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**New York State Office of the State Comptroller**  
Thomas P. DiNapoli

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Division of State Government Accountability

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# **Administration of the Article 8-A Loan Program**

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## **Department of Housing Preservation and Development**

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Report 2013-N-4

September 2014

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# Executive Summary

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## Purpose

To determine whether the loans awarded by New York City's Department of Housing Preservation and Development (HPD) under the Article 8-A Program are being used only for qualified projects and their intended purpose, and whether loan recipients are complying with the requirements of their loans with respect to correcting violations and making other needed repairs. The audit covers loans awarded during the two fiscal years ended June 30, 2012.

## Background

HPD administers the Article 8-A Loan Program (Program), which provides low interest rate loans to owners of rent-regulated multiple dwellings in New York City. The Program's goal is to improve living conditions and to preserve safe and affordable housing for low- and moderate-income households. HPD provided us with 27 projects for which a total of \$43.9 million in loans had been awarded during the audit period. We selected nine of these projects for review, consisting of 942 dwelling units, with loans totaling \$19.8 million.

## Key Findings

We found that HPD does not verify the accuracy of building owner affidavits submitted to support their Program eligibility, and the reduced interest rates assigned to some of these owners are not supported. Over time, these interest rate reductions will cost the Program several millions of dollars in revenue. We also found that many significant building violations and agreed-upon repairs go unaddressed by owners, contrary to contractual requirements. These uncorrected conditions pose significant health and safety threats to building occupants. Lastly, one of the building owners appears to have received favorable treatment from HPD. Such treatment could result in less Program monies available for other Program-eligible building owners.

## Key Recommendations

- Require independent confirmation of owner affidavits to ensure that only eligible applicants receive loans.
- Establish written procedures and guidelines for determining loan interest rates. Document the justification for any interest rate determinations below 3 percent.
- Establish written guidelines for building inspections that would ensure timely project compliance with Voluntary Repair Agreements and Housing Repair and Maintenance Agreements.
- Investigate the circumstances surrounding the apparent preferential treatment afforded Quadrant, as detailed in our report.

## Other Related Audit/Report of Interest

[New York City Department of Buildings: Outstanding Violations \(2010-N-5\)](#)

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**State of New York  
Office of the State Comptroller**

**Division of State Government Accountability**

September 18, 2014

Ms. Vicki Been  
Commissioner  
New York City Department of Housing Preservation and Development  
100 Gold Street  
New York, NY 10038

Dear Commissioner Been:

The Office of the State Comptroller is committed to helping State agencies, public authorities and local government agencies manage government resources efficiently and effectively and, by so doing, providing accountability for tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of State agencies, public authorities and local government agencies, as well as their compliance with relevant statutes and their observance of good business practices. The fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations. Audits can also identify strategies for reducing costs and strengthening controls that are intended to safeguard assets.

Following is a report of our audit of the Department of Housing Preservation and Development entitled *Administration of the Article 8-A Loan Program*. This audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1, of the State Constitution and Article III of the General Municipal Law.

This audit's results and recommendations are resources for you to use in effectively managing your operations and in meeting the expectations of taxpayers. If you have any questions about this draft report, please feel free to contact us.

Respectfully submitted,

*Office of the State Comptroller  
Division of State Government Accountability*

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This report is also available on our website at: [www.osc.state.ny.us](http://www.osc.state.ny.us)

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## Background

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Many New Yorkers have been increasingly challenged to find affordable housing, in the face of stagnant or declining income and rising housing costs. As of 2012, the U.S. Census Bureau estimates that more than 50 percent of renters and 30 percent of homeowners in New York exceeded the U.S. Department of Housing and Urban Development's "home affordability threshold" of 30 percent (i.e., percentage of income spent on housing costs); and within those groups about 1.5 million households spent more than half their income on housing. Thus, for a growing number of citizens, affordable housing is beyond reach. This audit is part of the Comptroller's statewide housing initiative to determine whether the State's low-income housing stock is meeting the needs of residents.

The New York City Department of Housing Preservation and Development (HPD) is the nation's largest municipal housing preservation and development agency. Its mission is to promote housing equality, and to create and sustain viable neighborhoods for New Yorkers through housing education, outreach, loan and development programs, and enforcement of housing standards. One such program - the Article 8-A Loan Program (Program) - is the subject of this audit.

The Program's goal is to improve living conditions and to preserve safe and affordable housing for low- and moderate-income households. The Program attempts to achieve this goal by providing low interest rate loans, of up to \$35,000 per unit, to owners of rent-regulated, multiple-dwelling buildings in New York City (City). The loans are to be used to correct substandard or unsanitary conditions, to replace and rehabilitate building systems (i.e., heating, plumbing, and electrical work), or for other necessary improvements.

HPD staff must follow the provisions of Article 8-A of New York's Private Housing Finance Law (Law) in addition to HPD's own policies and procedures for awarding and monitoring Program loans. HPD is responsible for ensuring that building owners who are granted loans are Program-eligible, and that the rehabilitation work performed by the owners is in compliance with statutory and Program requirements.

We reviewed the files for 9 of the 27 projects that were awarded 8-A loans (Loans) during the two fiscal years ended June 30, 2012 (Exhibit). These nine projects were awarded an aggregate of \$19.8 million, out of the total \$43.9 million awarded, and relate to 942 dwelling units.

