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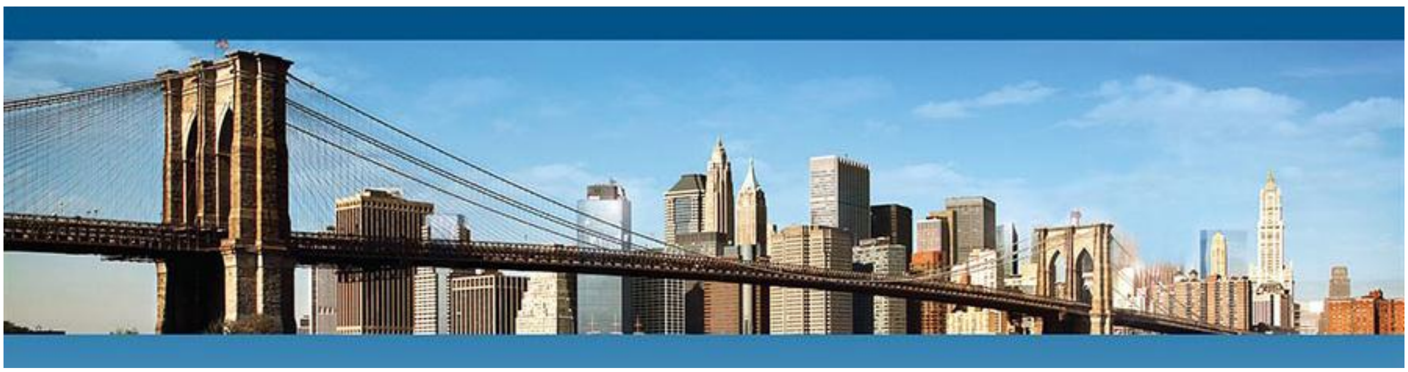

FINANCIAL AUDIT

Marjorie Landa

Deputy Comptroller for Audit

Audit Report on Efforts by the New York City Housing Authority to Maximize Federal Funding, Enhance Revenue, and Achieve Cost Savings

FK14-072A

December 16, 2014

http://comptroller.nyc.gov

THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
1 CENTRE STREET
NEW YORK, NY 10007

SCOTT M. STRINGER
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December 16, 2014

To the Residents of the City of New York:

My office has audited the New York City Housing Authority (NYCHA) to assess its major efforts to obtain federal funding and achieve cost savings and revenue enhancements. We audit entities such as NYCHA to ensure that they effectively manage assets entrusted them and do so in accordance with applicable rules and regulations.

The audit found that NYCHA failed to meet its goals to obtain much-needed funding and implement cost savings and revenue enhancement initiatives. As a result, it repeatedly failed to achieve the revenue projections and cost savings it presented to the public, the City, and the U.S. Department of Housing and Urban Development (HUD). NYCHA's failure to meet its funding and savings goals and the consequent inaccuracies in its budget estimates have hindered its ability to operate as well as to effectively budget and plan for its operations.

In total, we estimate that as a result of failing to effectively implement initiatives to which it had committed, NYCHA has forgone incentives and subsidies totaling $692 million. Additionally, NYCHA did not document and track whether joint NYCHA/Boston Consulting Group (BCG)-identified cost savings and revenues of $106 million were realized. Therefore, we could not assess the extent to which, if at all, any of the BCG report recommendations were implemented or the extent to which there were any resulting cost savings and revenues.

The audit recommends that NYCHA adequately plan for and consistently follow through on revenue and cost saving initiatives to ensure that estimated financial benefits are obtained, consult with HUD on applications for federal funds prior to submission and respond to HUD feedback, conduct rigorous independent reviews of federal funding applications prior to submission to HUD to ensure compliance with relevant rules and regulations, and reassess and document the extent to which all BCG report recommendations were implemented by examining the steps taken, calculating the costs incurred to date, calculating the cost savings and revenues achieved to date, and comparing anticipated and actual net cost savings and revenues achieved to date.

The results of the audit have been discussed with NYCHA 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,

Scott M. Stringer

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OFFICE OF THE COMPTROLLER
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Audit Report on Efforts by the New York City Housing Authority To Maximize Federal Funding, Enhance Revenue, and Achieve Cost Savings

FK14-072A

EXECUTIVE SUMMARY

The New York City Housing Authority (NYCHA) has provided housing for low and moderate income New York City residents since it was chartered in 1934. Currently, there are more than 400,000 residents in 334 public housing developments in all five boroughs. NYCHA also administers the Section 8 Housing Choice Voucher Program (Section 8) to provide subsidized rental assistance to 235,000 residents.

NYCHA's operations are governed by Title 24 of the Code of Federal Regulations and overseen by the United States Department of Housing and Urban Development (HUD). In addition, New York State and New York City law, regulations, and funding decisions govern aspects of NYCHA's operations as well.

In its 2013 CAFR, NYCHA reported total revenues of $3.1 billion, comprised primarily of $1 billion in federal Section 8 subsidy, $920 million in tenant revenue, and $830 million in federal public housing operating subsidy. NYCHA also reported the receipt of $419 million in federal public housing capital funds. However, since at least 2002, NYCHA's funding has not been sufficient to cover either its operating or its capital needs.

In an effort to ensure its long term fiscal stability and preserve public housing, NYCHA developed "The Plan to Preserve Public Housing" (PPPH) in 2006 and updated that initiative with "PLAN NYCHA: A Roadmap for Preservation" (Plan NYCHA), issued in December 2011. Each of these plans set forth what NYCHA considered to be critical initiatives that it contended would result in cost savings, revenue enhancements and improved performance. In connection with Plan NYCHA, NYCHA contracted with the Boston Consulting Group (BCG) to work with NYCHA to develop specific plans to improve the efficiency and effectiveness of NYCHA central support functions and redirect resulting savings to aid property management.

This audit is the first of a series of audits of NYCHA that has been undertaken by the Office of the New York City Comptroller to examine NYCHA's financial and operating practices in light of the long term persistent decline of operating and capital funding. The focus of this first audit is on NYCHA's efforts to maximize its revenue and cost savings in the face of the reduction in government funding. Based largely on the areas identified by NYCHA as key components of its revenue enhancement and savings plans, we looked at the following initiatives:

- NYCHA's efforts to obtain additional federal capital funding and decrease its utility expenses through Energy Performance Contracting (EPC) Plans. EPC is a HUD incentive that allows Public Housing Authorities (PHAs) to use energy/utility cost savings from reduced energy consumption to repay the cost of installing energy conservation measures (ECMs).
- NYCHA's efforts to obtain federal Section 8 funding for up to 8,400 units in 21 developments constructed but no longer funded by the State and the City. Pursuant to the Quality Housing and Work Responsibility Act of 1998, PHAs are allowed to enter into Voluntary Conversion Plans that, with tenant agreement, allow them to convert entire developments or individual units within developments from public housing to Section 8 funding.
- NYCHA's efforts to minimize its operating subsidy losses resulting from a November 2005 change in the operating subsidy formula. When HUD changed the federal operating subsidy formula, some PHAs would thereafter receive a larger operating subsidy and others would receive less. For those PHAs that would receive lower operating subsidies under the new formula, HUD offered a "stop-loss" provision to those that successfully demonstrated conversion to an asset management model and implemented project-based management, budgeting, and accounting systems. The more quickly PHAs converted, the more their losses would be limited.
- NYCHA's efforts to track and document whether BCG recommendations were implemented and whether and to what extent cost savings and revenue enhancements were realized.

Audit Findings and Conclusions

The audit found that NYCHA failed to meet its goals to obtain much needed funding and implement cost savings and revenue enhancement initiatives. As a result, it repeatedly failed to achieve the revenue projections and cost savings it presented to the public, the City, and HUD. NYCHA's failures to meet its funding and savings goals and the consequent inaccuracies in its budget estimates have hindered its ability to operate as well as to effectively budget and plan for its operations.

In total, we estimate that as a result of failing to effectively implement initiatives to which it had committed, NYCHA has forgone incentives and subsidies totaling $692 million (EPC funding of $353 million, Section 8 funding of $263.1 million, and operating subsidy of $75.9 million).

Additionally, NYCHA did not document and track whether joint NYCHA/BCG-identified cost savings and revenues of $106 million were realized. Therefore, we could not assess the extent to which, if at all, any of the BCG report recommendations were implemented or the extent to which there were any resulting cost savings and revenues.

Audit Recommendations

To address these issues, we make the following twelve recommendations:

- NYCHA should ensure adequate and transparent disclosure of budget estimates and forecasts supported by appropriate substantiated data.
- NYCHA should adequately plan for and consistently follow through on revenue and cost saving initiatives to ensure that estimated financial benefits are obtained.
- NYCHA should consider employing ESCOs to develop EPC plans appropriately scaled to NYCHA's utility costs and unmet capital needs.
- NYCHA should take steps to reduce the risk of self-managed plans including but not limited to insuring EPC plans, increasing EPC plan margins, and implementing EPC plans with shorter payback periods.
- NYCHA should immediately conduct and sustain both broad and targeted outreach efforts to engage and educate residents and market the Voluntary Conversion Plan including but not limited to periodically distributing flyers, sending direct mailings, calling and emailing residents, and conducting periodic public meetings with residents, Resident Associations, the Citywide Council of Presidents, the Resident Advisory Board, and housing advocacy groups.
- NYCHA should consult with HUD on developing a revised marketing and administrative plan to fully implement its Voluntary Conversion Plan.
- NYCHA should consult with HUD on applications for federal funds prior to submission and respond to HUD feedback.
- NYCHA should conduct rigorous independent reviews of federal funding applications prior to submission to HUD to ensure compliance with relevant rules and regulations.
- NYCHA should reassess and document the extent to which all BCG report recommendations were implemented by examining the steps taken, calculating the costs incurred to date, calculating the cost savings and revenues achieved to date, and comparing anticipated and actual net cost savings and revenues achieved to date.
- NYCHA should develop an appropriate Enterprise Program Management Office (or a comparable cross-departmental, independent unit) staffing structure, maintain authorized staffing levels, and track staff turnover to ensure implementation and tracking of the BCG report recommendations.
- For those recommendations for which anticipated cost savings and revenues were not achieved, NYCHA should assign project ownership to an Enterprise Program Management Office (or a comparable cross-departmental, independent unit) staff and generate weekly status reports until such time as recommendations are implemented and financial benefits are fully realized.
- NYCHA should generate status reports that include but are not limited to implementation status, issues, costs, and anticipated and actual cost savings and revenues.

