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STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

April 12, 2017

Ms. Maria Torres-Springer
Commissioner
New York City Department of Housing Preservation and Development
100 Gold Street
New York, NY 10038

Re: Administration of the Article 8-A Loan
Program
Report 2016-F-24

Dear Commissioner Torres-Springer:

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, we have followed up on the actions taken by officials of the New York City Department of Housing Preservation and Development (HPD) to implement the recommendations contained in our audit report, *Administration of the Article 8-A Loan Program* (Report 2013-N-4).

Background, Scope and Objective

The New York City Department of Housing Preservation and Development (HPD) is the largest municipal housing preservation and development agency in the nation. The agency promotes the construction and preservation of affordable, high quality housing for low- and moderate-income families in thriving and diverse neighborhoods in every borough by enforcing housing quality standards, financing affordable housing development and preservation, and ensuring sound management of the City's affordable housing stock.

Our initial audit report, which was issued September 18, 2014, examined whether the loans awarded by HPD under the Article 8-A Loan Program (Program) were used only for qualified projects and their intended purpose, and whether loan recipients complied with the requirements of their loans with respect to correcting violations and making needed repairs. We found that HPD did not verify the accuracy of affidavits that building owners submitted to support their Program eligibility, and that the reduced interest rates assigned to some of these owners were not supported. We determined that interest rate reductions will cost the Program several millions of dollars in revenue over time. We also found that many significant building violations and agreed-upon repairs went unaddressed by owners, contrary to contractual requirements.

Finally, we found that one building owner appeared to receive favorable treatment from HPD, which could have resulted in less Program monies available for other Program-eligible building owners.

Following our audit, in October 2014, HPD created the Multifamily Housing Rehabilitation Program (HRP), which provides rehabilitation loans to help owners undertake improvements to existing multi-family buildings. The Program was placed under the umbrella of the HRP. The HRP also provides loans under Article 8 of New York's Private Housing Finance Law. HPD officials advised us of ten projects that received approximately \$10.8 million in total loans under the Program since October 2014.

The objective of our follow-up report was to assess the extent of implementation, as of February 24, 2017, of the four recommendations included in our initial audit report. We focused our review only on those loans provided under the Program.

Summary Conclusions and Status of Audit Recommendations

HPD officials made some progress in addressing the problems we identified in the initial audit report; however, additional actions are still needed. Of the initial report's four audit recommendations, two were partially implemented and two were not implemented.

Follow-Up Observations

Recommendation 1

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

Status – Not Implemented

Agency Action – HPD has not enhanced their rules and regulations to require independent confirmation of affidavits from building owners attesting that they were unable to obtain a loan from at least two traditional lenders. HPD disagreed with the recommendation, responding that loan eligibility is determined based on several factors other than the owner's affidavit, and that review of the loan underwriting will indicate whether a project can financially support private debt. They stated that it is unnecessary to investigate any further into the owners' ability to obtain private financing and that the current written procedures and guidelines for determining loan interest rates will help ensure that only eligible applicants receive loans.

The Rules of the City of New York require that HPD obtain an affidavit from owners receiving loans under the Program stating they are unable to obtain private financing. We continue to maintain that independent confirmation of these affidavits, at least on a test basis, would provide assurance that the applicants attempted to obtain, but were denied private financing.

Recommendation 2

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

Status – Partially Implemented

Agency Action – In July 2014, HPD revised the narrative section of the credit memorandum to clarify the rationale for the interest rate. A departmental memorandum issued in December 2014 explained that the interest rate is derived from the combined debt service coverage ratio and the overall expense coverage ratio for the project. The memorandum also provided an example for documenting these ratios, however, it did not explain how the specific interest rates were determined based on these ratios.

We reviewed all eight HRP projects that had an interest rate provided under the Program since October 2014. We found the credit memorandums listed the ratio used to justify the interest rate.

Also, HPD officials asserted that their staff are skilled and knowledgeable on industry standards, and therefore, more detailed procedures would not add value to their process. Nevertheless, written procedures and guidelines are essential for business continuity and constitute good business practice. Because these loans involve large sums of government funds, we maintain that greater transparency in documenting more specific guidelines for determining loan interest rates is appropriate.

Recommendation 3

Establish written guidelines for building inspections that would ensure timely project compliance with VRAs (Voluntary Repair Agreement) and HRMAs (Housing Repair & Maintenance Agreement).

Status – Partially Implemented

Agency Action – Following our audit, in December 2014, HPD established guidelines that require applicants to address violations and make other agreed-upon repairs and improvements. Specifically, the guidelines require borrowers to submit a Dismissal Request Form, acknowledging the violations they corrected prior to loan closing. Within 90 days, HPD should inspect the building to confirm whether the violations were corrected and remove corrected violations from their database. Under HPD guidelines, the borrower is required to remove all class C violations (the most serious) and 80% of class A and B violations which were open at the time of the original Dismissal Request Form, to be in substantial compliance with the loan agreement and before making the final loan payment.

However, for administrative expediency, and to limit filing costs, HPD explained that their practice is to require owners to submit a Dismissal Request Form for all open violations (even those to be corrected with the proceeds of the loan) prior to closing. HPD explained

that they inspect the property multiple times after receipt of the Dismissal Request Form, with the goal of ensuring that violations are removed before final payment. As the final loan payment can be years after the Dismissal Request Form was submitted, this practice does not ensure that violations are in fact timely corrected.

According to HPD, none of the ten projects they've approved since October 2014 have requested final payment, and therefore none have been required to meet this standard. We maintain that HPD should strengthen their procedures to provide greater assurance that borrowers are correcting violations timely, as required.

When building owners apply for a Program loan, HPD may identify conditions that are not violations, but still need to be addressed. Such repairs are listed in an HRMA. Owners are generally given one year to complete the repairs. HPD's December 2014 guidelines require the owner to provide a certification that the work was completed prior to final loan payment. The guidelines do not require HPD to inspect and verify that the work specified in the HRMA was completed.

Eight of the ten projects we reviewed had an HRMA, including five projects where the expected completion date had passed. All five were to be completed no later than July 2016. Nevertheless, HPD indicated that, as of February 2017, requests for final loan payments had not been made for any of the ten projects, and therefore, HPD had not received any certifications regarding the completion of the agreed-upon work.

Recommendation 4

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

Status – Not Implemented

Agency Action – In response to our initial audit, HPD stated that no further investigation was necessary, because they disagreed that preferential treatment was given to Quadrant. The original audit report detailed the benefits that Quadrant received related to interest rates, construction management fees, and contingency allowances that other applicants generally did not receive. Thus, we continue to recommend that HPD investigate this circumstance and take corrective actions, as warranted.

Major contributors to this report were Nicholas Angel, Peter Blanchett, Amitai Uriarte, and Tina Jiang.

We would appreciate your response to this report within 30 days, indicating any additional action planned to address the unresolved issues discussed in this report. We also thank HPD officials for the cooperation extended to our auditors during this review.

Very truly yours,

Cindi Frieder
Audit Manager

cc: G. Davis, Mayor's Office