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## Audit Findings and Recommendations

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We found that HPD does not verify the accuracy of building owner affidavits submitted to support Program eligibility, and the reduced interest rates assigned to some of these owners are not supported. We also found that many significant building violations and agreed-upon repairs go unaddressed by owners, contrary to contractual requirements. Lastly, one of the building owners appears to have received favorable treatment from HPD. Such treatment could result in less Program monies available for other Program-eligible building owners.

### Compliance With Program Eligibility Requirements

Building owners applying for Article 8-A loans must submit an application demonstrating that the physical condition of the property in question, and the owner's property-related finances, warrant Program funding; and the applicant was unable to obtain a loan from at least two traditional lenders.

If the applicant establishes eligibility for Program monies, an HPD inspector is sent to visit the associated property site to assess the scope of the project so that HPD can develop cost estimates to complete the necessary work. Once the loan amount is established, HPD reviews the building owner's financial information (rental income, property-related expenses, etc.) to determine what the loan's interest rate should be, which can vary and is based on the financial needs of the property in question and the owner's ability to assume the debt.

We reviewed the nine sampled project files to determine whether the associated applicants submitted the proper documentation to warrant a Program loan.

Although all nine files contained an owner affidavit stating they were unable to obtain funding from traditional sources, and listed at least two lending institutions that reportedly turned them down, no one at HPD confirms an applicant's assertions. Thus, HPD officials have no assurance that an applicant's previous attempts to obtain traditional financing were actually denied. Further, we attempted to contact four lending institutions listed by two of the sampled applicants. However, none of the four institutions provided us with a response.

We also found that the application and affidavit for one of the projects reviewed had been submitted in 2006, five years before the loan was actually awarded (2011). After five years, a building's income and expenses can change significantly. Thus, HPD officials have limited assurance that this applicant is still Program-eligible after so much time has passed.

### Unsupported Interest Rates

The Law stipulates that Program loans should carry low interest rates, but it does not specify the actual rate. HPD's Rules and Regulations state that the loans are to bear a 3 percent interest rate unless otherwise determined by HPD officials. According to HPD officials, deviations from the 3 percent rate are supported by various financial analyses.

We found that for six of the nine projects in our sample, the loans carried interest rates below 3 percent: two projects were assessed a 2 percent interest rate, and three were assessed a 1 percent interest rate. (The remaining project, which carried a zero percent rate, was funded by one of New York City's Borough Presidents, and not subject to the Program's interest limits.) According to HPD officials, the reason for the reduced interest rates in our sampled cases was the result of HPD's financial assessment of the buildings' income and operating expenses, which showed lower rates were warranted. For example, one of the calculations performed is a ratio comparison of gross income to total expenses. If the result is less than 1.05, a lower interest rate is assigned.

HPD officials provided us with the worksheets for the sampled projects, which they asserted support the interest rates assigned. We reviewed the worksheets and found that none contained the reasons for the interest rate assigned, nor was there evidence that any ratio tests had been performed. In fact, we applied the cited ratio test to one of the projects that received a lower rate and found that the lower rate was not supported since the ratio result was 1.14.

Moreover, by awarding interest rates lower than 3 percent in these five cases, we determined that the Program would lose about \$3.7 million in revenue over the life of the sampled loans.

## **Violation and Repairs**

Buildings in New York City are periodically inspected by HPD's Division of Code Enforcement (DCE) as well as other City agencies (e.g., Fire Department). DCE inspections focus on building owner compliance with the City's Housing Maintenance Code (HMC) and Multiple Dwelling Law (MDL). The HMC and MDL set requirements for health- and safety-related conditions such as lighting, ventilation, cleanliness, and where applicable, fire escapes and window guards. DCE inspectors issue violations to those building owners who are not compliant with the HMC or the MDL.

As a prerequisite to obtaining an Article 8-A loan, building owners must agree to remove all active violations in their buildings covered by the loan agreement. These violations are listed in a document known as the Voluntary Repairs Agreement (VRA). The inspectors who visit the sites for which owners are applying for an Article 8-A loan may also identify conditions that do not warrant a violation but still require the building owners to address by predetermined dates. Such repairs are listed in an HPD document referred to as the Housing Repair and Maintenance Agreement (HRMA).

We found that many of these violations and agreed-upon repairs remain uncorrected after their respective due dates - and, in some cases, for two to three years after the projects have been completed.

## Violations

Violations are grouped into three classes:

- Class C violations are considered the most severe and present an immediate hazardous condition (e.g., defective fire escapes, inadequate heat or hot water). Most Class C violations must be corrected within 24 hours. However, certain Class C violations are afforded 21 days for correction where a certification by a licensed contractor is required.
- Class B violations are considered less serious than Class C and include such conditions as broken smoke detectors and unlawful cooking spaces. Class B violations are to be corrected by the owners within 30 days of the violation's issuance.
- Class A violations, the least severe, are non-hazardous conditions such as defective gutters or lack of proper notice in the building of superintendent contact information. Class A violations are to be corrected by the owners within 90 days of the violation's issuance.

Article 8-A Program agreements offer owners more lenient timeframes to correct violations. For example, VRAs require Class C violations to be corrected within 30 days of the date the VRA was signed, and Class A and B violations must be corrected generally within one year from the date the VRA was signed.

The total number of violations for the nine projects reviewed was 1,806 as of the dates the respective VRAs were signed. On February 6, 2014, we checked the status of these violations on HPD's online violations database to determine whether they were corrected. As illustrated in the table below, 415 violations had not been corrected by the building owners, 93 of which were classified as Class C violations.