NYCHA Response

In its response, NYCHA maintained that the Comptroller's audit report was "seriously flawed." First, NYCHA objected that much of the audit report concerned NYCHA's decisions and activities that it asserted took place prior to the audit scope period. Second, NYCHA stated that the audit report exaggerated or mischaracterized revenue and cost savings opportunities that NYCHA failed to maximize. Third, NYCHA stated that the audit report did not acknowledge substantial revenue opportunities that NYCHA took advantage of including $900 million from a mixed-finance transaction in connection with the American Recovery and Reinvestment Act (ARRA), $732 million in bond proceeds, and $303.5 million in transition (or "stop-loss") funding. Finally, with regard to NYCHA's failure to document and track how much, if any, of the joint NYCHA/BCG-identified cost savings and revenues of $106 million have been realized, NYCHA stated that it "did not consider it a priority to track those outcomes for the purpose of justifying the BCG study."

Upon careful consideration, we find NYCHA's objections to the audit report unfounded. First, NYCHA's objection that we have exceeded the audit scope fails to take into account that Generally Accepted Government Auditing Standards (GAGAS) permit audits to consider relevant information outside the audit scope period where necessary and to expand the audit scope beyond the initial stated scope periods where issues identified during the audit process present a need to do so. That is what was done in the case of this audit. Second, rather than exaggerating or mischaracterizing the lost revenue and cost savings opportunities identified, all revenue and cost savings figures in the audit report were based on NYCHA's own data and assumptions. Third, the report does, in fact, acknowledge revenues to the extent they were achieved. However, the focus of the audit report is on those revenue enhancements and cost savings that NYCHA itself identified in its planning documents as central to its efforts to ensure its long term fiscal stability and preserve public housing but that it failed to realize.

Lastly, NYCHA did not effectively track BCG report recommendation implementation status or resulting cost savings and revenues. Given NYCHA's extreme financial condition, the chronic problems it has faced trying to manage an increasingly aged and scarce housing stock and as a steward of public funds, NYCHA had a responsibility to do both. Only by tracking implementation of the BCG recommendations and assessing their effectiveness can NYCHA ensure that the ultimate goal of the BCG report is achieved—i.e., that funds are made available to redirect to property management and that they are so redirected to make much needed repairs.

Notwithstanding its objections, NYCHA thanked "the Comptroller's Office for its efforts and for several useful recommendations." Of the report's twelve recommendations, NYCHA agreed to implement one recommendation going forward, maintained that it had in the past and will continue to adhere to seven recommendations, and disagreed with four recommendations related to the BCG report.

NYCHA's responses and our rebuttals are discussed in greater detail in this report.

AUDIT REPORT

Background

NYCHA has provided housing for low and moderate income New York City residents since it was chartered in 1934 under the New York State Public Housing Law as a public benefit corporation, three years before the enactment of a national federal housing program. Pursuant to its charter and its status as a federal PHA, NYCHA develops, constructs, and manages affordable housing. Currently there are more than 400,000 residents in 334 public housing developments composed of 179,054 residential units in all five boroughs. NYCHA also administers Section 8 to provide subsidized rental assistance to 235,000 residents. Public housing now accounts for more than half of all the apartments in the City renting for $600 or less.[1]

NYCHA's operations are largely governed by the federal housing law and accompanying regulations at Title 24 of the Code of Federal Regulations and overseen by HUD. However, New York State and New York City law, regulations, and funding decisions impact NYCHA's operations as well. To comply with various governmental and operational reporting requirements, each year NYCHA issues a Comprehensive Annual Financial Report (CAFR) which includes management's discussion and analysis of NYCHA's financial performance, statistical data, and independently audited financial statements. In addition, NYCHA annually produces a PHA Agency Annual Plan which details major initiatives for the coming year and is developed in consultation with public housing and Section 8 residents, elected officials, and the public. NYCHA also annually produces Five Year Operating and Capital Plans which detail its financial plan, accomplishments, and budget. The Five Year Operating and Capital Plans are adopted by NYCHA's Board and are used for, among other things, NYCHA's annual budget reporting to the New York City Council.

NYCHA receives funds from multiple sources. In its 2013 CAFR, NYCHA reported total revenues of $3.1 billion, comprised primarily of $1 billion in federal Section 8 subsidy, $920 million in tenant revenue, and $830 million in federal public housing formula-based operating subsidy. Additionally, NYCHA reported receipt of $419 million in federal public housing capital funds.

Since at least 2002, NYCHA's funding has largely been insufficient to cover either its operating or its capital needs according to NYCHA's CAFRs. From 2002 to 2004, NYCHA received between 100 percent and 95 percent of its federal operating subsidy. However, from 2005 to 2009, federal operating subsidies were prorated to as low as 83 percent, resulting in a cumulative funding loss of over $500 million during this period. Federal operating subsidies increased once again, with NYCHA receiving as much at 103 percent of its federal operating subsidy in 2010. However, proration continued in subsequent years with NYCHA receiving only 88.8 percent of its federal operating subsidy in 2014.

During the past 12 years, NYCHA has consistently reported operating deficits. This has led to the repeated use of federal capital funds to cover annual operating deficits and correspondingly fewer dollars for capital repairs and other expenditures vital to maintenance of NYCHA's aging housing stock. During this general time frame, capital funding also declined. In its Operating

[1] This information was derived from the New York City Housing and Vacancy Survey microdata and cited in an Office of the New York City Bureau of Fiscal and Budget Studies report entitled "THE GROWING GAP: New York City's Housing Affordability Challenge" issued April 2014.

and Capital Plans Calendar Years 2014-2018, NYCHA reported that it received an annual federal capital grant of $420 million in 2001. Following persistent and steady declines, NYCHA's annual federal capital grant dropped to $259 million in 2013, which created a cumulative capital funding loss of over $1 billion during that twelve-year period.

In its Operating and Capital Plans Calendar Years 2014-2018, NYCHA reported that it has immediate unmet capital needs of more than $6 billion. Further, in testimony before the New York City Council, NYCHA Chair Shola Olatoye reported that NYCHA would need a total of approximately $18 billion dollars to bring all of the NYCHA developments into good repair. Based on NYCHA's reported information, significant factors that have contributed to the persistent operating deficits and unmet capital needs include:

Operating Deficits

- Between 2001 and 2013, HUD has repeatedly reduced the operating subsidies for all PHAs, including NYCHA, based on a prorated formula[2] which has, according to NYCHA's Operating and Capital Plans Calendar Years 2014-2018, resulted in a cumulative operating subsidy loss of more than $937 million.
- Effective November 2005, HUD changed the federal operating subsidy formula applicable to all PHAs. Under the new formula, HUD calculated that it would reduce NYCHA's annual operating subsidy by as much as $60.8 million each year. However, HUD created incentives for PHAs that converted to a prescribed system of asset management and project-based management, budgeting, and accounting that would decrease the percentage of their operating subsidy losses. Moreover, the sooner NYCHA made this conversion, the smaller the decrease in HUD's annual operating subsidy would be.
- Starting in 1998, New York State ceased to provide operating funds for 15 developments that had been constructed with State funds and historically maintained by New York State. NYCHA estimated that this led to an annual $60 million shortfall. In 2003, the City also stopped providing operating funds for 6 City-funded developments which NYCHA estimated led to an additional annual $30 million operating shortfall. In 1995, NYCHA sought and obtained HUD's approval to amend NYCHA's Annual Contributions Contract so that the 21 developments had federal public housing status, which allowed NYCHA to share existing federal funding with these 21 developments, but did not provide it with additional federal operating subsidies for them. However, in 2010, NYCHA was able to capitalize on an ARRA (American Recovery and Reinvestment Act of 2009) provision to obtain funding for these 21 developments. NYCHA received ARRA funds for capital repairs and leveraged additional public and private funding. NYCHA also obtained annual operating and capital subsidies for 11,743 of the 20,170 units in the 21 developments. This amounts to additional federal operating subsidies of approximately $65 million each year and represents a significant gain for NYCHA as it works to close its substantial operating deficits.

Unmet Capital Needs

- Due to reduced prorated federal payments of capital funds, NYCHA reported in its Operating and Capital Plans Calendar Years 2014-2018 that its annual federal capital

[2] NYCHA submits to HUD funding requests for the full amount of operating and capital funds that it is entitled to receive under statutory formulas. After receiving submissions from all PHAs, HUD prorates each allocation in accordance with actual appropriations.

grants have declined by $162 million from 2001 to 2013, resulting in a cumulative federal capital grant funding loss of $1.037 billion since 2001.

- According to NYCHA's Operating and Capital Plans Calendar Years 2014-2018, approximately 75 percent of its 2,596 residential buildings are more than 40 years old. The age of NYCHA's housing stock leads to inevitable deterioration and need for structural repairs and upgrades to its brickwork, roofs, elevators, building systems including heating and plumbing systems, and apartments.
- Over the years, NYCHA has used substantial amounts of its capital funds to cover its operating losses. This necessarily hindered NYCHA's ability to make capital improvements which only exacerbated further physical deterioration of the aging NYCHA housing stock.

Increased Operating Expenses

- NYCHA's annual operating expenses have increased by $1.1 billion or 43 percent from $2.5 billion in 2002 to $3.6 billion in 2013. This includes significant increases in NYCHA's utility expenses, including electricity, water, heating and cooking gas, oil, and steam costs. Specifically, NYCHA reported a 104 percent increase in utility expenses from $289 million in 2002 to $590 million in 2013.

In an effort to ensure its long term fiscal stability and preserve public housing, NYCHA developed its PPPH in 2006 and updated that initiative with Plan NYCHA, issued in December 2011. Each of these plans set forth what NYCHA considered to be critical initiatives that it contended would result in cost savings and revenue enhancements and improved performance. In furtherance of the Plan NYCHA initiative to strengthen NYCHA's frontline operations, NYCHA contracted with BCG to work with NYCHA to develop specific plans to improve the efficiency and effectiveness of NYCHA central support functions and redirect resulting savings to aid property management. In August 2012, BCG issued a report detailing more than 100 recommendations which, if implemented, BCG and NYCHA asserted would result in annual cost savings of $71 million and annual efficiencies and revenue enhancements of $56 million by 2016.

