State of New York
Office of the State Comptroller
Division of Management Audit and State Financial Services

DIVISION OF HOUSING AND COMMUNITY RENEWAL

VACANCY LOSSES AND TENANT ACCOUNTS RECEIVABLE AT MITCHELL-LAMA PROJECTS

REPORT 96-S-81

H. Carl McCall

Comptroller

State of New York
Office of the State Comptroller

Division of Management Audit and
State Financial Services

Report 96-S-81

Joseph Lynch
Acting Commissioner
Division of Housing and Community Renewal
Hampton Plaza
38-40 State Street
Albany, NY 12207

Dear Mr. Lynch:

The following is our report regarding the Division of Housing and Community Renewal's procedures for monitoring vacancy losses and the collection of tenant accounts receivable at Mitchell-Lama housing projects.

This audit was performed pursuant to the State Comptroller's authority as set forth in Section 1, Article V, of the State Constitution and Section 8, Article 2, of the State Finance Law. Major contributors to this report are listed in Appendix A.

Office of the State Comptroller
Division of Management Audit
and State Financial Services

September 11, 1998

Executive Summary

Division Of Housing And Community Renewal Vacancy Losses And Tenant Accounts Receivable At Mitchell-Lama Projects

Scope of Audit

The New York State Division of Housing and Community Renewal (DHCR) is charged by statute with formulating State policy for housing development and financing, maintaining the State's low and middle-income housing stock, and providing technical assistance to communities for housing and community revitalization. DHCR's responsibilities include supervision of the State-financed Mitchell-Lama middle-income housing projects (projects), each of which is operated by a housing company (company). In January 1997, DHCR was responsible for 242 such projects containing 94,670 housing units. Of these, 133 were financed with bonds issued through the New York State Housing Finance Agency (HFA) and the New York State Housing Loan Fund (SLF). The other 109 were financed by New York State Urban Development Corporation (UDC) bonds. The gross scheduled annual rental income for the 242 projects was $629 million, according to figures reported as of December 31, 1995, and March 31, 1996 (the latest available data from DHCR at the time of our audit). In January 1997, DHCR had 1,062 employees, with 154 assigned to the housing program. Of DHCR's total budget of $60 million for 1996-97, the housing program was allocated $11 million.

Our audit addressed the following questions about rent collections by Mitchell-Lama housing companies for the period of January 1, 1993 to June 30, 1997 with follow-up on certain matters pertaining to the use of the Jamaica Hospital Staff Housing Project extending until May 6, 1998.

- Have the companies maximized rent collections and minimized vacancy losses?
- Have DHCR housing representatives and staff accountants monitored the rent-collection process adequately?
- How has the failure by some companies to collect full rent from project tenants affected the payment of debt service and the funding of replacement reserves?
-

Audit Observations and Conclusions

We found that DHCR officials need to strengthen controls for documenting projects with rent-collection problems. They do not summarize data on rent collections for the projects; nor do they use standards to identify problem projects. Instead, they often rely on the judgment of staff

accountants and housing representatives to identify projects that require follow-up. Our review of DHCR's monitoring reports for the projects with the worst rent-collection problems indicated that DHCR housing representatives did not always maintain documentation either identifying these problems or recommending further action to address them.

According to the standards set by the U.S. Department of Housing and Urban Development (HUD) for Federally-funded housing, losses resulting from vacancies or unpaid rents are considered excessive if they exceed 7 percent or 6 percent, respectively, of the project's gross scheduled rents. By those standards, the losses suffered recently by some of DHCR's projects would be quite excessive. For example, according to figures reported for DHCR's 242 projects in March 1997, an estimated $26.9 million of the $53.4 million in gross tenant accounts receivable was uncollectible. Nearly one-fifth of the projects (48) had reported vacancy losses that were higher than 7 percent. HUD's 6 percent standard for tenant accounts receivable was exceeded at 62 (25.6 percent) of the 242 projects. In addition, 12 of these projects had exceeded both parameters. (See pp. 4-7)