Project #	Class C Violations Not Corrected	Class C Violations to Be Corrected by	Class B Violations Not Corrected	Class A Violations Not Corrected	Class A & B Violations to Be Corrected by	Total Violations Not Corrected
1	29	8/01/2011	68	41	7/01/2013	138
2	1	7/31/2011	0	0	N/A	1
3	31	8/01/2011	105	84	7/01/2012	220
4	1	1/30/2011	2	0	12/22/2011	3
5	0	8/01/2012	0	0	7/01/2013	0
6	4	8/01/2011	6	5	7/01/2012	15
7*	12	10/01/2012	80	31	7/01/2014	123
8	15	8/01/2012	2	1	7/01/2013	18
9	0	8/01/2012	5	3	7/01/2013	8
	<b>93</b>		<b>268</b>	<b>165</b>		<b>526</b>

\*The contractual due date for Project 7's Class A & B violations is July 1, 2014. We have included them in the above table for illustrative purposes.



We noted that some of these outstanding Class C violations pose significant health risks for the tenants. For example, Project #3 had 15 outstanding Class C violations related to lead paint hazards that were issued in the 2008 and 2009 calendar years; Project #1 had an outstanding Class C violation related to mold that was issued in 2006.

We discussed this issue with HPD officials, who told us that their Division of Neighborhood Preservation (DNP) is responsible for monitoring building owners' correction of the violations listed in their VRAs. However, DNP officials acknowledged that they monitored VRA compliance for just 3 of the 34 buildings in the nine projects we sampled; they admitted they were unaware of the VRAs for the other 31 buildings. DNP officials further stated that they consider the owners to be in substantial compliance with their VRAs as long as 80 percent of the violations have been corrected.

For example, one significant unaddressed violation at Project #1 required the installation of child window guards by June 29, 2012. However, as of February 2014, they had not been installed, as illustrated by the following photograph. Note: According to HPD officials, the building's owner advised HPD that window guards were installed subsequent to our observation.



### *Repairs*

Generally, the repairs and maintenance work listed in the HRMAs are to be completed within a year after the completion of the project's loan-financed rehabilitation work. HPD may allow the

owner two years to complete the HRMA work if extenuating circumstances exist.

An HRMA was issued for eight of the nine projects in our sample. We determined that the work required under the HRMAs for two of the projects (#7 and #8) was not due to be completed until July 2014. Therefore, we limited our follow-up on the noted repairs to the other six projects. Our findings follow.

For Project #3, the HRMA required the building owner to complete certain items (painting the building's lobby and hallways) by July 1, 2013. When we visited this site on December 12, 2013, the public halls had not been painted and the paint in the building's lobby was chipping, as evident in the photograph below.



For the remaining five projects, we were either unable to gain access to the applicable areas of the buildings where the work was to be done or, if we had access, unable to determine through our observations whether the required work was done. As a result, we requested that HPD inspectors visit these projects and report to us on the status of the HRMA work. To date, HPD has not provided us with the requested information.

In some cases, project officials offered explanations for why the repairs had not been made yet. For example, when we inquired about the paint required for Project #3, project officials told us that they were waiting for completion of elevator rehabilitation work, which had yet to be started. We note, however, that these contracts are firm on the due dates for repairs.

In summary, HPD officials do not actively follow up on the violations and repairs that building owners agree to address and are an integral part of their Article 8-A loan contracts. As a result, the objective of the Program to alleviate unsafe and unsanitary building conditions is not always achieved. Further, when violations are not corrected and repairs not completed, there is increased risk that these buildings will go into financial distress, thus compromising the Program's intended objectives.

## **Preferential Treatment of Building Owner**

HPD officials have a fiduciary duty to ensure that the Program is administered fairly, without preference to specific building owners, and to maintain transparency over uses of taxpayer funding. Yet, we concluded that one building owner, Quadrant, consistently received more favorable terms from HPD than other owners in our sample. The inconsistent practices give the appearance of preferential treatment on the part of HPD. Such treatment could result in less Program monies available for other Program-eligible building owners.

Quadrant received \$13.749 million in Program loans for the three projects we selected for review (31 percent of the total awards during our audit scope period). Further, as previously detailed, Quadrant was the only building owner whose selected projects received loans with 1 percent interest rates. HPD officials informed us that the 1 percent rate was determined by prior HPD administration officials and did not provide us with any further details.

Further, Quadrant was the only owner in our sample whose Article 8-A loan included costs for construction management services (which totaled \$607,247) and covered project scope preparation, assistance with bidding, project supervision, and post-construction loan compliance.

While we acknowledge that the Law does not prohibit the inclusion of construction management services costs in the loan, we also noted that Quadrant did not contract with an external vendor to perform these services, as is commonly done for construction projects. Instead, the services were performed by Quadrant personnel, thus precluding potential benefits that could be derived from independent project oversight.

HPD officials told us that industry practice is to provide "contingency" allowances for unexpected cost overruns. We found that Quadrant's three projects received higher allowances for contingencies than the other projects in our sample. Specifically, Quadrant's three projects received contingency allowances of \$995,397 (7.24 percent of the total loan amount), while other projects in our sample received far less. For example, Project #3 received just \$7,500 in contingency allowance (0.81 percent of the loan amount), and another project received an allowance of \$27,524 (3.43 percent of the loan).

