State of New York
Office of the State Comptroller
Division of Management Audit

AFFORDABLE HOUSING CORPORATION

AFFORDABLE HOME OWNERSHIP DEVELOPMENT PROGRAM

REPORT 95-S-9

H. Carl McCall

Comptroller

State of New York
Office of the State Comptroller

Division of Management Audit

Report 95-S-9

Mr. Stephen J. Hunt
President/Chief Executive Officer
Affordable Housing Corporation
641 Lexington Avenue
New York, NY 10022

Dear Mr. Hunt:

The following is our audit report on the Affordable Housing Corporation's Affordable Home Ownership Development 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 2, Section 8 of the State Finance Law. Major contributors to this report are listed in Appendix A.

Office of the State Comptroller
Division of Management Audit

Executive Summary

Affordable Housing Corporation
Affordable Home Ownership Development Program

Scope of Audit

The New York State Affordable Housing Corporation (AHC), a subsidiary public benefit corporation of the New York State Housing Finance Agency (HFA), was created in April 1985 by Chapter 67 of the New York State Laws of 1985. AHC was established to administer the Affordable Home Ownership Development Program (Program). The overall purpose of the Program is to promote home ownership by persons of low and moderate income with the expectation that such ownership will bolster the development, stabilization, and preservation of neighborhoods. The financial assistance provided under the Program is expected to make home ownership and improvement affordable to persons who would be unable to purchase or improve a home by relying on private sources for financing.

The Program provides grants, which are used in conjunction with other private and public investment, for the acquisition, construction, rehabilitation and improvement of projects such as owner-occupied, one- to four-family dwellings, including cooperatives and condominiums. AHC awards grants to municipalities, housing development fund companies, not-for-profit corporations and charitable organizations. The State appropriated $265 million for the Program through fiscal year 1993-94. According to AHC records, as of March 31, 1994, grants totaling $259 million had been awarded to over 150 grantees, which developed more than 500 projects involving more than 23,000 housing units.

Our audit addressed the following questions concerning the Program for the period from January 1, 1992 through December 31, 1994:

- Are grants being given to eligible homebuyers?
- Are homeowners meeting Program residency requirements?
- Is AHC monitoring grantee activities adequately?

Audit Observations and Conclusions

We reviewed selected policies and practices of several grantees with regard to their eligibility determinations. Using industry-recognized mortgage affordability ratios, we determined that most of the home-owners in a judgmental sample of ten grant recipients from two large AHC projects could have afforded larger mortgages from either the participating bank or from the State of New York Mortgage Agency (SONYMA), and did not need an AHC grant to finance the purchase of their homes. For example, one family with a monthly income of almost $4,000 received a $15,000 AHC grant towards the purchase of a $121,900 home and obtained a mortgage for the balance. Based

on industry standards, we concluded that this family could have afforded a mortgage for the full price of the home. We also found that the size of the grants awarded were not always based on the needs of the homebuyer; some grantees awarded the same amount of money to each eligible buyer, regardless of the buyer's income. AHC needs to maximize available grant monies by having grantees give eligible homebuyers the minimum amount of subsidy they need to purchase an AHC-assisted home. (See pp. 3-6)

Furthermore, we found that grantees did not use a uniform methodology for determining income eligibility. Most notably, the single largest grantee under the Program did not use the homebuyer's gross income to determine eligibility; instead, it deducted an applicant's annual debt from his or her income and used the difference for the income-eligibility test. Also, some grantees considered an applicant's assets in determining eligibility, while others did not. We believe that AHC should establish a uniform methodology for determining income eligibility of grant applicants. The applicants' assets should be considered, along with their incomes, in determining their eligibility for a grant subsidy. (See pp. 6-10)

Our audit also found that some recipients may not be complying with AHC's requirement that they occupy their homes for at least ten years. In our sample of 61 homeowners, we were unable to confirm residency for 7 homeowners who had received a total of $97,500 in AHC grants. AHC needs to ensure that grantees monitor the homebuyers' continued residency obligation and notify AHC of any non-compliance. Also, independent audits of grantees have not always assessed the grantee's system for monitoring homeowner occupancy and there was limited evidence of AHC's follow-up on deficiencies reported in this area. (See pp. 11-15)

We also recommend that AHC enforce its requirement that grantees establish criteria to ensure that rental units are affordable to persons who otherwise would have been unable to rent such accommodations. (See pp. 17-18)

Comments of AHC Officials

AHC officials agree with a number of our recommendations and indicate that actions are being taken to implement them. They disagree, however, with our conclusion that most of the grant recipients in our sample could have afforded a larger mortgage and did not need an AHC grant.

