding to 18 Mitchell-Lama properties. (See Appendix I for a list of the projects.)

Objectives

The objectives of this audit are to determine whether the Housing Development Corporation is approving property repairs to be financed by the loan program and ensuring that the repairs are carried out effectively.

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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. 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. This audit was conducted by staff that included auditors with engineering backgrounds.

The scope of this audit covers the period from the inception of the Repair Loan Program in 2004 through the present. 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

The matters covered in this report were discussed with Corporation officials during and at the conclusion of this audit. A preliminary draft report was sent to Corporation officials on March 28, 2013, and discussed at an exit conference held on April 9, 2013. On April 15, 2013, we submitted a draft report to Corporation officials with a request for comments. We received a written response from Corporation officials on April 26, 2013. In their response, Corporation officials agreed with five recommendations. HDC, however, disagreed with our finding that “funds were not used in accordance with program criteria.” According to Corporation officials, “Under the terms of the Board's approval, the President of the Corporation is authorized to make repair loans subject to HDC Credit Committee approval . . . As stated in your report, all Mitchell Lama Repair Loans were made with Credit Committee Approval. HDC therefore does not agree with your finding that funds were not used in accordance with program criteria.”

The full text of the Corporation’s response is included as an addendum to this report.

FINDINGS AND RECOMMENDATIONS

The Corporation has been approving property repairs to be financed by the Repair Loan Program, and these approvals are being made by Credit Committee vote prior to the loan closing date. Also, the repairs/improvements funded by the Repair Loans were performed in a satisfactory manner. However, as discussed in the findings below, we found that Repair Loan funds totaling more than $10 million are not being used in accordance with the program criteria. Also, we found some problems with the controls over the program.

Use of Repair Loan Funds for Other Purposes

Repair Loan funds totaling more than $10 million are not being used in accordance with the stated purpose of the program. The April 8, 2004, memo to the Board requesting approval of the Mitchell-Lama Repair Loan Program clearly states that "loans may be used to fund systems modernization, capital improvements or repairs." There are no other allowed uses specified in the memo. Additionally, the Repair Loan Program Term Sheet emphasizes this point by specifying "Use of Proceeds: Approved capital repairs to maintain properties in good working order." However, the audit found that Repair Loan funds are being used to reduce accounts payable, to pay off principal and/or interest of loans obtained from private entities, and to pay liens. Of $72,782,134 in Repair Loan funding that was provided to 18 Mitchell-Lama properties, $10,270,565 (14.1 percent) was used at eight properties for items in project work scopes that did not comply with the program criteria of funding capital improvement/repair or system modernization.

When questioned as to why these items were included in the project work scopes, Corporation officials stated that the Repair Loans were all approved by the Credit Committee to ensure that the properties remained financially viable.

$2.3 Million Expended for Non-Repair or Unidentified Accounts Payable

Of the $10.27 million in funds that was improperly used, $2,369,717 (which is 3.2 percent of all Repair Loan funding) was used to pay off non-repair accounts payable or accounts payable of an unidentified nature. The most blatant example of this type of improper use was at Crown Gardens Co-op where 100 percent ($252,320) of the Repair Loan Funds were used to pay off outstanding water and sewer charges.

$7.9 Million Expended to Pay Off Private Loans and Accounts Payable

Of the $10.27 million in funds that did not meet the stated "use of proceeds," $7,900,849 (which is 10.9 percent of all Repair Loan funding) was used to pay off private loans and accounts payable for prior repair work. Of this amount, $6,030,658 was used to pay off interest and/or principal on loans previously obtained by the properties from Amalgamated Bank. According to the Corporation, the Amalgamated loans were used to fund capital work prior to the inception of the Repair Loan Program. The remaining $1,870,191 was used to pay off accounts payable for other (non-Amalgamated loan funded) prior repair work.

Payoff of the Amalgamated loans and other repair work payables is problematic because new capital work to maintain properties in good working order is not being funded. Even if this stretch of the program criteria is allowed, the more than $2 million used to fund items that cannot be classified as repair or improvement work must not be overlooked. Clearly, there is a lack of compliance with the intent of the Repair Loan Program.