We found that vacancy problems occur primarily at projects located in upstate regions of the State where business closings and job losses have had a negative effect on the local economy. On the other hand, the tenant accounts receivable problem is more prevalent downstate in the New York City area, where its frequency further contributes to inadequate debt service and funding of the project replacement reserves. For example, the ten New York City projects with the highest accounts receivable during our audit period were owed total amounts that ranged from 25.6 percent to 232.5 percent of their gross scheduled annual rent. (See pp. 8-13)

The project with the largest accounts receivable balance, Jamaica Hospital Staff Housing, was not being used for housing purposes. Rather, the building has been completely converted to office space and is being used by Jamaica Hospital for doctors' and business offices. This use is inconsistent with the designed purposes of Mitchell-Lama housing projects. We were unable to ascertain if DHCR approved this conversion. (See pp. 13-14)

Comments of DHCR Officials

DHCR officials do not specifically address most of our recommendations. Rather, they indicate general disagreement with the need for formalized performance criteria and summary reporting and general agreement with the need for improved documentation as discussed in the recommendations. DHCR officials do specify that they plan to review the Jamaica Hospital matter and to take appropriate actions as recommended.

Contents

Introduction

Background

The New York State Division of Housing and Community Renewal (DHCR) is responsible for formulating the State's policy on housing development and financing, maintaining the State's low and middle-income housing stock, and providing technical assistance to communities in matters of housing and community revitalization. DHCR's responsibilities include supervision of the State-financed Mitchell-Lama middle-income housing projects (projects) each of which is operated by a housing company (company) responsible for management of the projects. In January 1997, DHCR was responsible for 242 such projects containing 94,670 housing units. Of these projects, 133 were financed with bonds issued through the New York State Housing Finance Agency (HFA) and New York State Housing Loan Fund (SLF). The other 109 were financed by New York State Urban Development Corporation (UDC) bonds. The gross scheduled annual rental income for the 242 projects was $629 million according to figures reported as of December 31, 1995 and March 31, 1996, the latest available data from DHCR at the time of our audit.

In January 1997, DHCR had 1,062 employees, with 154 assigned to the housing program. Of DHCR's total budget of $60 million for 1996-97, the housing program was allocated $11 million.

DHCR's Housing Audits and Accounts Bureau (Housing Bureau) is responsible for the review and approval of the company budgets that are used in determining project rental rates. The Housing Bureau also establishes and monitors escrow and reserve requirements to ensure that funds will be available to cover operating expenses and future replacement needs. In addition, Housing Bureau staff are supposed to analyze projects' annual financial statements, note any unusual items, and recommend follow-up action to be taken by DHCR's Housing Management Bureau (Management Bureau).

According to DHCR's Management Representative Guidelines for Evaluation of Project Operations (Guidelines), the main responsibility of a Management Bureau housing representative is to supervise and evaluate the management of the projects and to recommend improvements and corrections for any deficiencies noted. The Guidelines further state that DHCR management should address the Management Bureau's recommendations and correct any inefficiency, noncompliance, or failure to meet acceptable standards. These representatives are supposed to make annual reviews covering 11 areas of operation for financially-stable projects and 17 areas for financially-troubled projects. The areas to be reviewed

include fiscal and budget, accounts receivable, tenant selection, and rental income. The review of accounts receivable is to include write-offs, while the tenant selection review should cover vacancies and vacancy losses. In addition, some companies hire a managing agent for the day-to-day operation of a project. According to DHCR procedures, Management Bureau staff evaluate the performance of such managing agents every two years.

Audit Scope, Objectives, and Methodology

We audited DHCR's monitoring of rent collections at Mitchell-Lama projects for the period January 1, 1993 through June 30, 1997 with follow-up on certain matters pertaining to the use of the Jamaica Hospital Staff Housing Project extending until May 6, 1998. One objective of our performance audit was to determine whether the companies had maximized rent collections and minimized vacancy losses. Another objective was to assess the adequacy of DHCR's monitoring of rent collections and vacancy losses. We also sought to determine whether companies' failure to collect full rent from project tenants had affected the payment of debt service or the funding of replacement reserves. To accomplish these objectives, we reviewed applicable laws; DHCR policies and procedures; and the New York State Codes, Rules, and Regulations (Code). We also interviewed employees of DHCR, the Housing Finance Agency, and the Mortgage Loan and Enforcement Corporation; as well as company staff. In addition, we reviewed DHCR and company 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 DHCR which are included within the audit scope. Further, these standards require that we understand DHCR's internal control structures and their compliance with those laws, rules and regulations that are relevant to those 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 my 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 DHCR Officials to Audit

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

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Commissioner of the Division of Housing and Community Renewal 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.