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The comments of Agency Officials are not available in an electronic format. Please contact our Office if you would like us to mail you a copy of the report that contains their comments.

Introduction

Background

The New York State Affordable Housing Corporation (AHC), a subsidiary public benefit corporation of the New York State Housing Finance Agency (HFA), was created in April 1985 by Chapter 67 of the New York State Laws of 1985. AHC was established to administer the Affordable Home Ownership Development Program (Program). The overall purpose of the Program is to promote home ownership by persons of low and moderate income with the expectation that such ownership will bolster the development, stabilization, and preservation of neighborhoods. The financial assistance provided under the Program is expected to make home ownership and improvement affordable to persons who would be unable to purchase or improve a home by relying on private sources for financing.

The Program provides grants, which are used in conjunction with other private and public investment, for the acquisition, construction, rehabilitation and improvement of projects such as owner-occupied, one- to four-family dwellings, including cooperatives and condominiums. AHC awards these grants to municipalities, housing development fund companies, not-for-profit corporations and charitable organizations.

The State has appropriated $265 million for the Program through fiscal year 1993-94. According to AHC records, as of March 31, 1994, grants totaling $259 million had been awarded to over 150 grantees, which developed more than 500 projects involving more than 23,000 housing units. Grants are awarded throughout New York State; the largest grant amounts were awarded in Bronx, Erie, Kings, and Suffolk counties. The New York City Housing Partnership (Partnership), the largest recipient of grants, received 46 percent of all AHC grant funds.

Audit Scope, Objectives and Methodology

We audited Program activities for the period from January 1, 1992 through December 31, 1994. The primary objectives of our compliance audit were to determine whether the Program requirements regarding income eligibility and continued residency were being met, and whether AHC was adequately monitoring the grantees' activities to ensure that Program regulations were being enforced. To accomplish these objectives, we reviewed the enabling legislation, Program regulations and procedure manuals, grantee agreements, grantee audit reports, homeowner loan files and agency information reports. We also interviewed AHC, grantee and bank officials, and made site visits to the offices of grantees, community groups, banks and projects. We also

confirmed residency by referring to telephone directories, making telephone inquiries, mailing residency confirmation letters, and confirming addresses with New York State Department of Taxation and Finance records.

We conducted our audit in accordance with generally accepted government auditing standards. Such standards require that we plan and perform our audit to adequately assess those operations of AHC which are included within the audit scope. Further, these standards require that we understand AHC's internal control structure and compliance with those laws, rules and regulations that are relevant to AHC's operations which are included in our audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records and applying such other auditing procedures as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments, and decisions made by management. We believe our audit provides a reasonable basis for our findings, conclusions and recommendations.

We use a risk-based approach when selecting activities to be audited. This approach focuses our audit efforts on those operations that have been identified through a preliminary survey as having the greatest probability for needing improvement. Consequently, by design, finite audit resources are used to identify where and how improvements can be made. Thus, little audit effort is devoted to reviewing operations that may be relatively efficient or effective. As a result, our audit reports are prepared on an "exception basis." This report, therefore, highlights those areas needing improvement and does not address activities that may be functioning properly.

Response of AHC Officials to Audit

A draft copy of this report was provided to AHC officials for their review and comment. Their comments have been considered in preparing this report and are included as Appendix B.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the President of the Affordable Housing Corporation shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons therefor.