Recommendation

1. The Corporation should ensure that Repair Loan Funds are only used for new capital repair/improvement work or system modernization as per the program's criteria. Loan requests including other uses should be denied.

Corporation Response: The Corporation disagreed with this finding and recommendation stating, “In April of 2004, HDC's Board of Directors approved the Mitchell Lama Repair Loan Program to address the repair and preservation needs of HDC's aging Mitchell Lama housing portfolio. Under the terms of the Board's approval, the President of the Corporation is authorized to make repair loans subject to HDC Credit Committee approval. HDC's Credit Committee is charged with, among other things, minimizing the Corporation's risk in financial transactions. As stated in your report, all Mitchell Lama Repair Loans were made with Credit Committee Approval. HDC therefore does not agree with your finding that funds were not used in accordance with program criteria.

All but one loan were made to address repair and preservation needs. In that one instance, Crown Gardens in the amount of $252,320, funds were expended to pay water and sewer charges which had accrued due to the project's inability to afford them and which, if left unpaid, would have resulted in (a) loss of services to residents that could have placed their well-being at risk and (b) liens against the property that could have placed HDC's financial asset at risk. This loan was made in 2005 and the Mitchell Lama Repair Loan Program was in its infancy. The Corporation acted diligently and quickly to assist Crown Gardens with a genuine need and did so with the best program tool it had immediately available. In retrospect perhaps a separate program could have been created or the existing program re-titled to the effect of "The Mitchell Lama Repair & Stabilization Program." Ultimately, however, the Corporation chose to act as quickly as possible to assist Crown Gardens with the most appropriate program immediately available. As previously noted, HDC's Mitchell Lama Restructuring Program evolved precisely out of the Corporation's experience with developments like Crown Gardens.

Regarding the larger amounts in question which were used to pay off third party loans (including those from Amalgamated Bank) and accounts payables, HDC maintains that to be a valid - and in fact critical - use of funds under the program's mandate to repair and preserve Mitchell Lama projects. These funds were expended to repay prior higher interest capital improvement loans as well as for repair and non-repair-related payables- which collectively were placing the projects' in financial peril and putting our new, affordable repair loan program out of reach. Reducing that financial burden was crucial if the developments were to be able to take on the additional debt needed to address current and urgently needed capital work, while also reducing HDC's risk. In a very real way, all of these loan proceeds were utilized for purposes which allowed necessary capital work to be done in keeping with the program's underlying intent.

Even if one maintains a more literal approach to the program as described in the report, and continues to identify funds that you deem incompatible with the program's guidelines, we ask that you correct the number cited from $10.27 million to $4.26 million. The other $6.01 million was specifically approved by HDC's Board of Directors and therefore should not be included in your numbers. Specifically, $5,113,646 (Payment of Amalgamated Loan) for North Shore Plaza and $900,000 (Payment of Accounts Payable) for Stevenson Commons were approved by HDC's Board of Director's on June 14, 2005. The memo and minutes of that meeting have been provided to you. To conclude that these amounts were not consistent with the Program's intent when HDC's Board of Directors approved the Mitchell Lama Repair Loan program and explicitly approved the loans and the use of loan proceeds for these two properties does not seem reasonable to HDC.

HDC reiterates our position that all approved loan funds were true to the fundamental intent of the program to preserve the Mitchell Lama portfolio as decent, affordable housing."

Auditor Comment: As stated in the audit finding, the program criteria as per the April 8, 2004, memo to the Board requesting approval of the Mitchell-Lama Repair Loan Program is that "loans may be used to fund systems modernization, capital improvements or repairs." We understand HDC's position that it was "true to the fundamental intent of the program" by allowing other uses for these funds, however, programmatic criteria does not currently provide for such flexibility. Additionally, $2.3 million was expended for non-repair or unidentified accounts payable. Although Crown Gardens was the only repair loan where 100 percent of the funds were used for purposes that did not comply with the program criteria, four other properties (Atlantic Plaza, Carol Gardens, Second Atlantic Terminal, and Stevenson Commons) also paid for items that could not be classified as capital improvement/repair or system modernization (for example, utilities, legal fees, and management fees) using repair loans funds.

Other Issues

During the course of the audit, we identified a number of areas where controls and procedures could be strengthened. Specifically, we found that estimates are not presented consistently in the Credit Committee Memos, there are no formal procedures for changes in work scope, timeframes for preparing loan closing memos are protracted, and superintendent-occupied units are inconsistently counted.