Performance Criteria and Reporting

Two problems persist at DHCR-supervised Mitchell-Lama projects: late rental payments, and vacant apartments for which no rent can be collected. To adequately monitor project operations in these problem areas, DHCR's Housing Bureau should have criteria for determining excessive vacancy losses and excessive tenant accounts receivable. According to the United States Department of Housing and Urban Development (HUD), vacancy losses for Federally-funded housing are excessive if such losses exceed 7 percent of gross scheduled rents. HUD considers tenant accounts receivable to be excessive if such receivable amounts exceed 6 percent of gross scheduled rents.

We found that the Housing Bureau has no established criteria for determining either excessive vacancy losses or excessive tenant accounts receivable. Instead, DHCR staff rely on the judgments of Housing Bureau staff to identify projects with vacancy and rent-collection problems. DHCR officials stated that they did not believe that the criteria we suggested is necessary for effective oversight.

To better monitor project operations, DHCR management should prepare summary reports on the projects regarding rent collections, vacancy losses, and tenant accounts receivable. Although DHCR receives annual financial statements for all of its projects, the statements do not summarize the data on rent collections. Such a summary would help DHCR determine which projects have unacceptable vacancy losses or tenant accounts receivable. The decision to refer a project to management for special attention is made at the discretion of each representative and the staff accountants. Since representatives are responsible for an average of 13 projects, and may not be familiar with statistics from projects for which they are not personally responsible, this is not a reliable method of determining which projects should be referred for additional action.

We believe that, without the performance criteria, it is difficult to establish, summarize, and report projects that have excessive vacancy losses and tenant accounts receivable. Rent collection shortfalls may not be identified in a timely manner and necessary follow-up may not take place. As a result, there is increased risk that projects may not have revenues to pay for mortgages, to fund reserve requirements, or to cover operating expenses.

DHCR Response to Audit: DHCR officials respond that our report erroneously states that without such a system (one with formal, documented, and uniformly applied criteria), DHCR can not adequately monitor the Mitchell-Lama developments. In addition, DHCR contends that the report inaccurately assumes that performance criteria are essential to resolving the issues facing Mitchell-Lama housing in distressed areas. DHCR officials explain that the difficulty is not with the identification of problems, but with what DHCR can do, within available resources, to remedy the situations. In responding, DHCR officials also stated that the auditors did not present any findings supporting any relationship between the lack of formal classification systems and the existence of the vacancy rates and accounts receivable at sampled sites.

Auditor Comments: Our report neither states that DHCR can not monitor Mitchell-Lama developments without a system of formally documented and uniformly applied criteria nor implies that such a system is essential to resolving the issues facing Mitchell-Lama developments. As indicated in the text of the report, our conclusions are that such a system is needed to adequately monitor operations and to make monitoring less difficult. We recognize that to remedy the situations requires a proper allocation of DHCR resources. While we have no findings correlating the vacancy rates and accounts receivable with the lack of a formal classification system, it is our opinion that more formalized techniques are necessary and should help DHCR to monitor these situations and to make resource allocation decisions with respect to correcting them.

We reviewed and summarized project vacancy losses and tenant accounts receivable by examining financial statements for all 242 projects. We found that vacancy losses totaled $26.8 million out of the potential total rental income of $629 million, according to figures reported December 31, 1995 and March 31, 1996. Gross tenant accounts receivable as of March 31, 1997, totaled $53.4 million with $26.9 million estimated as uncollectible. Of the 242 projects, 48 (19.8 percent) had vacancy losses exceeding the 7 percent standard used by HUD and 62 (25.6 percent) had tenant accounts receivable exceeding HUD's 6 percent standard. In addition, 12 (5 percent) of the 242 projects exceeded both of the HUD criteria. These conditions indicate that rent collections are not being maximized and vacancy losses are not being minimized. DHCR did not provide us with written support that these conditions had been identified formally as part of a plan of corrective actions that needed to be pursued.

