

AUDIT REPORT

Office of Economic Development

Affordable Housing

December 2018



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December 20, 2018

AUDITOR'S REPORT

We have completed an audit of the Office of Economic Development's Housing Division. The objective was to examine internal controls over the creation and maintenance of affordable homes through the City's Affordable Housing Permanent Fund Ordinance, the Inclusionary Housing Ordinance, and City financing to developers. Our audit also reviewed processes administered by the Department of Community Planning and Development.

As described in the attached report, our audit revealed the Office of Economic Development is not ensuring housing affordability. Specific areas in need of improvement include the calculation of sale prices, the process for screening prospective home buyers for eligibility, and the recording of restrictive covenants on the City's affordable homes. We also found the office should improve its calculations for cash-in-lieu payments and incentive payments, its inventorying of affordable homes, and its compliance monitoring of federally funded affordable housing rental projects.

Similarly, our audit found that the Department of Community Planning and Development could improve its compliance with the City's affordable housing ordinances. Although we identified a well-designed and implemented system of internal controls, the department could improve how it grants linkage fee exemptions and documents linkage fee applications.

Through stronger internal controls and compliance, these agencies can improve affordable housing efforts. Our report lists several recommendations.

This performance audit is authorized pursuant to the City and County of Denver Charter, Article V, Part 2, Section 1, *General Powers and Duties of Auditor*, and was conducted in accordance with generally accepted government auditing standards. Those standards require we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We thank the Office of Economic Development's Housing Division and the Community Planning and Development personnel who assisted and cooperated with us during the audit.

Denver Auditor's Office

A handwritten signature in black ink, appearing to read "Timothy M. O'Brien".

Timothy M. O'Brien, CPA
Auditor



Affordable Housing December 2018

Objective

The objective of the audit was to examine internal controls over the creation and maintenance of affordable homes through the City's Affordable Housing Permanent Fund Ordinance, the Inclusionary Housing Ordinance, and City financing to developers. Because the Office of Economic Development is not the only City agency responsible for administering the affordable housing ordinances, our audit also included the Department of Community Planning and Development.

Background

The City has three main tools to produce affordable housing in Denver: the Inclusionary Housing Ordinance, the Affordable Housing Permanent Fund Ordinance, and providing gap financing to developers in exchange for the construction of affordable homes.

Affordability restrictions are placed on homes by means of covenants, which limit sale prices, allowable appreciation, and who is eligible to purchase an affordable home. Eligibility to purchase an affordable home is dependent on a homebuyer's gross household income and Denver's area median income.

REPORT HIGHLIGHTS

Highlights

Our audit of the City's affordable housing programs found the Office of Economic Development does not have sufficient controls to ensure its mission of providing affordable housing in Denver. In addition, while the Department of Community Planning and Development has sufficient controls to ensure developers pay affordable housing fees, we did find some areas for improvement in its assessment of linkage fees and its granting of exemptions from fees.

The Office of Economic Development's Lack of Proper Implementation and Enforcement of Regulations Is Not Ensuring Affordability of Housing

- The agency incorrectly calculated initial sale and resale prices of affordable homes, resulting in both overpricing and underpricing of homes.
- The agency is not properly determining income eligibility to ensure monthly housing payments are affordable.
- The agency did not accurately collect fees from developers meant to fund affordable housing, and it dispersed incentive payments to developers in excess of annual limits.
- The agency did not monitor federally funded rental projects for compliance in a timely manner.
- There are inaccurate dates in the agency's compliance spreadsheet and in memoranda of acceptance recorded with the Clerk and Recorder's Office.

The Department of Community Planning and Development's Process for Assessing Linkage Fees Is Effective but Could Be Improved

- The department incorrectly approved exemptions to the linkage fee for developments that did not qualify for the exemption.
- Additionally, the department did not consistently follow its internal process manual to document linkage fee exemptions.

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BACKGROUND

Affordable Housing and Affordability

Like many rapidly growing cities, Denver faces significant challenges when it comes to affordable housing. The City's population has grown by more than 100,000 in just over a decade and increases in home prices have made access to an affordable home unachievable for many.

Affordable housing is defined by the U.S. Department of Housing and Urban Development as housing for which occupants pay no more than 30 percent of their gross income for housing costs.¹ Eligibility for federally and locally funded affordable housing programs is based on a household's area median income (AMI).² AMI is a federal calculation based on census data from a geographic area; Denver's 2018 AMI for a single-person household is \$63,000.

MORE INFORMATION

For dollar-value equivalents of percentages of Denver area median income, reference Appendix A.

Office of Economic Development

Created in 2004, the City's Office of Economic Development provides coordinated planning and implementation of initiatives designed to grow and strengthen Denver's economic and community base through four program divisions supported by the Operational and Communications Division. These divisions include:

- Housing
- Neighborhood Equity
- Small Business Opportunities
- Business and Workforce Development

STRATEGIC GOALS	
	CREATE AFFORDABILITY
	PRESERVE AFFORDABILITY
	PROMOTE ACCESS
	STABILIZE RESIDENTS

Housing Division – The Housing Division works in partnership with other public, nonprofit, and private partners to understand, prioritize, and deliver programs and services to assist in meeting the City's housing needs. A comprehensive housing plan was developed with input from a variety of stakeholders throughout 2017 and approved in 2018. This plan includes four strategic goals involving the creation of affordability, preservation of affordability, access to housing, and stabilization of those at risk of losing their homes.

¹ Total housing costs include rent, or the principal and interest of a mortgage, taxes, insurance, and homeowner's association dues.

² An eligible household is defined as a household whose income qualifies the household to participate in the affordable housing program.

Inclusionary Housing Ordinance

To address concerns over rising housing costs, the Denver City Council enacted the Inclusionary Housing Ordinance in 2002.³ The Inclusionary Housing Ordinance's stated goal is to provide a full range of housing choices across all incomes by increasing the number of low- and moderate-income housing units. The ordinance achieves this by one of two ways: Requiring developers of for-sale residential units to build affordable units, and collecting a fee from developers in lieu of developing affordable units. Developers who opt to build affordable units are eligible to receive an incentive payment from the City.

Under the ordinance, 10 percent of units in new residential developments of 30 or more for-sale homes must be affordable.