Inconsistent Estimates

Cost estimates for work scopes are presented in the Credit Committee Memos. However, the Corporation does not have written guidelines as to what these estimates should include and how these estimates should be presented in the Credit Committee Memos. Consequently, we found that there is a lack of consistent presentation of contingencies and/or soft costs (e.g., engineering fees) in the estimates. Contingencies and/or soft costs are clearly stated in the memos for some of the projects, while for other projects, it is unclear whether these costs are already included or simply overlooked because they are not broken out or otherwise noted. Additionally, in some of the Credit Committee Memos, only a lump sum dollar amount is provided with the description of work; there is no itemized cost breakout given.

When questioned about this, Corporation officials stated that a property's reserve fund would pay soft costs and contingencies if they are not included in the loan. Also, they stated that breakdowns are given unless the work scope is limited. However, we found that there were larger projects for which no breakdowns were provided.

A construction cost estimate should be as complete and accurate as possible. Therefore, it is good practice to include all costs (not just hard construction costs) when developing the estimate. Additionally, these costs should be broken down on a work item basis.

By failing to include soft costs and an allowance for contingencies, the Credit Committee is not being given an accurate picture of a project's overall cost. A comprehensive estimate-- including all costs and allowing for potential contingencies-- will allow accurate assessment of the impact of the project on the financial health of the property.

No Formal Procedures for Changes in Work Scope

The Corporation lacks formal procedures for requesting changes in project work scope and related funding. There are no standardized procedures or forms to use when properties wish to initiate a change of this type. In fact, an e-mail from Atlantic Plaza's property management company asking for a re-allocation of funds states, "I haven't heard back from you as to how to present our request..." This indicates uncertainty regarding how to initiate the process. Furthermore, there are no procedures explaining how changes are to be reviewed, approved, and subsequently documented, including their impact on the overall project.

According to Corporation officials, each loan is addressed on a case-by-case basis depending on the ownership/management structure. The Corporation process is highly informal: ownership/management may reach out via phone call or e-mail to request the change, it will be discussed internally with the Corporation engineer, and it may be approved. If the Corporation and the borrower agree to the change, it will be reflected in the loan releases and contractor documents (i.e., a new contract or a change order on an existing contract). Additional funds may be obtained from a contingency item or by using reserve monies.

During our field inspections, we found a number of instances where funds were re-allocated from one item in the project work scope to another item in the scope. For example, at Atlantic Plaza, funds were re-allocated two times. In the second re-allocation, funding for the work items pool, sub-metering, and canopy were shifted to fund the work items terrace, roof, pointing, security fencing, and security doors.

In light of this, the process explained to us by Corporation officials is not sufficient. Unlike using reserve monies to fund additional work, re-allocations diminish the ability to perform other necessary work as scoped. When re-allocating, the impact on the overall project must be considered, and the justification and decision-making process documented. Even if contingency dollars are used, the changes should be appropriately approved and documented. Because a project may be composed of a number of contracts, if changes are only reflected in individual contractor documents, it is difficult to ascertain how the overall project scope is affected.

Prolonged Timeframe for Preparation of Closing Memos

We found that for two Mitchell-Lama properties, Lincoln Amsterdam and Seaview Towers, second consolidating Repair Loans had been approved, but no closing memos for these second loans were found. When questioned, Corporation officials informed us that the loans closed in August 2012 and the closing memos are not yet finalized. However, Corporation officials told us that in December 2012, approximately four months after the loan closed. Good practice requires that memos be prepared in a timely manner. The failure to expediently produce these memos may be attributable to a lack of specified timeframes and guidelines. Because these documents were not completed, the additional approved funds were not reflected in the listing of Mitchell-Lama loans given to us by the Corporation, and the information in the Corporation's database may be outdated and incorrect.

Superintendent-Occupied Units Not Consistently Counted

Minor discrepancies were found when testing the number of units as shown in the Mitchell-Lama loan listing given to us by the Corporation against those presented in the Credit Committee Memos. Corporation officials explained, "There may be a one to two unit discrepancy based upon whether or not super units were reported on the worksheet and/or credit committee memo." Although the Corporation does not appear to be concerned with these minor discrepancies, the number of units in a Mitchell-Lama development should be consistently reported. If not, the costs of repair work stated on a per unit basis are inconsistently computed and possibly incorrect.