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## Recommendations

1. Enhance HPD's Rules and Regulations to require independent confirmation of owner affidavits to ensure that only eligible applicants receive loans.
2. Establish written procedures and guidelines for determining loan interest rates. Document the justification for any interest rate determinations below 3 percent.
3. Establish written guidelines for building inspections that would ensure timely project compliance with VRAs and HRMAs.
4. Investigate the circumstances surrounding the apparent preferential treatment afforded Quadrant as detailed in our report.

## Audit Scope and Methodology

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We conducted this audit to determine whether the loans awarded by HPD under the Article 8-A Program are being used only for qualified projects and their intended purpose, and whether loan recipients are complying with the requirements of their loans with respect to repairs and correcting violations. To accomplish our objectives, we reviewed the relevant laws and HPD's Rules and Regulations and procedures. We interviewed HPD officials and staff to obtain an understanding of their administration of Article 8-A projects. We selected a judgmental sample of nine projects where building owners were awarded Article 8-A loans during calendar years 2011 and 2012. We interviewed building owners and their staff and visited some of the buildings in our sampled projects. We reviewed supporting documentation for the sampled nine projects and compared violations listed in the projects' VRAs to violations listed in the Housing Maintenance Code and Multiple Dwelling Law violations database (HPD Online) as of February 6, 2014.

We conducted our performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained during our audit provides a reasonable basis for our findings and conclusions based on our audit objectives.

As is our practice, we notified City HPD officials at the outset of the audit that we would be requesting a representation letter in which agency management provides assurances, to the best of their knowledge, concerning the relevance, accuracy, and competence of the evidence provided to the auditors during the course of the audit. The representation letter is intended to confirm oral representations made to the auditors and to reduce the likelihood of misunderstandings. Agency officials normally use the representation letter to assert that, to the best of their knowledge, all relevant financial and programmatic records and related data have been provided to the auditors. They affirm either that the agency has complied with all laws, rules, and regulations applicable to its operations that would have a significant effect on the operating practices being audited, or that any exceptions have been disclosed to the auditors. However, officials at the New York City

Mayor's Office of Operations have informed us that, as a matter of policy, mayoral agency officials do not provide representation letters in connection with our audits. As a result, we lack assurance from City HPD officials that all relevant information was provided to us during the audit.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members to certain boards, commissions, and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these functions do not affect our ability to conduct independent audits of program performance.

## Authority

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This audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1, of the State Constitution and Article III of the General Municipal Law.

## Reporting Requirements

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We provided a draft copy of our report to HPD officials for their review and comment. Their comments were considered in preparing this report and are included in their entirety at the end of it. In their response, HPD officials agreed with some of our findings and recommendations. Accordingly, officials have already implemented (or are in the process of implementing) certain changes, including better documentation of staff decisions. HPD officials, however, disagreed with our recommendation to investigate the apparent preferential treatment afforded Quadrant. Our rejoinders to certain HPD comments are included in the report's State Comptroller's Comments.

Within 90 days of the final release of this report, we request that the Commissioner of the New York City Department of Housing Preservation and Development report to the State Comptroller advising what steps were taken to implement the recommendations contained in this report, and where recommendations were not implemented, the reasons why.

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## Contributors to This Report

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**Frank Patone**, CPA, Audit Director  
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## Division of State Government Accountability

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### Vision

A team of accountability experts respected for providing information that decision makers value.

### Mission

To improve government operations by conducting independent audits, reviews and evaluations of New York State and New York City taxpayer financed programs.

# Exhibit

Project	Address	Art 8 A Loan Amount
1	1044 Avenue St. John (Quadrant II) HDFC, Bx <ol style="list-style-type: none"> <li>1. 357E 150 Street, Bx</li> <li>2. 223 Cypress Ave, Bx</li> <li>3. 235 Cypress Ave, Bx</li> <li>4. 1034 Ave St John, Bx</li> <li>5. 1044 Ave St John, Bx</li> <li>6. 660 -664 St. Ann's Ave, Bx</li> <li>7. 941 Leggett Ave, Bx</li> <li>8. 835-837 Trinity Ave, Bx</li> </ol>	\$7,011,827
2	318-320 East 151st Street HDFC, Bx <ol style="list-style-type: none"> <li>1. 318 East 151 Street</li> <li>2. 320 East 151 Street</li> </ol>	\$803,083
3	1885-93 7th Ave, HDFC, Manhattan <ol style="list-style-type: none"> <li>1. 1885-1897 7th Ave, Manhattan</li> <li>2. 1889-1893 7th Ave, Manhattan</li> </ol>	\$924,177
4	1278 Union Ave , LTD, Bx <ol style="list-style-type: none"> <li>1. 1278 Union Ave, Bx</li> </ol>	\$663,400
5	St. John's Place Family Center, HDFC, Bk <ol style="list-style-type: none"> <li>1. 1604 St John's Place, Bk</li> <li>2. 1620 St John's Place, Bk</li> <li>3. 1630 St John's Place, Bk</li> </ol>	\$2,010,990
6	509 East 182nd St & 2678 Valentine Avenue, Bx <ol style="list-style-type: none"> <li>1. 509 E 182 St, Bx</li> <li>2. 2678 Valentine Ave, Bx</li> </ol>	\$792,702
7	582 Southern Boulevard (Quadrant III), HDFC, Bx <ol style="list-style-type: none"> <li>1. 353-355 Cypress Ave, Bx</li> <li>2. 582 Southern Blvd, Bx</li> <li>3. 586 Southern Blvd, Bx</li> <li>4. 623-625 Courtlandt Ave, Bx</li> <li>5. 647E 138 St, Bx</li> <li>6. 678E 138 St, Bx</li> <li>7. 749 Jackson Ave, Bx</li> <li>8. 751 Jackson Ave, Bx</li> <li>9. 700E 141 St, Bx</li> <li>10. 990 Leggett Ave, Bx</li> </ol>	\$5,289,815
8	582 Courtland Ave (Quadrant IV), HDFC, Bx <ol style="list-style-type: none"> <li>1. 578 Courtlandt Ave, Bx</li> <li>2. 582 Courtlandt Ave, Bx</li> <li>3. 596 Courtlandt Ave, Bx</li> <li>4. 598 Courtlandt Ave, Bx</li> <li>5. 630 Courtlandt Ave, Bx</li> </ol>	\$1,447,363
9	50 East 168 Street (WHDCO), Bx <ol style="list-style-type: none"> <li>1. 50 E 168 Street, Bx</li> </ol>	\$849,000