Audit Focus

This audit is the first of a series of audits of NYCHA that has been undertaken by the Office of the New York City Comptroller to examine NYCHA's financial and operating practices in light of the long-term persistent decline of operating and capital funding. This audit focuses on NYCHA's efforts to maximize its revenue and cost savings in the face of the reduction in government funding. Based largely on the areas identified by NYCHA as key components of its revenue enhancement and savings plans, we looked at the following initiatives:

- <u>NYCHA's efforts to obtain HUD energy incentives and decrease its utility expenses</u>. We specifically examined NYCHA's EPC Plans. EPC is a HUD incentive that allows PHAs to use energy/utility cost savings from reduced energy consumption to repay the cost of installing energy conservation measures (ECMs).[3] A principal financial benefit from

[3] According to Public and Indian Housing Notice 2011-36: Guidance on Energy Performance Contracts, "ECMs may include, but are not limited to, the following: Energy and water-efficiency improvements; Mechanical, electrical, and plumbing upgrades (boilers, furnaces, etc.); Thermostatic controls, including programmable thermostats; Improvements to building envelope design and condition (air sealing, insulation, roof replacement, windows, storm doors, vent dampers, etc.); Lighting and lighting controls; Fuel conversions; On-site utility/energy distribution systems; Moisture-sensing irrigation systems and controls; and, On-site renewable energy and high-efficiency technologies (solar panels, wind turbines, geothermal systems, cogeneration, etc.)."

implementing HUD's EPC incentives is that utility savings may be used in place of capital funds to finance energy improvements. HUD's incentives offer PHAs the option to direct their capital funds to more emergent and long-term modernization efforts. EPCs are governed by federal rules and regulations and must specifically be approved by HUD.

- NYCHA's efforts to obtain federal Section 8 funding for up to 8,400 of the 20,170 units in the 21 former State and City developments. Pursuant to the Quality Housing and Work Responsibility Act of 1998, PHAs are allowed to enter into Voluntary Conversion Plans that, with tenant agreement, allow them to convert entire developments or individual units within developments from public housing to Section 8 funding. In October 2006, NYCHA submitted to HUD a formal application to within two years convert 8,400 units (4,700 units in 2007 and 3,700 units in 2008) that were not supported by annual operating subsidy. Subsequently, HUD approved plans for NYCHA to convert a total of 8,400 units over three year periods ending on January 8, 2011,[4] and May 22, 2011.[5] However, as of October 2014, 5,002 units have yet to be converted and remain unfunded.

- NYCHA's efforts to minimize its operating subsidy losses resulting from the change in the operating subsidy formula by converting to an asset management model. When in November 2005, HUD changed the federal operating subsidy formula applicable to all PHAs, some PHAs would thereafter receive a larger operating subsidy and others would receive less. For those PHAs that would receive lower operating subsidies under the new formula, HUD offered a "stop-loss" provision to those that successfully demonstrated conversion to an asset management model and implemented project-based management,[6] budgeting,[7] and accounting[8] systems. Specifically, HUD offered to limit operating subsidy losses by a sliding-scale percentage of the difference between subsidy received under the old and new funding formulas. The percentages ranged from 5 to 81 percent depending upon the year in which PHAs converted to the asset management model. The more quickly PHAs converted, the more their losses would be limited. The phase-in period was five years.

- NYCHA's efforts to track and document whether the initiatives it determined with BCG would result in costs savings and revenue enhancements were implemented and whether and to what extent the cost savings and revenue enhancements were realized. In its August 2012 report, BCG identified the implementation and sustained operation of an Enterprise Program Management Office as critical to ensuring that the more than 100 recommendations contained in the report would be implemented and $127 million in estimated annual financial benefits would be realized. According to the BCG report, the

[4] HUD approved conversion of 447 units at one of the 21 developments between January 9, 2008 and January 8, 2011.

[5] HUD approved conversion of 7,953 units at the remaining 20 developments between May 23, 2008 and May 22, 2011.

[6] Project-based management requires property management services to be arranged or provided in the best interest of the project, considering such factors as needs, cost, and responsiveness, relative to local market standards. According to Title 24, Section 990.265, an asset management project is a public housing building or set of buildings grouped for management purposes.

[7] Project-based budgeting requires PHAs, or their management agents, to produce monthly operating statements for each project that contain the revenues and expenses of each project compared against budgeted levels, including all fees and charges from the central office cost center. The operating statements must reasonably represent the financial performance of each project.

[8] Project-based accounting requires PHAs to track financial performance at the project level so they have the necessary information to make effective decisions at the project level.

Enterprise Program Management Office should report directly to the General Manager and work closely with the senior management team, help identify interdependencies between projects and departments, manage cross-department collaboration, support stakeholder engagement, track progress on a weekly basis across all initiatives, and measure enterprise-wide performance.

Objective

The objective of this audit was to assess the effectiveness of major NYCHA efforts to obtain federal funding, and to achieve cost savings and revenue enhancements.

Scope and Methodology Statement

We conducted this performance audit in accordance with GAGAS. 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.

The scope of this audit covers the period from January 1, 2012, to December 31, 2013, which reflects the most recent NYCHA financial statements available to us at the initiation of audit fieldwork. Our scope expanded to include additional timeframes as needed to adequately address specific issues within the original scope period noted. 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 NYCHA officials during and at the conclusion of this audit. A preliminary draft report was sent to NYCHA and was discussed at an exit conference on November 10, 2014. On November 17, 2014, we submitted a draft report to NYCHA with a request for comments. We received a written response from NYCHA on December 3, 2014.

In its response, NYCHA objected that while the report scope period was January 1, 2012 to December 31, 2013, much of the report pertained to decisions and activities prior to 2012. However, NYCHA's objection reflects a misunderstanding of GAGAS which permits audits to consider relevant information outside the audit scope period where necessary and to expand the audit scope beyond the initial stated scope periods where issues identified during the audit process present a need to do so. That is exactly what was done here.

In addition, NYCHA objected to the audit report, claiming that it exaggerated or mischaracterized revenue and cost savings opportunities that NYCHA did not maximize. NYCHA asserted that the finding that "NYCHA '*could have*' but '*failed*' to obtain EPC incentives of $353 million – is based on an erroneous and misleading assumption that such magnitude of savings could have been achieved without the HUD program rule waivers and flexibility that NYCHA consistently requested." However, in making this objection, NYCHA does not take into account that all of the revenue and cost savings figures in the report are based on data and assumptions reported by NYCHA, none of which NYCHA amended or withdrew, including in the exit conference where the preliminary audit findings were discussed or in its formal response to the audit annexed hereto. Moreover, NYCHA objects to the audit report's analysis of NYCHA's failure to obtain HUD approval for an EPC incentive plan that would have resulted in an additional $353 million from NYCHA on the basis that such incentives were not achievable without the waivers it requested that were denied. However, according to HUD, NYCHA-requested waivers were unnecessary and potentially detrimental to NYCHA. Rather than request waivers, HUD recommended that NYCHA use an ESCO (Energy Services Company) so that a viable and compliant EPC could be designed more quickly and easily. NYCHA's assertion is further belied by the fact that PHAs that are significantly smaller than NYCHA successfully implemented proportionate multi-phase plans of up to $74.6 million.

NYCHA additionally criticized the audit report for failing to recognize substantial revenue opportunities that NYCHA did take advantage of and cited the $900 million it obtained from a mixed-finance transaction in connection with ARRA, $732 million it has received in bond proceeds, and $303.5 million in transition (or "stop-loss") funding. However, the audit report does in fact recognize NYCHA's success in obtaining ARRA funding. As noted in this audit report, in 2010, "NYCHA received ARRA funds for capital repairs and leveraged additional public and private funding. NYCHA also obtained annual operating and capital subsidies for 11,743 of the 20,170 units in the 21 [formerly New York State and New York City] developments. This amounts to additional federal operating subsidies of approximately $65 million each year and represents a significant gain for NYCHA as it works to close its substantial operating deficits." The report also recognized that "NYCHA obtained HUD's approval for its Year 2 Stop Loss Package" but appropriately noted that the difference between Year 1 and Year 2 approval resulted in "less transition funding for NYCHA from 2008 in perpetuity or until such time as a new formula is developed and implemented." NYCHA's citation to Bond B proceeds as revenue is misplaced, however. In fact, the Series 2013 A, B-1, and B-2 Bond proceeds do not constitute revenues. Rather, the Series 2013 A, B-1, and B-2 Bonds represent additional long-term debt and annual debt service costs. According to NYCHA's 2013 CAFR, NYCHA must use a portion of its annual public housing capital funds through 2033 to pay off this debt. As of December 31, 2013, total remaining principal and interest on the combined Series 2013 A, B-1, and B-2 debt are $656.1 million and $350.7 million, respectively, with annual debt service ranging from $16.1 million in 2014 to $36.9 million in the final year.

Finally, NYCHA rejected the concerns and recommendations set forth in the audit report stemming from its failure to document or track whether the projected joint NYCHA/BCG-identified cost savings and revenues of $106 million have been realized. NYCHA stated that it "did not consider it a priority to track [the joint NYCHA/BCG report] outcomes for the purpose of justifying the BCG study. Instead, after evaluating BCG's recommendations, NYCHA's focus was on the implementation." However, NYCHA misapprehends the purpose of the audit report's recommendations related to the NYCHA/BCG implementation. Rather than simply seeking a justification for spending $10 million on the production of the report, prudent management requires NYCHA to track the savings and revenue achieved through implementation of the joint NYCHA/BCG initiatives in order to determine if specific programs and other measures should be continued and replicated where effective or modified and/or terminated where not. This way, NYCHA will be better able to ensure that the ultimate goal of the report was achieved—i.e., that funds were available to redirect to property management and make much needed repairs. As a secondary benefit, NYCHA will also be able to assess the costs and benefits of implementing recommendations and determine the value of the report so that NYCHA can make an informed evaluation of BCG's contract performance. We also question the effectiveness of implementation tracking that NYCHA claims it is engaged in since it took NYCHA fully five months to create a comprehensive implementation status report that was requested at the outset of the audit.

Notwithstanding its objections, NYCHA thanked “the Comptroller’s Office for its efforts and for several useful recommendations.” Of the report’s twelve recommendations, NYCHA agreed to implement one recommendation going forward, maintained that it had in the past and will continue to adhere to seven recommendations, and disagreed with four recommendations related to the BCG report. Although NYCHA indicated that it had in the past and will continue to adhere to seven recommendations, NYCHA’s assertions are inconsistent with its past actions and the substance of its response. In light of NYCHA’s present fiscal condition and persistent decreases in operating and capital funds, NYCHA cannot afford to merely pay lip service to the report’s recommendations.

The full text of NYCHA response is included as an addendum to this report.

FINDINGS

The audit found that NYCHA failed to meet its goals to obtain much needed funding and implement cost savings and revenue enhancement initiatives. As a result, it repeatedly failed to achieve the revenue projections and cost savings it presented to the public, the City, and HUD. NYCHA's failure to meet its funding and savings goals and the consequent inaccuracies in its budget estimates have hindered its ability to operate as well as to effectively budget and plan for its operations.