Recommendations

The Corporation should:

2. Develop guidelines, to be followed both internally and by properties, as to how estimates should be presented. These guidelines should address soft costs, contingencies, funding sources, and work item breakouts.

Corporation Response: "We appreciate and agree with this recommendation. Asset Management will include estimated soft costs and contingencies in all credit committee memos going forward."

3. Develop formal procedures for reviewing and approving changes in project work scopes and/or funding. Standardized documents or formats should be utilized in these procedures.

Corporation Response: "In all construction lending, there are times when reallocations of funds between scope items are necessary...All material changes are discussed internally and no funds are released unless changes have been approved by the appropriate senior manager. At the same time, we agree with your report's finding that this process needs to be more formally documented, and as such HDC will develop forms to be used by all involved staff for that purpose. HDC estimates to implement this enhancement by May 31, 2013."

4. Ensure that loan closing memos are prepared in a timely manner. Written procedures specifying timeframes for activities in the loan process should be developed.

Corporation Response: "HDC agrees that timely, accurate loan closing memo preparation is important, and we will ensure interdepartmental follow-up between staff project managers and attorneys to minimize such delays going forward."

5. Develop guidelines to explain how to count superintendent-occupied units in specific situations.

Corporation Response: "We recognize the importance of an accurate unit count and will endeavor to cleanse our data of any such discrepancies. HDC is in the midst of implementing a new loan servicing system. During this process we will be confirming all unit counts, both with and without superintendent units, to ensure proper input into the database. We estimate that the new software will be in service in the Fall of 2013."

Unreliable Closing Dates in Database

Information contained in databases should be complete and accurate. However, discrepancies were found when testing the loan closing dates shown in the listing of Mitchell-Lama loans given to us by the Corporation against those stated in the Closing Memos we found on the Corporation's "portal." Closing dates for the Mitchell-Lama Repair Loans were inaccurate in six of 18 cases (33 percent).

For one case, Clinton Towers, the Corporation stated that the date listed as the closing date in the listing is, in fact, the first advance date; no explanation was given as to why this date was input. For the other five properties for which a discrepancy was noted, the Corporation states that many of these properties have also refinanced their original debt with the Corporation and these refinancing loans closed on a different date than the Repair Loans, and the refinancing loan closure dates are those reflected in the listing. It is unclear why the refinancing dates were input instead of the Repair Loan closing dates for these cases.

The listing of Mitchell-Lama loans sent to us by the Corporation clearly identified each specific loan with its interest rate, maturity date, amount, etc.; therefore, the closing dates given should also be specific for each loan. Furthermore, although the Corporation states that the listing we "were given was a report pulled together for informational purposes only … and not an official record of HDC," it was generated from the Corporation database.

Recommendation

6. The Corporation should ensure that closing dates associated with Repair Loans are correct in its database system.

Corporation Response: "Since 2012, all closing dates have been automatically transferred into the database from the legal closing memo. Therefore, all future loans will have the correct closing dates. Also, last year an internal review of all closing and maturity dates was undertaken by the Corporation to ensure that the new loan servicing system will have the correct information. As we transition to the new system, we will again take that as an opportunity to review and cleanse the existing data."

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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. 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. This audit was conducted by staff that included auditors with engineering backgrounds.

The scope of this audit covers the period from the inception of the Repair Loan program in 2004 through the present.

We obtained background information from the Corporation website to familiarize ourselves with the Corporation's functions and the Mitchell-Lama Repair Loan Program. Of specific interest was the Repair Loan Term Sheet, which detailed the conditions under which loans would be made.

To further understand the policies, procedures, and regulations governing the Repair Loan Program and its processes, we reviewed information provided by the Corporation:

- NY PVH Law Sec. 654, which describes the Powers of the Corporation, including making loans
- Corporation Board memos/minutes approving the initial funding of the Repair Loan Program and its expansion
- Corporation's Repair Loan—Loan Advance Procedures, which specifies the documentation to be submitted for the release of loan funds
- Sample Credit Committee Memo, requesting approval for a Repair Loan, and sample Loan Agreement

We also reviewed Office of the New York City Comptroller reports entitled *Affordable No More* and *Affordable No More: An Update* for information about Mitchell-Lama housing.