Development Requirements – The primary way the Inclusionary Housing Ordinance addresses housing affordability is through the requirement that all new residential developments of 30 or more for-sale units offer 10 percent of those units as affordable. Under the ordinance, a unit must be affordable to households making no more than 80 percent of Denver's area median income upon initial sale, or \$50,350 for a single-person household. For developments deemed "high-cost structures," moderately priced dwelling units must be affordable to households making up to 95 percent of area median income, or \$59,850 for a single-person household.⁴

To determine compliance with Inclusionary Housing Ordinance requirements, developers of residential projects must submit an "affordable housing plan" to the Office of Economic Development. The affordable housing plan includes—among other pieces of information—the number of market-rate and affordable units in the development, the number of bedrooms for each affordable unit, and the maximum allowable pricing for each of the affordable units. Once the developer's affordable housing plan is approved by the Office of Economic Development, the approval is sent to the City's Department of Community Planning and Development so the process of issuing building permits can begin.

Cash-in-Lieu Fees – The Inclusionary Housing Ordinance also provides an alternate means of complying with the ordinance by accepting a cash-in-lieu fee from the developer that is credited to the Inclusionary Housing Ordinance Special Revenue Fund. The fee owed is equal to a percentage of the price per affordable unit that otherwise would have been required under the mandatory build option. That percentage is based on whether the Office of Economic Development categorizes the neighborhood where the development is to be built as in low-, medium-, or high-need of affordable housing.

The Office of Economic Development divided the City's neighborhoods

³ Denver Revised Municipal Code. § 27.4

⁴ A "high-cost structure" is a development in which the buildings are greater than three stories tall, elevators are provided, and more than 60 percent of the parking is contained in a structure.

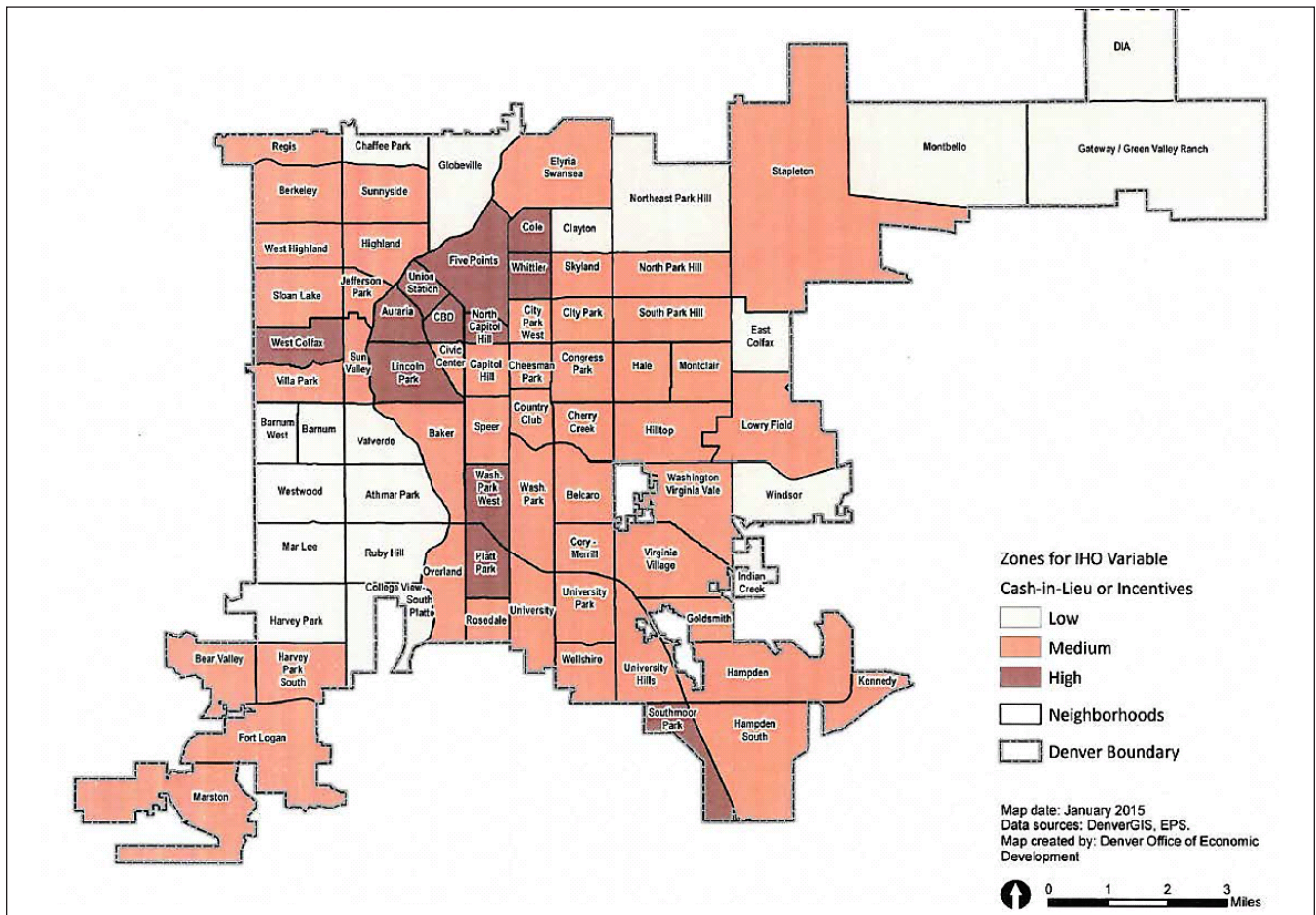
into those tiers based on available housing, the price of homes in the neighborhood, and the proximity to transit.

How much of a “cash-in-lieu” fee a developer owes for the affordable units they did not build depends on a neighborhood’s need classification: 25 percent per unit in low-need areas, 50 percent per unit in medium-need areas, or 70 percent per unit in high-need areas.

For example, if a developer built 100 homes in Denver’s Cherry Creek neighborhood—a medium-need area—10 of those units would be required to be sold at an affordable rate. If the sale price was \$200,000 per unit, then the developer could opt to pay a \$1 million fee (10 units multiplied by \$200,000 multiplied by 50 percent) in lieu of selling those 10 units at the required affordable rate. By paying the fee, the developer could instead sell them at market rate. The need categories for Denver’s neighborhoods can be found in Figure 1.

Income Verification – For developments offering affordable units, prospective homebuyers must go through an income verification

FIGURE 1. Neighborhood Inclusionary Housing Ordinance Zones



Source: Office of Economic Development’s Inclusionary Housing Ordinance 2015 Interim Report.



process to determine their eligibility to purchase the affordable unit. Applicants must have already secured outside financing from a lender for a specific affordable unit before income verification. The income verification process involves Office of Economic Development officials analyzing financial records of the applicant and of any other adult in the household—including tax returns, pay stubs, bank account information, and verification of employment—to determine the applicant's annual household income. If the applicant's annual household income falls within the income range set in that year's area median income limits, the applicant is eligible to purchase or rent the unit. In addition, the Office of Economic Development must ensure the monthly housing payments for the unit are affordable to the applicant. Affordability is determined by ensuring a prospective homeowner's monthly housing payments—including principal, interest, taxes, and insurance plus homeowner's association dues—do not exceed 30 percent of the household's gross income. If the applicant's monthly housing payments exceed the 30 percent threshold, the unit is not considered affordable to the prospective homebuyer and the applicant is deemed ineligible to purchase the unit.