In total, we estimate that as a result of failing to effectively implement initiatives to which it had committed, NYCHA has forgone incentives and subsidies totaling $692 million.

- *EPC Funding of $353 Million*: NYCHA failed to obtain HUD's approval for a $371 million EPC plan with a 20-year payback period that provided for the installation of instantaneous hot water heaters and lighting upgrades in developments throughout the entire City, and the replacement of certain central heating plants operating well beyond their useful life. NYCHA failed to obtain approval for this plan because it did not comply with HUD regulations and HUD concluded that it could not be assured that the resulting cost savings would cover project costs. Subsequently, NYCHA submitted an $18 million EPC plan with a 13-year payback period. However, it provided for substantially fewer upgrades and replacements and is not reflective of the size of NYCHA's operations, utility costs, and unmet capital needs.
- *Section 8 Funding of $263.1 Million*: NYCHA failed to ensure the timely completion of its Voluntary Conversion Plan to the federal Section 8 program of 8,400 units of public housing that do not receive federal operating funds because it was developed by the City or State. Among other reasons for this was NYCHA's failure to actively engage residents and market its conversion plan. Consequently, more than 5,000 units remain unconverted and unfunded. For the period June 2011 to October 2014, NYCHA therefore did not obtain Section 8 funding totaling $263.1 million. Additionally, at its current rate of conversion, we estimate that NYCHA may lose additional Section 8 funding of $713.4 million for the period November 2014 to November 2033.
- *Transition Funding of $75.9 Million*: NYCHA did not successfully convert to the asset management model until Year 2, resulting in less transition funding for NYCHA from 2008 in perpetuity or until such time as a new formula is developed and implemented. By December 2014, this will amount to a cumulative loss of $75.9 million.

Additionally, NYCHA did not document and track whether joint NYCHA/BCG-identified cost savings and revenues of $106 million were realized. Therefore, we could not assess the extent to which, if at all, any of the BCG report recommendations were implemented or the extent to which there were any resulting cost savings. Significantly, NYCHA failed to effectively implement and operate a project management office, a critical tool designed to ensure that the recommendations would be implemented.

These matters are discussed in detail in the following sections of this report.

NYCHA Did Not Obtain Energy Incentives of $353 Million

NYCHA was unable to obtain HUD's final approval for Phase I of a multi-phase EPC Plan estimated to save $1 billion in energy-related costs. NYCHA's inability to meet its goals and projections resulted from its failure to comply with HUD regulations. Had NYCHA been successful, NYCHA would have been able to finance its ECMs with the resulting cost savings. This would have had the effect of freeing up existing capital funds for other projects that would help address NYCHA's estimated $6 billion in immediate unmet capital needs.

In October 2007, NYCHA introduced Phase I of its EPC plan to HUD and sought its conceptual approval. The plan provided for the implementation of four ECMs with 20-year payback periods. NYCHA proposed to replace domestic hot water tanks with instantaneous hot water heaters and upgrade both apartment and common area lighting citywide. NYCHA also proposed the total demolition and replacement of certain central heating plants operating beyond their useful life. Subsequently, NYCHA submitted to HUD its *preliminary* EPC plan in April 2008 in the amount of $406.4 million and obtained HUD's approval in October 2008.

However, NYCHA was never able to obtain final HUD approval for NYCHA's EPC plan. In September 2009, NYCHA submitted a final EPC plan to HUD in the amount of $371 million. Subsequently, it submitted a revised final plan for $291 million in May 2010, and a further revised final plan for $253 million in November 2010.

We requested from both NYCHA and HUD correspondence and documentation related to NYCHA's EPC plan. However, the following key items regarding NYCHA's final EPC plans were not available:

- HUD comments and recommendations provided to NYCHA on August 8, 2008, to facilitate planning and rollout of the various project phases and NYCHA responses provided to HUD on August 22, 2008;
- Documentation of discussion between NYCHA and HUD at a meeting held on February 5, 2010 regarding NYCHA's initial final plan submission and the "Overview of the NYCHA EPC Contract" that HUD provided to NYCHA at this meeting; and
- Documentation of in-depth discussions between NYCHA and HUD at several meetings held in October 2010. These meetings were attended by representatives from HUD Headquarters, HUD Office of Field Operations Energy Center, HUD New York City Field Office, NYCHA, and a NYCHA consultant.

However, available correspondence, documentation, and discussions held by the audit team with both NYCHA and HUD establish that NYCHA was not able to obtain HUD's approval for NYCHA's final EPC plan because NYCHA did not comply with certain HUD regulations and because NYCHA did not reduce plan risk to a level acceptable to HUD.

Among other program mandates, federal regulations require PHAs developing EPCs to choose from different energy incentives set out in the regulations. For example, PHAs may choose to use the Add-on Subsidy incentive which provides additional subsidy to cover EPC debt service and other related direct costs. Alternatively, PHAs may choose to use the Frozen Rolling Base incentive which allows PHAs to retain the savings from the decreased energy consumption for the term of the contract. However, in its proposed final EPC plan, NYCHA incorporated the benefits of <u>both</u> the Add-on Subsidy and the Frozen Rolling Base incentives, which is not allowed by the regulations. According to HUD, while it considered granting a waiver to NYCHA to allow the dual incentives, it ultimately decided not to because it deemed NYCHA's plan too risky.

Additionally, NYCHA's plan was based on estimated costs and not firm costs as required by HUD. Specifically, the HUD Field Office Review Procedure—Energy Performance Contracting states:

> A preliminary energy project plan must be submitted to the HUD field office for review, and approval must be gained in writing. After a detailed engineering study is completed, the housing authority will submit its detailed project plan for field office review and approval. The study will be based on actual quotes for construction, finance, maintenance, and other costs.

NYCHA also failed to take measures to reduce the risk that the actual cost savings achieved by its plan would not in fact be sufficient to pay for ECMs to a level acceptable to HUD. The requirement that such measures be taken is set forth in HUD Public and Indian Housing (PIH) Notice 2008-22 (HA) which states:

> Paramount to all EPCs for HUD approval, regardless of the selected incentive, is that the PHA must demonstrate that it is reasonable to assume that savings generated through an energy performance contract will pay for the energy conservation measures and related project costs. . . .A critical aspect for a 20-year term over a 12-year term will be the need for savings to persist over the entire term of the energy project.

HUD informed us that it could not approve NYCHA's final EPC plan because the multiple risk factors it contained were not sufficiently mitigated. First, NYCHA's plan was self-managed rather than directed by an Energy Services Company (ESCO). While self-managed plans are permissible under HUD regulations, ESCOs develop, finance, and install projects and effectively assure a certain amount of savings by providing savings guarantees. If the guaranteed savings are not realized, the ESCO is contractually liable to pay for any shortfall. Second, HUD was concerned because, as noted, NYCHA's plan was based on estimated costs and not firm costs determined from a full bid process. Third, NYCHA's plan had only a narrow margin between projected ECM costs and resulting savings. Finally, NYCHA's plan involved multiple projects with long construction periods, making it more difficult to reliably predict project construction and energy costs. Consequently, NYCHA's EPC plan was never implemented. After investing four years and significant resources in development, NYCHA announced in its Annual Plan for Fiscal Year 2013 that "the decision was made to abandon the plan originally developed and restart the process. NYCHA has since developed a smaller EPC plan."

In April 2012, NYCHA submitted to HUD an $18 million EPC plan and subsequently received HUD's approval for this plan. The plan provided for the implementation of five ECMs with 13-year payback periods. NYCHA proposed to upgrade apartment and common area lighting in 17 NYCHA developments, install new boilers and equipment in 6 developments, and replace domestic hot water tanks with instantaneous hot water heaters in 3 developments.

While NYCHA was ultimately able to get approval for its $18 million plan, we note that it is not appropriately scaled to the size of NYCHA's operations, utility costs, and unmet capital needs and was $353 million less than NYCHA's proposed final EPC plan submitted in September 2009. Data maintained by HUD that reports approved EPC plans summarized in the chart below indicates that PHAs that are significantly smaller than NYCHA implemented EPC plans that contain multiple phases and are larger than the approved $18 million plan submitted by NYCHA.

Comparative Analysis of NYCHA and Other Select PHA EPC Plans

A	B	C	D	E	F
PHA Code	**PHA City and State**	**Number of EPC Phases**	**Total Number of PHA Units**	**Total Dollar Amount of EPC Plans**	**Dollar Amount of EPC Plan Per Total PHA Units (E ÷ D)**
IL002	Chicago, IL	5	21,134	$74,575,043	$3,529
OH003	Cleveland, OH	2	10,236	$42,910,000	$4,192
NY002	Buffalo, NY	3	4,213	$34,055,730	$8,083
MN002	Minneapolis, MN	1	6,255	$33,660,000	$5,381
PA001	Pittsburgh, PA	2	4,790	$28,054,978	$5,857
DC001	Washington, DC	1	8,207	$26,024,925	$3,171
NY012	Troy, NY	1	1,260	$18,392,036	$14,597
MA001	Lowell, MA	2	1,698	$18,103,492	$10,662
NY005	New York, NY	1	179,054	$18,045,580	$101

NYCHA Response*:* "[T]hat NYCHA '*could have*' but '*failed*' to obtain EPC incentives of $353 million - is based on an erroneous and misleading assumption that such magnitude of savings could have been achieved without the HUD program rule waivers and flexibility that NYCHA consistently requested during its EPC planning process. To the contrary, the EPC program rules made it nearly impossible for NYCHA to implement a long-term, multi-faceted, large-scale EPC program without the waivers that NYCHA had good reason to believe would be granted by HUD based on numerous discussions and correspondence…."

Auditor Comment: NYCHA's response was directly contradicted by HUD, which created and oversees the EPC incentive program. In a letter from HUD received by NYCHA in August 2011, HUD stated that NYCHA's requested waivers highlighted the high risk in its EPC and were "unnecessary for NYCHA to design a viable EPC…and that some may even be detrimental to NYCHA when considering the alternative policies and procedures that would need to be applied." Rather than request waivers, HUD recommended that NYCHA use an ESCO "so that a viable EPC can be designed more quickly and easily. We believe that with additional technical expertise, NYCHA would be available to develop and implement an EPC that has a reasonable contingency and meets federal regulations."