The need for performance criteria to focus attention on rent collections and vacancy losses has added significance because many of the projects

that have not collected the amount of rent that they are owed are also not repaying their State-financed loans; in fact, they are taking additional loans. Overall, for the UDC-funded projects, outstanding debt is higher than it was when the projects were first built. The original mortgage loans for the 109 UDC-funded projects totaled $1.138 billion. As of August 31, 1996, the outstanding debt to the State had risen 30 percent to $1.48 billion. Arrearage notes totaling $206 million were issued for 55 projects to cover unpaid interest costs. Another $166 million in interest is outstanding from 79 projects. Of the 109 UDC-funded projects, there are 39 for which none of the principal on the original loans has been repaid. For some of these projects, this condition has existed for as long as 26 years. Of the 109 UDC projects, 89 had past-due debt service, as of December 1996, totaling $294 million.

Most UDC projects are also not funding their replacement reserves adequately. Without adequate reserves, the projects will not be able to pay for future repairs and replacements. To keep the projects in a safe and sanitary condition, the companies may need to call upon the State for financial assistance at some point. According to information from the New York State Mortgage Loan and Enforcement Corporation, the 109 UDC projects had a total receivable amount for replacement reserves of $22.7 million, as of December 15, 1996, about 36 percent of the $62.9 million that was needed to fund reserves. Of the 109 UDC projects, 94 were more than one month late in funding replacement reserves.

The total value of the original loans for the 133 HFA and SLF projects was $1.66 billion. As of December 31, 1996, six of these projects owe past due debt service totaling $162.3 million. Of this total, overdue principal was $48.3 million, overdue interest was $104.4 million and cumulative fees in arrearage were $9.6 million.

DHCR officials pointed out that formalizing a ranking system for projects with problems was also the subject of an DHCR internal audit recommendation issued in May 1997. The recommendation called for a risk-based model for establishing different levels of scrutiny for a project to receive during the budget rent determination process (BRD). In addition, DHCR officials noted that the BRD process is supposed to assess operational issues including collections and vacancy rates every time rents are set. In this regard, DHCR views BRD as the key process for addressing our audit observations.

While we recognize the BRD process as affording DHCR a key opportunity to review vacancy losses and tenant accounts receivable, it should be noted that the BRD process is performed biannually for each individual

project at different points in time. Also, its main purpose is to establish a budget for each project and a schedule of tenant rents. The determination of the budget for vacancy losses, for example, is just one of multiple budget items considered during the BRD process. However, if vacancy loss and tenant accounts receivable performance criteria, summary reporting and risk ranking can be implemented into the BRD process, this may be an acceptable way of strengthening BRD control and giving the system wide attention to these issues as our report indicates is necessary.

DHCR Response to Audit: The response of DHCR officials acknowledges that the vacancy and rent collection problems impact on the ability to pay debt service and fund replacement reserves.

Recommendations

1. Establish formal criteria and guidance for identifying projects with excessive vacancy losses and excessive tenant accounts receivable.

2. Prepare summary reports on rent-collection activity at State-funded housing projects. Update them periodically.

Monitoring

In accordance with DHCR procedures, Housing Bureau staff should be analyzing annual financial statements from the projects in a timely manner to note unusual items such as excessive vacancy losses and excessive tenant accounts receivable. Management Bureau staff should also be conducting and documenting the results of project visits that staff perform to examine operations. These visits should produce recommended improvements over such areas as vacancy losses and tenants accounts receivable. However, based upon our review of DHCR records for the ten projects which we determined had the highest vacancy losses and the highest tenants accounts receivable, we concluded that both the Housing and Management bureaus often did not comply with required procedures. Our determinations of projects with the highest vacancy losses and the highest tenant accounts receivable was based upon the most current project financial data available at DHCR during January 1997. We expressed vacancy losses and tenant accounts receivable as a percentage of gross scheduled rents to identify our ranking of projects.

