

DISTRICT OF COLUMBIA OFFICE OF THE INSPECTOR GENERAL

OIG Project No. 20-1-23DB

September 2021



DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

DHCD Did Not Effectively and Efficiently Use the Housing Production Trust Fund to Produce Affordable Housing Units for Extremely Low-Income Households



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DHCD Did Not Effectively and Efficiently Use the Housing Production Trust Fund to Produce Affordable Housing Units for Extremely Low-Income Households

EXECUTIVE SUMMARY

WHY WE DID THIS AUDIT

The OIG identified this engagement because of stakeholder concerns regarding the production and preservation of affordable housing in the District of Columbia. The District uses the Housing Production Trust Fund (HPTF) as a primary tool to produce and preserve affordable housing.¹ According to D.C. Code §§ 42-2802(b-1)(1)-(2), at least 50 percent of the funds disbursed from the HPTF during a fiscal year shall be used to fund the creation and preservation of affordable housing units for extremely low-income (ELI) households. The remaining HPTF balance is required to be used to fund affordable housing units for very low-income (VLI) households (at least 40 percent) and low income (LI) households (10 percent or less). The audit focused on the Department of Housing and Community Development's (DHCD) use of the HPTF to produce and preserve affordable housing units.



OBJECTIVES

Our audit objectives were to assess: (1) the mechanisms used to produce and preserve affordable housing; and (2) how efficiently the HPTF provides and creates affordable housing for eligible District residents.

WHAT WE FOUND

DHCD met or exceeded its statutory goals for disbursing HPTF resources to produce and preserve affordable housing units for VLI and LI households. However, DHCD missed its statutory goals for disbursing HPTF resources to produce and preserve affordable housing units for ELI² households. Factors that contributed to the missed goals were DHCD's failure to:

- Follow its competitive project selection criteria included in the request for proposals. Our review of eight housing proposals, selected by the DHCD in Fiscal Year (FY) 2020, indicated that DHCD selected five lower-scored proposals instead of the higher-scored proposals. DHCD also did not select viable proposals that would have satisfied the funding requirements in creating housing opportunities for ELI households.
- Submit a required written request to the D.C. Council (Council) for a waiver when DHCD determines there are

¹ *Housing Production Trust Fund*, D.C. DEP'T OF HOUS. & CMTY. DEV., <https://dhcd.dc.gov/page/housing-production-trust-fund> (last visited Nov. 12, 2020).

² D.C. Code § 42-2801(3) defines "Extremely low income" as a "household with income equal to 30% or less of the area median income."

EXECUTIVE SUMMARY

not a sufficient number of viable housing proposals to produce and preserve affordable housing units for ELI households.

- Comparably increase the number of units produced or preserved when funding requirements were substantially increased after selections.

As a result, we calculate \$81.7 million in HPTF resources were used to produce and preserve affordable housing units for VLI and LI households, rather than the statutorily authorized use of these dollars to support housing needs for ELI households. We also calculated that DHCD disbursed an additional \$14.2 million of HPTF resources more than requested in project proposals, but DHCD did not comparably increase the number of units produced or preserved from these funds.

We identified 209 HPTF multi-family projects that DHCD should have monitored as part of its planned triennial compliance review process during the audit period. However, DHCD completed required compliance reviews only for 26 of 209 projects. Periodic compliance review would have identified instances where the HPTF did not produce or preserve affordable housing units as required in the loan agreements. As a result, DHCD could not assure that 88 percent of the projects funded with \$794.7 million from the HPTF were used to produce or preserve affordable housing units as required by the loan agreements.

Finally, we calculated \$10.2 million in past-due loans with no initiated collection activity or modification of loan terms. According to DHCD, “The majority of loans in the HPTF portfolio are structured as deferred loans, and many are also ‘cash flow loans’ payable out of available cash flow. Repayment is not necessarily its main priority.” Timely collection of outstanding loans is important as the collected funds can be redistributed for future affordable housing production and preservation.

WHAT WE RECOMMEND

The OIG made 20 recommendations for DHCD to identify and address noncompliance and control weaknesses, which in turn help DHCD to achieve HPTF strategic objectives effectively and efficiently, obtain reasonable assurance that affordable units are being produced and preserved for eligible residents, and prevent, detect, and correct past-due loans, overcharged rents, and improper payments.

MANAGEMENT RESPONSE

In total, we made 20 recommendations to DHCD for actions deemed necessary to correct the identified deficiencies. DHCD agreed with 10 recommendations, partially agreed with 2 recommendations, and disagreed with 8 recommendations.

GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Inspector General

Inspector General



September 30, 2021

Polly Donaldson
Director
Department of Housing and Community
Development
1800 Martin Luther King Jr., S.E.
Washington, D.C. 20020

Dear Director Donaldson:

Enclosed is our final report, *DHCD Did Not Effectively and Efficiently Use the Housing Production Trust Fund to Produce Affordable Housing Units for Extremely Low-Income Households* (OIG Project No. 20-1-23DB). We conducted this audit in accordance with generally accepted government auditing standards (GAGAS). Our audit objectives were to access: (1) the mechanisms used to produce and preserve affordable housing; and (2) how efficiently the HPTF provides and creates affordable housing for eligible District residents. The audit is included in our *Fiscal Year 2020 Audit and Inspection Plan*.

We provided the Department of Housing and Community Development (DHCD) with our draft report on September 9, 2021, and received its response on September 22, 2021, which is included in its entirety as Appendix E to this report. We appreciate that DHCD officials began addressing some of the findings immediately upon notification during the audit.

Our draft report included 20 recommendations we made to DHCD for actions we deemed necessary to correct identified deficiencies. DHCD agreed with Recommendations 2, 4, 7, 8, 13, 14, 16, 17, 19, and 20. Therefore, we consider these recommendations resolved but open pending evidence of stated actions. Although DHCD did not fully agree with Recommendations 10 and 15, DHCD's actions taken and/or planned are responsive and meet the recommendations intent. Therefore, we consider these recommendations resolved but open pending evidence of stated actions.

DHCD did not agree with Recommendations 1, 3, 5, 6, 9, 11, 12, and 18. Therefore, we consider these recommendations open and unresolved. We request that DHCD reconsider its position and provide additional responses to these Recommendations within 30 days of the date of this final report. During the audit, we received DHCD's views on our findings, recommendations, and conclusions in writing. We incorporated DHCD's views in our draft report if supported by sufficient and appropriate evidence. DHCD's September 22, 2021, response did not provide

Director Polly Donaldson
DHCD Did Not Effectively and Efficiently Use the Housing Production
Trust Fund to Produce Affordable Housing Units for Extremely
Low-Income Households
Final Report OIG No. 20-1-23DB
September 30, 2021
Page 2 of 3

additional evidence to support its disagreements. Based on DHCD's response, we re-examined our facts and conclusions and determined that the draft report is fairly presented.

We appreciate the cooperation and courtesies extended to our staff during this audit. If you have any questions concerning this report, please contact me or Fekede Gindaba, Assistant Inspector General for Audit, at (202) 727-2540.

Sincerely,

A handwritten signature in blue ink, appearing to read "D W Lucas", with a long horizontal stroke extending to the right.

Daniel W. Lucas
Inspector General

DWL/kh

Enclosure

cc: See Distribution List

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TABLE OF CONTENTS

	Page
BACKGROUND	1
FINDINGS	3
DHCD DID NOT ADEQUATELY DESIGN MECHANISMS TO PRODUCE AND PRESERVE AFFORDABLE HOUSING FOR ELIGIBLE DISTRICT RESIDENTS	3
DHCD Did Not Follow its Competitive Process to Select Housing Proposals Aligned with Statutory Requirements.	3
DHCD Did Not Obtain Council Approval When Statutory Funding Requirements Were Not Met.	5
DHCD Did Not Obtain Additional Housing Units for Increased Funding Requirements After Selections Were Made.	6
DHCD Did Not Periodically Compare Proposed Project Cash Flows to Actual Cash Flows to Ensure the Accuracy of Applicants’ Proposals.....	6
DHCD DID NOT ADEQUATELY CONDUCT COMPLIANCE REVIEWS TO ENSURE EFFICIENT USE OF THE HPTF	7
Required Periodic Monitoring Activities Were Not Conducted.	8
Maximum Allowable Rent Limits for Reserved Units were Exceeded.....	9
Required Tenant Income Eligibility Determinations Were Not Conducted.....	10
Established Income and Rent Limits Were Not Always Followed.....	11
Past Due Loans Were Not Identified for Collection Activities.....	11
Improvements to DHCD's Loan Recording Systems Are Needed.	12
Required Annual Certifications Were Not Conducted.....	13
CONCLUSION	13
AGENCY RESPONSES AND OFFICE OF THE INSPECTOR GENERAL COMMENTS	14
ACTIONS REQUIRED	14
Appendices	15