Covenant Recording – All eligible homebuyers who have purchased an affordable unit must sign a memorandum of acceptance agreeing to the terms of the property's covenant. The covenant identifies the unit's affordability restrictions, maximum purchase price calculation, and the control period of affordability restrictions.⁵ The homebuyer is responsible for paying recording fees for the covenant, and the Office of Economic Development is responsible for recording the covenant with the Clerk and Recorder's Office. Additionally, all owners of affordable units must sign a memorandum of acceptance acknowledging the owner is aware of the covenant's affordability restrictions. However, in many cases, large multi-family residential developments that have multiple affordable units will have one master covenant for the building, and each owner will accept the terms of the covenant by signing individual memoranda of acceptance.

Developer Incentive Payments – After an affordable unit has been sold to and closed on by a homebuyer, the developer of that unit may apply for financial incentives for building an affordable unit as approved in their affordable housing plan. The developer must submit a variety of documents to the Office of Economic Development to demonstrate compliance with relevant Inclusionary Housing Ordinance regulations before receiving the incentive payment, including: the affordable housing plan, recorded covenant and memorandum of acceptance, income eligibility verification, inspection report, settlement

⁵ "Control period" can be defined as the time an affordable unit is subject to the restrictions of a covenant. Control periods are set up to be no less than 15 years in length and begin on the date the unit is initially sold.

The Coloradan



In Lower Downtown adjacent to Union Station, the Coloradan was constructed under Inclusionary Housing Ordinance rules and is eligible for incentive payments. The Coloradan features 334 total residences, of which 33 will be affordable units. (Photo used with permission from Ryan Dravitz)

TABLE 1. Allowable Incentive Payments to Developers by Neighborhood Type

Neighborhood Type	Low-Need	Medium-Need	High-Need
Incentive per Unit	\$2,500	\$6,500	\$25,000

Source: Inclusionary Housing Ordinance Administrative Rules and Regulations.

statement, and purchase contract. The amount of incentives a developer is eligible to receive is dependent on the development's neighborhood type, as determined by the Office of Economic Development in Figure 1 on page 3. Table 1 above shows the amount of allowable incentive payments by neighborhood type.

Additionally, a single developer may not receive more than \$250,000 in one year in incentive payments. However, affordable units in designated "high-cost structures" have no such limits on the amount of incentive payments developers can collect in a single year.

Resale Requirements – Prior to reselling an affordable unit, a homeowner must submit a request for a maximum resale price quote to the Office of Economic Development to ensure the property is sold at an appropriate affordable price according to covenant restrictions. The Office of Economic Development is required to calculate the maximum

TABLE 2. Shared Appreciation Factor by Years Owned

Time of Ownership	Shared Appreciation Factor
Less than 1 Year	0%
1 Year to Less than 2 Years	10%
2 Years to Less than 3 Years	15%
3 Years to Less than 4 Years	20%
4 Years to Less than 5 Years	25%
5 Years to Less than 10 Years	35%
More than 10 Years	40%

Source: Inclusionary Housing Ordinance Administrative Rules and Regulations.

sale price using the formula in its Inclusionary Housing Ordinance Administrative Rules and Regulations. For affordable units built prior to May 31, 2010, the maximum sale price is based on the owner's prior purchase price plus the owner's share of market-rate appreciation according to an appraisal paid for by the owner. The owner's share of appreciation is predetermined based on how long they owned the home and cannot exceed 40 percent of the appreciation. Table 2 above shows how much appreciation an owner can receive based on how long they have lived in the home.

Affordable units built after June 1, 2010 use a different appreciation formula based on Standard and Poor's Case-Shiller Index, which tracks home sale price trends. This formula multiplies the previous purchase price by the percentage change from the prior year's index for each year the unit was owned, up to a maximum increase of 3.5 percent. Each year's increase is then added to the prior purchase price. Other factors are then added to this price, including: eligible capital improvements, sales commission paid by the owner, and any accrued negative amortization.⁶ Nevertheless, neither maximum sale price calculation guarantees the unit will sell for this price.

The Inclusionary Housing Ordinance sunsetted on December 31, 2016, when a new Affordable Housing Permanent Fund took its place. However, projects constructed under the ordinance are still subject to the affordability restrictions laid out in their covenants and under the Inclusionary Housing Ordinance Administrative Rules and Regulations.

⁶ An eligible capital improvement increases an asset's condition or value beyond its original or current state. For example, installing a new deck or kitchen cabinets.

Affordable Housing Permanent Fund Ordinance

As a result of continued demand for affordable housing in the City, Denver's City Council approved a permanent source of funding for affordable housing in September 2016, also known as the Affordable Housing Permanent Fund Ordinance.

The Affordable Housing Permanent Fund Ordinance took effect on January 1, 2017.⁷ This ordinance established two revenue sources to fund affordable housing programs: the Property Tax Revenue Fund and the Linkage Fee Revenue Fund. The Office of Economic Development administers the revenue from these funds in coordination with the Housing Advisory Committee.⁸ These two revenue funds receive revenue from different sources and have slightly different restrictions on what can be funded.

Property Tax – The Property Tax Revenue Fund receives its revenue from a mill levy.⁹ Projected to generate around \$6.5 million per year, the revenue collected can be used to fund various programs and projects that either provide affordable housing or support individuals seeking to secure affordable homes. The Office of Economic Development may invest the money in either construction of or preservation of for-sale and rental housing. In addition, the revenue may also be directed toward homebuyer assistance programs for households earning 120 percent or less than the AMI. Lastly, the revenue may be used for permanent supportive housing and supportive services for homeless persons and toward programs that seek to mitigate displacement for those at risk of losing their existing homes.

Linkage Fee – The Linkage Fee Revenue Fund collects revenue through a one-time fee on new commercial and residential developments and is projected to raise between \$7 million and \$8 million per year over the next decade. This fee expands the City's revenue collection opportunities by essentially broadening the rules surrounding the types of new developments that can be assessed. For example, linkage fees are assessed on both new residential and commercial developments, rather than just those new residential developments of 30 units or more.