Vacancy Losses

The ten projects shown in the chart below had the highest percentages of vacancy losses in terms of gross scheduled rent.

Project	Location	Gross Scheduled Rent	Vacancy Loss	Vacancy Loss Percent	Year Ended
UDC-40	Rome	$414,072	$259,902	62.8%	12/31/95
UDC-23	Rome	$723,720	$426,567	58.9	12/31/95
UDC-140	Clyde-Lyons	$709,066	$407,629	57.5	12/31/94
UDC-281	Utica	$1,048,848	$450,451	42.9	12/31/95
UDC-38	Niagara Falls	$1,011,520	$349,829	34.6	12/31/95
UDC-20	Syracuse	$936,000	$317,154	33.9	12/31/95
UDC-43	Syracuse	$2,017,512	$638,307	31.6	12/31/95
UDC-81	Rome	$404,868	$119,421	29.5	6/30/96
UDC-141	Albany	$918,384	$255,125	27.8	12/31/95
UDC-108	Syracuse	$936,000	$254,136	27.2	12/31/95

The vacancy loss percentages shown in the preceding chart are significantly in excess of the 7 percent standard which HUD uses for determining when vacancy loss percentages are excessive. Our review of Housing Bureau records pertaining to its financial statement analysis and of Management Bureau records pertaining to its field visits to the projects with the highest vacancy loss percentages showed the following:

Housing Bureau (using the ten projects with the highest vacancy losses)

- We requested the analyses for the ten projects. At the time of our request, the review was prepared for just four of these projects. The remaining six analyses were prepared after we requested them.

- Analyses for only three of the projects acknowledged that vacancy was a problem and two of these analyses were prepared a year after the statement date.

- For six of the projects, the analyses include only a comparison of the budgeted to the actual vacancy losses with no additional comments or observations provided.

- For one project, UDC-140, we noted that the analysis was based upon dated financial statements. Follow-up discussions with DHCR disclosed that vacancy losses at this project have resulted in so much rental income loss that project management could not afford to pay a public accountant for certified financial statements during the last two years.

Management Bureau (using the five projects with the highest vacancy losses)

- No site visit reports had been prepared for UDC-140 during 1996.

- Four projects had field visit reports which documented a problem with vacancy losses, but only one of the reports provided any recommendations for addressing the problem.

- Evaluation reports of managing agent performance existed for all five projects, but none contained recommendations for corrective actions regarding vacancy losses.

Moreover, our analysis indicates that the vacancy loss problem has become worse over time, as shown in the following chart.

		Vacancy Loss Percentage		
		Fiscal Year		
Project	**Location**	**1992-93**	**1995-96**	**Percentage Increase**
UDC-40	Rome	17.9%	62.8%	44.9%
UDC-23	Rome	26.6	58.9	32.3
UDC-140	Clyde-Lyons	42.4	57.5	15.1
UDC-281	Utica	26.0	42.9	16.9
UDC-38	Niagara Falls	11.3	34.6	23.3
UDC-20	Syracuse	24.7	33.9	9.2
UDC-43	Syracuse	10.2	31.6	21.4
UDC-81	Rome	7.2	29.5	22.3
UDC-141	Albany	15.1	27.8	12.7
UDC-108	Syracuse	12.1	27.2	15.1

Based on interviews we conducted with DHCR staff and project managing agents and project site staff, we were able to obtain some indications of the underlying problems that may have been causing these severe vacancy losses. For example, vacancy losses in projects located upstate were often attributed to a poor regional economy and local residential market conditions. In particular, we were told that eight of the ten projects lost tenants when the local United States Griffith Air Force Base in Rome was closed. Another reason mentioned for the vacancy problems was potential tenant impressions that utility costs would be high in apartments heated with electricity.

Tenant Accounts Receivable

The ten projects shown in the following chart have the highest accounts receivable stated as percentage of gross scheduled rent. These tenant

accounts receivable percentages are significantly higher than HUD's 6 percent standard for excessiveness.