TABLE OF CONTENTS

Appendix A. Objectives, Scope, and Methodology	15
Appendix B. Acronyms and Abbreviations	17
Appendix C. Table of Recommendations	18
Appendix D. Comparison of Proposed to Actual Cash Flows.....	22
Appendix E. DHCD'S Response to Draft Report	23

BACKGROUND

The Department of Housing and Community Development's (DHCD) mission is to “produce and preserve opportunities for affordable housing and economic development, and to revitalize underserved communities in the District of Columbia.”³ DHCD focuses on the following specific strategic objectives to stimulate economic development: (1) producing and preserving the supply of quality affordable housing; (2) increasing homeownership opportunities for underserved communities; and (3) revitalizing neighborhoods, promoting community development, and providing economic opportunities.⁴

Established in 1988,⁵ the HPTF is a special revenue fund administered by DHCD’s Development Finance Division (DFD). The DFD is responsible for providing gap financing⁶ in the form of loans and grants. The HPTF is funded through 15 percent of revenue from deed recordation taxes and real property transfer taxes,⁷ “as well as through the District’s general fund”⁸ when applicable.

Audit Objectives

The objectives of this audit were to assess: (1) the mechanisms used to produce and preserve affordable housing; and (2) how efficiently the HPTF provides and creates affordable housing for eligible District residents. The audit focused on the fund’s performance in meeting its statutory objectives. To evaluate the fund’s performance, we examined DHCD’s process for projects selection activities and contract monitoring activities for the period of October 1, 2016, through June 30, 2020. The audit was included in the Office of the Inspector General’s (OIG) *FY 2020 Audit and Inspection Plan*. We conducted our audit from August 2020 to July 2021. We conducted this audit in accordance with generally accepted government auditing standards (GAGAS).

The OIG assessed DHCD’s compliance with federal and District laws and regulations, and DHCD policies and procedures governing HPTF operations. In addition, the OIG used the *United States Government Accountability Office (GAO) Standards for Internal Control in the Federal Government* (Green Book) to evaluate the design and implementation of DHCD’s control activities to ensure compliance with laws and regulations and effectiveness and efficiency of operations. Control activities are a component of an internal control system, and the Green Book defines an internal control system as “a continuous built-in component of operations, effected by people, that provides reasonable assurance, not absolute assurance, that

³ *Mission and Vision*, D.C. DEP’T OF HOUS. & CMTY. DEV, <https://dhcd.dc.gov/page/mission-and-vision-DHCD> (last visited Jul. 28, 2021).

⁴ *Id.*

⁵ Housing Production Trust Fund Act of 1988, D.C. Law 7-202, § 3 (D.C. 1988); *see also* D.C. Code § 42-2802.

⁶ Applicants must demonstrate that they have pursued and secured all other feasible funding sources before applying for DHCD funds.

⁷ D.C. Code § 42-2802(c)(16).

⁸ *Housing Production Trust Fund* | [dhcd \(dc.gov\)](https://dhcd.dc.gov) (last visited Jul 28, 2021).

an entity's objectives will be achieved.”⁹ In addition to the federal government, GAO also recommends that state, local, and quasi-governmental entities follow these internal control standards.

DHCD's Competitive Selection Process for Disbursing HPTF

DHCD develops and revises its Qualified Allocation Plan (QAP)¹⁰ to periodically examine and update its project proposal minimum threshold and scoring criteria. To reflect its most current goals and priorities, DHCD releases the QAP and proposed updates to scoring for public comment. After evaluating public comments, DHCD finalizes the update of the minimum threshold and scoring criteria into a *Consolidated Request for Proposal* (RFP). To identify and fund projects that will produce and preserve affordable housing for District residents, DHCD issues a RFP and solicits qualified applicants. We note that DHCD obtained public comment prior to releasing the 2019 RFP. DHCD released the RFP on June 28, 2019, and required all responses to be created and submitted in DHCD's online application system by September 18, 2019. To address new features and questions applicants had about the RFP process, DHCD conducted an RFP orientation on July 25, 2019.

There are four stages in DHCD's RFP evaluation for financing processes: 1) Threshold Review; 2) Scoring and Selections; 3) Underwriting; and 4) Pre-Closing Due Diligence. Applicants that meet the Threshold Eligibility Requirements will be advanced to the scoring stage. During the scoring stage, applications are scored against underwriting and prioritization scoring criteria. Applications, scores, and tentative DFD recommendations are forwarded to the District Government Partners' Interagency Review Panel (Panel) for review and comment. The Panel will provide assistance, concerns, and insights about the proposal and project sponsor.

⁹ U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-14-704G, STANDARDS FOR INTERNAL CONTROL IN THE FEDERAL GOV'T (Green Book), § OV1.04 at 5 (Sept. 2014), <https://www.gao.gov/products/GAO-14-704G> (last visited Dec. 29, 2020).

¹⁰ Federal requirement for Low Income Housing Tax Credit that aligns with and defines RFP scoring criteria.

FINDINGS

DHCD DID NOT ADEQUATELY DESIGN MECHANISMS TO PRODUCE AND PRESERVE AFFORDABLE HOUSING FOR ELIGIBLE DISTRICT RESIDENTS

DHCD met or exceeded its statutory goals for disbursing HPTF resources to produce and preserve affordable housing units for VLI and LI households. However, DHCD did not (1) follow its competitive process to select housing proposals that were aligned with statutory requirements, (2) obtain required Council approval when statutory use of funding was not met, (3) obtain additional housing units for increased funding requirements after selections were made, and (4) compare proposed project cash flows to actual cash flows to ensure the accuracy of applicants' proposals. What follows is a discussion of each of these conditions.

DHCD Did Not Follow its Competitive Process to Select Housing Proposals Aligned with Statutory Requirements.

During the 2019 request for proposal (RFP) process, DHCD received 37 submissions, of which 31 were considered viable HPTF housing proposals. Our review of eight housing proposals the DHCD selected in FY 2020 for funding indicated that DHCD selected lower-scored proposals over higher-scored proposals. Although DHCD provided adequate explanations for the selections of lower-scored proposals, DHCD did not maintain explanations for not selecting highly-ranked proposals as part of RFP documentation. Below we discuss weaknesses related to DHCD's competitive selection process.

DHCD overruled its threshold determination requirements.

For the 2019 RFP, DHCD overruled DFD's determinations on February 4, 2020, with explanations for 6 of the 10 projects. DFD finalized its Threshold Review on December 20, 2019 and made written Threshold Eligibility Determinations showing that 10 housing proposals did not meet the minimum requirements. For example, for one of the projects DFD determined that "[t]he RFP requires that all projects above \$10 million submit a 4% LIHTC [Low Income Housing Tax Credit] scenario. Though the TDC [total development cost] for this project was \$15.6 million, the applicant did not provide a 4% scenario."

As part of the Threshold Review, DFD gave the applicant an opportunity to provide the required information but the applicant failed to do so. DHCD overruled DFD's determination by stating "[t]he language in the RFP is not explicit in requiring the submission of a 4% scenario." However, our review of the RFP language indicates that there was an explicit requirement. According to the RFP, "DHCD expects any project with \$10 million or more in total development costs to present a financing scenario that uses 4 percent LIHTCs."

Input from the independent review Panel was not documented.

On March 4, 2020, DFD met with the Panel to discuss potential concerns or insights regarding the applicants' proposals. DFD did not document the Panel's inputs it received and the meeting outcomes. On March 6, 2020, DFD finalized its scoring of the 31 HPTF proposals. However,

DFD's final score and recommendations did not include evidence of the independent review Panel's input.

DHCD overruled DFD's March 6, 2020 recommendations.

On June 29, 2020, DHCD selected 8 of 31 housing proposals for funding. Our review of the eight selected proposals indicated that DHCD selected lower-scored proposals instead of higher-scored proposals and did not maintain explanations in the project files or decision memorandums. Such explanations would have included applying newly introduced selection factors,¹¹ if any, after the scoring process was completed, to all 31 HPTF proposals and recalculating the total scoring for each proposal so that DHCD could demonstrate that each proposal received equal consideration and was evaluated on the same factors.