Eligibility of Homebuyers

Determining the Amount of Grant Subsidy

According to the enabling legislation, AHC grants should be awarded to individuals who would have been unable to purchase or improve their homes if they relied on private sources for financing. The law requires that limits be placed on the maximum income of grant recipients, to ensure that grants are given only to homebuyers who could not otherwise afford to purchase the homes. These limits are established by the grantees, and are subject to AHC approval. AHC officials do not require evidence of individual mortgage denial. AHC officials explained that most of the funded projects are new construction, which usually receive other public subsidies and benefits besides AHC funds. They believe the income-eligibility limits established by the grantees are being set at levels that exclude buyers who would be able to purchase the home without the total subsidy package. Our examination found that this is not always true.

We selected a judgmental sample of ten homebuyers who had received grants from two large AHC-assisted projects: College Woods in Suffolk County and Skyline Hills in Staten Island. The AHC-approved income limits were $51,040 - $57,000 (depending on family size) for College Woods, and $53,000 for Skyline Hills. To determine whether these grant recipients needed the AHC subsidy to purchase their homes, we reviewed the tax returns, applications or other financial information submitted by the grant recipients and applied the data to various industry standards for mortgage affordability:

Banking Department - According to the New York State Banking Department, banks generally require that the borrower's monthly housing expense (mortgage principal and interest, real estate taxes, and insurance payments) not exceed a range of 28 percent to 32 percent of the borrower's monthly income.

SONYMA - Many of the homeowners assisted by AHC grants have also received mortgage loans from the State of New York Mortgage Agency (SONYMA). SONYMA, a New York State public benefit corporation that shares office space with HFA in New York City, provides mortgages to low- and moderate-income households. According to the general criteria for determining affordability of a SONYMA loan, the borrower's monthly housing expense should not exceed 33 percent of his or her monthly income; nor should the entire monthly debt expense - the cost of housing plus payments for outstanding personal debt (e.g., car loans, credit card payments, student loans, etc.) - exceed 38 percent of income.

Partnership - According to its agreements with AHC, the Partnership determines mortgage affordability by limiting monthly housing expenses to 28 percent of income.

Applying the above standards, it appears that most of the grant recipients in our sample could have afforded a larger mortgage and did not need an AHC grant to finance the purchase of their homes. For example, one family with an annual income of $47,971 received an AHC grant for $15,000 in addition to a $106,900 mortgage from a private bank to purchase a home in Skyline Hills. According to our calculations, if this family had obtained a loan for $121,900 (the amount actually mortgaged plus the amount of the grant) at the same rate of interest at which the private bank approved the $106,900 mortgage, their monthly housing expense would have been $1,083. This is less than 28 percent of their monthly income of $3,998.

Another family with annual income of $43,812 received an AHC grant of $12,500, and also obtained a SONYMA loan for $90,000. Applying SONYMA's two eligibility tests, we determined that a buyer with this level of income should have been eligible for a SONYMA mortgage for the full $102,500 amount.

We also found that the size of the AHC grant an eligible homebuyer receives is not always related to his or her income. For example, while some grantees vary the amount of the award based on the need of the buyer, other grantees award the same amount to each eligible buyer, regardless of the level of income. Skyline Hills used the variable grant approach, while College Woods awarded the same grant to all eligible homeowners. College Woods was built under two different AHC-assisted grant projects: Projects #588 and #663. In 1990, the Town of Islip (Islip), the grantee for College Woods, was awarded funds for Project #588. As part of this project, each of 84 homebuyers received a grant of $12,500 between January 1992 and December 1993. In 1991, Islip was awarded funds for Project #663. As part of this project, each of 72 homebuyers received a grant of $22,000 from April 1992 through February 1994. Both of these projects, which include properties that are interspersed throughout the same community, include comparable homes that cost between $102,200 and $124,200; and the maximum income limits for buyers in both projects were the same. As a result, buyers in comparable financial situations received different grant awards, depending on when their applications were considered. As a practical matter, the project making the larger grants tended to serve a somewhat lower-income population because the more generous subsidies made the homes affordable to them.

We discussed our observations with AHC officials, who explained that their grant was not the only subsidy used to develop College Woods and Skyline Hills; other direct and indirect subsidies were leveraged to make the homes affordable. They further stated that it is the AHC financing that induces the builder to assume the construction and market risks in the first place, and that the housing market produces very little, if anything, that AHC-assisted buyers could afford. They explained that they must be cautious in their attempts to narrow the pool of eligible recipients, since banks, developers, and others involved in project development want to ensure that there will be a sufficient number of qualified buyers for the units constructed.