Similar to the Property Tax Revenue Fund, the Affordable Housing Permanent Fund Ordinance specifies allowable spending from the Linkage Fee Fund. Specifically, the revenue can be directed toward for-sale and rental affordable housing projects that serve households earning 80 percent or less of AMI. Additionally, the revenue can be

⁷ Denver Revised Municipal Code, § 27.5.

⁸ Established by the Affordable Housing Permanent Fund Ordinance, the Housing Advisory Committee comprises key affordable housing stakeholders, including Office of Economic Development employees, private sector representatives, and nonprofit representatives. The purpose of the committee is to provide recommendations to the agency regarding the expenditures of the permanent fund revenue.

⁹ A mill levy is a tax rate applied to the assessed value of a property. One mill is one dollar per \$1,000 assessed value.

used to fund homebuyer assistance programs for households earning 80 percent or less of AML.

Community Planning and Development – Responsibility for the calculation and the collection of linkage fees resides with the City's Community Planning and Development Department. The department calculates the linkage fee by multiplying the gross square footage of a development with the fee rate established for the different categories of development. Table 3 contains a list of the fees associated with each development type.

TABLE 3. Current Linkage Fee Rates

Project Type	Fee, per square foot
Multi-unit residential developments requiring commercial permits	\$1.55
Single-unit, two-unit, or multi-unit residential developments	\$0.62
Commercial sales, services and repair	\$1.76
Civic, public, or institutional	\$1.76
Industrial, manufacturing, and wholesale	\$0.41
Agricultural	\$0.41

Source: "Affordable Housing Fee", Denver Development Services, City and County of Denver, accessed October, 2018, https://www.denvergov.org/content/denvergov/en/denver-development-services/help-me-find-/Development-Services-updates/affordable_housing_fee.html.

Note: Rates are adjusted annually for inflation, according to the Consumer Price Index for All Urban Consumers.

The fee rates were informed by an impact study performed by David Paul Rosen & Associates, as well as an additional feasibility study. The analysis assessed the relative impact each development type has on housing demand and corresponding employment in the area. For example, the fee rate for a development with commercial sales use is set at a higher rate than a development with a residential use. The reasoning is that the development with commercial sales use is correlated with a higher increase of low- and moderate-income jobs than the increase of jobs resulting from residential development. In both cases, each development is found to spur economic growth, which in turn increases demand for housing. However, because there is a range of economic impacts caused by different types of development, the fee rates reflect those differences.

Exemptions – Examples of projects exempted from the linkage fee include: developments already required to build affordable housing units; projects receiving government resources to provide affordable housing units; or residential additions of less than 400 gross square

feet. To qualify for an exemption, the developer must fill out a linkage fee application, select the specific exemption type, and provide documentation showing they meet the requirements to receive the selected exemption. For example, if a developer is constructing a residential building in an area that has a pre-existing affordable housing requirement, then they can provide the contract to the Department of Community Planning and Development and receive an exemption from paying the linkage fee.

Developers also can opt for an exemption that requires the project to either include affordable units on-site or cause affordable units to be built off-site. If a developer chooses this exemption, then they must submit a “build alternative plan.”¹⁰ The plan must include the number of units, which is calculated based on the size of the development and the development type. All units constructed under such plans are to be income-restricted for households earning 80 percent or less of AML.

Gap Financing

The City's affordable housing ordinances have helped significantly increase the supply of affordable housing units in Denver.¹¹ Despite these efforts, the demand for affordable units has outpaced the City's current supply. Therefore, the Office of Economic Development relies on another tool as a primary mechanism for the creation of affordable housing. This tool, known as “gap financing,” helps drive the development and preservation of affordable housing by providing developers financing that helps covers the price between market-rate homes and affordable homes.

Gap financing is necessary for affordable housing developments because the cost to build an affordable unit does not dramatically differ from that of a market-rate housing unit. However, the sale price or rent charged for an affordable unit does significantly differ from that of a market-rate unit.

Funding Sources – The Office of Economic Development provides gap financing for the development of affordable rental and for-sale housing units through both local resources and federal grant funds. Current local funds used by the office for gap financing are generated through a portion of the City's property tax collections and the City's collection of linkage fees. Information on one gap-financed project using property tax funds can be found on page 10. The Office of Economic

¹⁰ “Build alternative plans” are required to be submitted to the Office of Economic Development. The plans must include the following elements: 1) number of affordable units to be included; 2) pricing limits; and 3) list of the bedroom types to be provided, which must be the same ratio as the market rate units in the development.

¹¹ The Office of Economic Development's five-year plan, titled *Housing an Inclusive Denver* and released in 2018, states that “the Mayor's 3x5 Challenge produced 3,000 housing units in just four years—one year ahead of schedule.”

Moline at Stapleton



Located in the Bluff Lake Neighborhood of Stapleton, Moline at Stapleton Apartments will contain 180 rental units. The development received a \$2.6 million cash-flow loan from the Property Tax Revenue Fund in 2018 to help fund a portion of the construction costs. Demonstrating the "gap" the funding helps to bridge, the City funds account for about 9 percent of the total construction costs. While accounting for only a small percentage of the project's total cost, the amount nonetheless helps the developer offer the units below market rate. Eligible tenants are households earning 60 percent or less of area median income. (Photo courtesy of the Office of Economic Development)

Development typically invests gap funding amounting to 5 percent to 7 percent of a project's costs. In exchange for the gap financing, the Office of Economic Development requires an income restriction be placed on the property through a restrictive covenant.

The Office of Economic Development provides a developer with gap financing typically in one of three forms:

- **Performance Loan** – Loan repayment is required only if the agreed-upon terms of the loan are not upheld by the borrower.
- **Hard-Paying or Standardized Loan** – Loan repayment is made on consistent intervals, such as monthly, with stated principal and interest repaid over a set period.
- **Cash-Flow Loan** – Loan payments are contingent on the developer having a surplus of cash available each year after paying operating costs.

FINDING 1

The Office of Economic Development's Lack of Proper Implementation and Enforcement of Regulations Is Not Ensuring Affordability of Housing

The City and County of Denver's Office of Economic Development is responsible for implementing, enforcing, and evaluating the Inclusionary Housing Ordinance. In addition, the Office of Economic Development is responsible for administering the recently created Affordable Housing Permanent Fund. Despite rules that clearly define these responsibilities, we found that the office's compliance efforts are greatly in need of improvement. Further, we found that many of the office's enforcement mechanisms are not ensuring the program's fundamental purpose of providing affordable housing.