According to a DHCD official:

I am bestowed with the authority to make the final selection of projects that I determine are in the best interest of the District. The recommendations, scoring, and supporting documentation I receive from the DFD team are informative and help me understand the project proposals, but are just some of the evaluative factors I use to make my final decisions. I also draw upon my extensive experience, expertise, and background in affordable housing finance, priorities for the production and preservation of affordable housing, resource availability, and my awareness of the statutes and regulations that govern the Housing Production Trust Fund.

However, the review process may be more effective when the official provides input to the QAP and RFP processes designed to capture "evaluative factors" and make necessary adjustments rather than override decisions made by DFD staff that have spent a considerable amount of time and effort to rank projects.

As a result of DHCD not following its competitive process to select housing proposals, final housing proposal selections were not made based on objective criteria included in the RFP process designed to promote accountability and transparency.

Conflict of interest disclosures were not considered.

DHCD did not establish policies and procedures to require and document that all personnel involved in the proposal review and selection process disclose any conflicts of interest related to the proposals under evaluation. Without requiring and documenting conflict of interest disclosures specific to DHCD, DHCD cannot obtain reasonable assurance that all personnel involved in the proposal review and selection process acted in the District's best interest and did not personally benefit or gain from the selection decision.

¹¹ Selection factors not included in the RFP.

We recommend that the Director, DHCD:

1. Develop procedures to require and enforce adherence to selection criteria included in the RFP, which shall apply to all DHCD personnel.
2. Develop a plan to evaluate DHCD's current selection criteria to better align selection criteria with statutory requirements to produce and preserve more units for extremely low-income households.
3. Develop policy and procedures to ensure that all DHCD employees engaged in the project selection process disclose any conflicts of interest.
4. Develop policy and procedures to ensure that the District Government Partners' Interagency Review Panel concerns and insights are documented and considered in the evaluation process.

DHCD Did Not Obtain Council Approval When Statutory Funding Requirements Were Not Met.

To determine whether the funding for selected projects was statutorily authorized, we reviewed applicable D.C. Code sections. According to D.C. Code § 42-2802(b-1)(2), at least 50 percent¹² of funds disbursed from the HPTF during a fiscal year shall be used in creating housing opportunities for ELI households. DHCD did not disburse at least 50 percent of the HPTF to produce housing opportunities for ELI households as required.

Our analysis of the four most recent RFPs¹³ indicated that DHCD should have spent at least \$142.8 million to produce and preserve affordable units for ELI households. However, DHCD spent \$61.1 million (43 percent of the \$142.8 million), creating housing opportunities for ELI households. Our evaluation of the 31 viable housing proposals included in the 2019 RFP indicated that DHCD had multiple alternatives that met the statutory funding requirements and would have produced and preserved more affordable housing units for ELI households.

According to a DHCD official, “[w]hile I do admit that we have not hit the statutory buckets ... I cannot and will not select projects simply based on a formula to achieve the statutory buckets. Doing so would simply recreate failed housing policy of old by concentrating deeply affordable units in certain parts of the city.”

D.C. Code § 42-2802(b-1) (2) previously stated that “[t]he Mayor may submit a written request to the Council for a waiver of the 40 percent requirement if, by the 4th quarter of the fiscal year,

¹² Effective September 11, 2019, the funding requirement in D.C. Code § 42-2802(b-1) (2) was increased from 40 percent to 50 percent for ELI housing households. See Housing Production Trust Fund Target Modification Amendment Act of 2019, D.C. Law 23-16, §§ 2181-2182 (D.C. 2019)

¹³ The four most recent RFPs include 2017 Spring, 2017 Fall, 2018, and 2019. The 2017 Spring, 2017 Fall, and 2018 were issued before September 11, 2019, and required 40 percent of funds disbursed from HPTF during a fiscal year should be used in creating housing opportunities for ELI households.

the Mayor has not received a sufficient number of viable housing proposals” and was later amended to reflect that the Mayor could request a waiver for the 50 percent requirement.¹⁴

As a result of DHCD missing its statutory goals for disbursing HPTF resources to produce and preserve affordable housing units for ELI households, we calculate \$81.7 million (57 percent of the \$142.8 million) in HPTF resources used to produce and preserve affordable housing units for VLI and LI households, rather than the statutorily authorized use of these dollars to support housing needs for ELI households.

We recommend that the Director, DHCD:

5. Develop procedures to request and obtain a required waiver from the Council prior to selecting and funding projects when proposals received do not meet statutory funding requirements.

DHCD Did Not Obtain Additional Housing Units for Increased Funding Requirements After Selections Were Made.

To determine whether the selected housing proposals also received additional funding during the underwriting process, we compared applicants' requests to actual funding documentation. We found instances where DHCD substantially increased the funding amount (after selection based on all submitted proposals) but did not comparably increase the number of units being produced or preserved by that proposal. For example, an applicant submitted two projects to DHCD proposing 131 affordable housing units and combining the projects into one with \$8.0 million in HPTF financing. DHCD increased the funding level to \$9.7 million without ensuring the number of affordable units increased.

According to a DHCD official, the funding increase is due to construction cost increases between the application and loan closing dates. However, DHCD has not provided documentation to support construction cost increases. In total, we noted that DHCD increased funding by \$14.2 million for 13 housing proposals without comparably increasing the number of affordable housing units or providing documentation to support construction cost increases.

We recommend that the Director, DHCD:

6. Develop policies and procedures to ensure additional affordable housing units are produced when project funding is increased.

DHCD Did Not Periodically Compare Proposed Project Cash Flows to Actual Cash Flows to Ensure the Accuracy of Applicants' Proposals.

To determine whether selected projects were financially performing as expected, we compared proposed project cash flows to actual cash flows and found that projects were not generating cash flows from operations as projected. We noted proposed project expenses and financing

¹⁴ Effective September 11, 2019.

costs were significantly understated in the project proposals, which adversely impacted actual cash flows. For example, our review of a project file indicated proposed administrative expenses were \$92,015 per year, while corresponding actual administrative expenses were \$294,427, indicating a 220 percent increase. Administrative expenses were significantly understated in the proposal, and the 220 percent increase was significantly outside DHCD's proposal tolerance.¹⁵ (See Appendix D.) Finally, proposed financing costs were \$304,229 per year, and corresponding actual financing costs were \$438,047, indicating a 44 percent increase, which is outside DHCD's acceptable range.

According to the HPTF loan agreements, loan repayments are not required when the project has a negative cash flow. The borrower for this project could not pay back interest and principal to the HPTF as planned due to cash flow shortages. Specifically, we note that the proposed cash flows for the project were positive \$60,846, but actual cash flows were negative \$252,178 per year. We attribute projects not performing as expected to inaccurate proposal expense estimates and/or mismanagement of properties.

According to a DHCD official, "the step after project selection is a thorough underwriting of the project, its budget, and operating projections. So, by the time a project closes, all partners have a much better picture of the financial projections and have found them acceptable to meet their individual funding constraints and requirements." However, DHCD did not provide evidence for our review indicating that applicants provided DHCD revised financial projections during the underwriting process. Comparing proposed project cash flows to actual cash flows helps DHCD evaluate its scoring and selection process to reduce risks of non-payment and identify developers that provide unrealistic cash flows at the time of application.

We recommend that the Director, DHCD:

7. Develop policies and procedures to periodically compare proposed project cash flows to actual cash flows and hold borrowers accountable for inaccurate proposals.

DHCD DID NOT ADEQUATELY CONDUCT COMPLIANCE REVIEWS TO ENSURE EFFICIENT USE OF THE HPTF

DHCD did not adequately monitor its portfolio of HPTF loan performances to ensure compliance with loan terms and conditions. To assist with this task, DHCD engaged a contractor to conduct 900 project compliance reviews during our audit period. According to payment data in Procurement Automated Support System (PASS), the contractor billed and received approximately \$9.4 million over 5 years. However, invoices did not demonstrate that the contractor performed project compliance reviews as required. What follows is a discussion of examples where required monitoring activities were not performed as required and DHCD's failure to ensure the contractor performed compliance reviews in accordance with contract terms and conditions.

¹⁵ DHCD has determined that changes in actual project financing amounts not exceeding 10 percent of proposed funding are considered acceptable for post-proposal changes.

Required Periodic Monitoring Activities Were Not Conducted.

We identified 209 HPTF multi-family projects that DHCD or the contractor should have monitored as part of the triennial compliance review process during the audit period. However, DHCD completed the required compliance reviews for 26 of 209 projects. Our review of available information indicated that the contractor did not conduct any of the ongoing or triennial compliance reviews of these projects.¹⁶ These reviews ensure continuing compliance with HPTF requirements. (See Table 1 below.)

