



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

Division of State Government Accountability

Enforcement of the Mitchell-Lama Surcharge Provisions

Homes and Community Renewal Division of Housing and Community Renewal



Report 2017-S-12

April 2018

Executive Summary

Purpose

To determine if surcharges are being properly assessed at Mitchell-Lama housing developments supervised by Homes and Community Renewal's Division of Housing and Community Renewal (DHCR). Our audit focused on the income affidavits submitted for the 2012 calendar year, the most recent year for which DHCR had verified affidavits at the time of our audit in 2017.

Background

The Mitchell-Lama program was created in 1955 to provide affordable rental and cooperative housing to middle-income families. A total of 269 State-supervised Mitchell-Lama developments with over 105,000 apartments were built under the program. In exchange for low-interest mortgage loans and real property tax exemptions, the program required limitations on profit, income limits on tenants, and supervision by DHCR.

Apartments are rented or sold to prospective tenants from waiting lists maintained by DHCR's Automated Waiting List System. Applicants must meet eligibility requirements related to income limits, family size, and apartment size prior to taking occupancy of the apartment. Residents must also meet DHCR's income eligibility requirements on an ongoing basis during occupancy. By April 30 of every year, occupants of each apartment are required to submit an income affidavit attesting to their income and certain deductible expenses incurred during the preceding calendar year. Mitchell-Lama housing developments are responsible for distributing and collecting these annual income affidavits. If the reported aggregate annual income of all occupants in an apartment exceeds the development's maximum income limit for that apartment, building management is required to add a surcharge, up to a maximum of 50 percent, to the monthly rent or carrying charge.

Payment of surcharges is a legal obligation. It is important that surcharges for tenants with incomes exceeding legal thresholds be calculated correctly and collected timely, as surcharge income is applied to meet the operating costs of each development. Tenants who do not pay surcharges are not paying their required share, and this has an impact on other tenants since lost revenue from uncollected surcharges can result in an increase in rent or carrying charges for all tenants. Such an increase weakens the affordability of the State's Mitchell-Lama housing stock, hurts those tenants who are paying the surcharges, and places an unnecessary financial burden on lower-income tenants living in those developments. Our testing focused on the three developments that were expected to receive the highest surcharge income for 2012: Co-op City (Bronx); Rochdale Village (Queens); and Electchester First through Fifth Houses (Queens).

Key Findings

- While some exceptions were noted, surcharges were generally properly calculated and assessed for the tested transactions at the sampled developments. However, there were significant deficiencies in the practices used to confirm the accuracy of tenants' self-reported income at two (Co-op City and Rochdale Village) of the three developments we reviewed.
- Income verification audits were required for 110 of the selected tenants in our review. However,

we found that just 33 (30 percent) of the required audits had been done: 31 at Electchester, two at Co-op City, and none at Rochdale Village. As a result, there is limited assurance that tenants are paying surcharges based on their actual income.

- Developments are not charging tenants the maximum allowable surcharges when tenants do not provide a certified tax return to substantiate self-reported income.
- The data file used to identify tenants subject to an income verification audit was incorrect for 17 percent of the transactions we sampled. As a result, certain tenants may have been incorrectly excluded from audit and possibly from additional surcharges.
- DHCR is several years behind in generating the match between tenants' self-reported information and their tax records. At the time of our review in 2017, DHCR's most recent match was for 2012.
- The Private Housing Finance Law states that tenants whose income exceeds the maximum income limit by 25 percent or more require DHCR's approval to remain in their units. We identified 29 units at our sampled developments that exceeded the limit. However, we found no evidence that DHCR had approved the residency of these tenants.

Key Recommendations

- Monitor building managers to ensure that follow-up verification audits are completed properly and timely and surcharges are correctly assessed.
- Follow up on the occupant-related matters at the three developments we examined, as detailed in the report.
- Ensure the data file prepared for the Department of Taxation and Finance income match is accurate.
- Develop formal policies and protocols regarding tenants whose incomes exceed the maximum allowable household income limit. Perform periodic reviews to ensure compliance with those policies and protocols.

Other Related Audit/Report of Interest

[Division of Housing and Community Renewal: Administration of Mitchell-Lama Waiting Lists \(2016-S-46\)](#)

State of New York
Office of the State Comptroller

Division of State Government Accountability

April 10, 2018

Ms. RuthAnne Visnauskas
Commissioner/CEO
Homes and Community Renewal
25 Beaver Street
New York, NY 10004

Dear Ms. Visnauskas:

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

The following is a report of our audit entitled *Enforcement of the Mitchell-Lama Surcharge Provisions*. The audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law.

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

Respectfully submitted,

Office of the State Comptroller
Division of State Government Accountability

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State Government Accountability Contact Information:

Audit Director: Kenrick Sifontes

Phone: (212) 417-5200

Email: StateGovernmentAccountability@osc.state.ny.us

Address:

Office of the State Comptroller
 Division of State Government Accountability
 110 State Street, 11th Floor
 Albany, NY 12236

This report is also available on our website at: www.osc.state.ny.us

Background

The Mitchell-Lama program (Program) was created in 1955 to provide affordable rental and cooperative (co-op) housing to middle-income families. A total of 269 State-supervised Mitchell-Lama developments with over 105,000 apartments were built under the Program. In exchange for low-interest mortgage loans and real property tax exemptions, the Program required limitations on profit, income limits for tenants, and supervision by Homes and Community Renewal's Division of Housing and Community Renewal (DHCR). There are currently 152 State-supervised Mitchell-Lama developments with a total of approximately 68,000 apartments.

Apartments are rented or sold to prospective tenants from waiting lists maintained by DHCR's Automated Waiting List System. Applicants must meet eligibility requirements related to income limits, family size, and apartment size prior to taking occupancy of the apartment. As detailed in Private Housing Finance Law (Law) Article II, Section 31(2)(a), residents must also meet DHCR's income eligibility requirements on an ongoing basis during occupancy. By April 30 of every year, occupants of each apartment are required to submit an income affidavit attesting to their income and certain deductible expenses incurred during the preceding calendar year. Mitchell-Lama housing developments are responsible for distributing and collecting these annual income affidavits. If the reported aggregate annual income of all occupants in an apartment exceeds the development's maximum income limit for that apartment, building management adds a surcharge (of up to 50 percent, depending on income) to the monthly rent or carrying charge. Surcharge billings begin on July 1 of each year.

Payment of surcharges is a legal obligation. It is important that surcharges for tenants with incomes exceeding legal thresholds be calculated correctly and collected timely, as surcharge income is applied to meet the operating costs of each development. Tenants who do not pay surcharges are not paying their required share, and this has an impact on other tenants since lost revenue from uncollected surcharges can result in an increase in rent or carrying charges for all tenants. Such an increase weakens the affordability of the State's Mitchell-Lama housing stock, hurts those tenants who are paying the surcharges, and places an unnecessary financial burden on lower-income tenants living in those developments.

Housing developments must submit completed income affidavits as well as a listing of residents who did not file an affidavit to DHCR by September of each year. DHCR then sends the paper income affidavits to a vendor to be entered into an electronic format. The electronic data is then forwarded by DHCR to the Office of Information and Technology Services (ITS) to be verified for accuracy by matching the income reported on the affidavits (as entered by the vendor) with that on the residents' State tax returns filed with the Department of Taxation and Finance (Finance). The results are then sent to DHCR in an income match report, usually within two weeks.