# Agency Comments



VICKI BEEN  
Commissioner

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

August 6, 2014

Tina Kim  
Deputy Comptroller  
Office of the State Comptroller  
Division of State Government Accountability  
123 William Street - 21 Floor  
New York, New York 10038

**Re: Audit of the Administration of the Article 8A Program at HPD**  
**Audit Number: 2013-N-4**

Dear Ms. Kim:

The following represents the Department of Housing Preservation and Development's response to the findings and recommendations contained in your audit on the Administration of the Article 8A Program by HPD.

If you have any additional questions, please call Assistant Commissioner Joshua Cucchiaro at 863-6610.

Thank you.

Sincerely,

Vicki Been



**HPD Response to NYS Office of the State Comptroller  
Audit of the Administration of the Article 8-A Loan Program  
Report 2013-N-4**

We are writing to respond to the draft findings of your audit of the Article 8-A Loan Program (Report 2013-N-4). As detailed below, HPD agrees with some of the audit findings and recommendations and has already implemented, or is in the process of implementing, changes accordingly.

**AUDIT FINDINGS AND RECOMMENDATIONS**

**COMPLIANCE WITH PROGRAM ELIGIBILITY REQUIREMENTS**

**Key findings:**

Although all nine files contained an owner affidavit stating they were unable to obtain funding from traditional sources, no one at HPD confirms an applicant's assertions. Thus, HPD officials have no assurance that an applicant's previous attempts to obtain traditional financing were actually denied. We also found that the application and affidavit for one of the projects had been submitted in 2006, five years before the loan was actually awarded. After five years, a building's income and expenses can change significantly.

**Recommendations:**

Enhance HPD's Rules and Regulations to require independent confirmation of owner affidavits to ensure that only eligible applicants receive loans.

**HPD's Response:**

HPD's 8-A Loan Program (or, the "Program") operates pursuant to Article 8-A of the New York State Private Housing Finance Law and Title 28, Chapter 2 of the Rules of the City of New York. The rules require that HPD obtain an affidavit from the owner that they have been unable to obtain private financing; neither the law nor the rules require the Program to verify the Affidavit on Inability to Obtain Private Financing provided by the Owner/Developer. An affidavit is a written sworn statement of fact by the borrower, serving as written evidence of any statement made therein. To further ensure we are lending appropriately, the Program conducts a review of the building's rehab needs, cash flow and debt situation to determine any need for the 8-A subsidized financing. Accordingly, HPD is in compliance with both existing rules and law.

In some circumstances, HPD may review with the owner the basis for rejection to help ensure the Program is assisting only those properties that cannot privately finance the rehabilitation costs. Interest rates for loans made through the Article 8-A Loan Program typically range from 0% to a maximum of 3%, with the rate and payment terms set based on the project's ability to meet income to expense and debt coverage ratios (see additional information in the "Unsupported Interest Rate" section below). Market interest rates currently utilized by private financial institutions for this product are between 4.5% and 7%. If we determine that a specific project has unusually high debt service coverage and/or income-to-expense coverage with the loan at the maximum interest rate of 3%, we would discuss the basis for the rejection with the applicant, explore options for privately financing the project, and/or consider eligibility for another HPD rehabilitation loan program.

* Comment 1
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\* See State Comptroller's Comments on page 24.

**HPD Response to NYS Office of the State Comptroller  
Audit of the Administration of the Article 8-A Loan Program  
Report 2013-N-4**

The auditors note that the application and affidavit for one of the projects was submitted five years before the loan was actually awarded, and question whether the affidavit was still valid so many years later. In the circumstance identified in the audit, the date of the affidavit was provided as required within a six-month time period of the application date. The regulations do not require that the affidavits be resubmitted if a loan doesn't close within a certain amount of time. As noted in more detail in the following section, HPD's determination of whether a building can support a given amount of private debt is made not just on the basis of the owner affidavit, but on a full review of the application and financial conditions of the project. The project in question could not have supported private debt based on income to expense and debt coverage requirements.

* Comment 2
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**UNSUPPORTED INTEREST RATES**

**Key findings:**

HPD's Rules and Regulations state that the loans are to bear a 3 percent interest rate unless otherwise determined by HPD officials. According to HPD officials, deviations from the 3 percent rate are supported by various financial analyses. We reviewed the worksheets that HPD officials provided for the sampled projects and found that none contained the reasons for the interest rate assigned, nor was there evidence that any ratio tests had been performed. In fact, we applied the cited ratio test to one of the projects that received a lower rate and found that the lower rate was not supported, since the ratio result was 1.14.