Table 1: Summary of Planned and Actual Reviews of Multi-Family Properties and Value of Portfolio Reviewed

Calendar Year	Planned Reviews	DHCD Actual Reviews ¹⁷	Contractor Reviews	Value of Loans Reviewed (in millions)
2017	66	10	0	\$ 44.1
2018	59	10	0	68.9
2019	16	6	0	39.4
Not Scheduled	68	0	0	0.0
Total	209 ¹⁸	26 (12%)	0	\$ 152.4 (16%)

Source: OIG analysis of HPTF loan portfolio and DHCD inspection schedule.

Periodic compliance review would have identified instances where HPTF did not produce or preserve affordable housing units as required in the loan agreements. DHCD’s failure to monitor contractor performance contributed to the contractor’s failure to conduct required triennial compliance reviews. According to DHCD:

The [contractor] was engaged to perform “On-going Multi-Family Asset Monitoring and Reporting Services” under CLIN 0002 and specifically outlined in Sections C.5.3 and C.5.8 of the contract. Monthly Status Reports indicate the [contractor] fully fulfilled its obligations under Section C.5.8 of the contract and fulfilled work under Section C.5.3 of the contract, as directed by the agency. The [contractor] appropriately invoiced and was paid for services performed as directed.

DHCD provided “Monthly Status Reports” for May and June 2016 as part of its written explanations. We could not rely on the monthly status reports because the documents were produced on July 8, 2021. The monthly status reports also did not include the number of HPTF multi-family compliance services the contractor performed.

¹⁶ Contract CW35134, line items 1002, 2002, 3002, and 4002 specify on-going multi-family asset, monitoring, and reporting services and meetings. The vendor was contracted to perform 300 project reviews in option year 4.

¹⁷ Actual reviews exclude multiple reviews performed on the same property and properties with no funding from the HPTF.

¹⁸ The value of the multi-family loans in the HPTF portfolio as of July 31, 2020, was approximately \$947.1 million.

As a result, DHCD could not assure that 88 percent of the projects funded with \$794.7 million from the HPTF were used to produce or preserve affordable housing units as required by the loan agreements.

We recommend that the Director, DHCD:

8. Develop procedures to ensure DHCD's triennial compliance review plans include all HPTF rental properties and are fully completed as scheduled.
9. Perform reconciliation of deliverables under Contract Line Item Numbers (CLIN) 1002, 2002, and 3002 to determine and recoup any excess payments from the contractor as appropriate.
10. Recoup from the contractor \$2,352,000 in improper payments for not conducting required on-going multi-family asset monitoring, and reporting services under CLIN 1002 during the option year 4 contract term.

Maximum Allowable Rent Limits for Reserved Units were Exceeded.

According to 10B DCMR § 4107.3(b), the "maximum allowable monthly rents for Reserved Units, including utilities, determined periodically by DHCD shall be based on thirty percent (30%) of one-twelfth (1/12) of the annual top income limit for low, very low and extremely low income households, as published periodically by DHCD." We found that monthly rents for some reserved HPTF units improperly exceeded the maximum allowable rent limits that DHCD published.

For example, an apartment complex funded by the HPTF produced 19 affordable housing units, but the landlord charged and collected rents higher than allowed on 14 of the 19 units. We attribute this condition to DHCD's contractor failing to review and detect the landlord's unauthorized rents.

According to the scope of the contract, the contractor is required to conduct a "thorough ongoing review and monitoring of overall compliance with all applicable loan documents and DHCD affordable housing program requirements." The contractor did review tenants' annual self-reported information, including established rent limits, but the contractor failed to identify and report the landlord's non-compliance with maximum allowed rent limits to DHCD for action.

According to DHCD:

The initial application started in 2007 or 2008 and completing the project rehabilitation process took about 10 years. The ... units have a mix of income levels with the majority at 80% [of Median Family Income] MFI. At lease-up, the property accepted applications from residents who had a tenant-based voucher. DHCD legally cannot prohibit properties from accepting tenant-based vouchers for DCHD [sic] subsidized buildings because

discriminating based on source of income is illegal. The property charged the allowable voucher contract rents.

In instances where the issue of voucher contract rents has come up, the Director has waived the HPTF rent limit pursuant to 10B DCMR section 4100.4 where imposition of the HPTF rent limit would adversely impact the viability of the affordable housing project.

However, DHCD has not provided evidence that the waiver was obtained from the Director as required. DHCD also did not make changes to the terms and conditions of the loan agreement to allow the landlord to charge a higher rent amount. We estimate \$114,528 per year in unauthorized rent charged for reserved HPTF units for one apartment complex in our sample.

We recommend that the Director, DHCD:

11. Recoup from the landlord \$114,528 per year in unauthorized excess rents.
12. Make additional determinations and recoup rent as appropriate for the project period outside the audit period.
13. Develop procedures to ensure landlords do not charge in excess of the maximum allowable rent for reserved units.

Required Tenant Income Eligibility Determinations Were Not Conducted.

According to section C.5.3.1.4, the contractor is required to complete an initial tenant file review to ensure compliance with all applicable loan documents. Tenant income eligibility reviews were not performed for 128 of the 1,070 tenant applications we examined. We attribute this condition to the contractor's failure to determine income eligibility by conducting initial tenant file reviews for first-year leases as required.

According to DHCD, "Section C.5.3.1.4 requires the contractor to "conduct initial tenant file review, based upon files provided by DHCD, the borrower or its management agent." The contractor conducted eligibility reviews, when files were provided, in accordance with the relevant contract section." We note that DHCD provided access to the 128 files as part of ongoing compliance review requirements. As a result of not performing tenant income eligibility reviews, DHCD could not assure that projects were reserved as affordable housing for eligible households.

We recommend that the Director, DHCD:

14. Determine which properties did not receive initial income certification and eligibility reviews in the last 3 years and prioritize those properties in the triennial review plan.

Established Income and Rent Limits Were Not Always Followed.

Landlords did not always follow annually published income and rent limits when approving tenant residency in reserved units. According to D.C. Code § 42-2802(a), the HPTF shall provide “assistance in housing production for targeted populations.” However, we noted instances where reserved units set aside for one targeted population were utilized by a different targeted population. For example, an ELI three-person household, with an annual household income of \$6,948 could reside in a unit reserved for a LI household. Income limits for LI three-person households were between \$52,751 and \$84,400 per year.¹⁹

According to DHCD, it “does not restrict an extremely low income household (0%-30% MFI) from renting an affordable unit reserved for a low-income household (51-80% MFI). If the extremely low-income household is able to qualify for the unit, whether it is by using a housing subsidy or through some other means, then DHCD will not prohibit that family from attaining safe, affordable housing by renting that vacant unit.”

Although the application form requires explicitly disclosing all sources of income, in the example above, the applicant did not disclose a housing subsidy amount or other means that DHCD described in its explanations. As a result, units produced for specific income classes were utilized by other targeted populations.

We recommend that the Director, DHCD:

15. Develop procedures to ensure units are reserved for specific targeted populations and are utilized by their intended population.

Past Due Loans Were Not Identified for Collection Activities.

We found past-due loans²⁰ with principal and interest balances for which DHCD has not initiated collection activity or sought to modify the loan terms. Our analysis of outstanding loans in the portfolio as of July 31, 2020, indicated 493 loans with an original loan value of \$996.3 million. The current principal balance of these loans is \$964.4 million and an additional \$68.3 million in accrued (unpaid) interest. We attribute this condition to DHCD’s failure to monitor its portfolio or to ensure the contractor-provided monitoring services are under contract terms and conditions. Section C.5.2.2 of the contract required the “contractor [to] identify which, if any, loans should be written off as bad debts, sent to a collection agency, sold to a third party or otherwise disposed or transferred, or modified or restructured with the borrower.”

According to a DHCD official:

The majority of loans in the HPTF portfolio are structured as deferred loans and many are also “cash flow loans” payable out of available cash flow. These are intentional structures used to get

¹⁹ Income limit for three-person LI household for the 12 months beginning July 1, 2018.

²⁰ Past due loans are loans that remain outstanding at the end of the loan maturity date. Some loans were past due for more than 6 years.

these much needed affordable housing projects across the finish line to closing. Again, the purpose of the Housing Production Trust Fund is the production, and preservation, of affordable housing. Repayment is not necessarily its main priority.