The DHCR income match report for the 2012 calendar year – the most recent year verified by DHCR at the time of our audit in 2017 – includes the following four classifications:

- Okay – Indicates that the income reported on the affidavit is within \$500 of, or greater

than, the income reported on the tenant's State tax return.

- Low – Indicates that the income reported on the affidavit is lower than the income reported on the State tax return by \$500 or more.
- Not Found (NFND) – Usually indicates that the Social Security number (SSN) was not found in Finance's files; in some cases, this is because the resident did not file a tax return.
- Unmatched (UNMT) – Indicates that the SSN was found in Finance's files but the name does not match.

The report also listed tenants who submitted income affidavits but were not identified with one of the four classification codes.

Based on the four classifications, DHCR determines whether a tenant's income needs to be verified. Residents classified as "okay" do not require verification. Residents classified as "low" or "unmatched" are flagged for verification. Tenants classified as "not found" are inconsistently flagged for verification, as detailed in a later section of this report. Developments are required to contact the flagged tenants to obtain a certified tax return as proof of income and to report the results of these verifications (income verification audits) to DHCR.

We selected the three developments that, based on reports the developments filed with DHCR as part of the income verification process, expected to receive the highest surcharge income for the 2012 calendar year: Co-op City, a 15,372-unit co-op in the Bronx; Rochdale Village (Rochdale), a 5,860-unit co-op in Queens; and Electchester Houses (Electchester), a 2,399-unit co-op in Queens consisting of five housing developments (Electchester First through Fifth) managed by the same managing agent using a shared waiting list. From these developments, we selected and reviewed 90 apartments occupied by 194 tenants.

Audit Findings and Recommendations

Generally, we found that surcharges were properly calculated and assessed based on the self-reported information on tenants' income affidavits. However, we identified significant deficiencies in the practices used to confirm the accuracy of tenants' self-reported income at two of the three developments: Co-op City and Rochdale. At the time of our field visit in May 2017, Rochdale had not performed any of the required verification audits for the most recent year. Co-op City conducted only about 30 percent of the required verification audits. As a result, there is little assurance that tenants in these two developments were paying surcharges based on their actual income. While we found the third development, Electchester, completed the sampled verification audits through comparison with the tenants' certified tax returns, the surcharge due was not always posted to tenants' rent accounts. In total, of the 110 tenants in our sample who required an income verification audit, only 33 were actually audited. We also found that DHCR was several years behind in confirming the match between tenant self-reported information and tenant tax records. In addition, we found non-compliance with certain provisions of the Law regarding tenants whose incomes exceeded the maximum allowable limits. DHCR should strengthen its monitoring of these processes.

Income Verification Audits

DHCR's Rules and Regulations (Regulations) require DHCR to annually verify tenant-reported income through Finance's income match report. However, as of September 2017, DHCR had only completed the 2012 income match. Delays in income verifications can result in lost surcharge revenue due to tenant turnover. DHCR officials explained that staffing losses and a lengthy verification process resulted in these delays. They agreed to make the process more efficient.

DHCR officials told us that the results of the 2012 income match report were sent to the Mitchell-Lama housing management companies in November 2015 for them to conduct income verification audits. The developments were required to provide DHCR with the results of these audits by March 2016. DHCR provides guidance to the developments for completing these audits, including how to identify tenants who require follow-up and the form to request certified tax information. These verification audits are crucial in determining whether tenants are accurately reporting their income and being properly surcharged.

Table 1 shows the number of tenants from our sample who required verification.

Table 1 – Tenants Requiring Income Verification by Development

Development	Apartments	Tenants	Tenants Verified
Co-op City	22	41	2
Electchester	20	31	31
Rochdale	21	38	0
Total	63	110	33

Based on the income match report, the 110 tenants in our sample required income verification audits. However, verification audits were conducted for only 33 tenants: 31 at Electchester and two at Co-op City. Rochdale had not conducted any of the verification audits.

Payment of surcharges is a legal obligation. It is important that surcharges for tenants with incomes exceeding legal thresholds be calculated correctly and collected timely, as surcharge income is applied to meet the operating costs of each development. Tenants who do not pay surcharges are not paying their required share, and this has an impact on other tenants since lost revenue from uncollected surcharges can result in an increase in rent or carrying charges for all tenants. Such an increase weakens the affordability of the State's Mitchell-Lama housing stock, hurts those tenants who are paying the surcharges, and places an unnecessary financial burden on lower-income tenants living in those developments.

Rochdale

During our May 2017 site visit to Rochdale, we found that officials had not conducted the 2012 verification audits. The results of these audits should have been submitted to DHCR by March 2016. Therefore, there was no verification of the self-reported income for the 38 tenants identified in our sample or the 4,960 tenants identified in the income match report as requiring verification. Consequently, there is little assurance that Rochdale's tenants are being properly surcharged.

Rochdale officials claimed that they never received the 2012 income match report from DHCR. However, DHCR officials assert that the report was in fact emailed in November 2015, and provided documentation showing that it was emailed again in May 2017. Further, Rochdale also did not complete or submit the verification audits for 2011. In fact, DHCR officials were not able to determine the last time Rochdale submitted a report demonstrating that the required income verification audits had been conducted.

Although DHCR requires the income verification report, officials told us they do not review them or follow up with developments that do not submit them. DHCR officials were not aware of Rochdale's non-compliance until we requested the report from them. In response to our preliminary findings in October 2017, DHCR officials reported that Rochdale has since completed and submitted its 2012 verification audit report.

Co-op City

Co-op City officials reported that they took action to verify the income of 11 of the 41 tenants who required audits; however, they obtained certified tax returns from only two of them. Further, they accepted non-certified tax returns from four tenants and reported that they received no responses from the other five tenants.

DHCR policies state that tenants who do not timely submit certified tax returns upon request will be assessed the maximum retroactive surcharge. However, none of the 39 tenants who did not provide certified tax returns were assessed such a surcharge. Had the surcharge been assessed, it would have amounted to a total of \$33,567 in revenue for the development. Co-op City officials

told us that they will post these charges to the tenants' accounts when they receive the 2013 income match from DHCR. Delayed collection of these amounts impacts the development's cash flow and could lead to lost revenue if the tenants leave the development.

A Co-op City official explained that the other 30 tenants were not audited as they only review apartments where the head of household (as opposed to another tenant in the apartment) is classified as "low" on the income match report. For example, if an apartment had three tenants and two were flagged for follow-up (not including the head of household), Co-op City officials would not follow up with tenants in that apartment. This is contrary to the Regulations and DHCR's policies and procedures, and resulted in the majority of tenants who required income verification not being audited. Co-op City's verification audit report listed 2,323 apartments as being audited; however, the income match report identified 7,173 apartments to be audited. DHCR officials did not offer an explanation for why the 30 tenants in our sample were not audited and why Co-op City's verification audit report listed 2,323 audited apartments instead of the 7,173 that required verification.