Inaccurate Initial Sale Prices Resulted in Mispricing of Homes

The Inclusionary Housing Ordinance Rules and Regulations requires the Office of Economic Development every six months to publish a table listing the maximum price a developer can sell an affordable unit for.¹² These current price tables are then used by developers when they are ready to sell an affordable unit. To set the affordable prices, the Office of Economic Development uses the following assumptions:

- A down payment of 5 percent;
- The prior six-month average rate of interest based on the Fannie Mae yield on a 30-year mortgage bond, plus a 0.5 percent mark-up;
- A mortgage term of 30 years; and,
- Total housing costs (mortgage payment and interest, plus property taxes and mortgage insurance) were set at 30 percent of the current AMI adjusted for household size.¹³

As part of our audit work, we examined 25 initial home sales under the Inclusionary Housing Ordinance. We found three affordable units purchased for more than the maximum sale price published in the Office of Economic Development's price table. Table 4 on page 12 shows the results of this issue in more detail.

Additionally, the Office of Economic Development failed to calculate a maximum sale price table for the entire year of 2007. The office

¹² Denver Revised Municipal Code, § 27.4.1.

¹³ Total housing costs would be set at 95 percent of area median income if the affordable unit being sold was considered a "high-cost structure."

TABLE 4. Sampling of Incorrect Initial Sales under the Inclusionary Housing Ordinance

Date of Initial Home Sale	Selling Price of Home	Maximum Allowed Sale Price	Amount Buyer Overpaid	Percentage Buyer Overpaid
September 2006	\$155,000	\$141,309	\$13,691	10%
December 2006	\$155,000	\$141,309	\$13,691	10%
March 2012	\$170,650	\$155,189	\$15,461	10%

Source: Developed by Audit Services Division from analysis of initial home sales under the Inclusionary Housing Ordinance.

produced a table in July 2006 but did not produce an updated table until April 2008. Therefore, any initial sales that occurred from January 2007 through April 2008 were based on an outdated 2006 table. From January 2007 through April 2008, there were 51 initial sales of affordable homes under the Inclusionary Housing Ordinance.

As mentioned previously, one of the assumptions used to calculate the initial sale price of an affordable unit is the prior six-month average rate of interest based on the Fannie Mae yield on a 30-year mortgage. The relationship between this interest rate and the calculated initial sale price of an affordable unit is inversely related. Therefore, when the interest rate attached to a 30-year Fannie Mae mortgage decreases, the calculated initial sale price an affordable unit can be sold for increases.

During the period of January 2007 through April 2008, the average interest rate attached to a 30-year Fannie Mae mortgage had decreased from rates at the end of 2006. By using the outdated 2006 maximum home price table to set prices of affordable units from January 2007 through April 2008, the Office of Economic Development was providing developers with maximum prices lower than what they should have been in that time. This potentially resulted in developers receiving less in sale proceeds than what they should have received.¹⁴

Our work determined that the Office of Economic Development lacks the proper internal controls over the calculation of initial sale prices. "Standards for Internal Control in the Federal Government," also known as the Green Book, states that management should design controls to achieve objectives and respond to risks.¹⁵ Further, these standards state that management implements controls through policies and procedures. Despite having well-documented policies for determining the initial sale price of an affordable house, the office

¹⁴ The word "potentially" is used because there is no guarantee that a developer will sell an affordable unit for the maximum price.

¹⁵ *Standards for Internal Control in the Federal Government*, also known as the "Green Book," and published by the U.S. Government Accountability Office, sets the standards for an effective internal control system for federal agencies and is also used as a best-practices guide for state and local governments.

lacks corresponding procedures that should accompany these policies. Procedures lay out the steps to be followed as a consistent approach to comply with a corresponding policy.

RECOMMENDATION 1.1

Inclusionary Housing Ordinance Initial Home Sales – The Office of Economic Development's Chief Housing Officer should design internal controls to ensure maximum sale price tables are calculated annually according to Inclusionary Housing Ordinance rules and that the correct table is used when selling an affordable unit.

Agency Response: Agree, Implementation Date – March 31, 2019

The Office of Economic Development Is Not Properly Determining Income Eligibility for Prospective Homebuyers of Affordable Homes

According to the Inclusionary Housing Ordinance Administrative Rules and Regulations, prospective homebuyers must first become income verified by submitting an income eligibility application to the Office of Economic Development prior to purchasing an affordable home.¹⁶ Additionally, applicants must submit a number of financial documents to aid the Office of Economic Development in determining the buyer's annual income, such as: tax returns, pay stubs, verification of employment, and bank account statements, among others. Based on this documentation, the agency then calculates the buyer's gross household annual income to ensure the prospective homebuyer falls within the area median income limitations dictated in the affordable unit's covenant.

In addition, these rules and regulations specify that the Office of Economic Development is responsible for ensuring the prospective homebuyer's monthly housing payments—including principal, interest, taxes, insurance, and homeowner's association dues—are affordable. In other words, this means that a homebuyer's payments must be at or below a certain percentage of their gross household income. As seen in Table 5 on page 14, the percentage of gross household income deemed affordable has changed over the life of the ordinance.

During the audit, we tested 23 Inclusionary Housing Ordinance for-sale units for compliance with income verification requirements. We found that owners of all 23 units were not properly income-verified to

¹⁶ City and County of Denver Office of Economic Development, Inclusionary Housing Ordinance Administrative Rules and Regulations. January 16, 2015. These rules and regulations are the most current departmental guidance available for the requirements of the income verification process. The appendices to the rules and regulations also specify all required documentation necessary to become income-verified.

TABLE 5. Level of Gross Household Income Deemed Affordable

Time Period	Percentage of Gross Household Income
December 13, 2013 – Present	30%
December 9, 2008 – December 13, 2013	40%
July 31, 2003 – December 9, 2008	30%

Source: Office of Economic Development's Inclusionary Housing Ordinance Administrative Rules and Regulations.

ensure their monthly housing payments were affordable. Rather than calculating each applicant's maximum monthly payments based on their household income, the Office of Economic Development instead calculated maximum monthly payments based on the maximum area median income level permitted in the unit. Depending on the structure, the maximum allowed area median income could be as much as 80 percent to 95 percent. However, applicants could be approved when making as low as 50 percent of area median income.

In addition, we tested one development composed of seven gap-financed units. In all seven cases, we found no evidence that the Office of Economic Development performed income verification checks to ensure the affordability of owners' monthly housing payments.

Furthermore, seven of the 23 Inclusionary Housing Ordinance for-sale units we tested were held by owners with housing payments above 30 percent of their household's gross income, making their payments unaffordable under the City's rules. These seven units included two Inclusionary Housing Ordinance units that were foreclosed on and thus lost as affordable units to the City.¹⁷

Auditors also found that four of the seven gap-financed affordable units we tested had missing supporting documentation for the Office of Economic Development's calculation of gross household income. This included missing or insufficient numbers of tax returns and pay stubs. Four out of five Inclusionary Housing Ordinance units did not have a certification of a homeownership course being completed, as required by rules and regulations at the time.