Timely collection of outstanding loans is important because collected funds are redistributed for future affordable housing production and preservation. In total, we calculated \$10.2 million in past-due loans for which DHCD has not initiated collection activity or sought to modify the loan terms.

We recommend that the Director, DHCD:

16. Develop a plan to assess the contractor's performance under the contract to ensure the contractor adequately assessed and analyzed existing loans to reduce loan delinquencies and increase collections of the multi-family housing projects as required.
17. Develop a plan to identify loan balances approaching maturity and determine the best course of action for the District.

Improvements to DHCD's Loan Recording Systems Are Needed.

According to contract section C.5.2.1, the “contractor shall review and evaluate the DHCD's database of loans within its portfolio of low income, affordable and LIHTC housing projects[,] make recommendations to reduce loan delinquencies, increase collections and improve any of the DHCD's loan collection and recording systems.”²¹ Our review of DHCD's loan portfolio records identified several data errors. For example, we noted two examples where the property address was out of state. Also, we noted numerous cases in which the property address listed was not the actual address of the affordable housing property. Further, there were approximately 89 loans with a maturity date of 12/31/2099, and most of those loans had no loan terms identified in the records.

According to DHCD, “[l]oans with a maturity date of 2099 are “pay upon sale” loans meaning the balance is only due to be repaid upon sale of the property and 2099 is used as a placeholder.” However, of the 89 outstanding loans indicated as “pay upon sale,” we determined that DHCD incorrectly identified 7 loans as either HPTF-Deferred, multi-family loans, or the loan received multiple funding sources. We attribute the data errors identified in the loan portfolio records to a lack of management oversight over the contractor. The data errors in the account status report impact DHCD's ability to prepare meaningful portfolio analyses.

²¹ DHCD provided a draft copy of a report to meet this requirement. We did not observe any evidence that this report was finalized or accepted by the contract administrator.

We recommend that the Director, DHCD:

18. Conduct reconciliation of deliverables under contract section C.5.2.1 to determine and recoup any excess payments from the contractor for not conducting the necessary reviews of loan databases.
19. Conduct a review of the loan portfolio to ensure data errors are corrected and are accurately reflected.

Required Annual Certifications Were Not Conducted.

We found 42 Limited Equity Cooperative (LEC) projects for which DHCD did not obtain the required annual certifications. According to some LEC project loan agreements that we reviewed, the LEC is required to certify every year that all reserved units will be leased to low or very low-income households.²² We note that DHCD is in the process of developing Standard Operating Procedures (SOPs) to enforce the requirement to obtain LEC yearly certifications.

According to DHCD, “LECs [will be included] in its 2021 annual reporting activities, which include both project financial reporting and project compliance reporting (in the form of the Annual Owner’s Certification of Continuing Program Compliance). Targeted outreach will be conducted in the initial year to ensure understanding and compliance with the process.” As a result of not obtaining the required annual certifications, DHCD could not assure that 42 LEC projects, funded with \$114.1 million from the HPTF, produced housing for eligible households.

We recommend that the Director, DHCD:

20. Establish policies and procedures to ensure LEC projects are properly monitored for compliance with HPTF program requirements.

CONCLUSION

Although DHCD met or exceeded its statutory goals for disbursing HPTF to produce and preserve affordable housing units for VLI and LI households, they did not meet the statutory goal for ELI households. The internal controls in place did not adequately reduce the risks of periodic monitoring activities not being conducted, allowable rents exceeding rent limits, and past due loans not being identified for collection activities. Without addressing the internal control weaknesses identified, DHCD cannot ensure HPTF statutory objectives are met and yield intended benefits for the District.

²² Paraphrased excerpt from a loan agreement between a cooperative association and the District in FY 2017.

AGENCY RESPONSES AND OFFICE OF THE INSPECTOR GENERAL COMMENTS

We provided the Department of Housing and Community Development (DHCD) with our draft report on September 9, 2021, and received its response on September 22, 2021, which is included in its entirety as Appendix E to this report. We appreciate that DHCD officials began addressing some of the findings immediately upon notification during the audit.

Our draft report included 20 recommendations we made to DHCD for actions we deemed necessary to correct identified deficiencies. DHCD agreed with Recommendations 2, 4, 7, 8, 13, 14, 16, 17, 19, and 20. Therefore, we consider these recommendations resolved but open pending evidence of stated actions. Although DHCD did not fully agree with Recommendations 10 and 15, DHCD's actions taken and/or planned are responsive and meet the recommendations intent. Therefore, we consider these recommendations resolved but open pending evidence of stated actions.

DHCD did not agree with the remaining Recommendations 1, 3, 5, 6, 9, 11, 12, and 18. Therefore, we consider these recommendations open and unresolved. We request that DHCD reconsider its position and provide additional responses to these Recommendations within 30 days of the date of this final report. During the audit, we received DHCD's views on our findings, recommendations, and conclusions in writing. We incorporated DHCD's views in our draft report if supported by sufficient and appropriate evidence. DHCD's September 22, 2021, response did not provide additional evidence to support its disagreement.

ACTIONS REQUIRED

We request that DHCD reconsider its position and provide additional responses to Recommendations 1, 3, 5, 6, 9, 11, 12, and 18 within 30 days of the date of this final report.

APPENDIX A. OBJECTIVES, SCOPE, AND METHODOLOGY

We conducted our audit work from August 2020 through July 2021, in accordance with generally accepted government auditing standards (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.

The objectives of this audit were to assess: (1) the mechanisms used to produce and preserve affordable housing; and (2) how efficiently the HPTF provides and creates affordable housing for eligible District residents. The audit was included in the Office of the Inspector General's (OIG) *Fiscal Year 2020 Audit and Inspection Plan*.

To accomplish our audit objectives, we:

- Reviewed applicable laws and regulations governing the operation of the HPTF and DHCD's responsibility for the administration of the fund, as well as DHCD's internal policies and procedures, and assessed compliance with these criteria;
- Reviewed prior audits, external or internal audits, and pertinent reviews;
- Interviewed DHCD officials and staff to gain an understanding of the threshold, scoring, selection, underwriting, and compliance monitoring processes;
- Analyzed projects selected from the 2017 through 2019 RFPs to determine compliance with the statutory requirements;
- Reviewed and analyzed the 2019 RFP and the decision memoranda with regard to the project selections from the applications received from the 2019 RFP;
- To assess compliance with the HPTF requirements, we selected 12 projects from DHCD's list of completed construction projects and reviewed and analyzed submitted financial statements, income certifications when available, annual owner certifications, loan agreements, covenants, and information pertaining to loan repayments;
- Compared proposed project cash flows to the submitted financial statements to determine whether projects were financially performing as expected;
- Reviewed DHCD's annual published income and rent limits and determined compliance with reserved units;
- Analyzed the HPTF loan portfolio for accuracy and completeness of projects;
- Reviewed and analyzed the planned and actual ongoing triennial compliance reviews of multi-family projects; and

APPENDIX A. OBJECTIVES, SCOPE, AND METHODOLOGY

- Reviewed the third-party contract for asset management services and DHCD's Compliance and Long-Term Monitoring processes.

We assessed the validity and reliability of computer-processed data and performed limited testing to verify the data's accuracy and completeness. We determined that the data was sufficiently reliable for this report.

APPENDIX B. ACRONYMS AND ABBREVIATIONS

DFD	Development Finance Division
DHCD	Department of Housing and Community Development
DCMR	D.C. Municipal Regulations
ELI	Extremely Low Income
FY	Fiscal Year
GAO	United States Government Accountability Office
GAGAS	Generally Accepted Government Auditing Standards
Green Book	GAO Standards for Internal Control in the Federal Government
HPTF	Housing Production Trust Fund
LEC	Limited Equity Cooperative
LI	Low Income
LIHTC	Low-Income Housing Tax Credit
OIG	Office of the Inspector General
PASS	Procurement Automated Support System
QAP	Qualified Allocation Plan
RFP	Request for Proposal
VLI	Very Low Income

APPENDIX C. TABLE OF RECOMMENDATIONS

Responsible Agency	Recommendations	Potential Monetary Benefits	Agency Response
DHCD	1. Develop procedures to require and enforce adherence to selection criteria included in the RFP, which shall apply to all DHCD personnel.		Disagreed
DHCD	2. Develop a plan to evaluate DHCD’s current selection criteria to better align selection criteria with statutory requirements to produce and preserve more units for extremely low-income households.		Agreed
DHCD	3. Develop a policy and procedures to ensure that all DHCD employees engaged in the project selection process disclose any conflicts of interest.		Objected
DHCD	4. Develop a policy and procedures to ensure that the District Government Partners’ Interagency Review Panel concerns and insights are documented and considered in the evaluation process.		Agreed
DHCD	5. Develop procedures to request and obtain a required waiver from the Council when proposals received do not meet statutory funding requirements prior to selecting and funding projects.		Disagreed
DHCD	6. Develop policies and procedures to ensure additional affordable housing units are produced when funding is increased.	\$14,200,000	Disagreed