AHC officials did indicate that they prefer that grantees make awards on a variable basis. Although some grantees are reluctant to use that approach, the officials told us that, since the 1994-95 fiscal year began, they have been giving preference to grantees that vary the amount of the subsidy based on the buyer's income.

AHC officials disagreed with our observation that most of the grant recipients sampled could have afforded a larger mortgage and did not need an AHC grant to finance the purchase of their homes. AHC officials indicate that our analysis is incomplete and did not consider a number of other relevant factors. Specifically, AHC officials indicate that an affordability analysis should consider:

- *the "back-end" ratio, a measure of overall debt*. - In fact, we did include the back-end ratio as one of our mortgage affordability tests. Using SONYMA's back-end ratio of 38 percent, we determined that the sampled homebuyers met that affordability standard.

- *the applicant's credit and employment histories*. - These factors were considered, as we only sampled homeowners who had already been approved for mortgages. The credit and employment histories of these homeowners were apparently acceptable to the respective mortgaging banks.

- *the appraised value because banks will not lend more than the value of the property*. - Information we received independently from the Partnership does not support this position. Partnership officials, who have direct responsibility for administering grants within New York City, told us that the appraised value of the property has rarely presented a problem in determining the amount of subsidy. Similarly, the appraised value of the homes in the other sampled project, located in Suffolk County, did not play a role in determining the amount of subsidy.

- *whether that same family could afford the downpayment on a higher mortgage*. - Families in the College Woods project received a $12,500 grant; while families in the Skyline Hills project received a maximum grant of up to $15,000. The maximum additional down payment based on the higher mortgage would have been $625 for purchasers in the College Woods project, and $1,500 for purchasers in the Skyline Hills project. Based on the information available, we could not determine whether this incremental amount would have jeopardized the purchases. However, in circumstances where this may in fact be the case, we suggest it would be far more cost effective for AHC to provide the homeowner with the $625 or $1,500 incremental down payment, than provide the much larger grant.

Lastly, AHC officials indicate that we should consider the more macro issues. They state that the grant is not the only value to be added to the mortgage amount; the full cost of the house must include the value of donated land, reduced profit, and accelerated local approvals. AHC officials assert that without their grant, other subsidies would not be available. Our audit does not take issue with the instrumental role AHC may play in planning and developing these housing projects. The issues we raise relate to determining the amount of subsidy needed.

We believe that the best way for AHC to maximize its limited grant funds is to have grantees give eligible homebuyers the minimum amount of subsidy needed to enable them to purchase the AHC-assisted home. Providing larger subsidies than necessary is not an economical and efficient use of State funds. AHC should seek to maximize the benefit of the grants available. If AHC has difficulty in finding qualified buyers for their units, we suggest they consider limiting the number of units constructed, rather than broadening the eligibility criteria to include buyers that may not need AHC assistance.

Consistency of Income-Eligibility Determinations

While the agreements between AHC and the grantees include income-eligibility limits, AHC does not require that a uniform methodology be used by grantees to calculate income. We reviewed the income-eligibility determination practices related to four projects developed by two of the largest grantees in AHC's program: Aqueduct and Skyline Hills from the Partnership; and College Woods Projects #588 and #663 from Islip. Our review included 121 sampled homebuyers who were awarded grants totaling $2.6 million from these projects during the period January 1992 through June 1994. We found significant variations in the methodologies used to determine income eligibility on these projects.

The agreements between AHC and the Partnership set forth the maximum income limit for grant eligibility. In part, they precluded the awarding of grants to those with a mortgageable income greater than $53,000, but did not detail the methodology for arriving at eligible income. In contrast, a Land Disposition Agreement between the Partnership and the City of New York, that also related to the Partnership's AHC-assisted projects, defined bona-fide purchasers, in part, as those whose, "annual gross income from all sources which an Institutional Lender would recognize in determining eligibility for a mortgage loan do not exceed $53,000."