Electchester

Electchester officials either verified the income or appropriately assessed the maximum surcharge for all 31 of the tenants in our sample who required a verification audit.

Tenants Excluded From Income Verification Audit

The income match report classifies some tenants as "NFND" (not found), which usually indicates that the SSN provided by the tenant was not found in Finance's files. We analyzed the income match data for the three sampled developments and found a significant number of those classified as not found – 4,476 of 10,506 tenants – had been excluded from income verifications. DHCR officials stated that since these tenants had reported not filing a tax return, there would be no certified tax return to audit against. However, as the inability to find a tenant's record with Finance may be the result of the vendor or the tenant entering the incorrect SSN on the income affidavit, DHCR should not have excluded these tenants from verifications. In fact, we determined that 340 of these tenants who reported that they had not filed a tax return also self-reported income – in some cases as high as \$90,000. Tenants should not be excluded from verifications and potential surcharges based on unsubstantiated self-reporting that they had not filed tax returns.

Surcharge Calculation and Assessment Based on Tenants' Self-Reported Income

We reviewed the calculation and assessment of surcharges for a sample of 90 apartments (occupied by 194 tenants) at the three developments (see Table 2) based on tenants' self-reported income. To calculate an apartment's surcharge, development officials determine each apartment's maximum income based on carrying charges, equity, number of rooms, and number of tenants. According to Section 1727-4.1 of the Regulations, if the household income is above the maximum limit by more than 5 percent, a surcharge will be assessed.

Table 2 – Sampled Apartments and Tenants

Classification	Co-Op City		Electchester		Rochdale		Totals	
	Apartments	Tenants	Apartments	Tenants	Apartments	Tenants	Apartments	Tenants
Low	6	10	6	11	9	16	21	37
Not Found	6	28	6	22	5	14	17	64
Unmatched	6	13	6	7	6	12	18	32
Okay	5	15	5	15	5	11	15	41
Failed to File	5	5	5	5	4	4	14	14
Blank	2	3	2	2	1	1	5	6
Totals	30	74	30	62	30	58	90	194

Rochdale

For 29 of the 30 apartments at Rochdale, officials correctly determined whether a surcharge was required based on tenant income affidavits. When a surcharge was required, the correct amount was posted to tenant accounts. However, for one apartment, Rochdale officials incorrectly excluded the income of one of the two tenants in the apartment and incorrectly concluded that a surcharge was not due. In response, DHCR agreed that the income of both tenants should have been included, but stated that it had determined that a surcharge was not due after deducting amounts for personal exemptions from the income calculation that it states the tenants were entitled to but had not claimed. However, DHCR's instructions require developments to use the deductions listed on the income affidavits. Consequently, if a tenant fails to list deductions on an affidavit, the development should not include them in the surcharge calculation.

While the surcharge amounts assessed at Rochdale were accurate overall, we found errors in the supporting calculations for 15 of 30 of the apartments in our sample. Although there was no financial impact from these errors, it is important for calculations to be accurate, as they determine if a tenant receives a surcharge and the amount of the surcharge. DHCR officials informed us that they have since retrained Rochdale on the calculations and have provided the development with additional guidance.

Electchester

For 26 of the 30 apartments in our sample, Electchester officials correctly calculated whether a surcharge was required based on tenants' income affidavits. For the remaining apartments, two should have been assessed the maximum surcharge but were not; for the other two, surcharges were calculated but not posted to the tenants' accounts (one should have been posted in July 2016 but wasn't posted until May 2017, the same month as our site visit).

Co-op City

For our 30 sampled units, Co-op City officials correctly calculated the surcharge amounts and posted them to tenants' accounts based on the self-reported information from the income affidavits.

Data Entry Errors on Income Match Report

DHCR uses a third-party vendor to input the income affidavit information into a database, which is matched against Finance's tax records. We compared the income and tenant information for the 90 sampled apartments to the verification results, and found that 16 (or about 18 percent) had data entry errors related to income, SSN, or resident name. For example:

- A tenant at Co-op City reported an income of \$85,688, but the vendor entered the tenant's income as \$885,688; and
- A tenant at Co-op City and another at Electchester had incorrect SSNs entered by the vendor.

The accuracy of the data entered by the vendor is key to identifying which tenants warrant income verification audits, and ensuring that surcharges are assessed to tenants whose incomes exceeded the maximum allowable limits for their apartments. DHCR officials stated that the vendor who made these errors no longer provides these services.

Tenants Exceeding Maximum Allowable Income

The Private Housing Finance Law states that Mitchell-Lama tenants whose incomes exceed the maximum allowable limit by more than 25 percent will be subject to removal unless they receive approval to stay from DHCR.

In our review of the 90 sampled apartments, we identified ten apartments where the household income for 2012 was more than 25 percent above the maximum allowable limit (see Table 3). The incomes for the ten apartments ranged from \$120,796 to \$564,075.

Table 3 – Units Exceeding Maximum Allowable Income

Development	Total Units Sampled	Number of Units Exceeding 25 Percent
Co-op City	30	4
Electchester	30	5
Rochdale	30	1
Totals	90	10

Additionally, through a review of all household incomes at our three sampled developments, we identified another 19 apartments with household incomes ranging from \$250,000 to \$478,657, well over the maximum allowable limit. Thus, some tenants with incomes exceeding the maximum limits (and sometimes by large amounts) were residing in Mitchell-Lama apartments without the required DHCR approval. While DHCR officials acknowledged this requirement in the Law, they also acknowledged difficulties in enforcing this requirement, citing various court rulings. DHCR officials also noted that in enforcing their own Regulations, they may consider the rights of tenants and the public interest. DHCR should develop policies and protocols for addressing compliance with this section of the Law.

Refunding of Surcharges Assessed

The Regulations provide that in no event will credit be given for excess surcharges that were already assessed as a result of failure, neglect, or refusal of a tenant or cooperator to cooperate in income determination.

For the 2012 verification year, tenants selected for verification were required to submit their certified tax returns by March 2016. Those who did not were to be assessed the maximum surcharge on July 1, 2016. Nonetheless, during our May 2017 site visit to Electchester, officials told us they were still accepting certified tax returns for 2012 and were refunding surcharges that had been previously assessed because the returns were not submitted timely. A surcharge report provided by Electchester showed that surcharges – as much as \$2,600 in some cases – were being refunded to tenants even though they had failed to provide certified tax returns in a timely manner.

We discussed this issue with DHCR officials, who told us that developments may accept late certified tax returns and not assess the surcharge in certain circumstances, such as when there is a delay in receiving the certified tax return from Finance. However, there was no indication that the tenants whose surcharges were refunded were unable to timely provide certified tax returns because of delays from Finance.

As previously reported, neither Co-op City nor Rochdale had collected maximum surcharges based on tenants' failure to submit a certified tax return. Co-op City officials told us that they would not assess the surcharge until the following year's verification process was underway. At the time of our field visit, Rochdale officials had not contacted any of their tenants who had been identified for verification. DHCR officials reported that, as of October 2017, Rochdale officials had begun their verification process.