**Recommendations:**

Establish written procedures and guidelines for determining loan interest rates. Document the justification for any interest determinations below 3 percent.

**HPD's Response:**

The Program undertakes a full review of the financial condition of each building, and determines the interest rate charged based on industry underwriting standards. The loan approval backup contains summary data supporting those decisions. Specifically, industry standards, used to determine a property's ability to make loan payments and meet existing obligations are the debt service coverage ratio (DSCR) and income/expense ratio. These minimum requirements generally indicate that a project has sufficient income to cover expenses and debt service with minimum risk of default. We require that 8-A loans have a minimum DSCR of 1.25 if the 8-A loan is the only financing on the building and a minimum combined DSCR of 1.15 if additional mortgage loans are outstanding. In addition, properties should have an income to expense ratio of at least 1.05. Applicants for 8-A loans often have prior existing private debt; existing lenders may impose additional requirements and restrictions, including higher debt coverage or income to expense coverage, that need to be accounted for when setting interest rates.

However, while we are confident that our financial reviews satisfy these requirements, we agree that the process of setting interest rates should be better documented. For this reason, we

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began including additional narrative sections in the credit memorandum in fiscal year 2014 and will continue to do so in the future.

With regard to the project cited by the auditors that had a lower interest rate despite having an income/expense ratio of 1.14, it should be noted that while this was the income to expense coverage for this specific project, the project was assessed along with the other Quadrant properties known as the Quadrant Portfolio. This portfolio of troubled buildings (to be discussed further under the "Preferential Treatment" finding) collectively satisfied the requirements for a lower interest rate. Buildings with higher cash flows offset those with less available cash. The blended income to expense coverage for the four loans was 1.06 and the blended debt coverage ratio was 1.33; the projects could not have supported a higher interest rate while ensuring sufficient income to expense coverage. The interest rates were set to ensure the long-term viability of the entire portfolio.

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**PROJECT MONITORING**

**Key findings:**

We found that the number of visits made by HPD inspectors to their respective projects varied significantly, from between 12 (project #7) to 49 (project #3), during the life of the project. Further, HPD inspectors tended to make more visits to projects with lesser loan amounts. We also found that for those projects with lesser loan amounts, site visits were also made by inspectors with specific expertise (i.e. plumbing and electrical work) in addition to those made by the general construction inspector. In contrast, the projects with the higher loan amounts were visited by the general construction inspector only, even though they also had work performed in specialty areas.

**Recommendations:**

Establish written guidelines for building inspections that would ensure effective and consistent monitoring of construction projects.

***HPD's Response:***

The frequency of monitoring inspections is determined by project activity and construction stage. We note that the report indicates 12 monitoring reports were provided for Project #7 – Quadrant III. This is incorrect. Project #7- Quadrant III has a total of 10 buildings, with a total construction fund of \$5.3 million. Initially the audit team requested the monitoring reports for only one building within Project #7, 582 Southern Blvd., and HPD provided a total of 18 monitoring reports for that building. However, as part of our reply to the Preliminary Report #1, a total of 143 monitoring inspections were provided for the entire project. With regard to the frequency of site inspections, certain projects with a high dollar value had mechanical or electrical work of such a minor degree that a specialized mechanical or electrical inspector from HPD's Division of Building and Land Development Services ("BLDS") was not warranted. Specialized mechanical or electrical inspectors are assigned based on the degree of mechanical

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or electrical work being done on the project, which often is unrelated to the contract dollar amount of the project.

To provide improved consistency in monitoring, BLDs established Monitoring Guidelines in December 2013 that set forth in comprehensive detail the protocols that we expect our monitoring inspection staff to follow.

**VIOLATIONS AND REPAIRS**

**Key findings:**

As a prerequisite to obtaining an Article 8-A loan, building owners must agree to remove all active violations in their buildings covered by the loan agreement. These violations are listed in a document known as the Voluntary Repair Agreement (VRA). The inspectors who visit the sites for which owners are applying for an 8-A loan may also identify conditions that do not warrant a violation but still require the owners to address by predetermined dates. Such repairs are listed in an HPD document referred to as the Housing Repair and Maintenance Agreement (HRMA). We found that many of these violations and agree-upon repairs remain uncorrected after their respective due dates – and in some cases, for two to three years after the projects have been completed. HPD officials do not actively follow up on the violations and repairs that building owners agree to address and are an integral part of their Article 8-A loan contracts. As a result, the objective of the program to alleviate unsafe and unsanitary building conditions is not always achieved.

**Recommendations:**

Establish written guidelines for building inspections that would ensure timely project compliance with VRAs and HRMAs.

**HPD's Response:**

Pursuant to the Article 8-A Rules and Regulations, loans may be made to eliminate substandard or unsanitary conditions existing in a multiple dwelling in violation of the Multiple Dwelling Law or Housing Maintenance Code ("HMC"), or for the replacement and rehabilitation of the heating, plumbing, electrical and related systems or other improvements reasonably necessary to prolong the useful life of the building. The loans are not required to address all repair issues within buildings.