To understand internal controls that are relevant to our audit and to understand the loan process, we interviewed officials of the Corporation's Asset Management division and its Engineering group. To gain first-hand knowledge of the role of the Corporation engineer/inspector, we observed a status meeting and work inspection for a project with current Repair Loan work. Also, IT support staff were interviewed to understand what data is contained in the Corporation's Oracle database.

Additionally, we reviewed an organizational chart showing Corporation lines of responsibility for administering the Repair Loan Program.

We documented our understanding of these controls and procedures in written memoranda and flowcharts.

The Corporation provided us with a listing of all Corporation-financed Mitchell-Lamas with their loan information including Closing Date, Maturity Date, Loan Amount, Outstanding Loan Balance, and Interest Rate. Additionally, the listing classified the loans into nine different categories. Only two of these categories, totaling 18 projects, were Repair Loans monitored by the Corporation. The data was tested for accuracy.

To determine whether the Corporation is approving property repairs to be financed by the loan program, a spreadsheet analysis was performed on all 18 projects. Additionally, the items in the project work scope were analyzed to determine if they complied with Repair Loan Program criteria.

To determine whether the Corporation is ensuring that repairs are carried out effectively, field inspections are necessary. We initially visited one project when observing the Corporation inspector/engineer and judgmentally selected eight additional properties for inspection. (See Appendix I for a list of the sampled projects.) We selected two properties indicated as having work in progress, and six properties based on a number of characteristics (dollar value of work, scope of work, Corporation inspector, and location of property (i.e., various boroughs)) to obtain a diverse sample.

Field inspections were performed by the audit team at the sampled properties to determine whether project scopes were completed satisfactorily. Clarification was required of some problems identified during these inspections. The Corporation was questioned, and a response was received and reviewed.

Because the sample was not selected randomly, the results cannot be projected. However, the results of our sample provided sufficient, appropriate evidence as to whether approved repair work was performed as intended.

The 18 Mitchell-Lama Developments with Repair Loans

Mitchell-Lama Development	Borough	Number of Units	Amount of Repair Loans	Notes	Field Inspection Sample
Atlantic Plaza	Brooklyn	716	$9,668,345.60	1	X
Bethune Tower	Manhattan	135	$1,660,243.00		X
Carol Gardens Apart	Bronx	315	$3,564,000.00		
Clinton Tower	Manhattan	396	$3,843,400.00	3	
Crown Gardens Coop	Brooklyn	238	$252,320.49		
Esplanade Gardens	Manhattan	1872	$5,364,492.00		X
Goddard Riverside	Manhattan	194	$1,505,859.77		X
Hamilton Housing	Manhattan	176	$4,840,000.00		X
Jefferson Tower	Manhattan	190	$1,447,795.00		
Lincoln Amsterdam	Manhattan	186	$4,355,257.24	1, 2	
North Shore Plaza	Staten Island	536	$11,157,846.00		X
RNA House	Manhattan	208	$954,945.00		
Rosalie Manning	Manhattan	109	$275,000.00		
Seaview Towers	Queens	460	$2,132,641.00	1, 2	
Second Atlantic Terminal	Brooklyn	305	$6,945,839.30	1	X
Stevenson Commons	Bronx	947	$11,499,150.00	1	X
Stryckers Bay	Manhattan	234	$1,995,000.00		
Washington Square SE	Manhattan	175	$1,320,000.00		
			$72,782,134.40		

Notes:

1. Property has received two repair loans. The second repair loan consolidated the remaining balance of the first repair loan. The dollar amount shown reflects both loans.

2. Closing memo for the second repair loan is not completed. The dollar value stated in the Credit Committee Memo for the second loan was used in computing the dollar amount.

3. Although not included in the field inspection sample, this property was visited during our observation of the engineer/inspector performing his duties.