Questionable Primary Residence

The Regulations require that the Mitchell-Lama apartment be the primary residence of the tenant/cooperator. During our review at Electchester, we identified one tenant in our sample with multiple addresses in her file. The certified tax return the tenant requested as part of the verification process was sent to her at an address other than the Mitchell-Lama development, indicating that the tenant's Electchester unit might not have been her primary residence. When we brought this to the attention of DHCR officials, they told us that neither the agency nor the housing companies can use this type of information as evidence of questionable primary residence. Nonetheless, after we brought this to DHCR's attention in June 2017, they agreed to investigate the matter. DHCR has informed us that the tenant relinquished the apartment on September 29, 2017.

Recommendations

1. Provide training to development officials on the proper surcharge and income verification procedures.
2. Monitor building managers to ensure that follow-up verification audits are completed properly and timely and surcharges are correctly assessed.
3. Follow up on the occupant-related matters at the three developments we examined, as detailed in the report.
4. Develop formal policies and protocols regarding tenants whose incomes exceed the maximum allowable limit. Perform periodic reviews to ensure compliance with those policies and protocols.
5. Conduct the outstanding annual tenant income matches with Finance records for 2013-2015 promptly, and ensure future matches are conducted and communicated to the developments on a current basis.
6. Ensure the data file prepared for the Finance income match is accurate.

Audit Scope, Objective, and Methodology

We conducted this audit to determine if surcharges were properly assessed at Mitchell-Lama housing developments supervised by DHCR. Our audit focused on the income affidavits submitted for the 2012 calendar year, which, at the time of our audit in 2017, were the most recent affidavits that DHCR had matched with Finance records.

To accomplish our objective and evaluate the relevant internal controls, we reviewed the Private Housing Finance Law, DHCR's Rules and Regulations, and procedures relating to the income verification audits and the surcharge assessment process. We interviewed relevant DHCR officials and the managing agents for the three selected housing developments regarding the Mitchell-Lama program and the income verification and surcharge assessment processes. We also interviewed representatives from Finance and a representative from ITS regarding the data verification process.

We conducted site visits to the three developments that, based on surcharge tabulation sheets the developments had submitted to DHCR as part of the income verification process, expected to receive the highest amount of surcharge income for the 2012 calendar year. We used the 2012 tabulation sheets and the Finance match report to select a judgmental sample totaling 90 apartments with a total of 194 tenants at the three sampled developments. Our sample included tenants from the four classifications, tenants left blank on the Finance match reports, as well as a sample of tenants who did not submit an income affidavit. We reviewed the sampled developments' rent rolls, tenant files, tenant ledgers, income affidavits, records related to income verification audits, bank statements, and deposit records.

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

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

Authority

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 II, Section 8 of the State Finance Law.

Reporting Requirements

We provided a draft copy of this report to DHCR officials for their review and comment. Their comments were considered in preparing this report and are attached at the end of the report. In DHCR's response, officials disagreed with many of our audit recommendations while agreeing with others. Their response often mischaracterized the audit findings and recommendations and ascribed to us statements that we did not make. Additionally, their response is misleading, diverts attention from the audit work performed and the deficiencies we identified, and does not serve to improve government operations under DHCR's purview. Our rejoinders to some of the more significant errors and mischaracterizations are contained in the attached State Comptroller's Comments. Further, DHCR also included additional attachments with their response. Those attachments are not included in this report, and are retained on file at the Office of the State Comptroller.

Within 90 days after final release of this report, we request that the Commissioner/Chief Executive Officer of Homes and Community Renewal report to the State Comptroller advising what steps were taken to implement the recommendations contained in this report, and where recommendations were not implemented, the reasons why.

Contributors to This Report

Kenrick Sifontes, Audit Director
Cindi Frieder, CPA, Audit Manager
Diane Gustard, Audit Supervisor
Dana Bitterman, Examiner-In-Charge
Marsha Millington, CPA, Senior Examiner
Kevin Fung, Senior Editor

Division of State Government Accountability

Andrew A. SanFilippo, Executive Deputy Comptroller
518-474-4593, asanfilippo@osc.state.ny.us

Tina Kim, Deputy Comptroller
518-473-3596, tkim@osc.state.ny.us

Ken Shulman, Assistant Comptroller
518-473-0334, kshulman@osc.state.ny.us

Vision

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

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

Agency Comments and State Comptroller's Comments

Andrew M. Cuomo
Governor



RuthAnne Visnauskas
Commissioner

New York State Division of Housing and Community Renewal
25 Beaver Street
New York, NY 10004

March 2, 2018

Via UPS and Electronic Mail

Mr. Kenrick Sifontes, Audit Director
Office of the State Comptroller
Division of State Governmental Accountability
59 Maiden Lane 21st Floor
New York, New York 10038 -3804

Re: **OSC Draft Report 2017-S-12**

I. Introduction

Thank you for providing the New York State Division of Housing and Community Renewal ("DHCR") (a component of New York State's Homes and Community Renewal ("HCR")) the opportunity to respond to the New York State Office of the State Comptroller's ("OSC") draft report 2017-S-12 (the "Draft Report") regarding DHCR's administration of the Mitchell-Lama income affidavit and surcharge processes.

At the outset, we would like to note that DHCR staff have been diligent, transparent and responsive in providing OSC with information and answering OSC's questions regarding these complicated and sensitive procedures. DHCR appreciates that this audit has been both interactive and useful to its operations.

Nevertheless, before addressing your specific recommendations and findings, it is important to point out some basic errors and potential improprieties of OSC's analysis, and request that they be corrected in OSC's final report.

State Comptroller's Comment - While DHCR asserts a need to point out some basic errors and potential improprieties in OSC's analysis, it failed to clearly do so.

Mr. Kenrick Sifontes, Audit Director
 March 2, 2018
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The income verification process involves two state agencies (DHCR and New York State Department of Tax and Finance ("DOF")) and more than 130 housing companies across New York State ranging in size from 15,000+ units to some with a little over one hundred units.¹

As we have attempted to explain, administering the income verification and surcharge process for the State's 65,000 Mitchell-Lama units entails considerable privacy and equity concerns that OSC continues to either discount or ignore.

State Comptroller's Comment - OSC did not discount or ignore privacy and equity concerns. Rather, we were cognizant of relevant privacy and equity concerns and complied with applicable laws and regulations, as well as with relevant audit standards.

DHCR's processes aim to protect residents' highly sensitive, private and confidential tax information. DHCR's relevant statutes and regulations require DOF involvement because the provided tax information can only be used for the confirmation of household income—nothing else. *See* 9 NYCRR § 1727-2.4 ("[i]t is the responsibility of applicants, tenants, or cooperators to report to the *housing company* their aggregate annual family income and family composition") (emphasis added); *see also* PHFL § 60(9); Tax Law § 171-b (expressly providing that such information is to verify income to which it is "limited solely"); 9 NYCRR § 1727-2.5(a)(2).² Accordingly, OSC's use of a resident's tax information in this audit for the purposes of determining primary residency was inappropriate and potentially illegal. *See* Draft Report at 12. Such activity goes beyond the safe-harbor given to the State and housing company officials under PHFL § 60(9) and Tax Law § 171-b and, therefore, DHCR does not use private and confidential tax information for determining primary residency.