Violations clearance and completion of scope items included in the HRMA are the owner's responsibility. We acknowledge that HPD can do more to ensure that this work is completed as required. As such, we have implemented a change with regard to ensuring that HMC violations are corrected, and are exploring possible changes related to completion of the HRMA scope of work. The following subsections discuss the changes we have implemented or are considering in more detail:

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*Maintenance:*

Each 8-A loan is based on the scope of work. In the application, applicants request funds for certain repairs or improvements. HPD’s BLDS division performs an inspection of the property and prepares an intake report/scope of work. The scope of work includes all work that is required to bring it into substantial compliance with the Multiple Dwelling Law and Housing Maintenance Code. The applicant submits bids for the loan-funded portion of the scope of work for HPD to review, and the accepted bid is used to determine the amount of the hard cost included in the loan. HPD determines what portion of the scope of work will be covered by the HPD 8-A loan and what portion will be covered by the owner. At closing, the owner is required to execute an HRMA for the portion covered by the owner. It should be noted that work covered by the HRMA includes work that does not meet OMB capital funding eligibility requirements, as well as any capitally eligible work that exceeds the \$35,000 per unit loan cap. The HRMA requires that the owner complete the work identified within a certain period of time. HPD’s BLDS division monitors construction with regard to the 8-A loan funded scope of work and not the HRMA.

While it is the owner’s responsibility to complete the work identified in the HRMA, HPD can better ensure the owner completes this work. To accomplish this we are exploring ways to strengthen compliance, such as requiring the owner to submit an affidavit certifying that the work has been completed prior to releasing the final loan disbursement.

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*Violations:*

Article 8-A of the Private Housing Finance Law of New York requires that the project be brought into substantial compliance with the Multiple Dwelling Law and HMC no later than one year from the date set forth in the loan documents for the commencement of principal and interest payments on the loan. Substantial completion has been defined as clearance of 80% of the violations. HMC violations are issued if HPD receives a complaint and, upon inspection, HPD’s Division of Code Enforcement determines there is a violation. The HMC gives owners a defined period of time to cure the violation. If HPD does not receive the documentation that the violation has been cured, the violation stays on record even if the condition has been addressed. In the Article 8-A Loan Program, the loan-funded scope of work or owner-funded HRMA scope of work may address violation-related conditions. Regardless of the funding source, the owner is required to clear any HMC violations. HPD’s BLDS division inspectors monitor construction with regard to the loan-funded scope of work, not violations.

In fiscal year 2014, HPD’s Article 8-A Loan Program began requiring owners to submit a Certification that the violations were corrected within the required time period specified in the Notice of Violation, or a Dismissal Request. Through this process, the owner of a property with violations that were not corrected within the required time period can have their property inspected and have corrected violations removed from HPD’s records prior to the loan closing for all violations not being addressed by the scope of work. The building loan agreement requires that the owner clear any violations of record on the day of closing within the construction loan period. HPD is reviewing ways to strengthen compliance and is

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considering adding a requirement that the owner confirm that all violations have been cleared prior to the final loan disbursement.

In addition, we have some general comments and clarification concerning the operation of the Article 8-A Loan Program in relation to specific comments within this section of the audit:

- Over 80% of the violations of record at the time of the loan closings for the nine projects were cleared by the time of the audit. This is a significant improvement in the condition of the buildings, especially as all projects reviewed were still in construction at the time of review other than Project #4, which had cleared 96% of the violations.
- The draft audit notes one unaddressed violation at Project #1 which requires the installation of child window guards. The owner has confirmed that they have installed window guards for all required units.
- The draft audit also notes Project #3 has not been painted and the paint in the building's lobby was chipping. We note that the owner is completing elevator work at this project. The painting will be addressed upon completion of the elevator work. HPD extended the contract expiration date for the HRMA for this project in order to complete the work.

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**PREFERENTIAL TREATMENT OF BUILDING OWNER**

**Key findings:**

We concluded that one building owner, Quadrant, consistently received more favorable terms from HPD than other owners in our sample. Quadrant received \$13.749 million in program loans for the three projects we selected for review (31% of total awards during our audit period). Further, as previously detailed, Quadrant was the only building owner whose selected projects received loans with 1 percent interest rates. Further, Quadrant was the only owner in our sample whose Article 8-A loan included costs for construction management services (which totaled \$607,247). While we acknowledge that the Law does not prohibit the inclusion of construction management services costs in the loan, we also noted that Quadrant did not contract with an external vendor to perform these services. Instead, the services were performed by Quadrant personnel, thus precluding potential benefits that could be derived from independent project oversight. We found that Quadrant's three projects received higher allowances for contingencies than the other projects in the sample. Specifically, Quadrant's three projects received contingency allowances of \$995,397 (7.24 percent of the total loan amount) while other projects in our sample received far less.

**Recommendations:**

Investigate the circumstances surrounding the apparent preferential treatment afforded Quadrant as detailed in our report.

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**HPD's Response:**

HPD disagrees with the finding that preferential treatment was given to Quadrant and does not believe further investigation is warranted. All of the actions described as preferential treatment derived from the needs of the portfolio, not the particular ownership entity. Background on the properties is included below, followed by specific responses to the four categories of alleged preferential treatment.

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*Background:*

The Quadrant properties were part of a portfolio of 45 properties (1,229 units) owned by South Bronx Community Management (SBCM). Ownership of these properties was transferred to newly created housing development fund companies (HDFCs), including Quadrant Properties HDFC. HPD consented to this change in ownership and management as a key step in the implementation of a strategy to eliminate the financial and physical distress of these properties.