However, we found that the Partnership did not use an applicant's gross income to determine eligibility. Instead, it deducted the applicant's annual debt from his or her annual income, and used the resulting amount for the income-eligibility test. As a result, of the 101 Partnership applications we reviewed, $222,000 in grants were awarded to 12 homebuyers whose gross incomes exceeded the stipulated $53,000 limit. For example, one grant recipient had a gross annual income of $69,445 and estimated annual payments

of $19,320 for debts that reportedly consisted of a car loan, student loans and various credit-card debt. The Partnership subtracted the annualized debt from the purchaser's income. Since the resulting adjusted income of $50,125 was below the eligibility limit, the Partnership determined that this applicant met the income-eligibility test and was awarded a $35,000 grant.

This methodology appears to create an inequity in that applicants with high income and high personal debt could qualify for a grant, while applicants with lower income who assume little personal debt may not qualify. We discussed with AHC officials the appropriateness of the Partnership's methodology for qualifying applicants. AHC officials stated that the methodology was in accordance with their agreement, and acceptable to them. They explained that such flexibility is critical to the success of the Program, because it attracts buyers to inner-city neighborhoods. They said the flexibility, and likelihood of success in attracting solid, income-eligible and mortgageable buyers to such locations, is important to financial institutions participating in the Program.

Nonetheless, AHC officials stated that they are examining the Partnership's methodology for qualifying applicants and discussions are being held with City officials regarding income adjustments. We support such a re-examination, and question whether the goals of the Program are best served by determining eligibility in this manner.

In contrast to the Partnership, Islip delegated its eligibility-determination responsibility to the private banks that participated in the financing of the projects. We found that the banks did not use consistent criteria. For example, one of the banks used the applicant's gross income as reported on the Federal tax return. This bank's procedure was to increase that amount by any deferred compensation not reported on the tax return. In contrast, another bank reviewing eligibility for the same Islip project made its determination based on the applicant's adjusted gross income as reported on the tax return (after deductions for contributions to individual retirement accounts, etc.). It was this bank's policy not to consider an applicant's deferred compensation in performing its income test. As a result of these inconsistencies, the acceptance or rejection of applicants who had similar incomes could depend on which bank reviewed their applications.

Islip officials asserted that 95 percent of its buyers have been processed through the system maintained by SONYMA, whose participating lenders apply consistent criteria in their underwriting procedures. However, our review revealed that applications have not been reviewed in a uniform manner. We believe grantees should ensure that all applicants are evaluated against the same standards.

Moreover, the agreement between AHC and the grantees requires that all parties maintain books and records related to their Program-funded activities.

As previously stated, Islip relied on participating banks to perform the income-eligibility test for its applicants, and to maintain the records of the qualifying process. We found that the eligibility records for four sample homebuyers to whom Islip had awarded grants, totaling $69,000, were missing. In all four cases, one bank had performed the eligibility verification, and neither the grantee nor AHC had reviewed the bank's determinations. Without evidence of such a review, there is no assurance that the four homebuyers were eligible for the grants they received.

Grantees should be sufficiently involved in the approval process to ensure that eligibility determinations for their projects are appropriate and made correctly. AHC officials agree, and stated that they have already informed Islip of the need for greater involvement in this area. They note that grantees are contractually required to maintain adequate records.

Limits on Assets

The purpose of the Program is to promote home ownership by families who have no other reasonable and affordable alternatives. Therefore, the value of an applicant's assets should be taken into account. However, AHC does not require grantees to consider such assets as part of their eligibility criteria. We found that while some grantees, such as the Town of Riverhead and the Partnership, considered an applicant's assets in determining eligibility, others, such as Islip, did not. Town of Riverhead officials told us they established a maximum asset limit of $50,000 for grant applicants. The Partnership, which sold homes ranging from $113,900 to $160,639 for the two projects we reviewed, had an asset limit of $165,000.

We believe AHC should require all grantees to consider an applicant's assets as part of their eligibility criteria, and should require that the maximum asset limit be set low enough that only applicants who actually need the grant will qualify. AHC officials agree with us that assets should be considered, and indicated that they have already drafted a standardized asset limit test.

Verifying Decreased Income

Our review of 40 homebuyers found that four (three approved by the Partnership and one approved by Islip) had received grants based on the homebuyers' claims that their current incomes were lower than those indicated in their most recent tax returns. In these four cases, the grantees applied the income-eligibility test to the reduced amount, without, in our opinion, taking adequate steps to confirm the homebuyers' current incomes with their employers.