State Comptroller's Comment - DHCR misstates the facts and cites inapplicable law. OSC did nothing inappropriate or potentially illegal. Conflicting addresses were on documents provided by the tenant to the housing company – not on tax documents provided by DOF to the housing company or DHCR. Further, we did not, as DHCR indicates, make a determination as to the tenant's primary residence. Rather, we referred the matter to DHCR for its consideration. We also note that, contrary to DHCR's contention, certified copies of tax returns can be used to establish proof of primary residency in an analogous context. *See* 9 NYCRR Section 1727-8.2. Moreover, we do believe that housing companies and DHCR should be alert to red flags such as

¹ The process involves solicitation, compilation and review of income affidavits and verification reports from 132 housing companies with more than 65,000 units, of which OSC sampled six housing companies and reviewed affidavits and verification reports for 90 units.

² In fact, it is well-settled that confidential tax information is generally not even discoverable in a court proceeding. *See* *Atthens Indus. Piping Co. v. Mobil Oil Corp.*, 114 A.D.2d 772, 495 N.Y.S.2d 35, 36 (1st Dep't 1985) ("[t]he disclosure of tax returns is disfavored due to their confidential and private nature."); *see also* *Latture v. Smith*, 304 A.D.2d 534, 536, 758 N.Y.S.2d 135, 137 (2nd Dep't 2003) ("tax returns are generally not discoverable in the absence of a strong showing that the information is indispensable to the claim and cannot be obtained from other sources"); *Div-Com. Inc. v. Tousignant*, 2014 NY Slip Op 2364, 116 A.D.3d 1118, 984 N.Y.S.2d 182 (3rd Dep't 2014) ("because they contain information of a confidential and private nature, tax returns are generally not discoverable ..."); *Has K'Paw Mu v. Lyon*, 2018 NY Slip Op 00687, ¶ 2S (4th Dep't 2018) ("[i]ndividual tax returns are generally not discoverable")

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these, which indicate that a tenant may not be maintaining the Mitchell-Lama unit as his/her primary residence, as required by the Regulations. We note DHCR informed us that the tenant subsequently vacated the unit.

In addition, OSC is unduly punitive when insisting that housing companies assess maximum retroactive surcharges (which amount to one year's worth of surcharges payable immediately) against households who cannot supply requested information due to bureaucratic delay.

State Comptroller's Comment - DHCR's statement is inaccurate – and ascribes to OSC a position that we did not take. It is DHCR's requirement (which is reflected on page 5, paragraph 1 of DHCR's response) that residents have 60 days to provide the tax transcript, and that residents not supplying the tax transcript within 60 days will be assessed a Verification Surcharge against the household as a lump sum, 12-month maximum surcharge plus a \$150 administrative fee. As stated in the audit report, there was no evidence that tenants were unable to provide their tax returns due to bureaucratic delays. At the time of our audit, some tenants had not yet provided copies of their tax returns, which constitutes a delay of approximately two years.

It is DHCR's policy to administer the Mitchell-Lama program in a fair and equitable manner. *See* 9 NYCRR § 1700.7 ("... the division may take into consideration all factors bearing upon the equities involved, with due regard for preservation of the subject housing, the rights of the tenants and the public interest."). This requires a balance between its obligation to oversee surcharge assessments with its responsibility to consider the practical difficulties in meeting the program's deadlines. DHCR recognizes the merit behind the relevant housing companies' policies to postpone assessing these surcharges to provide time for income-qualified residents to obtain tax information. Therefore, DHCR's policy discourages the application of draconian measures (e.g. a maximum retroactive surcharge) for the failure to strictly adhere to a regulation (e.g. a delay in submitting proof of income-qualification).

State Comptroller's Comment - The "draconian measures" that DHCR refers to relate to DHCR's own policies – not OSC's.

OSC similarly discounts or ignores the exceptional circumstances which contributed to the significant delay in the income verification process for the period reviewed.³ OSC's sample captured the period immediately following the departure of DHCR's entire data-entry and verification group (which aggregated housing company information and codified it for DOF's use). This group entered and won the Lotto jackpot. They simultaneously left DHCR's employ in the space of a single pay period and retired. Thereafter, DHCR was left with an extraordinary staffing issue and, more importantly, a knowledge gap that DHCR could not have anticipated. Accordingly, DHCR procured and hired a third-party vendor which was time-intensive, costly and required review and approval by OSC.

³ DHCR has taken steps to remedy this delay by prioritizing the most recent year.

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State Comptroller's Comment - We neither discounted nor ignored any fact presented to us during the audit. The retiring data entry group won the New York Lottery in March 2011. Our audit began in 2017 – six years later. In 2017, DHCR had not verified the income affidavits for 2013, 2014, or 2015 with DOF. The income verification process is key to the integrity of the surcharge process. Attributing the lapse in verification to staff departures, which occurred six years earlier, raises concerns about DHCR's ability to provide effective oversight for this program. Further, DHCR's chronology is not accurate. A vendor was hired to perform data entry work two years prior to the group's departure.

Nonetheless, the Draft Report frequently focuses on outlying cases and transcription errors which OSC concedes made little, if any, difference in surcharge assessments. In addition, these errors were made by the third-party vendor whose retention had been approved by OSC and **whose employment had already been terminated by DHCR prior to the commencement of OSC's audit.**

OSC also makes an inaccurate claim that Co-Op City only follows-up on the income of the head of household to ascertain whether family income has been reported. This is incorrect. Follow-up letters by Co-Op City are addressed to the head of household as the shareholder of record, but the request asks for all relevant family income.

State Comptroller's Comment - DHCR again misstates our finding. We do not report that Co-op City only follows up on heads of household. Rather, we state on page 9 of the report that Co-op City only followed up where the head of household, as opposed to any other tenant in the apartment, is classified as "low." This practice was confirmed in writing by Co-op City officials. Further, DHCR does not explain why follow-up was not conducted on 30 of the 41 tenants.

It is important to note that the core finding of your Draft Report is that "**surcharges are generally properly calculated and assessed.**" The aggregate annual surcharges assessed for each of the three sampled housing companies were:

State Comptroller's Comment - DHCR misstates the audit's "core" finding. While we found the sampled surcharges were generally properly calculated and assessed based on the tenant's self-reported income, we determined that the accuracy of tenants' self-reported income was not being verified with DOF. Therefore, there is limited assurance that over-income tenants were paying surcharges based on their actual income.

- Co-Op City - \$2,469,025 (the housing company contains 15,372 units);
- Electchester - \$667,624 (the housing company contains 2,399 units); and
- Rochdale - \$822,650 (the housing company contains 5,860 units).

Furthermore, the Draft Report's page 10 notes:

For 29 of the 30 apartments [sampled] at Rochdale, officials correctly determined whether a surcharge was required based on tenant income

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affidavits. When a surcharge was required, the correct amount was posted to tenant accounts.

* * *

For 26 of the 30 apartments in our sample, Electchester officials correctly calculated whether a surcharge was required based on tenants' income affidavits.

* * *

For our 30 sampled units, Co-op city officials correctly calculated the surcharge amounts and posted them to tenants' accounts.

This reflects a 91% + success rate.