Project	County Location	Gross Scheduled Rent	Gross Tenant Accounts Receivable	Accounts Receivable Percentage	Year Ended
HCNP-172	Queens	$675,990	$1,571,347	232.5%	3/31/96
UDC-58	Yonkers	$1,530,276	$877,003	57.3	3/31/96
UDC-84	Brooklyn	$2,451,942	$1,196,178	48.8	12/31/95
UDC-17	Bronx	$2,667,432	$1,133,577	42.5	12/31/95
UDC-18	Bronx	$13,210,372	$4,188,342	31.7	12/31/95
UDC-83	Brooklyn	$1,199,893	$343,961	28.7	12/31/95
HCUR-107	Bronx	$6,870,681	$1,938,450	28.2	3/31/96
UDC-31	Bronx	$2,346,529	$613,752	26.2	12/31/95
UDC-237	Brooklyn	$3,900,690	$1,002,394	25.7	12/31/95
UDC-141	Albany	$918,384	$234,685	25.6	12/31/95

Our review of Housing Bureau records pertaining to required financial statement analysis and Management Bureau records pertaining to required field visits for the projects with the highest tenant accounts receivable percentages shows the following:

Housing Bureau (using the ten projects with the highest accounts receivable)

- Only three projects had analyses including comments that an accounts receivable problem had been identified.

- None of the projects had analyses indicating follow-up actions regarding tenant accounts receivable.

- At the time of our request, reviews had been prepared for just six of the projects.

Management Bureau (using the five projects with the highest accounts receivable)

- No site visit report was prepared for one of the projects, UDC-18.

- The site visit reports of three of the four projects contained statistics on tenants accounts receivable, but no statement that there was a problem or recommendation for action to be taken.

DHCR officials pointed out that the DHCR's Budget and Rent Determination (BRD) process is also relied on to review project vacancies and revenue collections. DHCR officials concurred with our findings that housing representative activities is an area that needs attention and they stated that steps are being taken to address this. They added, however, that the absence of documentation does not mean that DHCR is unaware of vacancy problems. They stated that separate from the staff activities of the staff accountants and housing representatives, DHCR management frequently contact other agencies and consider a variety of actions to address these problems regarding the projects. They acknowledged that the documentation of these efforts needs to be improved.

DHCR Response to Audit: Officials responded that there are no specific findings regarding inadequate steps taken by the sampled companies to maximize rent collections and to minimize vacancy losses. Therefore, officials conclude that there are no deficiencies in this area. In addition, officials responded that there were no findings that DHCR was unaware of the conditions we reported on or that actions taken in addressing these problems were not reasonable and appropriate. DHCR officials stated that certain problems have existed for years and are covered by other DHCR systems and reviews as well and, therefore, need not be reported visit after visit. With respect to documentation, DHCR officials also stated that whether analyses are available when DHCR staff need them is what is significant rather than if analyses are available when the auditors asked for them. Officials further stated that it is not appropriate for staff to make recommendations for improvement over vacancy and accounts receivable problems resulting from conditions over which they have no control over such as downturns in local economies.

Auditor Comments: As our report points out, the analysis of financial statements in a timely manner to note unusual items and the documented operational review of sites to generate recommendations for improvement, are the requirements that must be met as part of adequate monitoring and oversight in accordance with DHCR procedures. We believe our report amply shows deficiencies with respect to compliance with these requirements of DHCR. If required documentation is not available for inspection upon audit, we question how it can be available in a timely

manner when staff require it and whether DHCR is exercising the oversight and monitoring that is suggested in its response to this audit.

In our examination of the Jamaica Hospital Staff Housing project (the project with the highest tenant accounts receivable percentage) we found that the entire amount owed was due from Jamaica Hospital (Hospital) rather than individual tenants. This project was developed as non-profit staff housing for the faculty, students, employees, nurses and other related personnel of the Hospital pursuant to Article II of the New York State Private Housing Finance Law. When we spoke to DHCR and Hospital officials and visited the project, we learned that the building was not being used for Hospital staff housing. Rather, the apartments are being used as doctors' offices and hospital-related business offices.