For example, one College Woods homebuyer, who received a $22,000 grant, had reported 1991 income of $62,743, which exceeded the project's $51,040 income limit by $11,703. The homebuyer's gross income had also exceeded $62,000 in the 1990 calendar year. A bank official told us the homebuyer reported that he expected his income to drop in 1992, because he had a

different position with the same employer that would not allow him to earn as much overtime pay. However, we saw no evidence that the bank had verified this with the homebuyer's employer. AHC officials agree that such decreases in income should be verified with the homebuyer's employer.

Recommendations

1. Maximize available grant monies by having grantees give eligible homebuyers the minimum amount of subsidy they need to purchase the AHC-assisted home.

2. Establish a uniform methodology for determining income eligibility of grant applicants.

3. Establish appropriate asset limits to be considered when determining homebuyer eligibility.

4. Require grantees to verify homebuyer claims of declines in income.

5. Ensure that grantees maintain adequate recordkeeping and oversight for Program activities.

Compliance with Residency Requirements

Applicants awarded grant funds under this Program must agree to reside in the assisted residence for a stipulated period. This residency requirement is clearly outlined in the promissory note signed by the homebuyer. AHC grant recipients who buy a new home must occupy that home for at least ten years; recipients of home improvement grants must occupy the improved home for at least two, five or ten years, depending on the amount of the grant. In effect, this grant is an interest-free loan that is forgiven upon completion of the residency period. If the original homebuyer is unable to fulfill the residency requirement, he or she may be required to make a full or partial repayment (calculated according to the number of years the homeowner has occupied the premises). Grantees are responsible for monitoring homeowners' compliance with the residency requirement.

We found that grantees are not adequately monitoring the residency requirements. Consequently, some homeowners may not be residing in the assisted home for the agreed-upon period. AHC also needs to improve its oversight of grantee-monitoring efforts.

Grantee Monitoring Efforts

AHC requires grantees to monitor the homebuyers' continued residency obligation. The agreements between AHC and the grantees require the grantees to establish a reasonable system, satisfactory to AHC, for monitoring occupancy of the home during the applicable period; and to notify AHC of any non-compliance. We reviewed 14 agreements with grantees that covered 18 projects throughout the State. While all 14 agreements indicated that the grantee was responsible for monitoring residency, only 4 of the 14 agreements contained a description of the system that was to be used to fulfill that obligation (i.e., verification through the mail).

We believe the residency obligation is an important aspect of the Program, and suggest that monitoring requirements be detailed more specifically in AHC's agreements. AHC officials agree and assert that they have begun to take corrective action. In 1988 they began requiring grantees to address the monitoring of occupancy in their contract exhibits (all 14 agreements we reviewed were entered into after 1988), and that the contracts were recently amended to include language requiring grantees to report occupancy violations.

To determine whether grantees are monitoring the residency requirement, we reviewed the systems used by three grantees, during the period January 1992 through September 1994, to monitor residency in the four projects we tested. These three grantees were the Partnership, Suffolk County Community Development (SCCD), and Town of East Hampton (East Hampton).

Officials of the Partnership, the grantee for two of the projects, told us they perform no residency monitoring. Instead, they rely on reports from the community sponsor or complaints from neighbors to learn that a homeowner has moved. We noted, however, that there was no community sponsor for one of these two projects; and the sponsor for the other project told us that her group performs no formalized residency monitoring.

A September 1991 audit performed by an independent accounting firm reported that SCCD did not send residency confirmation letters to homeowners in its project. According to SCCD officials, after the 1991 audit report was received they sent out residency confirmation letters for all of their projects. We found, however, that none of these letters were dated, and SCCD officials were unable to estimate when they were mailed. Out of a sample of 20 homeowners, we verified that SCCD had received 12 responses as of September 1994. Significantly, there was no indication that SCCD had followed up on the eight cases in which the homeowners failed to respond; nor was there any evidence that SCCD officials had advised AHC of these homeowners' failure to respond to their inquiry.