In response to these issues, Office of Economic Development officials said the office had not been ensuring monthly payments were below the 30 percent threshold of affordability for individual homeowners during the income verification process. Despite a requirement since 2003 that monthly housing payments be verified as affordable for each prospective homeowner, the Office of Economic Development did not

Seven of 23 for-sale units had housing payments above 30 percent of the owners' gross income, in violation of City rules. Two of these units were foreclosed on and lost as affordable housing.

¹⁷ Affordable housing covenants are subordinate to foreclosures. Therefore, any foreclosure on an affordable home results in the City losing the affordable unit.

begin to comply with the regulation until this audit was in progress.

We found the Office of Economic Development has no procedures for conducting or reviewing income verifications. While the office's Inclusionary Housing Ordinance Administrative Rules and Regulations lay out clear policies for the program, there are no specific procedures for how this task occurs, nor does the office have any formal review process of income verifications to ensure any errors are caught and all necessary requirements are complete.

Standards published by the U.S. Government Accountability Office highlight the need for documenting procedures and for internal controls to meet operational needs and retain organizational knowledge.¹⁸ Furthermore, these government standards also emphasize the importance of the segregation of duties among different people or groups in order to reduce the risk of error in important agency processes.

Without the full income verification process in place or procedures to ensure that prospective homebuyers are properly vetted prior to purchasing an affordable home, the Office of Economic Development cannot ensure units are affordable to its program participants in accordance with its own rules and regulations. As other non-Inclusionary Housing Ordinance for-sale affordable units go through a similar process prior to the purchase of the unit, there is a potential for more buyers to be burdened with unaffordable housing payments throughout the City. This could lead to foreclosures on affordable units, and therefore, the loss of affordable units to the City's affordable housing supply.

RECOMMENDATION 1.2

Design Internal Controls for Income Verification – The Office of Economic Development's Chief Housing Officer should design internal controls to ensure applicants' maximum monthly payments are calculated based on household monthly gross income.

Agency Response: Agree, Implementation Date – Completed

¹⁸ U.S. Government Accountability Office. *Standards for Internal Control in the Federal Government*. GAO-14-704G (Washington, D.C.: September 10, 2014). These standards can also be adopted by state, local, quasi-governmental entities, and not-for-profit organizations as a framework for an internal control system.

Errors Exist in the Office of Economic Development's Recording Process

All applicants approved as eligible to purchase an affordable home must sign and complete a memorandum of acceptance to the master covenant, securing the property's affordability restrictions upon closing on the home. Once signed, it is the title company's responsibility to record the memorandum of acceptance with the Office of the Clerk and Recorder and return the original, signed, and recorded copy to the Office of Economic Development. After recording, the memorandum of acceptance is assigned a unique identifying number, called a reception number.¹⁹

Covenants, on the other hand, are signed by the developer and recorded by the Office of Economic Development, prior to affordable units being available for occupancy. A representative from the agency gives the physical copy of the covenant to the Clerk and Recorder's Office and waits for the document to be recorded. After it is recorded and given a reception number, the Clerk and Recorder's Office returns the physical copy to the Office of Economic Development.

The recording process is especially important as title companies for prospective buyers of affordable units rely on covenants to find any restrictions on a property, such as price restrictions in affordable housing. This was identified as a key issue in the City's recent review of compliance with affordability restrictions. Specifically, the Office of Economic Development identified more than 300 units out of compliance with covenant restrictions. Of those identified, a majority were sold without the agency's knowledge to buyers who had not been income-verified.

We identified eight properties out of 21 that had one or more memoranda of acceptance recorded with errors.

During testing of the Office of Economic Development's recording process, we identified eight properties out of 21 that had one or more memoranda of acceptance recorded with errors. Audit work found that six memoranda of acceptance from five properties were improperly categorized as other documents. For instance, several memoranda of acceptance were categorized as "Covenant;" others were categorized as "Warranty Deed," "Agreement," or "Miscellaneous," rather than "Memorandum." Additionally, there were three memoranda of acceptance recorded under homeowners' misspelled names. Finally, there were five memoranda of acceptance that contained incorrect or no reception numbers to reference their associated covenants. In some instances, the reception number would refer to other documents, such as the property's condominium map or homeowner's association declarations.

While Office of Economic Development officials maintain these errors were due to mistakes by the Clerk and Recorder's Office during

¹⁹ A reception number is the document number assigned to recorded documents by the Clerk and Recorder's Office.

recording, Inclusionary Housing Ordinance Administrative Rules and Regulations state it is the Office of Economic Development's responsibility to record covenants. However, the Office of Economic Development does not have a documented process for recording covenants and memoranda of acceptance or a process for reviewing recorded documents for errors.

The Green Book advises that quality information is necessary to ensure an organization achieves its objectives.²⁰ Quality information should be complete and accurate as well as evaluated to determine its quality. Furthermore, these government standards also emphasize the importance of the segregation of duties among different people or groups to reduce the risk of error in important agency processes.

One city records a secondary, \$10 lien on all its affordable properties separate from the restrictive covenant.

Secondary Liens Could Improve Controls – The audit team conducted benchmarking with other high-cost cities to determine any best practices for ensuring potential buyers are aware of affordability restrictions on a property.²¹ We found one city that records a secondary low-cost lien in the amount of \$10 on all its affordable properties separate from the restrictive covenant. In this case, even if a seller did not inform potential buyers, or the City, that the property was price restricted, the seller would still have to contact the City when seeking new financing to release or subordinate the lien. During this contact, the City could then use the opportunity to inform the potential buyer of affordability restrictions and verify they meet requirements.

Errors in the recording of covenants and memoranda of acceptance increases the risk of an affordable home being sold to an ineligible homebuyer. In addition, this can increase the probability future homebuyers could be unaware of affordability restrictions attached to their prospective home purchase.

RECOMMENDATION 1.3

Design Internal Controls for Recording – The Office of Economic Development's Chief Housing Officer should design internal controls so that recorded covenants and memoranda of acceptance are accurate, including incorporating a final review. Additionally, the Housing Officer should coordinate with the Clerk and Recorder's Office to remediate existing errors.

Agency Response: Agree, Implementation Date – May 31, 2019

²⁰ U.S. Government Accountability Office. *Standards for Internal Control in the Federal Government*. GAO-14-704G (Washington, D.C.: September 10, 2014).