NYC HDC
NEW YORK CITY
HOUSING DEVELOPMENT
CORPORATION

Marc E. Jahr
President

April 26, 2013

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City of New York
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Re: Audit Report on the Housing Development Corporation's Administration of the Mitchell-Lama Repair Program 7E12-139A

Dear Ms. Kim:

Thank you for the opportunity to comment upon the above-referenced draft audit report dated April 15, 2013. Reflecting the concerns expressed by Mayor Bloomberg in his New Housing Marketplace Plan and many advocates, as well as by the Comptroller's office in two studies[1], since 2004, HDC has provided financing in excess of $1.3 billion to 49 Mitchell Lama developments comprising more than 28,000 units.

Through our Mitchell Lama Repair Loan and Mitchell Lama Restructuring Programs, HDC has both improved the quality of living conditions for current tenants and protected these units as a long-term source of affordable housing for middle-income New Yorkers for years to come. We take great pride in these programs and appreciate your recognition that all "repairs/improvements funded by the Repair Loans were performed in a satisfactory manner".

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[1] Affordable No More: New York City's Looming Crisis in Mitchell-Lama and Limited Dividend Housing; Office of the Comptroller, February 18, 2004; and, Affordable No More: An Update; Office the New York City Comptroller, May 25, 2006.

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We also appreciate your more detailed observations and administrative recommendations. As these programs have grown in scope and volume over the years, our administration efforts have evolved as well to ensure that HDC is preserving these Mitchell Lama developments in the most efficient and cost-effective ways possible. Some of the report's observations from the earliest of the projects served by these programs may therefore have already been resolved with respect to newer projects. HDC developed the Mitchell Lama Restructuring Program to more fully address the financial and physical needs of these aging developments. This program refinances all existing debt, provides funds for repairs and where applicable removes FHA Insurance restrictions and brings these properties fully under HPD's supervision.

Other recommendations were helpful to us as we continuously look at ways of improving our organizational administration of the programs, and as such will be incorporated into our plans accordingly.

Our responses to all the report's findings and recommendations are as follows:

1. Ensure that Repair Loan Funds are only used for new capital repair/improvement work or system modernization as per the program criteria; other uses should be denied.

In April of 2004, HDC's Board of Directors approved the Mitchell Lama Repair Loan Program to address the repair and preservation needs of HDC's aging Mitchell Lama housing portfolio. Under the terms of the Board's approval, the President of the Corporation is authorized to make repair loans subject to HDC Credit Committee approval. HDC's Credit Committee is charged with, among other things, minimizing the Corporation's risk in financial transactions. As stated in your report, all Mitchell Lama Repair Loans were made with Credit Committee Approval. HDC therefore does not agree with your finding that funds were not used in accordance with program criteria.

All but one loan were made to address repair and preservation needs. In that one instance, Crown Gardens in the amount of $252,320, funds were expended to pay water and sewer charges which had accrued due to the project's inability to afford them and which, if left unpaid, would have resulted in (a) loss of services to residents that could have placed their well-being at risk and (b) liens against the property that could have placed HDC's financial asset at risk. This loan was made in 2005 and the Mitchell Lama Repair Loan Program was in its infancy. The Corporation acted diligently and quickly to assist Crown Gardens with a genuine need and did so with the best program tool it had immediately available. In retrospect perhaps a separate program could have been created or the existing program re-titled to the effect of "The Mitchell Lama Repair & Stabilization Program." Ultimately, however, the Corporation chose to act as quickly as possible to assist Crown Gardens with the most appropriate program immediately available. As previously noted, HDC's Mitchell Lama Restructuring Program evolved precisely out of the Corporation's experience with developments like Crown Gardens.

Regarding the larger amounts in question which were used to pay off third party loans (including those from Amalgamated Bank) and accounts payables, HDC maintains that to be a valid – and in fact critical – use of funds under the program's mandate to repair and preserve Mitchell Lama projects. These funds were expended to repay prior higher interest capital improvement loans as well as for repair and non-repair-related payables – which collectively were placing the projects' in financial peril and putting our new, affordable repair loan program out of reach. Reducing that financial burden was crucial if the developments were to be able to take on the additional debt needed to address current and urgently needed capital work, while also reducing HDC's risk. In a very real way, all of these loan proceeds were utilized for purposes which allowed necessary capital work to be done in keeping with the program's underlying intent.