Finally, NYCHA's assertion that it was not possible for it to do a larger project is belied by the fact that PHAs that are significantly smaller than NYCHA successfully implemented multi-phase plans of up to $74.6 million. Thus, these much smaller PHAs have been able to implement proportionately larger programs than the $18 million program NYCHA was able to ultimately get approved by HUD.

NYCHA Did Not Obtain Section 8 Funding of $263.1 Million to Date

NYCHA has failed to ensure the timely completion of its Voluntary Conversion Plan to the federal Section 8 program of up to 8,400 units of public housing that do not receive federal operating funds because it was developed by the City or State. This is notwithstanding the fact that HUD approved NYCHA's conversion plan, which established that 447 units would be converted to Section 8 between January 9, 2008, and January 8, 2011, and 7,953 units would be converted between May 23, 2008, and May 22, 2011. However, as of October 2014, 5,002 units have not yet been converted to Section 8. Nonetheless, NYCHA continues to include the projected revenues from these conversions in its budget plans.

The Voluntary Conversion Plan is a central part of NYCHA's efforts to obtain funding for the 21 former State and City developments that received no dedicated federal funding and cost as much as $98 million a year to operate. In April 2006, as part of its PPPH, NYCHA announced it was introducing the Section 8 conversions as a new funding stream because "[w]ithout a source of subsidy to fill the gap between the rents collected and the costs of operating the buildings, NYCHA can no longer afford to maintain these non-federal units." Subsequently, HUD approved plans for NYCHA to convert up to 8,400 units over three year periods.

Participation in the plan by residents then residing in the 21 former State and City developments was strictly voluntary and there were both impediments and incentives to conversion. Most notably, residents who chose to convert would have their rent set at the HUD Fair Market Rents and pay rent equal to 30 percent of their adjusted family income. NYCHA anticipated that 71 percent of the tenants then residing in the 21 former State and City developments would see only a minimal rent increase. Additionally, residents who chose to convert might have to "rightsize" and move to smaller units. However, the conversion plan offered residents who converted to Section 8 the opportunity to move anywhere within the United States and gave residents who chose not to convert the highest relocation priority to transfer to another federal development. All vacancies would be filled using Section 8 vouchers.

NYCHA's efforts to engage and educate residents and market the Voluntary Conversion Plan were not sufficient to enable it to meet its 3-year timetable and as a result, by the end of the three year conversion periods, NYCHA had converted only 2,508[9] of the 8,400 units. NYCHA conducted only HUD-required outreach efforts between April and October 2006 which were comprised of:

- Meetings with the Citywide Council of Presidents[10] and the Resident Advisory Board[11] on April 20, 2006 to present the PPPH which included the Voluntary Conversion Plan;

[9] According to NYCHA's 2012-2016 Dwelling Rent Projection, NYCHA converted 230 of the 447 units by January 31, 2011 and 2,278 of the 7,953 units by May 31, 2011.

[10] The Citywide Council of Presidents works with senior NYCHA staff on the many issues affecting life in NYCHA developments, including issues at the local, state and federal government levels. Every president of a recognized Resident Association is a member of one of nine Citywide Council of Presidents (CCOP) districts in the city. Resident Association presidents of each district elect a Chair who represents that district on the CCOP. Members of the CCOP automatically become members on the Resident Advisory Board.

- Initial public meetings with residents between April 26, 2006 and June 21, 2006;
- Making the NYCHA Transition Assessment and Plan available to residents for review and comments between September 8, 2006 and October 10, 2006; and
- Additional public meetings with residents and Resident Associations[12] between September 13, 2006, and October 5, 2006.

Notwithstanding the persistent failure to meet its own time frame for conversion, NYCHA continued to report in each of its last three CAFRs, PHA Agency Annual Plans, and Five Year Operating Plans that it was undertaking conversion efforts and expected to convert a substantial number of the remaining units. Most recently, in its Operating and Capital Plans Calendar Years 2014-2018, NYCHA stated:

> This Plan reflects an initiative to accelerate conversion of approximately 4,000 (of the remaining 5,100) unfunded public housing units to Section 8 assistance by implementing a conversion program beginning 2015. Through this initiative, subsidy income from Section 8 conversions is projected to more than double from $47 million in 2014 to $95 million in 2018.

However, when we asked NYCHA to describe its past and planned accelerated conversion efforts, NYCHA informed us that there were no such initiatives. Rather, these numbers reflected only the number of units eligible for conversion. NYCHA further informed us that its conversion efforts are limited to filling vacant apartments with Section 8 voucher holders—on average 263 per year.[13] At this rate, NYCHA will not convert the remaining 5,002 units until 2033.[14] Since 2009, NYCHA has continued to change its timeline for the completion of the conversions. However, NYCHA has failed to disclose to the public the inherent difficulties it has had in completing its Voluntary Conversion Plan and obtaining additional revenue. NYCHA's subsidy revenue projections are based on unsubstantiated speculative assumptions. Consequently, NYCHA's budget forecasting is not conservative. NYCHA's practice of overestimating the level of participation as a basis for additional revenue obscures from the public the actual viability of future revenue streams.

Since NYCHA's efforts to convert the 8,400 units during the conversion periods and thereafter have been ineffective, we estimate that NYCHA has forgone Section 8 subsidy of $263.1 million[15] from June 1, 2011 to October 31, 2014 that it anticipated as part of its budget process.

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[11] The Resident Advisory Board consists of public housing and Section 8 residents. Their primary function is to address various aspects of NYCHA's Annual and Five-Year Agency Plans, which set forth NYCHA's priorities and policies in 18 core areas and chart the course for NYCHA's short-term and long-term future. Resident Advisory Board members are responsible for keeping residents in each development/district informed of the Plans' development at both the draft and final stages. There are 80 plus members of the RAB, consisting of 45 elected Resident Association Presidents, 5 Section 8 representatives, and 31 Alternates.

[12] Most NYCHA developments have Resident Associations, which are also known as Tenant Associations, Resident Councils or Tenant Councils. These are democratic organizations dedicated to improving the quality of life in NYCHA developments and the surrounding neighborhoods. Resident Associations work with NYCHA management at every level, which gives residents a real voice in the operation of their developments.

[13] The average number of units converted per year was calculated based on the difference between the number of units converted as of June 30, 2011, and the number of units converted as of October 31, 2014, divided by a 3.3 year period.

[14] Based on our estimation of converting 263 units per year, NYCHA will convert the remaining 5,002 units to Section 8 by November 7, 2033.

[15] To estimate forgone Section 8 subsidy for the period June 1, 2011, through October 31, 2014, we multiplied the number of unconverted units at the end of each month by the average Section 8 per unit payment for the 21 former State and City developments according to NYCHA's Section 8 Conversion Analysis.

Further, at its current rate of converting 263 units per year, we estimate that NYCHA may lose additional Section 8 subsidy of $713.4 million from November 1, 2014, to November 7, 2033.[16]

> ***NYCHA Response**:* "[T]he audit report extrapolates a large loss only by forecasting losses all the way out to 2033. It is axiomatic that financial projections nearly 20 years into the future are not meaningful."
>
> ***Auditor Comment:*** The report calculated losses through 2033 because this is how long at the current rate it will take NYCHA to convert the remaining 5,002 units from public housing to Section 8. Unlike NYCHA's budget reporting, our forecasts are not speculative. As noted, the report estimate of future Section 8 subsidy losses of $713.4 million was based on NYCHA's own data—its reported number of completed conversions, Section 8 payments, and growth rates—and is meaningful because it represents the cost of NYCHA's current conversion efforts. NYCHA's budget planning would be more accurate and more effective if it takes into account the reality of these conversion efforts.
>
> Moreover, the report estimate is conservative in that it is based on NYCHA's historical conversion rate for the past 3.3 years as opposed to NYCHA's reported Fiscal Year 2015 budget plan. Based on NYCHA's more conservative forecast of completing 230 Section 8 conversions in Fiscal Year 2015 and 100 conversions per year from 2016 to 2019, NYCHA may not fully effect its conversion until 2063, for which we estimate that NYCHA may lose additional Section 8 subsidy of $2.2 billion from November 1, 2014, to September 30, 2063.

NYCHA Did Not Obtain Transition Funding of $75.9 Million

NYCHA did not successfully demonstrate to HUD that NYCHA converted to the asset management model in the first year that monetary incentives were offered by HUD for conversions. As a result, NYCHA failed to achieve the lower reduction in its operating subsidy of 5 percent rather than a 24 percent reduction that was otherwise applied. This failure resulted in an estimated ongoing loss to NYCHA of between $10 million and $12.4 million each year in its federal operating subsidy. Consequently, HUD has through the end of 2014 provided NYCHA with $75.9 million less in operating subsidy than it would have received had it successfully converted to the asset management model in the first possible year.

As is described briefly above, in November 2005, HUD changed its federal operating subsidy formula. For those PHAs, like NYCHA, that would receive a lower operating subsidy under the new formula, HUD offered a stop-loss provision to PHAs that successfully demonstrated conversion to asset management and implemented project-based management, budgeting, and accounting. HUD offered to limit operating subsidy losses by a sliding-scale percentage of the difference between subsidy received under the old and new funding formulas. Under the new formula, HUD calculated that NYCHA would receive $60.8 million less operating subsidy each

[16] To estimate future potential loss of Section 8 subsidy, we first determined how long it would take NYCHA to convert the remaining 5,002 units based on the average number of units converted each month (see footnote #13). We calculated that by converting 263 units per year, NYCHA will convert the remaining 5,002 units to Section 8 in 19 years or by November 7, 2033. The amount of potential lost subsidy during these years was calculated using the number of unconverted units at the end of each year multiplied by estimated Section 8 payment for each year based on NYCHA's assumption of annual growth rate of 1.49 percent. In its Section 8 Conversion Analysis, NYCHA applied the 1.49 percent growth rate for Calendar Years 2014 through 2018.

year unless it were able to demonstrate its conversion to the asset management model, in which case it would receive a reduced decrease in the operating funds provided by HUD.

To assess whether PHAs successfully demonstrated conversion to asset management, HUD required PHAs to submit to HUD-approved independent assessors a Stop Loss Package, including project-based budgets and operating statements, Central Office Cost Center (COCC) budget, schedule of COCC fees and charges and proceeds from Capital Fund, demonstrating compliance with criteria for successful conversion to an asset management model. Afterwards, the independent assessors reviewed this documentation, performed on-site reviews, conducted exit conferences with PHAs, and ultimately submitted to HUD a final report. In turn, HUD made a final determination on conversion based on the independent assessor's report, PHA management responses, and other relevant information.