If you have any questions in considering these material issues, we would be glad to answer them and provide you with additional information. We look forward to continuing to work with OSC to create efficiencies in these procedures. We believe that in this interactive audit process with OSC, DHCR has demonstrated its strong commitment to the Mitchell-Lama program and its efficient and effective management and oversight.

II. Overview of the Income Affidavit and Income Verification Processes

There appears to be a fundamental misunderstanding regarding DHCR's income-verification system. OSC mischaracterizes DHCR's statutory and regulatory duties during the income affidavit and income verification processes. Specifically, DHCR's regulations require residents to report their income to the housing company- not to DHCR. *See* 9 NYCRR § 1727-2.4 ("[i]t is the responsibility of applicants, tenants, or cooperators to report to the *housing company* their aggregate annual family income and family composition") (emphasis added).

State Comptroller's Comment - We did not misunderstand DHCR's income verification process. It is the tenants'/cooperators' responsibility to report their income to the housing company, and DHCR's responsibility to refer the reported income to DOF for verification.

This statutorily designed system gives the three participants (the housing companies, DOF, and DHCR) separate and distinct responsibilities. The housing company is responsible for the collection of data, communication with its residents and enforcement. DOF is the repository of income information held in a confidential manner, as required by law. DOF is responsible for matching resident income data collected by the housing company and transmitted by DHCR against the data maintained by DOF. DHCR acts as the data packager for DOF and functions as the "go between" for exchanges between DOF and the housing companies.

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State Comptroller's Comment - DHCR is not, as asserted in its response, merely a data packager for DOF, nor merely a "go between" for exchanges between DOF and the housing companies. DHCR is the agency specifically charged with oversight of the State's Mitchell-Lama housing program.

The system is designed with these steps, by statute, recognizing the different responsibilities of the three parties and the need to shield the confidentiality of tax information submitted to DOF. Recognizing the difficulty inherent in administering such a system, DHCR and DOF recently engaged in a LEAN exercise, aimed at reducing the processing time and complexity of administering the income verification process.

State Comptroller's Comment - Our audit did not identify delays in DOF's processing time. The delays occurred in DHCR's transfer of information from a tenant's paper income affidavit to an electronic form for submission to DOF.

Surcharges may be first assessed by a housing company after it receives an income affidavit from a resident showing that the household's residents are over-income (the "Affidavit Surcharge"). The housing company calculates and assesses a surcharge against that household to be paid with each monthly rental or carrying charge payment **without further interaction by DOF or DHCR**. This Affidavit Surcharge is generally not refundable because it is based on the resident's own report of household income.

The next opportunity to assess a surcharge is during the income verification period. These will hereafter be referred to as "Verification Surcharges." Based on information received from DOF, DHCR will notify the housing company through its Oracle system that a resident requires additional follow-up because the income reported on their income affidavit was lower than the aggregated income reported on the household's tax returns (or if DOF experienced difficulty matching the income information).⁴ Should this happen, the housing company will send a follow-up letter to the household requesting a tax transcript for the resident in question. The resident then has 60 days to provide this information. By law, neither DHCR nor the housing company may obtain those tax transcripts from DOF.

State Comptroller's Comment - Our report does not state that DHCR or the housing company has the right to obtain a resident's tax transcript directly from DOF.

Should the resident not supply the tax transcript within 60 days, the housing company will assess a Verification Surcharge against the household. This surcharge is a lump sum, twelve-month maximum surcharge plus a \$150 administrative fee. Occasionally, the resident's delay in providing the tax information is due to delays in receiving information from DOF. Accordingly, the housing company will reverse the Verification Surcharge if the resident subsequently provides the necessary tax information.

⁴ An exact match or higher reported income on the affidavit upon which such surcharge was then based (sometimes referred to as "HIGH" in DOF nomenclature) requires no additional follow up (referred to in DHCR nomenclature as "OK").

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The system of income verification, by its nature, takes a significant amount of time. OSC's sample unfortunately captured a highly unusual period of transition, both for DHCR personnel and these processes. DHCR's data-entry and verification group (which aggregated housing company information and codified it for DOF's use) all simultaneously left DHCR's employ in the space of a single pay period due to circumstances that could not be accounted for by any amount of contingency planning, thus leaving DHCR with an extraordinary staffing gap.⁵

State Comptroller's Comment - We neither discounted nor ignored any fact presented to us during the audit. The retiring data entry group won the New York Lottery in March 2011. Our audit began in 2017 – six years later. In 2017, DHCR had not verified the income affidavits for 2013, 2014, or 2015 with DOF. The income verification process is key to the integrity of the surcharge process. Attributing the lapse in verification to staff departures, which occurred six years earlier, raises concerns about DHCR's ability to provide effective oversight for this program. Further, DHCR's chronology is not accurate. A vendor was hired to perform data entry work two years prior to the group's departure.

DHCR also needed to institute a new income affidavit and income verification process after 2012. DHCR procured and hired a new third-party vendor which required review and approval by OSC. In an effort to bridge the gap as much as possible internally, DHCR transferred some of the prior team's duties to DHCR's Office of Housing Management ("OHM") personnel, with new processing criteria based on a LEAN review designed to streamline the system.⁶ DHCR continues to review and revise the process to progressively shorten the timeline.

III. Responses to Recommendations.

A. Recommendation 1: Provide training to development officials on the proper surcharge and income verification procedures

DHCR already provides training to its portfolio regarding the proper surcharge and income verification procedures. In fact, OSC's Draft Report reflects and confirms the effectiveness of DHCR's training model.

State Comptroller's Comment - We did not review, nor does the report comment upon, the effectiveness of DHCR's training model.

Annually, DHCR issues memoranda and detailed instructions to each housing company when it distributes the form of income affidavit. The memorandum explains the annual tenant income reexamination procedure and is affixed to the updated income affidavit which sets forth all relevant deadlines. *See* 9 NYCRR § 1927-2.S(a); **Exhibit A**. DHCR also issues income verification follow-up instructions to the housing companies. *See* **Exhibit B**. These instructions detail notification procedures, how to review DOF's income verification report, and how to

⁵ This team, as a group, entered and won the state lottery.

⁶ The Lean Initiative was implemented in 2013 at the suggestion of Governor Cuomo's Spending and Government Efficiency Commission to make government more efficient and responsive. Since the Lean initiative, DHCR has continued to work on the efficiency of the income affidavit and income verification processes.

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assess Verification Surcharges. DHCR has OHM representatives and OHM administrative staff available to answer questions from housing company personnel. In addition, DHCR hosts workshops and on-site training for housing company management on administering DHCR's requirements. In fact, DHCR hosted a workshop on April 18, 2017 to train management personnel on, among other things, the income affidavit process and the income verification process. *See Exhibit C.* DHCR will perform additional workshops and will advise housing companies of any changes as necessary.

Thus, many of OSC's findings, specifically that Rochdale had errors in 50% of its calculations, are exaggerated and/or without merit. As OSC even conceded, DHCR personnel retrained the Rochdale staff on surcharge calculations, and **there were no financial impacts from Rochdale's errors.**

State Comptroller's Comment - DHCR does not provide information to support these out-of-context statements. Our audit report accurately reflects the impact of the 50 percent error rate in calculations at Rochdale. Moreover, these statements divert from the key finding, which is that Rochdale did not follow up to determine the correct income for tenants who were flagged through the DOF income match for 2011 or 2012.

