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

September 22, 2021

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

Dear Inspector General Lucas:

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

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

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

I am pleased that the OIG report confirms that our intentional approach to targeting the lower income bands is working. However, as I have acknowledged to the DC Council and the general public, we know we need to do more to coordinate HPTF investment at extremely low-income levels, i.e., 30% MFI, with the necessary operating subsidy to produce units serving our most vulnerable residents. That is, HPTF cannot and does not operate in a silo as producing housing for low-income residents necessitates ongoing financial support for those residents through supportive rental payments and/or services – and the lower the income of future tenants or residents, the more operating subsidy and resources are necessary. Those are not HPTF resources, but instead require the coordination of available vouchers and other supports, supports that often come from other agencies, such as the DC Housing Finance Agency and the Department of Human Services.

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

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

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

Sincerely,

Polly Donaldson
Director

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

DHCD Responses to OIG Recommendations:

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

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

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

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

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

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

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

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

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

Response: DHCD objects to the inclusion of this recommendation in this OIG report. DHCD employees engaged in the project review and evaluation process must comply with existing statutory annual financial and conflict of interest disclosure requirements administered by the District's Board of Ethics and Government Accountability (BEGA), as well as, of course, federal and District criminal law that bar making decisions for one's personal financial benefit. There are no instances of any conflict of interest issues amongst DHCD employees engaged in project selection, and this OIG audit provides no evidence of any conflicts of interest. The OIG has available to it the financial disclosure forms submitted by DHCD project reviewers who are public filers as they are posted on the BEGA website, and its auditors did not ask to see the Confidential Filers' forms of DHCD project reviewers in DHCD's possession. All DHCD project reviewers are in compliance with the District's annual financial and conflict of interest filing requirements, and BEGA has not notified DHCD of any DHCD project reviewer who has a conflict of interest or other ethics violation that would prevent him or her from serving as a project reviewer. Thus, the inclusion of this recommendation, not grounded in any factual predicate, is misleading and derogatory.

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

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

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

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

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

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

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

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

DHCD analyzes funding increase requests and negotiates with the borrower to minimize the additional DHCD funds required. The Development Finance Division (DFD) analyzes each funding increase request and provides a recommendation to the DHCD Loan Review Committee or the DHCD Director to approve or deny the request. Loan increase requests that are made after Loan Review Committee funding recommendation or that exceed 10% of the original loan amount must be approved by Director via Decision Memo. A Decision Memo includes relevant facts that explain the reason(s) for a requested cost increase, borrower's efforts to mitigate the cost increase, supporting financial data, and analysis that justifies the cost increase. The OIG report misleadingly suggests that developers pursue a "bait and switch" strategy of winning the project, then just increasing requests for funds, which are then rubber-stamped by the agency. This simply is not true. As explained above, requests for additional funds are fully vetted and, if granted, supported by documentation and evidence that the increased costs are, in fact, reality. Again, without DHCD's involvement as a gap financing partner, creating, and preserving affordable housing would not be possible.

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

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

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

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

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

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

Response: Disagree. See response to Recommendation #10.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

    Response: Agree; Underway. DHCD has engaged the current loan servicer in revised mature loan procedures. The procedures outline outreach and collection actions in three distinct loan categories:
    1) Loans set to mature within the next 60 days
    2) Loan that have already matured within the last 12 months
    3) Loans that have matured in excess of 12 months

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

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

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

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

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

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

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