NYCHA submitted a Year 1 Stop Loss Package. However, HUD denied NYCHA's Year 1 application on two procedural grounds—failure to obtain pre-approval for management fees, and charging central warehouse costs as a front-line expense—and three material grounds—HUD deemed NYCHA's management fees unreasonable, NYCHA's Central Office Cost Center operated at a significant deficit, and NYCHA did not properly allocate or support costs, and charge costs based on actual services provided. NYCHA unsuccessfully appealed HUD's decision.

Subsequently, NYCHA obtained HUD's approval for its Year 2 Stop Loss Package. However, this resulted in less transition funding for NYCHA from 2008 in perpetuity or until such time as a new formula is developed and implemented. As of December 2014, this will amount to a cumulative loss of $75.9 million as follows:

Estimated Forgone Transition Funding 2008 – 2014

Federal Fiscal Year	Year 1 Transition Funding Rate	Year 2 Transition Funding Rate	Difference between Year 1 and Year 2 Funding Rates	Number of Eligible Unit Months[17]	Forgone Transition Funding	Proration %	Prorated Forgone Transition Funding
2008	$30.15[18]	$24.12[19]	**$6.03**	1,886,694	$11,376,765	89.0	$10,120,770
2009	$30.15	$24.12	**$6.03**	1,873,888	$11,299,545	88.4	$9,991,057
2010	$30.15	$24.12	**$6.03**	1,872,348	$11,290,258	103.0	$11,628,966
2011	$30.15	$24.12	**$6.03**	2,062,149	$12,434,758	100.0	$12,434,758
2012	$30.15	$24.12	**$6.03**	2,034,984	$12,270,954	88.5	$10,859,794
2013	$30.15	$24.12	**$6.03**	2,024,726	$12,209,098	81.9	$9,994,367
2014	$30.15	$24.12	**$6.03**	2,024,726[20]	$12,209,098	88.8	$10,841,679
TOTAL							$75,870,171

NYCHA Response*:* "[T]hough HUD (wrongly, in NYCHA's view) did not accept NYCHA's Year 1 Stop Loss submission, NYCHA's Year 2 Stop Loss package was accepted. That has earned NYCHA a total of $303.5 million in transition funding to date."

Auditor Comment: As noted, HUD denied NYCHA's Year 1 Stop Loss Package on two procedural grounds and three material grounds. While NYCHA disputed some of the grounds for its denial, NYCHA also acknowledged that its Year 1 Stop Loss Package was not fully compliant. For example, NYCHA acknowledged that it did not request pre-approval for charging central warehouse costs as a front-line expense. In HUD's denial letter, HUD informed NYCHA that "[t]hese procedural items alone disqualify the PHA for Year 1 Stop-Loss." Thus, while NYCHA was able to obtain approval of its Year 2 Stop Loss Package, as noted, it did lose out on transition funding for NYCHA from 2008 in perpetuity or until such time as a new formula is developed and implemented. As of December 2014, this will amount to a cumulative loss of $75.9 million.

[17] Title 24, Section 990.115 defines the number of eligible unit months as "the actual number of PHA units in eligible categories expressed as months." Units are that are eligible for HUD operating subsidy include dwelling units occupied by public housing eligible families and dwelling units with approved vacancies and limited vacancies.

[18] To calculate NYCHA's Year 1 per unit per month transition funding amount, we calculated 95 percent of the HUD-calculated NYCHA subsidy loss (i.e., to limit the subsidy loss to five percent of the HUD-calculated NYCHA subsidy loss) and then divided this number by the total number of eligible unit months (as of 2004) as follows:

[(100% - 5 %) ($60,811,301)] ÷ 1,915,920 = $30.15.

[19] To calculate NYCHA's Year 2 per unit per month transition funding amount, we calculated 76 percent of the HUD-calculated NYCHA subsidy loss (i.e., to limit the subsidy loss to 24 percent of the HUD-calculated NYCHA subsidy loss) and then divided this number by the total number of eligible unit months (as of 2004) as follows:

[(100% - 24 %) ($60,811,301)] ÷ 1,915,920 = $24.12.

[20] We estimated the 2014 number of eligible unit months to be the same as the 2013 number of eligible unit months (i.e., 2,024,726).

NYCHA Did Not Track and Document Whether Joint NYCHA/BCG-Identified Cost Savings and Revenues of $106 Million Were Fully Achieved

NYCHA has failed to ensure that "The Boston Consulting Group (BCG) Reshaping NYCHA Support Functions" report recommendations were fully implemented and that the cost savings and revenue increases were fully achieved. The December 2011 Plan NYCHA detailing critical initiatives designed to ensure NYCHA's long-term fiscal stability included as a significant component NYCHA's work with BCG to assess NYCHA's central support functions, develop and make recommendations to improve these functions, and provide strategic, tactical, and technical support to implement recommendations. NYCHA's goal was to improve the efficiency and effectiveness of its administrative functions and thereby increase resources available to property-level management.

In August 2012, working closely with NYCHA, BCG issued a report detailing more than 100 recommendations which, if implemented, BCG estimated would result in annual cost savings of $71 million and annual efficiencies and revenue enhancements of $56 million by 2016 described in the table below.

BCG-Identified Annual Cost Savings and Revenues for Calendar Years 2012 to 2016

	2012	**2013**	**2014**	**2015**	**2016**
Net Cost Savings					
Other Than Personal Services	5,000,000	11,000,000	20,000,000	23,000,000	23,000,000
Personnel Services	8,000,000	14,000,000	25,000,000	36,000,000	48,000,000
Total Cost Savings	**$13,000,000**	**$24,000,000**[21]	**$45,000,000**	**$59,000,000**	**$71,000,000**
New Revenues					
Parking and Commercial Space	0	2,000,000	3,000,000	4,000,000	4,000,000
Additional Section 8 Revenues	0	2,000,000	17,000,000	42,000,000	52,000,000
Total Revenues	**$0**	**$4,000,000**	**$20,000,000**	**$46,000,000**	**$56,000,000**
Combined Annual Cost Savings and Revenues	**$13,000,000**	**$28,000,000**	**$65,000,000**	**$105,000,000**	**$127,000,000**
Cumulative Cost Savings and Revenues	**$13,000,000**	**$41,000,000**	**$106,000,000**	**$211,000,000**	**$338,000,000**

In its report, BCG identified the implementation and sustained operation of an Enterprise Program Management Office (EPMO) as critical to ensuring that recommendations were implemented and financial benefits were realized. BCG stated that "[t]he EPMO is responsible for driving the overall program to ensure that the cost savings and revenue increases are actually accomplished. . . . This EPMO will serve as a critical tool to help guide NYCHA along its journey. NYCHA's transformation is not a short-term effort. . . . NYCHA's transformation and related change efforts will need to be managed and the organization will face ongoing challenges over the next 5 years."

However, NYCHA failed to effectively implement and operate the EPMO. NYCHA's reported authorized staffing levels reflect that from the outset, NYCHA did not properly staff the EPMO. Moreover, there was significant turnover in the EPMO Director and Analyst positions and so the EPMO lacked consistent leadership and project ownership.

[21] "The Boston Consulting Group (BCG) Reshaping NYCHA Support Functions" reported Other Than Personal Services cost savings of $11 million, Personnel Services cost savings of $14 million, and total 2014 cost savings of $24 million.

Further, NYCHA failed to ensure that the EPMO effectively tracked recommendation implementation status, associated costs, and resulting cost savings and revenues. NYCHA informed us that it used BCG proprietary software to generate weekly status reports and track recommendation implementation status from January 2012 to December 2012. According to NYCHA, these reports detailed project information such as project scope, deliverables, milestones, and due dates. In January 2013, NYCHA maintained that it developed its own status reports which captured the same information and were generated monthly until the BCG recommendations that NYCHA pursued were implemented.

However, we question the effectiveness of these reports because NYCHA did not track recommendation implementation costs such as additional consulting costs and system development costs, and compare anticipated and actual cost savings and revenues. In the absence of this critical information, NYCHA cannot assess the extent to which recommendations were implemented, anticipated cost savings and revenues were achieved, and funds were available to be redirected to the frontline. Without such basic information, it is impossible to determine the ultimate value of the BCG report. Following a request by the audit team, it took NYCHA five months to create a comprehensive implementation status report, a report that would have been a useful tool for NYCHA to have maintained to assist it in tracking implementation and savings. Notably, the report that was produced did not address all of the BCG recommendations and did not adequately detail implementation status.

Further, NYCHA has failed to maintain EPMO project management. As noted, BCG recommended that EPMO manage NYCHA's "transformation" over the five year period from 2012 through 2016 to ensure that recommendations are implemented *and* that "cost savings and revenue increases are actually accomplished." However, when we asked NYCHA about the EPMO in February 2014, NYCHA informed us that the EPMO was not really functioning. Rather, they reported that it is composed of just two staffers who perform minor project management activities. NYCHA maintained that project management responsibilities were transferred to and carried out by respective department heads. However, this is contrary to the BCG plan. Moreover, we note that it does not provide for cross-departmental or independent oversight which would have been achieved by the EPMO.

NYCHA maintains that it has implemented BCG's recommendations. However, its failure to fully establish and staff the EPMO is itself a failure to fulfill one key element in the BCG plan. Moreover, as a result, NYCHA has failed to consistently track and document whether anticipated cost savings and revenues were fully realized.

Since NYCHA did not track and document implementation costs and whether BCG-identified cost savings and revenues of $106 million were realized,[22] NYCHA cannot accurately determine whether it has or will have additional funds available to address its significant repair and maintenance needs. Further, it is unable to determine whether the costs incurred to procure the report—$10.3 million—and implement its recommendations exceed the cost savings and revenues achieved.

> ***NYCHA Response****:* "Given NYCHA's resource constraints, NYCHA did not consider it a priority to track those outcomes for the purpose of justifying the BCG study. Instead, after evaluating BCG's recommendations, NYCHA's focus was on the implementation, whether through the Enterprise Program Management Office or otherwise, of the recommendations that it considered to be most feasible and beneficial. What NYCHA

[22] The combined annual cost savings and revenues for Calendar Years 2012 through 2014 as noted in the preceding table are $13 + $28 + $65 million.

did track was that implementation process, through BCG's proprietary Roadmapping application, as well as monthly reports to the General Manager."