B. Recommendation 2: Monitor building managers to ensure that follow-up verification audits are properly and timely completed and surcharges are correctly assessed.

DHCR agrees and intends to contact the appropriate office to amend its ORACLE program to include follow-up capabilities.

However, DHCR disagrees with the recommendation to monitor housing companies' surcharge assessments. As noted herein, the Draft Report's findings indicate that the sampled housing companies had a 91%+ rate of success when calculating surcharges.

State Comptroller's Comment - DHCR again mischaracterizes our findings by omitting the very significant fact that the accuracy of the self-reported income was often not confirmed, as required. Thus, there is limited assurance that surcharges were calculated correctly.

OSC's recommendation overemphasizes the need to calculate a maximum surcharge at the expense of residents caught up in bureaucratic delay. It is DHCR's policy to favor treating residents in a fair and equitable manner without the application of unreasonable penalties.

State Comptroller's Comment - DHCR's interpretation of OSC's recommendation is inaccurate. As detailed in State Comptroller's Comment 4, we reported on compliance with DHCR's own requirements. Further, it is difficult to comprehend DHCR's assertion that the assessment of correct surcharges would be unfair and inequitable when such surcharges are required by DHCR's Regulations.

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i. "[O]f the 100 tenants in our sample who required an income verification audit, only 33 were actually audited."

This is a mischaracterization of the process. Housing companies are not required to conduct an "audit" of residents whose income cannot be confirmed by DOF.

State Comptroller's Comment - We did not mischaracterize the process. The term "audit" was used to mean income verification follow-up.

Rather, housing companies are required to issue follow-up letters to all residents marked as "follow-up required" after receipt of information from DOF. Thus, only residents who are flagged require income verification by the housing company issuing a follow-up letter. If the resident does not respond to the follow up letter, the resident's household is charged a maximum retroactive surcharge for the resident's non-compliance. In this situation, the housing company has performed its regulatory obligations and can proceed no further. This does not indicate that a tenant failed to be "actually audited." This also does not indicate that a housing company failed to fulfill its regulatory duties. It means that a resident has had the regulatory penalty imposed pursuant to NYCRR 9 § 1727-2.6.

This finding also fails to account for the remedial measures conducted by DHCR prior to the issuance of the Draft Report. For instance, the Draft Report states that only 2 residents were verified of the 41 residents requiring verification at Co-Op City. This is misleading. Due to a legacy policy, Co-Op City previously followed up only with residents marked as "Low." Co-Op City has since corrected this policy, issued follow-up letters to the remainder of unverified households and is monitoring all responses. In addition, Rochdale has issued follow-up letters to all residents for the most recent year they received DOF information.

ii. Refunding of Retroactive Surcharges

Page 12 of the Draft Report provides that the sampled housing companies refunded retroactive surcharges to residents who ultimately provided their tax returns for income verification. DHCR supports the housing companies' policy. Residents who ultimately provide the requested income information should not be penalized by an assessment of a lump sum, twelve-month surcharge caused by administrative or bureaucratic delay. Any alternative reading of the relevant regulation would produce draconian results.

State Comptroller's Comment - As detailed in State Comptroller's Comment 4, there was no evidence that tenants were unable to provide their tax returns due to bureaucratic delays.

The Draft Report also states that OSC found record of two tenants submitting regular tax returns instead of certified tax returns. Though Co-Op City denies accepting any state or federal tax returns that were not "certified," DHCR will remind the housing companies of what is appropriate proof.

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State Comptroller's Comment - Our report accurately reflects that Co-op City accepted non-certified tax returns from four (not two, as DHCR stated) tenants. Certified returns for these tenants have yet to be provided to us.

iii. Co-Op City's Follow-Up Processes

The Draft Report makes several alleged findings regarding Co-Op City's follow-up processes. Many of the findings are incorrect or misleading.

State Comptroller's Comment - Our evidence-based findings are neither incorrect nor misleading.

Page 9 of the Draft Report states that Co-Op City will not follow-up with residents if the head of household does not require follow-up. This is untrue. As explained in DHCR's email dated November 30, 2017, Co-Op City issues follow-up letters requesting verification information to the shareholder of record (or the "head of household"). This is consistent with DHCR's regulations. *See* 9 NYCRR § 1727-2.4 ("it is the responsibility of ... cooperators to report to the housing company their aggregate annual family income and family composition").⁷

While Co-Op City will only issue one follow-up letter per apartment, each follow-up letter can list several residents requiring follow-up. It is for these reasons that DHCR believes that the statistics in the Draft Report (e.g. Co-Op City only follows up with 30% of residents requiring follow-up) are incorrect.

State Comptroller's Comment - DHCR continues to misunderstand the finding, which is clearly detailed on page 9 of our report.

The Draft Report states that Co-Op City only follows up with heads of household marked as "Low." DHCR has since reached out to Co-Op City and reminded the housing company that it must follow-up with all residents marked as "follow up required."

The Draft Report also states that Co-Op city waits one year to post income verification surcharges. DHCR is aware of the housing company's practice and believes it is a valid exercise of its business judgment. Co-Op City is the largest single residential development in the world, containing more than 15,000 units and 60,000 residents. In order to manage this unprecedented scale, Co-Op City's management has computerized and automated its income verification process. Therefore, the housing company waits until DHCR issues the following year's verification report in order to assess retroactive surcharges en masse against all relevant units in the cooperative. This is done to avoid time-consuming piece-meal assessments. Accordingly, DHCR approves of the practice.

⁷ The regulations do not require the housing company to communicate with each household member and any such reading would make this requirement unnecessarily burdensome to implement and enforce. Rather, the housing company (in the case of Co-Op City) communicates with the shareholder of record to provide any additional requested income information on behalf of the shareholder of record's co-habitants.

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State Comptroller's Comment - Co-op City's practice, which was approved by DHCR, does not comply with DHCR's requirements. As previously stated (and included on page 5, paragraph 1 of DHCR's response), DHCR requires tenants who have not supplied their tax transcripts within 60 days to be assessed a Verification Surcharge. This surcharge represents a lump sum, 12-month maximum surcharge plus a \$150 administrative fee. Moreover, DHCR understates the amount of time Co-op City waits before actually assessing the surcharges. At the time of our site visit in 2017, Co-op City had not yet posted the surcharges related to the 2012 certification year, even though Co-op City had received the related income match report from DHCR in 2015.

C. Recommendation 3: Follow up on the occupant-related matters at the three developments we examined, as detailed in the report.

DHCR disagrees with this recommendation and notes that OSC highlighted immaterial issues at housing companies that do not warrant findings.

State Comptroller's Comment - The occupant-related issues do warrant follow-ups. Despite their disagreement, DHCR officials indicate they are working with the housing companies to remediate the issues.

As highlighted in the Draft Report, the sampled housing companies correctly calculated surcharges for over 91% of households.

State Comptroller's Comment - This statement is taken out of context and fails to recognize that the accuracy of tenants' self-reported income was not verified by DOF. Therefore, there is limited assurance that over-income tenants were paying surcharges based on their actual income.