²¹ High-cost cities were determined based on cost of living and housing market indexes.

RECOMMENDATION 1.4

Research Use of Secondary Liens – The Office of Economic Development's Chief Housing Officer should research the feasibility of using secondary liens to prevent improper resales of affordable homes.

Agency Response: Agree, Implementation Date – May 31, 2019

Miscalculated Maximum Resale Prices

Any owner of an affordable home who chooses to sell their home must submit a request to the Office of Economic Development to determine the maximum allowable resale price. According to the Inclusionary Housing Ordinance Administrative Rules and Regulations, the Office of Economic Development must follow a specific formula for determining the maximum resale price of an affordable home created before May 31, 2010. These rules state that the maximum allowable resale price shall be calculated using an appreciation formula.²² The maximum resale price formula is equal to the affordable home's prior purchase price plus the owner's share of appreciation in market value. The owner's share of appreciation in market value is calculated based on the home's current and prior appraised value and factored against the length of ownership of the current owner.

Based on these requirements, we judgmentally selected 19 affordable units to determine if the Office of Economic Development calculated the maximum resale prices correctly. We found that in some instances, the restrictive covenants for some sampled homes were amended to allow for a maximum resale pricing formula that followed the Case-Shiller Index, as previously described in the Background section.²³

The Office of Economic Development Incorrectly Calculated Maximum Resale Prices

After review, we found that the Office of Economic Development is not consistently providing accurate maximum resale prices for home owners seeking to resell their affordable homes under Inclusionary Housing Ordinance rules. Specifically, we found eight instances out of 19 sampled resales that contained errors. These errors included incorrect and unsupported appraisals used in calculating maximum

²² Inclusionary Housing Ordinance Administrative Rules and Regulations, Section K.

²³ The Case-Shiller Index measures changes in values of residential real estate at national and metropolitan levels. These changes are measured in multi-month averages that fluctuate depending on available information at the time of reference.

selling prices, incorrect and unsupported Case-Shiller Index rates used to calculate maximum selling prices, and miscalculations in total days of ownership when factoring total appreciation for some home sellers. For example, one resale we tested was originally constructed and sold in 2007. This same unit resold twice over the next 11 years, once in 2009 and again in 2017. After reviewing supporting documentation, including appraisals for the unit, we found that incorrect appraisal figures were used to calculate the total maximum selling price, resulting in the unit being sold for \$810 less than it could have been in 2009.

For another affordable home that resold, we found that the Office of Economic Development calculated a maximum selling price of \$112,271 using the Case-Shiller Index calculation. After review, we found that the office did not apply the correct index rates for the ownership period of seven years, resulting in a maximum selling price that was underpriced by about \$5,700. Further, we found that the home still resold at a price higher than quoted, for \$112,500.

Lack of Review – These errors occurred because the Office of Economic Development lacks a review process for these calculations that could have helped prevent these errors. According to the Green Book, management is charged with designing control activities at the appropriate levels in the organizational structure. Controls are actions built directly into operational processes that support the achievement of an entity's objectives.

RECOMMENDATION 1.5

Design Internal Controls for Review – The Office of Economic Development's Chief Housing Officer should design internal controls to ensure maximum resale pricing calculations are accurate and reviewed before issuing final quotes to prospective home sellers.

Agency Response: Agree, Implementation Date – March 1, 2019

The Office of Economic Development Mishandled Cash-in-Lieu Payments

Under the Inclusionary Housing Ordinance, a developer producing 30 or more residential units has two options: designate 10 percent of the number of homes in the project as affordable or pay the City a fee. The latter option, is referred to as a "cash-in-lieu fee," meaning that in lieu of building the required number of affordable housing units, a developer may make a payment for each housing unit not provided. The cash-in-lieu fee amount was based on the following:

- The then-current price of an affordable home pulled from the

Office of Economic Development's maximum sale price table;

- The number of units that were required to be provided under the Inclusionary Housing Ordinance; and
- The applicable percentage, based on the neighborhood in which the development was being constructed.

The Office of Economic Development divided the City's neighborhoods into three tiers based on the need for affordable housing in the area—high-need, medium-need, and low-need. The agency determined need by home prices in the neighborhood and proximity to transit. For example, a neighborhood with homes priced higher than average and located within a half mile of a light rail station would likely fall within the classification of high-need.

We found that the Office of Economic Development failed to properly collect cash-in-lieu payments from some developers subject to these rules. We reached this conclusion by examining all cash-in-lieu payments spanning the period from 2014 through 2016, the year the Inclusionary Housing Ordinance sunsetted. During this period, there were two developers who took the cash-in-lieu option, and in both instances, the Office of Economic Development did not follow City ordinance when calculating and collecting fees.

In one instance, Economic Development incorrectly calculated the developer's cash-in-lieu fee, resulting in an overcollection of \$35,762.

In one instance, the Office of Economic Development incorrectly calculated the developer's cash-in-lieu fee, resulting in an overcollection of \$35,762. This occurred because the office used an incorrect sale price table for an affordable housing unit in 2014 when calculating the developer's fee. In the other instance, the office allowed a developer to receive a building permit from the City's permitting department prior to receiving the cash-in-lieu payment. According to the Inclusionary Housing Ordinance Administrative Rules and Regulations, a developer is not supposed to be issued a building permit until the cash-in-lieu payment had been paid. The requirement to pay before a permit is issued was the City's primary enforcement mechanism for ensuring all cash-in-lieu payments were collected.

Further, these rules and regulations restrict the City's permitting department from issuing a certificate of occupancy upon completion of a project until all requirements have been satisfied. However, we found the Office of Economic Development violated this rule when it allowed the developer to receive both a building permit and a certificate of occupancy prior to paying the cash-in-lieu fee. This resulted in the City having to wait 12 years to receive the \$1.5 million cash-in-lieu payment it was owed from the developer. These were funds that could have been reinvested by the City into more affordable housing projects.

Green Book standards say management should design controls to achieve objectives and respond to risks. Further, these standards say management implements controls through policies and procedures. The Office of Economic Development has well-documented policies. What it lacks are the required corresponding procedures that should accompany these policies. Since the Inclusionary Housing Ordinance sunsetted on December 31, 2016, there is no future risk related to a lack of internal controls around the cash-in-lieu process. However, the \$35,762 the City overcollected in 2014 remains to be addressed.

RECOMMENDATION 1.6

Cash-in-Lieu Payments – The Office of Economic Development's Chief Housing Officer should rectify the overpayment the office received in 2014.