Auditor Comment: As noted above, rather than simply seeking a justification for spending $10 million on the production of the report, prudent management requires NYCHA to track the savings and revenue achieved through implementation of the joint NYCHA/BCG initiatives in order to determine if specific programs and other measures should be continued and replicated where effective or modified and/or terminated where not. With such monitoring, NYCHA will be better able to ensure that the ultimate goal of the report was achieved—i.e., that funds were available to redirect to property management and make much needed repairs. As a secondary benefit, NYCHA will also be able to assess the costs and benefits of implementing recommendations and determine the value of the report so that NYCHA can make an informed evaluation of BCG's contract performance. Moreover, NYCHA appears to not be effectively tracking recommendation implementation status as evidenced by the fact that it took NYCHA five months to create a comprehensive implementation status report.

RECOMMENDATIONS

1. NYCHA should ensure adequate and transparent disclosure of budget estimates and forecasts supported by appropriate substantiated data.

   NYCHA Response: "NYCHA has done so and will continue to do so.

   With respect to the specific issue of Section 8 conversions, NYCHA's FY2015 budget plan is based on more realistic forecasts of 230 Section 8 conversions in FY2015 and 100 conversions per year from 2016 to 2019."

   Auditor Comment: In the past, NYCHA did not ensure adequate and transparent disclosure of budget estimates and forecasts supported by appropriate substantiated data. Most notably, in its Five Year Operating Plan Calendar Years 2012-2016, Five Year Operating Plan Calendar Years 2013-2017, and Operating and Capital Plans Calendar Years 2014-2018, NYCHA reported it was implementing accelerated conversion plans and projected that Section 8 subsidy revenue would nearly or more than double for the 21 former State and City developments. However, as noted, these projections were purely speculative because there were no such accelerated conversion initiatives.

   With regard to the future, NYCHA's 2015 budget plans are not yet publicly available. So, we cannot verify whether NYCHA is more realistically and conservatively budgeting and forecasting.

2. NYCHA should adequately plan for and consistently follow through on revenue and cost saving initiatives to ensure that estimated financial benefits are obtained.

   NYCHA Response: "NYCHA has done so and will continue to do so."

   Auditor Comment: Contrary to NYCHA's assertions, it did not do so in the past—as detailed throughout the report—and does not intend to do so going forward—as evidenced by its unwillingness to implement Recommendation #9 through Recommendation #12 aimed at ensuring that BCG financial benefits are achieved.

3. NYCHA should consider employing ESCOs to develop EPC plans appropriately scaled to NYCHA's utility costs and unmet capital needs.

   NYCHA Response: "NYCHA has considered and will continue to consider the option of using ESCOs. We note, however, that there can be benefits to using ESCOs, such as planning expertise and risk, there are also substantial costs associated with the use of an ESCO."

   Auditor Comment: We acknowledge that there are costs associated with the use of ESCOs. However, as noted, ESCOs develop, finance, and install projects and assume performance risk by guaranteeing savings. Additionally, ESCO compensation may be tied to measured performance. Therefore, ESCO costs may be warranted if they result in approved plans that are appropriately scaled to the size of NYCHA's operations, utility costs, and unmet capital needs.

   In August 2011, HUD also advised NYCHA to use ESCOs stating "we recommend that NYCHA solicit the services of a company that is highly experienced in this field, such as an Energy Services Company (ESCO), so that a viable EPC can be designed more quickly and easily. We believe that with additional technical expertise, NYCHA would be available to develop and implement an EPC that has a reasonable contingency and meets federal regulations."

4. NYCHA should take steps to reduce the risk of self-managed plans including but not limited to insuring EPC plans, increasing EPC plan margins, and implementing EPC plans with shorter payback periods.

   NYCHA Response: "NYCHA will continue to work with HUD to develop and implement, and obtain necessary EPC program waivers and flexibility for, a multi-faceted, large-scale EPC that is appropriate in scale for NYCHA."

   Auditor Comment: By continuing to pursue only EPCs that necessitate waivers and flexibility, NYCHA is not complying with federal regulations, reducing plan risk, and heeding HUD's and this report's recommendations and therefore, will likely continue to be unable to implement EPC plans that are appropriately scaled to the size of NYCHA's operations, utility costs, and unmet capital needs.

5. NYCHA should immediately conduct and sustain both broad and targeted outreach efforts to engage and educate residents and market the Voluntary Conversion Plan including but not limited to periodically distributing flyers, sending direct mailings, calling and emailing residents, and conducting periodic public meetings with residents, Resident Associations, the Citywide Council of Presidents, the Resident Advisory Board, and housing advocacy groups.

   NYCHA Response: "NYCHA agrees with this recommendation."

6. NYCHA should consult with HUD on its developing a revised marketing and administrative plan to fully implement its Voluntary Conversion Plan.

   NYCHA Response: "NYCHA regularly and diligently consults with HUD on Section 8 conversion plans, and will continue to do so."

7. NYCHA should consult with HUD on applications for federal funds prior to submission and respond to HUD feedback.

   NYCHA Response: "NYCHA regularly and diligently consults with HUD on funding applications, and will continue to do so."

   Auditor Comment: While NYCHA may consult with HUD, NYCHA continues to not respond to HUD feedback as evidenced by NYCHA's persistence in pursuing only EPCs that necessitate waivers and flexibility. Consultation is meaningless if NYCHA will not listen to HUD's input and revise applications to ensure that much needed federal funds are obtained.

8. NYCHA should conduct rigorous independent reviews of federal funding applications prior to submission to HUD to ensure compliance with relevant rules and regulations.

   NYCHA Response: "NYCHA diligently reviews funding applications to ensure compliance, and will continue to do so."

   Auditor Comment: As detailed throughout this report, NYCHA did not diligently review funding applications to ensure compliance in the past. Additionally, recent events reflect that NYCHA has continued to not diligently review funding applications based on

NYCHA's recent failure to obtain federal emergency safety and security grant funding. In May 2014, HUD notified PHAs that Fiscal Year 2014 Emergency Safety and Security grants were available and that applications were due by June 30, 2014. In September 2014, HUD announced that grant awards were made to 13 PHAs and NYCHA was not among them. It was reported that NYCHA was denied funding because it submitted an application that "was not complete and did not meet the minimum threshold requirements."

9. NYCHA should reassess and document the extent to which all BCG report recommendations were implemented by examining the steps taken, calculating the costs incurred to date, calculating the cost savings and revenues achieved to date, and comparing anticipated and actual net cost savings and revenues achieved to date.

   NYCHA Response: See response to Recommendation #12.

10. NYCHA should develop an appropriate EPMO (or a comparable cross-departmental, independent unit) staffing structure, maintain authorized staffing levels, and track staff turnover to ensure implementation and tracking of the BCG report recommendations.

    NYCHA Response: See response to Recommendation #12.

11. For those recommendations for which anticipated cost savings and revenues were not achieved, NYCHA should assign project ownership to EPMO (or a comparable cross-departmental, independent unit) staff and generate weekly status reports until such time as recommendations are implemented and financial benefits are fully realized.

    NYCHA Response: See response to Recommendation #12.

12. NYCHA should generate status reports that include but are not limited to implementation status, issues, costs, and anticipated and actual cost savings and revenues.

    NYCHA Response: "NYCHA disagrees with these recommendations. On-going assessment of the merits of the BCG study is not an optimum use of NYCHA's staff time or other resources."

    Auditor Comment: As noted above, NYCHA has a responsibility to track whether and to what extent joint NYCHA/BCG-identified recommendations were implemented and resulting cost savings and revenues were achieved. This is primarily to ensure that the programs are working effecitively so it can determine if they should be continued and replicated or modified and/or terminated where they have not been effective. With such monitoring, NYCHA will be better able to ensure that the ultimate goal of the BCG report was achieved—i.e., that funds were available to redirect to property management and make much needed repairs. In addition, it will also be able to assess the cost-benefit of implementing recommendations and determine the value of the report so that NYCHA could make an informed evaluation of BCG's contract performance.

DETAILED SCOPE AND METHODOLOGY

We conducted this performance audit in accordance with GAGAS. 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.

The initial scope of this audit was Calendar Years 2012 and 2013, which reflects the most recent NYCHA financial statements available to us at the initiation of audit fieldwork. Our scope expanded to other timeframes depending on the specific issues noted.

To assess NYCHA's financial status in relation to our audit objectives, we performed a trend analysis of its Statement of Revenues, Expenses and Changes in Net Position for the calendar years 2002 through 2013. Based on the noted persistent funding gaps and use of capital funds to cover the operating deficits, we focused our audit review on NYCHA's efforts in achieving cost savings and revenue enhancement.

To identify NYCHA's major efforts to obtain federal funding and to achieve cost savings and revenue enhancements, we reviewed various NYCHA annual reports (CAFR, PHA Agency Plan, and Five Year Operating and Capital Plans), budget and other City Council testimony, as well as its Plan NYCHA and the BCG report. Based on our review, we identified the operating and capital underfunding issues and critical NYCHA imperatives: EPC plan, Section 8 conversion, transition funding, and BCG cost savings and revenue enhancements.

EPC

To obtain details of the $371 million multi-phase EPC that was submitted in 2009, we reviewed NYCHA's conceptual, preliminary, initial final, revised final, and the second revised final plans submitted to HUD. To obtain an understanding of HUD's review of the plan submissions, we reviewed NYCHA's correspondence with HUD. As noted in the findings section of this report, certain critical documents and details of discussions prior to each submission were unavailable for our review. To obtain a better understanding of the EPC plan review process and the issues hindering HUD's final approval of the plan, we conducted separate meetings with NYCHA and HUD officials. Based on the documentation and information provided, we summarized and analyzed the issues in the 2009 EPC application process.

To assess whether NYCHA properly submitted its 2009 EPC in accordance with HUD's guidelines, we reviewed related federal rules and regulations, including Title 24 of the Code of Federal Regulations, Public and Indian Housing (PIH) Notices for both self-managed and third-party managed EPC plans. We also analyzed and abstracted the rule changes from the PIH Notices that covered the plan application process.

We also conducted independent reviews of the cash flows included in all 2009 EPC plan submissions to determine whether NYCHA properly projected savings to cover all related project costs. We further reviewed other issues that HUD addressed in its letters to determine whether NYCHA complied with the prevailing rules and regulations or HUD amended regulations during the application process.

To obtain an overview of NYCHA's $18 million EPC plan that was subsequently submitted in 2012 and approved in 2013, we conducted meetings with NYCHA Energy Department officials to discuss the plan details and also obtained information regarding NYCHA's utility procurement, billing management, and reporting of utility data in HUD form 52722. To determine whether the 2013 plan achieved the anticipated energy cost savings, we compared the plan's anticipated savings and the actual savings measured by an independent energy measurement and verification service provider.