The Draft Report also cites two units where no surcharge was posted despite a failure to file. One cooperator had vacated. As discussed with OSC and DHCR personnel, the surcharge for another unit was posted. We are working with the housing companies to remediate any remaining issues.

Finally, the Draft Report also questions the primary residence of a tenant who vacated. The resident vacated the unit on September 29, 2017. Accordingly, DHCR respectfully requests that these findings be removed from the final report.

State Comptroller's Comment - This is a reportable matter. The tenant vacated the unit only after OSC's audit identified the questionable primary residency issue and brought it to DHCR's attention.

D. Recommendation 4: Develop formal policies and protocols regarding tenants whose incomes exceed the maximum allowable limit. Perform periodic reviews to ensure compliance with those policies and protocols.

While DHCR understands OSC's concerns, the imposition of protocols that seem largely designed for eviction is restricted (and may be prohibited) by court decisions limiting DHCR's ability to unilaterally dictate actions which are legally within the purview of the housing

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companies. We review the relevant case law below. However, as an initial matter, it is important to note that the PHFL does not mandate evictions. Rather, it says that occupancy may be extended with the approval of the commissioner or the supervising agency on a case-by-case basis. *See* PHFL § 31(3). HPD, when asked about the same provision by OSC, noted that it would seek legislation to increase surcharges as well as to remove any reference to eviction.

Courts have found that housing companies are private entities with the power to exercise their own business judgment. Neither DHCR nor HPD have the authority to commence eviction proceedings. Evictions must be commenced by the housing companies. Although housing companies are regulated by HPD and DHCR, courts have noted that these housing companies are still private corporations which must make their own business judgments within the parameters of the PHFL. For example, when DHCR sought to impose higher surcharges by itself on a housing company, the Appellate Division held that what DHCR was seeking to do was illegal, without actual housing company approval. *Rivercross Tenants Corp. v. DHCR*, 70 A.D.3d 577, 894 N.Y.S.2d 748 (2010). The Court decision stated as follows:

No deference should be accorded DHCR's determination unilaterally imposing an increased surcharge schedule upon Rivercross, where the language of the Private Housing Finance Law is clear that the schedule of surcharges is to be promulgated by the housing company "with the approval" of DHCR.

Id.; *see also Levandusky v. One Fifth Ave. Apartment Corp.*, 75 N.Y.2d 530 (1990) (precluding review of co-op board decisions pursuant to the business judgment rule). Of particular interest is the Court's use of "approval" in prohibiting DHCR from unilaterally directing action against "over-income tenants" as the term "approval" is noted in both sections of the PHFL, the provision that governs the imposition of the maximum surcharge as well as for eviction. While one seems based on "DHCR approval" and the other "housing company approval" the effect is the same. DHCR regulations do not mandate evictions be commenced by a housing company but set forth ground upon which such action "may be commenced by the housing company." *See* 9 NYCRR § 1727-5.3.

Courts have additionally noted that Mitchell-Lama developments should be comprised of a mix of household incomes. *See Vink v. N.Y. State Div. of Hous. & Comty. Renewal*, 285 A.D.2d 203, 206 (1st Dep't 2001) ("[t]he policy underpinning . . . [PHFL Article II] was the recognition that the rehabilitation or redevelopment of slum ghettos and other areas into sound healthy balanced viable communities . . . and the expansion of their social and economic opportunity require . . . the attraction to the neighborhoods of varying economic classes in addition to persons of low income. Although this policy was directed mostly at maintaining a stratum of middle, rather than high, income people, *higher income residents were not to be excluded from these buildings*") (emphasis added) (internal citations and quotations omitted).

DHCR will continue to explore criteria for and will continue to discuss this matter with HPD to assure consistency between agency policies. DHCR notes that most of the more recently created affordable housing programs allow continued residency without mandating eviction for residents who are income qualified at the time of admission but subsequently became over-income

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(See e.g. the federal Low-Income Housing Tax Credit program, IRC §42(g)(1)). The Mitchell-Lama program was originally envisioned as a median-income alternative that could enable its residents to live and thrive in New York and any remedial process must take that into account.

DHCR notes that HPD received similar criticism from OSC regarding over-income residents. Accordingly, DHCR intends to reach out to HPD to jointly study a legislative alternative such as an enhanced surcharge structure to ensure that over-income residents pay their fair share.

State Comptroller's Comment – Again, DHCR mischaracterizes our findings. The report does not recommend eviction of any tenants. Rather, we report on non-compliance with the Private Housing Finance Law. This Law requires DHCR's approval for certain over-income tenants to remain in their units; DHCR has not provided the requisite approval. Our concern is that DHCR's simple disregard of the Law leaves certain Mitchell-Lama residents in a state of ambiguity. Our recommendation does not suggest that such tenants be evicted. We simply recommended that DHCR develop policies and protocols regarding such tenants, and ensure compliance with such policies and protocols. We are pleased that DHCR now intends to explore criteria to address this issue, which may include an enhanced surcharge structure to ensure that over-income residents pay their fair share.

E. Recommendation 5: Conduct the outstanding annual tenant income matches with Finance records for 2013-2015 promptly, and ensure future matches are conducted and communicated to the developments on a current basis.

DHCR explained earlier that this is a two-year process and that extreme circumstances resulted in the backlog of verifications. That being said, DHCR is considering efficiency measures to expedite this process, including but not limited to taking advantage of DOF's DTF-65 form. In addition, DHCR has decided to prioritize the income verification process for the most recent year.

F. Recommendation 6: Ensure the data file prepared for the Finance income match is accurate.

DHCR has a new vendor to prepare these files. While spot-checking may be appropriate, redoing the work of an outside contractor would be duplicative and self-defeating.

State Comptroller's Comment – Again, DHCR mischaracterizes our statement; the report does not recommend that DHCR redo the work of the vendor.

Furthermore, OSC has issues with DHCR directed auditing criteria that includes residents marked "NFND." Residents marked as NFND are those whose social security number as self-reported on the household's income affidavit does not match a social security number in DOF's system. Those that have unmatched social security numbers are, rather than those whose self-reported income was lower than the amount in DOF's files, are usually for family members with no taxable income reported to New York State. Given that the statute defines such income as the

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amount reported and given, it is not unusual to have family members without income. This group was considered a low priority for audit. While OSC may disagree, DHCR stands by its auditing criteria.

State Comptroller's Comment - As stated on page 9 of the report, we found 340 tenants who were classified as "NFND" who reported to the housing companies that they had income – in some cases as high as \$90,000. As the report states, the inability to find a tenant's record with DOF may be the result of the vendor or the tenant (accidentally or intentionally) entering the incorrect SSN on the income affidavit. We maintain that tenants should not be excluded from verification and potential surcharges based on their unsubstantiated report that they had not filed a tax return.

Conclusion

DHCR firmly believes that this interactive process has allowed us to clear up any misconceptions that may have been reflected in the preliminary findings as well as to undertake action to strengthen our processes where appropriate. We stand ready to discuss these matters with OSC further as OSC deems appropriate.

Very truly yours,



Mark Colón
Deputy Commissioner