Even if one maintains a more literal approach to the program as described in the report, and continues to identify funds that you deem incompatible with the program's guidelines, we ask that you correct the number cited from $10.27 million to $4.26 million. The other $6.01 million was specifically approved by HDC's Board of Directors and therefore should not be included in your numbers. Specifically, $5,113,646 (Payment of Amalgamated Loan) for North Shore Plaza and $900,000 (Payment of Accounts Payable) for Stevenson Commons were approved by HDC's Board of Director's on June 14, 2005. The memo and minutes of that meeting have been provided to you. To conclude that these amounts were not consistent with the Program's intent when HDC's Board of Directors approved the Mitchell Lama Repair Loan program and explicitly approved the loans and the use of loan proceeds for these two properties does not seem reasonable to HDC.

HDC reiterates our position that all approved loan funds were true to the fundamental intent of the program to preserve the Mitchell Lama portfolio as decent, affordable housing.

2. <u>Develop guidelines as to how estimates should be presented. These guidelines should address soft costs, contingencies, funding sources, and work item breakouts.</u>

We appreciate and agree with this recommendation. Asset Management will include estimated soft costs and contingencies in all credit committee memos going forward.

3. <u>Develop formal procedures for reviewing and approving changes in project work scopes and/or funding.</u>

In all construction lending, there are times when reallocations of funds between scope items are necessary. As work progresses, certain scope items can be discovered to be more (or less) complex and costlier than anticipated. When these situations arise, assigned engineers/project managers confer with Senior Management as needed. HDC engineers are aware of the impact these changes will have on the overall project. The needs of the entire building and the residents are always considered before any changes are approved. Health and safety issues are always paramount. For example, if during the construction phase unanticipated health and safety issues arise, funds from other line items will be reallocated. All material changes are discussed internally and no funds are released unless changes have been approved by the appropriate senior manager. At the same time, we agree with your report's finding that this process needs to be more formally documented, and as such HDC will develop forms to be used by all involved staff for that purpose. HDC estimates to implement this enhancement by May 31, 2013.

4. <u>Ensure that loan closing memos are prepared in a timely manner.</u>

As noted in the audit, the closing memos for two properties which closed in August of 2012 were delayed. The memos for the two specific projects in question, Seaview Towers and Lincoln Amsterdam, have since been completed.

HDC agrees that timely, accurate loan closing memo preparation is important, and we will ensure interdepartmental follow-up between staff project managers and attorneys to minimize such delays going forward.

5. <u>Develop guidelines to explain how to count superintendent occupied units in specific situations.</u>

It is critical that HDC count units both ways: inclusive of superintendent units in terms of calculating construction costs and exclusive of those units in terms of tracking revenue-producing and rent-restricted unit totals. There have been times when current recordkeeping mechanisms have confused this distinction.

We recognize the importance of an accurate unit count and will endeavor to cleanse our data of any such discrepancies. HDC is in the midst of implementing a new loan servicing system. During this process we will be confirming all unit counts, both with and without superintendent units, to ensure proper input into the database. We estimate that the new software will be in service in the Fall of 2013.

6. <u>Ensure that closing dates associated with Repair Loans are correct in HDC's database system.</u>

We will continue to address this in conjunction with ensuring timely closing memo preparation. Since 2012, all closing dates have been automatically transferred into the database from the legal closing memo. Therefore, all future loans will have the correct closing dates. Also, last year an internal review of all closing and maturity dates was undertaken by the Corporation to ensure that the new loan servicing system will have the correct information. As we transition to the new system, we will again take that as an opportunity to review and cleanse the existing data.

In closing, we appreciate the opportunity to provide our comments to the Audit Report. We believe that many of the Auditors' recommendations have already been adopted and implemented, or are in the process of being incorporated into our administration activities. The other recommendations as noted above are appreciated and will be implemented in conjunction with our ongoing initiatives to maximize the efficiency of our administrative controls while still allowing for the flexibility needed to assist and preserve these aging projects in the timely manner that is required.

We thank your staff for their time and effort during the audit.

Sincerely,

Marc Jahr

cc: Joan Tally, Executive Vice President for Real Estate, HDC
Richard Froehlich, Chief Operating Officer, HDC
Terry Gigliello, Senior Vice President, Asset Management, HDC
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