APPENDIX C. TABLE OF RECOMMENDATIONS

Responsible Agency	Recommendations	Potential Monetary Benefits	Agency Response
DHCD	7. Develop policies and procedures to periodically compare proposed project cash flows to actual cash flows and hold borrowers accountable for inaccurate proposals.		Completed
DHCD	8. Develop procedures to ensure DHCD’s triennial compliance review plans include all HPTF rental properties and are fully completed as scheduled.		Agreed
DHCD	9. Perform reconciliation of deliverables under Contract Line Item Numbers (CLIN) 1002, 2002, and 3002 to determine and recoup any excess payments from the contractor as appropriate.		Disagreed
DHCD	10. Recoup from the contractor \$2,352,000 in improper payments for not conducting required on-going multi-family asset monitoring, and reporting services under CLIN 1002 during the option year 4 contract term.	\$2,352,000	Agreed in Part
DHCD	11. Recoup from the landlord \$114,528 per year in unauthorized excess rents.	\$114,528	Disagreed
DHCD	12. Make additional determinations and recoup rent as appropriate for the project period outside the audit period.		Disagreed
DHCD	13. Develop procedures to ensure landlords do not charge in excess of the maximum allowable rent for reserved units.		Agreed

APPENDIX C. TABLE OF RECOMMENDATIONS

Responsible Agency	Recommendations	Potential Monetary Benefits	Agency Response
DHCD	14. Determine which properties did not receive initial income certification and eligibility reviews in the last three years and prioritize those properties in the triennial review plan.		Completed
DHCD	15. Develop procedures to ensure units are reserved for specific targeted populations and are utilized by their intended population.		Agreed in Part
DHCD	16. Develop a plan to assess the contractor's performance under the contract to ensure the contractor adequately assessed and analyzed existing loans to reduce loan delinquencies and increase collections of the multi-family housing projects as required.		Agreed
DHCD	17. Develop a plan to identify loan balances approaching maturity and determine the best course of actions for the District.	\$10,200,000	Agreed
DHCD	18. Conduct reconciliation of deliverables under contract section C.5.2.1 to determine and recoup any excess payments from the contractor for not conducting the necessary reviews of loan databases.		Disagreed
DHCD	19. Conduct a review of the loan portfolio to ensure data errors are corrected and are accurately reflected.		Agreed

APPENDIX C. TABLE OF RECOMMENDATIONS

Responsible Agency	Recommendations	Potential Monetary Benefits	Agency Response
DHCD	20. Establish policies and procedures to ensure LEC projects are properly monitored for compliance with HPTF Program requirements.		Agreed

APPENDIX D. COMPARISON OF PROPOSED TO ACTUAL CASH FLOWS

Example of Proposed to Actual Cash flow from Operations in Calendar Year 2018.

	Proposed	Actual	Over/ (Under)
Income			
Low Income Units	\$ 800,095	\$ 832,610	4%
Market Rate Units	0	0	0%
Nonresidential	15,202	4,820	(68%)
Gross Project Income	815,297	837,430	3%
Vacancy Allowance	(40,005)	(37,688)	(6%)
Effective Gross Income	\$ 775,292	\$ 799,742	3%
Expenses			
Administrative	\$ 92,015	\$ 294,427	220%
Management Fee	30,652	37,842	23%
Utilities	21,300	77,893	266%
Maintenance	142,000	162,001	14%
Taxes and Insurance	106,500	41,710	(61%)
Reserves (including operating)	17,750		(100%)
Total Expenses	\$ 410,217	\$ 613,873	50%
Net Operating Income	\$ 365,075	\$ 185,869	(49%)
Primary Debt Service Financing			
Tax-exempt Bonds	304,229	0	(100%)
Private Loan	0	438,047	N/A
Total Debt Service	\$ 304,229	\$ 438,047	44%
Cash Flow	\$ 60,846	\$ (252,178)	(514%)
Debt Coverage Ratio	1.20	0.42	(65%)
Subordinate Debt			
HPTF	\$ 21,296	\$ 0	(100%)
Total Cash Flow Debt	\$ 21,296	\$ 0	(100%)
Remaining Cash Flow	\$ 39,550	\$ (252,178)	(738%)
Debt Coverage Ratio	1.12	0.42	(62%)

APPENDIX E. DHCD'S RESPONSE TO DRAFT REPORT



**GOVERNMENT OF THE DISTRICT OF COLUMBIA
DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT**



September 22, 2021



Daniel W. Lucas
Inspector General
Office of the Inspector General
717 14th Street, NW, First Floor
Washington, DC 20005

Dear Inspector General Lucas:

We are in receipt of the draft report regarding the audit of the District of Columbia's Affordable Housing Programs pursuant to OIG's Fiscal Year 2020 Audit and Inspection Plan. We appreciate the opportunity to respond while providing clarifications where appropriate.

Since assuming the role of DHCD Director in 2015, I have worked assiduously to improve the way we fund affordable housing developments across our city, making the process more efficient while better targeting resources to our most vulnerable residents. Under Mayor Bowser's leadership, I have had the privilege of helping design and implement the District's housing strategy that has resulted in over \$600 million invested in affordable housing projects with an unprecedented \$400 million investment in the Housing Production Trust Fund (HPTF) in the FY21 and FY22 budgets. In fact, over the past six years, the District has invested more funds into affordable housing, per capita, than any other city in the country and has seen the results. This strategy has produced over 14,250 units of affordable housing with another 12,300 under construction or in the pipeline and has preserved another 1,400 units of existing affordable housing.

I am extremely proud of these achievements and especially proud that the overwhelming majority of HPTF dollars have gone to serve very low-income families at or below 50% of the Median Family Income ("MFI"). Median Family Income is also sometimes referred to as Area Median Income ("AMI"). In fact, since the 2015 Consolidated Request for Proposals ("RFP"), new construction projects financed by HPTF have only financed units at or below this very low-income band. By targeting our resources to the lower income bands, we have not only been able to surpass statutory requirements for very low-income households, but provide thousands of safe, clean affordable housing units for those households across our city.

I am pleased that the OIG report confirms that our intentional approach to targeting the lower income bands is working. However, as I have acknowledged to the DC Council and the general public, we know we need to do more to coordinate HPTF investment at extremely low-income levels, i.e., 30% MFI, with the necessary operating subsidy to produce units

APPENDIX E. DHCD'S RESPONSE TO DRAFT REPORT

servicing our most vulnerable residents. That is, HPTF cannot and does not operate in a silo as producing housing for low-income residents necessitates ongoing financial support for those residents through supportive rental payments and/or services – and the lower the income of future tenants or residents, the more operating subsidy and resources are necessary. Those are not HPTF resources, but instead require the coordination of available vouchers and other supports, supports that often come from other agencies, such as the DC Housing Finance Agency and the Department of Human Services.

One such supportive program that is critical to the success of HPTF in reaching the lowest income residents is the Local Rent Support Program, known as LSRP. To advance the necessary coordination among programs, Mayor Bowser's inclusion of the "Local Rent Supplement Program Enhancement Amendment Act of 2021" in the FY 2022 Budget Support Act of 2021 will allow DHCD, for the first time, to coordinate operating resources to achieve the lowest income statutory goals. DHCD will also make the production of affordable housing units serving extremely low-income households a priority project evaluation criteria in the District's 2021 Qualified Allocation Plan and subsequent Consolidated RFP. It has been an incremental process over the years to target the 50% MFI and below bucket and we are now at the next stage where the city, and DHCD, can align our resources to better target the 30% MFI and below bucket for the first time.

Below, please find additional responses and clarification regarding the draft report's recommendations and findings. We note that the draft report contains many references where OIG did not request documentation and so assumed it does not exist. We would like to make ourselves available should additional documentation or information be helpful moving forward.

Finally, we strongly recommend that the title of the OIG report more accurately reflect the report's findings pursuant to the stated goals of this engagement to say "DHCD Has Exceeded Some HPTF Requirements, but Must Increase Investments for Extremely Low-Income Households."