East Hampton officials overseeing the fourth project (Whalebone Woods) mailed residency confirmation letters once, in April 1992. As of September 1994, they had received confirmations from 18 of the 20 homeowners in our sample. For one case with no response, we saw evidence that East Hampton and AHC officials had commenced legal action against the homeowner. In the other case, East Hampton officials advised us that the property had been transferred to a new owner around the same time as the mailing.

We attempted to confirm the residency of a sample of 61 homeowners who lived in these four projects. Twenty were selected from each of three sampled projects, and one was selected from the fourth. (The fourth project made home improvement grants, and the required residency period for 19 of the 20 homeowners sampled had lapsed by the time of our review.) We received information from the New York State Department of Taxation and Finance (Tax and Finance). Referring to its current database of taxpayer addresses, Tax and Finance was not able to confirm that 16 (24 percent) of the 61 homeowners were still living in their Program-assisted home. (Because of the confidentiality requirements of New York State Tax Law, Tax and Finance officials could not provide us with the identities of the 16 homeowners.)

Also, using telephone directories, we were able to match the names and addresses for 33 of the 61 homeowners sampled. When we attempted to contact the remaining 28 homeowners through letters and/or telephone calls, persons who identified themselves as the homeowners confirmed residency in 17 instances, although it had taken several weeks for some to respond to our inquiry. AHA officials confirmed the residency for four additional homeowners. We were unable to confirm residency for the remaining seven homeowners

(11 percent) who had received a total of $97,500 in AHC grants. In 3 cases, our confirmation letter was returned to us by the Post Office with a written indication that the grant recipient no longer lived in the Program-funded home. In a fourth case the current resident told us the homeowner had moved.

Since all or part of the grant must be recaptured if the homeowner does not live in the funded home for the agreed-upon period, we provided AHC officials with a list of the seven homeowners whose residency status we were unable to confirm. (AHC officials indicate that follow-up was done on the seven homeowners and, where appropriate, action to recover grant funds was commenced.)

AHC Monitoring Efforts

According to its enabling legislation, AHC is required to ensure that the performance of grantees is reviewed at least once a year. This review, among other things, is supposed to verify conformity with contractual provisions and the financial integrity and efficiency of grantees, and to evaluate grantee activities. AHC may terminate contracts, withhold funds, and recapture unspent funds if the review shows that the grantee is in substantial non-compliance, or has breached its contractual obligations.

AHC officials explained to us that they are notified by grantees only on an exception basis that a homeowner is no longer residing in the home purchased with AHC assistance. They said grantees do not notify AHC if they have reviewed the occupancy and have found no exceptions. In addition, AHC officials asserted that they would be notified about a sale or foreclosure, because of the note and lien on the property, and indicated that they believed this level of monitoring was sufficient.

In addition to these "exception" notifications, AHC periodically reviews the practices of grantees on a sample basis through independent audits. HFA's Internal Audit Unit requests that selected grantees be audited by independent firms. Based on a risk assessment, about 20 grantee projects are audited each year. These audits are paid for by AHC. A letter from the HFA unit requesting the audit specifies areas that should be addressed. While AHC's procedure manual states that, in most cases, the auditor is required to determine whether the grantee is monitoring the home occupancy requirements, we found that many of the audits did not address this key issue.

We reviewed 45 of the 46 audit reports received by AHC between January 1992 and May 1994 (AHC was unable to locate one report) and found that 17 (38 percent) did not address the system used by the grantee to monitor home occupancy. For 15 of the 17, HFA had not asked the auditors to review the grantee's system of occupancy monitoring. HFA officials explained that home improvement projects involved smaller grants and had shorter occupancy requirements. In such cases, they said they do not ask the auditors to review the manner in which home occupancy is being monitored. They also indicated that since they were already aware that the Partnership does not monitor occupancy in its projects, they had not requested that such reviews be performed.

However, home improvement and Partnership projects represented only 8 of the 15 projects that HFA had not requested to be audited for evidence of occupancy monitoring. Of the 28 reports that did include reviews of compliance with occupancy requirements, 8 reported deficiencies; these included six reports that the respective grantee had not even established such a monitoring system. Although AHC officials claimed that they followed up on all eight cases, they provided evidence of follow up for just two of the eight projects for which deficiencies were reported.