Section 8 Conversion

To obtain an understanding of NYCHA's proposal to convert 8,400 units of 21 former State and City developments, we reviewed NYCHA's 2006 submission to HUD, the voluntary transition assessment plan addressed to the residents of each of the 21 developments, City Council testimony, and other information related to NYCHA's efforts to promoting the conversion prior to its submission. To obtain the details of the Section 8 Voluntary Conversion Plan (VCP), we reviewed the management plan approved by HUD in 2008, and subsequent correspondence in connection with NYCHA's proposals submitted prior to the end of the three year periods.

To assess NYCHA's effort in the Section 8 conversion, we conducted a meeting with NYCHA officials to discuss the impediments related to the conversion and NYCHA's plan to accelerate the conversion as stated in its Operating and Capital Plans. Based on the delay in the conversion process, we calculated the forgone revenue to date based on NYCHA-provided Section 8 payment per unit month for all unconverted/unfunded units. In addition, based on the pace of the conversion, we estimated the expected completion date for the conversion and calculated the potential Section 8 funding loss.

Stop-Loss/Transition Funding

To determine whether NYCHA properly submitted its stop-loss package in accordance with HUD's application guidelines, we reviewed NYCHA's Year 1 and Year 2 submissions, Independent Assessors' Report, NYCHA's management response, and HUD's letter for the denial of the Year 1 application and acceptance of the Year 2 application. To determine whether NYCHA complied with application requirements, we reviewed the HUD rules and regulations, PIH Notices, Stop-Loss submission kit and Financial Management Handbook 7475.1.

We independently recalculated the funding loss under the new operating fund rule and the Transition Amount in accordance with HUD's guidelines. We also calculated the lost transition funding between 95 percent (Year 1 conversion) and 76 percent (Year 2 conversion) of the subsidy reduction from 2008 through 2014.

BCG

To obtain an understanding of BCG's recommendations and NYCHA's implementations, we reviewed BCG report and prepared a summary of key recommendations and associated cost savings and revenue enhancements in the report.

To determine whether NYCHA procured BCG services in accordance with relevant policies and procedures, we obtained and reviewed the BCG contracts and amendments and NYCHA's internal approval documentation. In addition, we reviewed and abstracted the transcript of the City Council Meeting on NYCHA's BCG Contract.

To assess NYCHA's efforts to implement revenue enhancement and cost saving initiatives, we conducted a walkthrough meeting with EPMO officials to determine whether the EPMO operated as recommended by BCG. Specifically, we discussed EPMO's staffing, functions, and the process in place to track BCG's recommendations, implementation status and dollar amounts of the anticipated cost savings and revenue enhancements.

To assess NYCHA's efforts in implementing BCG recommendations, we requested that NYCHA provide us an update of the implementation status and the achieved savings and revenue enhancements, the headcount reduction and the associated third-party vendors and consultants' contracts and amount paid. However, as noted in the findings section of this report, NYCHA was unable to provide us details of the information requested.

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December 3, 2014

Marjorie Landa
Deputy Comptroller for Audit
The City of New York
Office of the Comptroller
1 Centre Street
New York, NY 10007-2341

Re: Audit Report on Efforts by the New York City Housing Authority to Maximize Federal Funding, Enhance Revenue and Achieve Cost Savings

Dear Ms. Landa:

We write in response to the Office of the Comptroller of the City of New York's draft audit report titled Audit Report on Efforts by the New York City Housing Authority to Maximize Federal Funding, Enhance Revenue and Achieve Cost Savings.

While we are in agreement with a number of the recommendations in the draft audit report, it is our view that the audit report is seriously flawed in three respects. First, while the period that was to be covered by the audit was described in the audit scope as January 1, 2012 to December 31, 2013, much of the audit report actually pertains to decisions and activities prior to 2012, even activities as far back as 2006. Moreover, virtually all of the decisions and activities covered in the audit report, as well as the audit findings, took place prior to January 1, 2014.

Second, the audit report exaggerates and/or mischaracterizes revenue and cost savings opportunities that NYCHA did not maximize. In particular, the first finding in the audit report -- that NYCHA "*could have*" but "*failed*" to obtain EPC incentives of $353 million – is based on an erroneous and misleading assumption that such magnitude of savings could have been achieved without the HUD program rule waivers and flexibility that NYCHA consistently requested during its EPC planning process. To the contrary, the EPC program rules made it nearly impossible for NYCHA to implement a long-term, multi-faceted, large-scale EPC program without the waivers that NYCHA had good reason to believe would be granted by HUD based on numerous discussions and correspondence. It was HUD's eventual denial of those waivers that resulted in NYCHA's election to proceed, at the very least, with a small EPC that did not require any waivers. At present, NYCHA is continuing to work with HUD to obtain program flexibility that will enable NYCHA to implement a multi-phase, large-scale EPC program.

Similarly, in its discussion of NYCHA's "*loss*" of Section 8 funding, the audit report extrapolates a large loss only by forecasting losses all the way out to 2033. It is axiomatic that financial projections nearly 20 years into the future are not meaningful.

Third, in addition to exaggerating and/or mischaracterizing missed revenue or cost savings opportunities, the audit report unfairly disregards a number of substantial revenue opportunities that NYCHA successfully took advantage of during the same period as the purported missed opportunities. Those successes included two of the largest revenue-generating public housing transactions ever:

- 2010 "Federalization". In March 2010, HUD completed a $900 million mixed-finance transaction to take advantage of a one-time opportunity under the American Recovery and Reinvestment Act of 2009 ("ARRA"). As described by the Director of HUD's Office of Urban Revitalization, it was "the biggest mixed-finance deal in the history of mixed-finance."

- 2013 "Bond B". In September 2013, NYCHA, in collaboration with the New York City Housing Development Corporation ("HDC") and HUD, took advantage of HUD's Capital Fund Financing Program to raise approximately $732 million for repairs at NYCHA public housing developments across the City as well as the refinancing of existing debt. It was the largest bond sale ever undertaken for public housing authority capital funds.

Also, with respect to the transition funding opportunity discussed in the audit report, though HUD (wrongly, in NYCHA's view) did not accept NYCHA's Year 1 Stop Loss submission, NYCHA's Year 2 Stop Loss package was accepted. That has earned NYCHA a total of $303.5 million in transition funding to date.

The fourth finding of the draft audit is that NYCHA did not "track and document" the outcomes of its implementation of certain recommendations in the 2012 Boston Consulting Group ("BCG") report. Given NYCHA's resource constraints, NYCHA did not consider it a priority to track those outcomes for the purpose of justifying the BCG study. Instead, after evaluating BCG's recommendations, NYCHA's focus was on the implementation, whether through the Enterprise Program Management Office or otherwise, of the recommendations that it considered to be most feasible and beneficial. What NYCHA did track was that implementation process, through BCG's proprietary Roadmapping application, as well as monthly reports to the General Manager.

Comments on Audit Report Recommendations

Recommendation #1 - NYCHA should ensure adequate and transparent disclosure of budget estimates and forecasts supported by appropriate substantial data.

Management's Response
NYCHA has done so and will continue to do so.

With respect to the specific issue of Section 8 conversions, NYCHA's FY2015 budget plan is based on more realistic forecasts of 230 Section 8 conversions in FY2015 and 100 conversions per year from 2016 to 2019.

Recommendation #2 - NYCHA should adequately plan for and consistently follow through on revenue and cost saving initiatives to ensure that estimated financial benefits are obtained.

Management's Response
NYCHA has done so and will continue to do so.

Recommendation #3 - NYCHA should consider employing ESCOs to develop EPC plans appropriately scaled to NYCHA's utility costs and unmet capital needs

Management's Response
NYCHA has considered and will continue to consider the option of using ESCOs. We note, however, that there can be benefits to using ESCOs, such as planning expertise and risk, there are also substantial costs associated with the use of an ESCO.

Recommendation #4 - NYCHA should take steps to reduce the risk of self-managed plans including but not limited to insuring EPC plans, increasing EPC plan margins, and implementing EPC plans with shorter payback periods.

Management's Response
NYCHA will continue to work with HUD to develop and implement, and obtain necessary EPC program waivers and flexibility for, a multi-faceted, large-scale EPC that is appropriate in scale for NYCHA.

Recommendation #5 - NYCHA should immediately conduct and sustain outreach efforts to engage and educate residents and market the Voluntary Conversion Plan.

Management's Response
NYCHA agrees with this recommendation.

Recommendation #6 - NYCHA should consult with HUD on its developing a revised marketing and administrative plan to fully implement its Voluntary Conversion Plan.

Management's Response

NYCHA regularly and diligently consults with HUD on Section 8 conversion plans, and will continue to do so.

Recommendation #7 - NYCHA should consult with HUD on applications for federal funds prior to submission and respond to HUD feedback

Management's Response
NYCHA regularly and diligently consults with HUD on funding applications, and will continue to do so.

Recommendation #8 - NYCHA should conduct rigorous independent reviews of federal funding applications prior to submission to HUD to ensure compliance with relevant rules and regulations

Management's Response
NYCHA diligently reviews funding applications to ensure compliance, and will continue to do so.

Recommendations #9, #10, #11, #12
#9 - NYCHA should reassess and document the extent to which all [the 2012] BCG report recommendations were implemented by examining the steps taken, calculating the costs incurred to date, calculating the cost savings and revenue achieved to date, and comparing anticipated and actual net cost savings and revenues achieved to date.

#10 - NYCHA should develop an appropriate EPMO (or a comparable cross-department, independent unit) staffing structure, maintain authorized staffing levels, and track staff turnover to ensure implementation and tracking of the BCG report recommendations.

#11 - For those recommendations for which anticipated cost savings and revenue were not achieved, NYCHA should assign project ownership to EPMO (or a comparable cross-department, independent unit) staff and generate weekly status reports until such time a recommendations are implemented and financial benefits are fully realized.

#12 - NYCHA should generate status reports that include but are not limited to implementation status, issues, costs, and anticipated and actual cost savings and revenue.

Management's Response:
As discussed on page 2 of this letter, NYCHA disagrees with these recommendations. On-going assessment of the merits of the BCG study is not an optimum use of NYCHA's staff time or other resources.

In conclusion, we thank the Comptroller's office for its efforts and for several useful recommendations. Also, we are pleased that the draft audit report recognizes and reflects the growing challenges faced by NYCHA in recent years in obtaining much needed federal resources to support operational and capital needs. We hope that this report helps highlight and garner support for additional resources from a variety of sources. NYCHA will continue its efforts to identify and pursue opportunities to maximize revenues and achieve cost savings, including ongoing dialogue with HUD and other funders and stakeholders.

Sincerely yours,

David I. Farber
General Counsel