We did not find any provision in the Law that would allow using the entire seven story building for other than housing purposes. In addition, while we reviewed a variety of correspondence requesting alternative funding or a reconsideration of the building usage, we were not provided with any documentation that DHCR approved converting the building from residential apartments to offices.

Apparently, just as the construction of the building was being completed in 1977, Hospital officials believed that it would not be economically feasible to rent the apartments to employees. It was believed that the apartment rent that would have to be charged to fund the debt service would be too high to attract a sufficient number of tenants.

As a result, during 1977, the Hospital used separate funding to convert floors 2, 3 and 4 to office use. Sometime later floors 5, 6 and 7 were also converted. In 1984, 19 apartments were occupied by tenants and only 10 tenants were in the building in 1991. By 1997, no residents were in any of the 102 apartments; all were occupied by Hospital doctors and office personnel.

DHCR officials stated that these decisions were made by the prior administration over 10 years ago and that we should draw whatever conclusions we considered to be appropriate. They stated that DHCR would not approve any such arrangements in the future. In the absence of documentation to the contrary, we conclude that the current use of the premises does not appear to comply with Article II of the New York State Private Housing Finance Law. Unless DHCR can establish a documented and legally valid basis for the use of the premises for nonresidential

housing purposes, DHCR must take steps needed to bring the use of the premises into compliance with the Law.

Recommendations

3. Ensure that Housing Bureau Financial analyses and Management Bureau site visits are documented, timely and useful in addressing vacancy losses and tenant accounts receivable for projects.

4. Determine whether there is a documented and legally valid basis for using the Jamaica Hospital Staff Housing Project for nonresidential purposes. If not, take steps necessary to bring the use of the premises into compliance with the Law.

   (DHCR officials concurred with Recommendation 4.)

Major Contributors to This Report

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July 21, 1998

Mr. Jerry Barber
Director of State Audits
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Dear Mr. Barber:

Attached are comments by the Division of Housing and Community Renewal regarding draft audit report 96-S-81, entitled "Vacancy Losses and Tenants Accounts Receivable at Mitchell-Lama Projects." We appreciate the efforts of your staff in the audit of these matters and thank you for the opportunity to comment on this draft report.

Sincerely,

John J. Solodow
Internal Control Officer

Attachment
cc: Joseph B. Lynch, Acting Commissioner
N. Reuss - DOB
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DHCR comments:
Vacancy Losses and Tenant Accounts Receivable at Mitchell-Lama Projects
Comptroller's audit report 96-S-81

The Division of Housing and Community Renewal is in general agreement with the need to improve documentation, as several of the recommendations in this report suggest. We appreciate the auditors' input on the issues regarding Jamaica Hospital and will conduct a legal review to fully explore the issues and determine the most appropriate actions to ensure compliance with applicable statutes and agreements.

Most of this report focuses on what the auditors perceive as a need for formal, documented, and uniformly applied criteria for the identification and classification of Mitchell-Lama developments which have excess vacancy losses and accounts receivable. Care must taken to insure that the reader fully understands the issues being addressed. The report erroneously states that without such a system DHCR can not adequately monitor the Mitchell-Lama developments. However, the auditors do not present any findings supporting any relationship between not having the formal classification systems they recommend and the existence of the vacancy rates and accounts receivables at the sites they sampled. The auditors have not identified deficiencies in the on-site project management, or in the Division's awareness of and actions taken in addressing the vacancy losses and accounts receivable problems. This despite the fact that the auditors focused on those companies with the most pervasive problems.

This audit addressed three questions. The first question was, have the companies minimized vacancy losses and maximized rent collections? As the auditors state this is an exception based report, therefore the auditors only report on problems. There are no specific findings regarding inadequacies in the steps taken by the sampled companies to maximize rent collections and minimize vacancy losses. Therefore the reader should conclude that the auditors did not identify any deficiencies in these areas.