Sincerely,



Polly Donaldson
Director

Cc: Kevin Donahue, City Administrator
Betsy Cavendish, General Counsel to Mayor
John Falcicchio, Deputy Mayor for Planning and Economic Development

APPENDIX E. DHCD'S RESPONSE TO DRAFT REPORT

DHCD Responses to OIG Recommendations:

1. Develop procedures to require and enforce adherence to selection criteria included in the RFP, which shall apply to all DHCD personnel.

Response: Disagree. DHCD maintains, as it has to the DC Auditor, the DC Council, and the general public, that the final selection of projects is a duty of the DHCD Director who is bestowed with the authority to make these decisions in the best interest of the District. The process and priorities outlined in the QAP and Consolidated RFP by which project applications go through threshold review and further evaluation create the baseline of viable projects that will produce or preserve affordable housing. The Director then considers a number of evaluative factors, many of which change throughout the months of the RFP selection process, when making final project selections. For example, the amount and type of resources available or updated data on the number of affordable housing units under construction in each Planning Area are considered. The agency's organizational law allows for this discretion, and there is absolutely nothing wrong, as a policy matter, with considering more holistic goals – such as advancing neighborhood diversification and making high-amenity neighborhoods accessible to low-income people – that entail consideration of all the applications taken as a whole, rather than just the scored merits of each application. The availability of vouchers or funding may change during the course of project evaluation, and it's entirely proper for the Director to consider the available supports in making final decisions, so as to best support the interests of the DC residents and to advance the goals of the HPTF.

2. Develop a plan to evaluate DHCD's current selection criteria to better align criteria with statutory requirements to produce and preserve more units for extremely low-income households.

Response: Agree; Underway. Beginning with the 2015 Consolidated RFP, DHCD has placed much greater emphasis on funding units for households at 30 and 50 percent MFI. In fact, new construction projects selected from the 2015 RFP and subsequent RFPs to date have only funded HPTF units at 50% MFI or below. As this OIG report itself confirms, annual HPTF expenditures for the 31% – 50% MFI category exceed the statutory requirement. However, recognizing the need to do more, DHCD and Mayor Bowser's administration have taken steps to better align resources to hit the extremely low-income bucket.

The availability and targeting of long-term operating subsidy is critical for sustaining 0-30% MFI units. In recent Consolidated RFPs, the amount of available Local Rent Supplement Program ("LRSP") vouchers was unpredictable and severely limited the 0-

APPENDIX E. DHCD'S RESPONSE TO DRAFT REPORT

30% MFI units that could be initially funded and sustainably maintained throughout the project's affordability term commitment. With the recent passage of the "Local Rent Supplement Program Enhancement Amendment Act of 2021" in the Fiscal Year 2022 Budget Support Act of 2021, we will be better able to target out funding with an intentionality to achieve the statutory MFI requirements. Additionally, in the 2021 Draft QAP, we have included an evaluation priority for projects targeting the 30% MFI and below range. This priority will also be included in the Consolidated RFP. It has been an incremental process over the years to target the 50% and below MFI bucket and we are now at the next stage where we can align our HPTF production resources with essential project operating resources to better target the 30% and below MFI bucket for the first time.

Notwithstanding the above, DHCD does continue to have a fundamental, long-term concern that the emphasis on 0-30% MFI expenditures contradicts long-established best practices in the affordable housing field that developing mixed-income housing leads to strong communities and long-term financial sustainability for affordable housing projects. The agency also seeks to avoid incentivizing the concentration of large numbers of extremely and very low-income housing in a way that repeats the housing policy mistakes of the past – policies that had baleful consequences for the residents in those situations of concentrated poverty. In addition, DHCD is acutely aware of equity issues surrounding the existing concentrations of affordable housing in wards 7 and 8.

Fundamentally, the Mayor, backed by Council, has invested record amounts in the HPTF, but immediately meeting the Council-established, extremely ambitious, goals for housing those at the 0-30% MFI band would have run the risk of: advancing residential segregation patterns; concentrating poverty and attendant consequences; and setting up projects that lack ongoing subsidies for failure. Make no mistake: the Administration desires both to comply with the letter and spirit of the law and to help residents most in need, but housing those at the 0-30% poverty levels is a lot tougher and more complicated to implement than just setting a big goal.

3. Develop policy and procedures to ensure that all DHCD employees engaged in the project selection process disclose any conflicts of interest.

Response: DHCD objects to the inclusion of this recommendation in this OIG report. DHCD employees engaged in the project review and evaluation process must comply with existing statutory annual financial and conflict of interest disclosure requirements administered by the District's Board of Ethics and Government Accountability (BEGA), as well as, of course, federal and District criminal law that bar making

APPENDIX E. DHCD'S RESPONSE TO DRAFT REPORT

decisions for one's personal financial benefit. There are no instances of any conflict of interest issues amongst DHCD employees engaged in project selection, and this OIG audit provides no evidence of any conflicts of interest. The OIG has available to it the financial disclosure forms submitted by DHCD project reviewers who are public filers as they are posted on the BEGA website, and its auditors did not ask to see the Confidential Filers' forms of DHCD project reviewers in DHCD's possession. All DHCD project reviewers are in compliance with the District's annual financial and conflict of interest filing requirements, and BEGA has not notified DHCD of any DHCD project reviewer who has a conflict of interest or other ethics violation that would prevent him or her from serving as a project reviewer. Thus, the inclusion of this recommendation, not grounded in any factual predicate, is misleading and derogatory.

4. Develop policy and procedures to ensure that the District Government Partners' Interagency Review Panel concerns and insights are documented and considered in the evaluation process.

Response: Agree. DHCD will more formally document comments given at the Interagency Review Panel meeting. However, it must be noted that the Interagency Review Panel is advisory and only reviews project narratives and budgets to provide comment.

5. Develop procedures to request and obtain a required waiver from the Council prior to selecting and funding projects when proposals received do not meet statutory funding requirements.

Response: Disagree. The DC Council, its Committee on Housing and Executive Administration, and the members of the Committee are keenly aware of the continued success of the HTPF at targeting households at 50% MFI and below, but also of the need to do more at the 30% MFI range. At DHCD's performance and budget oversight hearings in recent years, the statutory requirements and how the HPTF has targeted the lower income bands has been discussed at length. While Committee members praise the work done so far, both the Council and Executive know we must continue to work together to meet the District's affordable housing goals in a manner that does not exacerbate concentrated poverty and that is sustainable, to include the provision of necessary project operating subsidies. Given this transparent relationship, the Council has not made a formal request for this waiver in its budget recommendations, in hearings, or otherwise. Instead, they continue to work with DHCD to keep improving how resources are targeted to the lowest MFI bands.

APPENDIX E. DHCD'S RESPONSE TO DRAFT REPORT

Additionally, as noted in the draft audit report, the DC Code allows the option for the Mayor to submit a written waiver in the 4th quarter of the fiscal year, not, as suggested in the recommendation, "prior to selecting and funding projects," which would not be feasible.

Note: The OIG report states that their analysis provided multiple alternatives for project selections that met the statutory requirements. However, it is unclear if OIG's analysis correctly assessed necessary operating subsidy that is needed to be coupled with 30% MFI units and the availability of those resources. DHCD requested OIG's analysis multiple times but has yet to receive it.

6. Develop policies and procedures to ensure additional affordable housing units are produced when project funding is increased.

Response: Disagree. DHCD, through the HPTF and other funding sources, serves as the gap financing partner on affordable housing developments. Without DHCD's involvement, these projects creating and preserving affordable housing units in our city will simply not happen. After an initial budget is submitted, a project's costs may increase due to a variety of reasons, for example, an increase in costs of construction materials (e.g., the COVID-19 pandemic caused a spike in the cost of lumber) or increased labor costs. The expectation is that all of the project financial partners come to the table to resolve a funding gap due to cost increases. An increase in project funding provided by DHCD only happens after all other possible sources are exhausted. However, increased costs do not come with a commensurate increase in buildable space or additional sources of gap financing to balance the inclusion of more affordable units.

DHCD analyzes funding increase requests and negotiates with the borrower to minimize the additional DHCD funds required. The Development Finance Division (DFD) analyzes each funding increase request and provides a recommendation to the DHCD Loan Review Committee or the DHCD Director to approve or deny the request. Loan increase requests that are made after Loan Review Committee funding recommendation or that exceed 10% of the original loan amount must be approved by Director via Decision Memo. A Decision Memo includes relevant facts that explain the reason(s) for a requested cost increase, borrower's efforts to mitigate the cost increase, supporting financial data, and analysis that justifies the cost increase. The OIG report misleadingly suggests that developers pursue a "bait and switch" strategy of winning the project, then just increasing requests for funds, which are then rubber-stamped by the agency. This simply is not true. As explained above, requests for additional funds are fully vetted and, if granted, supported by documentation and

APPENDIX E. DHCD'S RESPONSE TO DRAFT REPORT

evidence that the increased costs are, in fact, reality. Again, without DHCD's involvement as a gap financing partner, creating, and preserving affordable housing would not be possible.