After the problems of mismanagement in the SBCM portfolio came to the attention of HPD, the agency considered several options to address the issue, including foreclosure. In this case, it was determined that foreclosure would not be the most efficient way to address the issues of physical deterioration and accrual of municipal arrears at these properties. The process would have been complicated and time consuming as there would have had to be several different foreclosure actions. The municipal arrears would have continued to grow, other debtors would have filed liens against the properties, and the eventual workout would have been more costly and complicated as a result.

The agency determined that the most effective means to address the physical and financial distress in these properties and maintain their affordability was to allow SBCM to retain nominal ownership, but for SBCM to transfer effective control and management to a new development entity with a history of successful affordable housing development and management. Under the workout plan, SBCM transferred ownership of 41 properties to Quadrant Properties HDFC, a joint venture between housing development fund corporations affiliated with SBCM and the new developer. These properties ultimately received rehabilitation funding either through HPD's Article 8-A Loan Program or another rehabilitation loan program as appropriate, based on the rehabilitation needs. The first tranche of the 8-A rehabilitation closing occurred in FY 2011.

*Responses:*

- While the amount allocated to Quadrant loans in the sample may be high as a percentage of the total 8-A budget, Quadrant represented four out of 27 loans during the audit period. The amount allocated was a function of the size of the Quadrant buildings. The four Quadrant buildings in the audit have a total of 709 units and were larger than the other buildings that also received 8-A loans during this time. The Quadrant portfolio received more because its buildings were larger, not because of a biased allocation of dollars. Funds are allocated to projects based on project needs and project readiness. If needs exceed the available program budget, the Office of Development can transfer funds from other program lines if necessary.

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- As stated in the interest rate section, the rates for specific loans are set based on the cash flow and debt circumstances of each project. The Quadrant portfolio was evaluated and underwritten as a package.
- An allocation for construction management services can be added to the budget for a number of reasons, including more complicated scopes and concerns about developer capacity. In the case of the Quadrant portfolio, the allocation represented a construction management fee, compensating the designated developer entity for the organizational expenses incurred in bringing this complicated project to completion. We may consider inclusion of such fees more broadly in future pipeline projects.
- Article 8-A loans usually include a contingency of 5%, and may be adjusted depending on the complexity of the scope of work or if conditions cannot be fully determined prior to the loan closing. We may also reduce the amount of the contingency if the loan exceeds the limitation of \$35,000 per unit. In order to utilize a contingency, the owner must submit a change order approved by HPD. If the contingency is not large enough to cover any additional needs, HPD could consider a loan increase as long as the total does not exceed \$35,000 per unit or require the owner to cover the costs. Given the complexity of the relevant Quadrant projects and since the loan was under \$35,000 per dwelling unit, we allowed contingencies of more than 5%.

**CONCLUSION**

HPD's Article 8-A Loan Program provides funds to improve multiple dwelling projects throughout NYC. The Program has initiated changes to further ensure qualified owners are awarded the loan proceeds, the financial stability of the project, rehabilitation work is successfully completed to improve projects' conditions, and owners comply with requirements to complete non-loan funded scope items and remove violations. Going forward, HPD will continue to explore ways to improve the Article 8-A process within the framework of our existing regulations and examine other means of assisting distressed properties. The Program will continue to evolve as further changes, some which are recommended by the Audit, are explored and implemented.

HPD thanks the New York State Office of the Comptroller for their work and looks forward to continuing to enhance the effectiveness of the Article 8-A Program.



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## State Comptroller's Comments

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1. We do not question the merit of reviewing with owners the basis for the rejection of an application for an Article 8-A Program loan. Nevertheless, we maintain our recommendation that HPD obtain independent verification of owner affidavits, on a test basis at least, to help ensure individual owner's eligibility and overall Program integrity.
2. We acknowledge that the regulations do not require affidavits to be resubmitted if a loan does not close within a certain amount of time. Nonetheless, the fact remains that nearly five years passed between loan application and approval, and as noted in our report, financial circumstances can change significantly over that amount of time. In this particular case, updated financial data could have helped to ensure the continued eligibility of the applicant. However, there was no documentation to indicate that updated information had been requested or obtained.
3. We can neither confirm nor challenge HPD officials' explanation for the loan in question to Quadrant. Officials provided us with no documentation of a comprehensive assessment of the "Quadrant Portfolio" either during the audit fieldwork or with their response to the draft audit report. Also, this is a further illustration of the unique manner in which Quadrant's application for this loan was administered.
4. Based on the information provided by HPD officials in their response, we deleted the section on Project Monitoring from our final report.
5. We do not question the merit of requiring owners to submit an affidavit certifying that they have completed work required by Housing Repair and Maintenance Agreements (HRMAs). Nevertheless, we maintain our recommendation that HPD develop written guidelines for inspections to ensure timely compliance with HRMAs. This could be particularly applicable when owners do not submit affidavits for the completion of required work.
6. We acknowledge that requesting owners to certify that building violations have been corrected within the required time periods will help ensure owners have taken the required actions. Nevertheless, we maintain our recommendation that HPD develop written guidelines for building inspections to ensure violations are corrected in a timely manner.
7. We added language to our report to note that the owner advised HPD that window guards were installed for all required units for the project in question.
8. As detailed in our report, it is clear that Quadrant received benefits related to interest rates, construction management fees, and contingency allowances that other applicants generally did not receive. Further, although HPD assessed the overall "Quadrant Portfolio," the fact remains that Program loans must be made on a project-by-project basis. In light of the unusually favorable loan package afforded Quadrant, we maintain our recommendation to investigate this project. Based on the results of the investigation, HPD should take corrective actions, as warranted.