The second question this audit seeks to answer is, has DHCR oversight been adequate? There are no findings that DHCR was unaware of the observed conditions, or that the actions taken in addressing these problems were not reasonable and appropriate. Agency staff were aware of all the specific issues regarding the status of accounts receivables and vacancy losses identified by the auditors, long before this audit started.

Staff assigned to the monitoring and oversight of these companies are professional level housing specialists, architects, engineers and accountants. Experience has shown that the best manner to fully assess the conditions at these developments and to identify appropriate corrective actions is through the full utilization of the professional skills, knowledge and informed judgements of this staff. Such a level of expertise is needed as the issues are complex and frequently technical. Economic conditions in a city may vary from neighborhood to neighborhood. What may be an unavoidable accounts receivable level at one project may be unacceptable at a project less than a mile away. Rural areas may be impacted by the closing of one major employer as happened in

the Utica-Rome area. The purpose of the auditor recommended systems is to insure just such an awareness. This has been accomplished. The auditors had no findings indicating otherwise.

The Division recognizes that there were instances where the documentation was in need of improvement. Existing agency standards were not always adhered to. We agree that documentation in certain areas can and will be improved. However, when assessing the adequacy of documentation it should be understood that the purpose of monitoring is to identify conditions of which management needs to be aware. Certain problems which have existed for a number of years need not be reported on visit after visit in monitoring reports. Compensating controls in other DHCR systems ensure that there are routine reviews of issues which are on-going and not subject to change over the short-term (several years or less). It is reasonable that these substitute for continually reporting the same conditions visit after visit.

The third question this audit sought to answer was, have the vacancy problems and rent collection problems at the sampled companies impacted their ability to meet debt service and funding of replacement reserves? The answer is obviously "yes". The impact of vacancies and accounts receivables on reserve fund balances and debt service payments is well documented in DHCR's project files. This is reviewed periodically as part of the routine budget rent determination process. The auditors' selected those companies with greatest problems in these areas for their audit sample. They used DHCR monitoring files to identify these companies.

There are also certain assumptions and statements made in this report which are incorrect and will mislead the reader. The assumption is made that the suggested performance criteria are necessary to identify problems and conduct follow-up. This is not the case as the report points out the problems addressed have been persistent over a number of years. Existing systems have identified these issues and staff were well aware of them prior to this audit.

The basic assumption in this report is that performance criteria as defined by the auditors are essential to resolving the issues facing Mitchell-Lama housing in distressed areas. This is an inaccurate assumption. DHCR continually assesses the condition of the Mitchell-Lama portfolio. It is DHCR's opinion that the difficulties it faces is not in the identification of problem developments, but in what DHCR can, within available resources, do to remedy the situations. Each housing company must be assessed on a case by case basis. Effective solutions go far beyond what can be recommended in a routine monitoring report. Solutions may include finding new developers, refinancing etc. Fortunately, in some cases, actions have been quite successful in turning developments around. UDC 141, which was included in the audit sample, was redeveloped and now has 100 percent occupancy.

The vacancy losses section includes a number of findings, on page 8, in bullet format. The context in which these findings are presented is unclear. The fact that certain analyses were unavailable at the time the auditors asked for them is not significant. Whether they were available when staff needed them for processing is the criteria by which this should be judged.

In the findings related to evaluation reports for the managing agents, the audit criticizes DHCR because there are no recommendations in the managing agents' evaluations for corrective actions

at some of these developments. It is not appropriate to address issues such as downturns in local economies, etc. in this manner. Evaluations of the managing agents are based on criteria which relate to the responsibilities and duties they have control over and their performance during the evaluation period. There are other methods used by DHCR which are better suited to addressing the issues this report focuses on.

The accounts receivable table on page 10 is also misleading. The gross rent is an annual figure and the gross accounts receivable may represent all accounts receivable since the project start up. Not all receivables have been written off, even though the tenants may have been evicted or moved out 10 or 20 years ago, and there is no hope of ever collecting the rents due. This makes the percentage comparison invalid for the purposes used. We recognize that there is a need to utilize the existing agency standards for writing these off as uncollectible.

We appreciate the opportunity to comment on this draft and appreciate the efforts of your staff in the audit of these matters. We hope you find our comments constructive and useful.