Of the audits that addressed the need to verify income eligibility, 7 audit reports cited exceptions. These seven included four reports indicating that grantees had awarded funds to applicants with income over the limit, and another noting that a grantee had included unborn children in the family size (family size is an important factor for some grantees in determining income limits). Other findings included: the absence of supporting documentation for a homebuyer's income; and a lack of consistency in the method used to determine the buyer's income. AHC officials provided evidence of follow up for just one of the seven audit reports that contained eligibility findings. AHC officials told us about in-house discussions and follow up related to other reported deficiencies. They indicated that, in the future, they would take care to document such activities.

While AHC officials agree that monitoring of home occupancy is an important issue, they believe that in some situations their limited audit resources are

better used in other areas. We believe AHC should make a more aggressive effort to verify that grantees are monitoring residency within their projects. We believe our review indicates that homeowners may not be fulfilling this obligation, and that there is a need for more thorough reviews of compliance with this part of the agreement.

Recommendations

6. Ensure that the grantee's system for monitoring residency requirements is reported in the agreement between AHC and the grantee.

7. Require grantees to report on the results of their residency-monitoring efforts.

8. Ensure that the independent audits of grantees include a review of residency monitoring.

9. Follow up on independent audit report findings and document corrective actions taken.

10. Investigate the seven homeowners for whom we were unable to establish residency.

Oversight of Rental Units

As previously stated, the primary purpose of the Program is to promote home ownership by persons of low and moderate income, with the expectation that such ownership will bolster economic development, social stabilization, and preservation of neighborhoods. Assistance provided under the Program is expected to make home ownership affordable to families who would be unable to purchase the home by relying on private sources for financing. The law authorizing the Program also allows the creation of 2- to 4-unit homes. We found that many of the homes built through this Program are multi-family homes in which the homeowner occupies one unit and rents the others. In fact, the Partnership, which is the single largest grantee for the Program and distributes Program funds to the New York City area, develops mostly 2- and 3-family homes (61 of the 95 projects developed by the Partnership are in this category). More than one-third ($44 million) of the grant funds awarded to the Partnership, as of June 1994, was used to create rental units. The Partnership has produced 8,318 dwelling units in New York City, 2,897 units are rentals.

According to AHC regulations, when multi-family homes are built with AHC funds, grantees must establish criteria, satisfactory to AHC to ensure to the maximum extent feasible, that rental units will be affordable to persons or families who otherwise could not afford to rent these units if produced by the ordinary, unaided operation of private enterprise. However, we found that neither AHC nor the Partnership monitors the amount of rent charged by the homeowners. We believe there is no assurance that the AHC-produced rental units are, in fact, affordable for individuals who otherwise could not have afforded such a unit; nor is it clear that the tenant is receiving the financial benefit of the grant (as opposed to the homeowner/landlord).

AHC officials do not agree that criteria have not been established to ensure that rental units are affordable. They believe that the rents charged on the units are fair and reasonable since they are made available to the low and moderate income families who wish to live in the communities AHC has served. AHC officials state that specific restrictions on rents charged would depress the value of the homes and cause lenders to withdraw from participation in the program since any specific system of rent controls would limit the owner's income stream from the rental units in a manner that would erode property values. They also assert that such a system of rent control is administratively impractical.

AHC officials, however, acknowledge that they do not know the amount of rent being charged or the income of the renters. Homeowners independently choose the tenant and set the rental fee. We maintain that without such data, AHC has no assurance that rental units are being made affordable to persons who otherwise could not afford these units; or that the renter, as opposed to the

homeowner, is obtaining the benefit of the grant. Moreover, just as AHC does not rely on the location of its projects to ensure that homeowners meet AHC's income criteria, we believe that AHC should not rely solely on the location of its projects to ensure that rental units meet AHC's affordability criteria.

Substantial State funds are being used to create rental units. AHC should enforce its requirement that grantees ensure that rental units are affordable to individuals who otherwise would have been unable to rent these units.

Recommendation

11. Enforce the requirement that grantees establish criteria to ensure that rental units are affordable to persons who otherwise would have been unable to rent such accommodations.

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