7. Develop policies and procedures to periodically compare proposed project cash flows to actual cash flows and hold borrowers accountable for inaccurate proposals.

Response: Completed. DHCD's Property and Asset Management Division performs regular asset management functions for the developments financed by the HPTF and other sources. These functions include review of cash flows and project financials. Comparison of proposed to actual cash flow data is conducted periodically.

It should be noted that DHCD is rarely the sole financing partner in the project. There are multiple financial partners (lenders, investors, etc.) who are simultaneously underwriting a project and verifying all the assumptions used in cash flow projections.

8. Develop procedures to ensure DHCD's triennial compliance review plans include all HPTF rental properties and are fully completed as scheduled.

Response: Agree; Underway. DHCD has prepared a draft Long-Term Compliance Administrative Issuance to clarify triennial compliance review plans that is currently being reviewed by the agency's Office of Program Monitoring. The agency has also drafted an HPTF Compliance Manual that is similar to the existing DHCD LIHTC Compliance Manual. Both the Long-Term Compliance AI and HPTF Compliance Manual will be finalized in the coming months.

9. Perform reconciliation of deliverables under Contract Line Item Numbers (CLIN) 1002, 2002, and 3002 to determine and recoup any excess payments from the contractor as appropriate.

Response: Disagree. See response to Recommendation #10.

10. Recoup from the contractor \$2,352,000 in improper payments for not conducting required on-going multi-family asset monitoring, and reporting services under CLIN 1002 during the option year 4 contract term.

APPENDIX E. DHCD'S RESPONSE TO DRAFT REPORT

Response: Agree in part and Disagree in part. DHCD agrees that improper payments should, of course, be recouped. Where DHCD disagrees is with the finding of improper payments. The contractor appropriately invoiced and was paid for services performed as directed. DHCD provided OIG with examples of the Monthly Status Reports that exemplify the contractor's fulfillment of its obligations under the applicable contract section. It is disconcerting that the OIG report states that the monthly status reports provided could not be relied upon because they were produced on July 8, 2021. The OIG report, in Appendix A, clearly states that the audit work was done from August 2020 through July 2021. Instead, it seems the report drafters preferred to provocatively and inaccurately imply that millions of dollars from the HPTF could possibly have gone to something other than producing or preserving affordable housing. The timing of our production does not indicate that the contractor improperly invoiced DHCD. The documents were produced in 2016, but provided in July 2021 to OIG once DHCD realized supporting documentation would be necessary to explain its position.

11. Recoup from the landlord \$114,528 per year in unauthorized excess rents.

Response: Disagree. The project charged the allowable voucher contract rents. Additionally, use of vouchers to rent units results in several benefits for the project including: increased income that can be used to maintain the building and ensure the project meets debt-service requirements; increased income diversity in a building by including households at lower MFI levels; and additional loan repayments to DHCD.

12. Make additional determinations and recoup rent as appropriate for the project period outside the audit period.

Response. Disagree. Please see response to Recommendation #11.

13. Develop procedures to ensure landlords do not charge in excess of the maximum allowable rent for reserved units.

Response: Agree; Underway. The majority of DHCD projects use multiple funding sources. Under Low Income Housing Tax Credit (LIHTC) regulations, the calculation of gross rent *excludes* Section 8 or other rental assistance or supportive services fees made on behalf of a household. 26 USC § 42(g)(2)(B). This exception allows LIHTC project owners to accept payments made on behalf of tenants under Section 8 or any comparable rental assistance or supportive services program even when those payments exceed LIHTC maximum rent restrictions for that unit. When projects include LIHTC and HPTF financing (LIHTC/HPTF Projects), the District's policy is to allow federal LIHTC affordability restrictions to control if there is a conflict between the LIHTC and

APPENDIX E. DHCD'S RESPONSE TO DRAFT REPORT

HPTF affordability restrictions. Therefore, DHCD underwrites projects with project-based vouchers at the maximum contract rent for the geographic area of the project. This rental income allows the project to support more first trust debt and require less HPTF gap financing for one project, freeing up HPTF to finance additional projects in the pipeline.

Although the allowances that permit tax credit units to exceed maximum rent limits for units with operating subsidy are not codified in the HPTF regulations, the HPTF rules at 10B DCMR section 4100.4 authorize the Director to waive the HPTF rent limits on a project-by-project basis where application of the rule would adversely affect the purpose and objective of the Fund to produce affordable units. DHCD will work to update the HPTF regulations to better reflect current affordable housing policies and best market practices.

14. Determine which properties did not receive initial income certification and eligibility reviews in the last 3 years and prioritize those properties in the triennial review plan.

Response: Completed. Initial income certifications and eligibility reviews are conducted on *all* HPTF funded developments. However, DHCD will work to better document their completion and will prioritize, in its triennial review plan, properties for which income certifications were not readily available.

15. Develop procedures to ensure units are reserved for specific targeted populations and are utilized by their intended population.

Response: Agree in part and Disagree in part. While we strive to allocate units as reserved for the intended population's particular income band, a countervailing and sometimes superseding value is to make sure a unit never goes empty for long. If an extremely low-income household is able to qualify for an affordable housing unit, whether it be by using a housing subsidy or through some other means, then DHCD will not prohibit that family from attaining safe, affordable housing by renting that vacant unit, even if it was intended for a family with a higher family income; the opposite situation is also occasionally true. As we are in the midst of an affordable housing crisis in the District exacerbated by the COVID-19 pandemic, we cannot leave affordable housing units vacant when they could be occupied by other low-income qualified households. Remember that while there is a long list of persons seeking affordable units, persons when called may decline a unit for a number of reasons or their income may have changed since they applied.

16. Develop a plan to assess the contractor's performance under the contract to ensure the contractor adequately assessed and analyzed existing loans to reduce loan delinquencies and increase collections of the multi-family housing projects as required.

Response: Agree but overtaken by events. DHCD does not consider this recommendation to be specifically applicable because the current loan servicer is a different vendor than the one OIG found to be inadequate during the audit period.

APPENDIX E. DHCD'S RESPONSE TO DRAFT REPORT

That said, reading the recommendation more broadly, DHCD has already developed a plan with the new servicer to improve analysis, decrease delinquencies, and increase collections of multi-family housing projects, as appropriate.

17. Develop a plan to identify loan balances approaching maturity and determine the best course of action for the District.

Response: Agree; Underway. DHCD has engaged the current loan servicer in revised mature loan procedures. The procedures outline outreach and collection actions in three distinct loan categories:

- 1) Loans set to mature within the next 60 days
- 2) Loan that have already matured within the last 12 months
- 3) Loans that have matured in excess of 12 months

Note: The past-due loan amount identified by in the OIG draft report represents just 1% of the total outstanding HPTF loan balance.

18. Conduct reconciliation of deliverables under contract section C.5.2.1 to determine and recoup any excess payments from the contractor for not conducting the necessary reviews of loan databases.

Response: Disagree. The contractor satisfied the deliverable in Section C.5.2.1 by producing a "Portfolio Overview Report" that was submitted to DHCD. This report utilized data from reviews of loan databases and clearly highlighted data limitations, as applicable.

19. Conduct a review of the loan portfolio to ensure data errors are corrected and are accurately reflected.

Response: Agree; Underway. The current loan servicer conducted a project study of the portfolio to identify gaps and inconsistencies in data and, after an internal quality control process, will upload missing data and corrections into the loan servicing database. Additionally, DHCD has improved its loan transmittal forms to capture more data at the time of loan booking, supporting the integrity of portfolio data. Finally, DHCD has worked to digitize all available loan documents so indexed data fields can be utilized as another source to reconcile possible inconsistencies in the loan servicer database.

20. Establish policies and procedures to ensure LEC projects are properly monitored for compliance with HPTF program requirements.

Response: Agree; Underway. DHCD will include LECs in its 2021 annual reporting activities, which includes both project financial reporting and project compliance reporting (in the form of the Annual Owner's Certification of Continuing Program Compliance). Targeted outreach will be conducted in spring of 2022 to ensure understanding and compliance with the process.