Agency Response: Agree, Implementation Date – January 31, 2019

The Office of Economic Development Lacks an Accurate and Complete Compliance Database of Affordable Units

In November 2017, the Office of Economic Development began compiling a listing of all for-sale affordable homes in the City in the form of a spreadsheet to support compliance efforts. The spreadsheet was created by various Office of Economic Development officials collecting information from for-sale covenants and the City Assessor's Office title records. The spreadsheet is meant to keep track of information such as: unit addresses, current and past owners, dates of sale, sale prices, covenant expiration dates, and identified violations. Moreover, this spreadsheet is used to identify compliance issues by comparing ownership and restriction information from covenants and memoranda of acceptance to the City Assessor's Office tax assessment records.

However, we found several instances of inaccurate information within the compliance spreadsheet. Within a sample of 20 for-sale homes, we found 10 homes recorded with inaccurate data. These data inaccuracies included:

- Nine instances of reception dates in place of dates of sale;²⁴
- One instance of previous owners placed in incorrect fields;
- One instance of a duplicated owner with an incorrect sale price; and
- One instance of a missing sale price listed in the memorandum of acceptance.

²⁴ A reception date is the date the sale was recorded with the Office of the Clerk and Recorder.

We discovered 27 units from two developments were missing from Economic Development's compliance spreadsheet.

Furthermore, we discovered 27 units from two affordable housing developments were missing from the Office of Economic Development's compliance spreadsheet, suggesting the spreadsheet was not complete.

Office of Economic Development officials attributed the inaccuracies to the fact that several employees compiled the compliance spreadsheet, and each person input information differently. The agency also lacks internal controls around data input or integrity. For instance, there are no procedures on how or when information should be entered or updated in the spreadsheet. There is also no review process to ensure the data is accurate and complete. Finally, there are no restrictions on who can access and edit the spreadsheet because it is placed on the Office of Economic Development's shared drive. Although one agency official has a master copy in their personal drive, there are no procedures for how this information should be reconciled with the version used by other office employees.

Green Book standards say quality information is necessary to ensure an organization achieves its objectives.²⁵ Quality information should be complete, accurate, and recorded in a timely manner as well as evaluated to determine its quality. Furthermore, these government standards also emphasize the importance of the segregation of duties among different people or groups to reduce the risk of error in important agency processes.

The lack of such internal controls and the presence of inaccurate and incomplete data can lead to an increased likelihood of covenant restrictions being violated and going undetected by the Office of Economic Development. Due to affordable homes potentially being bought by ineligible home buyers, persistent compliance issues in affordable homes could essentially remove units from the City's stock of affordable housing as a result.

RECOMMENDATION 1.7

Design Internal Controls for Data Accuracy – The Office of Economic Development's Chief Housing Officer should design internal controls to ensure a complete and accurate inventory of affordable units is maintained.

Agency Response: Agree, Implementation Date – Fourth Quarter 2019

²⁵ U.S. Government Accountability Office. *Standards for Internal Control in the Federal Government*. GAO-14-704G (Washington, D.C. September 10, 2014).

The Office of Economic Development Exceeded Incentive Payment Annual Limit

The Inclusionary Housing Ordinance allows developers to receive an incentive payment in return for producing affordable units.²⁶ According to the ordinance, the incentive was tiered based on the neighborhood in which the affordable units were built. Similar to the cash-in-lieu process, there were three tiers broken down based on the need for affordable housing in the area.

- Developers building in high-need neighborhoods were given up to \$25,000 per affordable unit built;
- Developers building in medium-need neighborhoods were given up to \$6,500 per affordable unit built; and
- Developers building in low-need neighborhoods were given up to \$2,500 per affordable unit built.

Incentive payments were not to be paid until the developer had completed construction of the affordable unit and executed either a lease agreement, if the unit was a rental, or upon completion of sale, if the home was a for-sale unit. Upon successfully renting or selling the unit, the developer would apply to the Office of Economic Development and request their incentive payment in exchange for the affordable unit.

The Inclusionary Housing Ordinance placed a \$250,000 cap on the maximum amount that could be paid for incentives to any one developer in a calendar year. The \$250,000 cap is not a maximum payout permitted per developer, but merely a cap on the amount any individual developer could receive in one calendar year. To illustrate this point, assume a developer had \$300,000 worth of incentives to apply for. The Inclusionary Housing Ordinance would require the Office of Economic Development to pay out up to \$250,000 in the first year and the remaining \$50,000 in the second year. The rationale behind limiting the annual payout was to prevent a large developer from depleting all the funds the Office of Economic Development budgeted for incentive payments, leaving nothing for other developers. Setting a cap would allow City Council time to appropriate more funds for incentive payments the following budget year.

Our audit work found that the Office of Economic Development did not adhere to the \$250,000 annual cap and paid one developer \$318,500 in 2018—exceeding the annual cap by \$68,500. This occurred because the Office of Economic Development erroneously accounted for an incentive payment in calendar year 2017 when in fact the incentive request was received, processed, and paid in 2018. The agency lacks internal controls surrounding the incentive payment process.

Green Book standards say management should design controls to

The Office of Economic Development exceeded the incentive payment annual cap by \$68,500 in 2018.

²⁶ Denver Revised Municipal Code, § 27.107.

achieve objectives and respond to risks. Further, these standards state management implements controls through policies and procedures. As with issues previously discussed, the Office of Economic Development does have well-documented policies; what it lacks are the required corresponding procedures that should accompany these policies.

Since the Inclusionary Housing Ordinance sunsetted December 31, 2016, the risk assumed by the Office of Economic Development is reduced because future incentive payments should be few, if any. To qualify for an incentive payment, a developer must have begun a project prior to the 2016 sunset of the Inclusionary Housing Ordinance. Because development projects typically take two to three years to complete, 2019 should mark the end of any incentive payments. However, if there are future incentive payments in the pipeline to be paid out, the agency runs the risk of processing, accounting for, and paying an incentive in an untimely or incorrect manner.

RECOMMENDATION 1.8

Incentive Payments – The Office of Economic Development's Chief Housing Officer should design internal controls to ensure future Inclusionary Housing Ordinance incentive payments are processed, accounted for, and disbursed in a timely and accurate manner.

Agency Response: Agree, Implementation Date – Completed

The Office of Economic Development Is Not Monitoring Federally Funded Rental Projects in a Timely Manner

In addition to for-sale units, the Office of Economic Development also provides gap financing to multi-family affordable rental developments with local and federal money. The office receives federal money from the U.S. Department of Housing and Urban Development through a variety of programs and provides funding to developers to build affordable units. One such federal program is the Home Investment Partnership Program, also known as HOME, which requires participating jurisdictions to monitor HOME-funded rental projects in the form of desk reviews.²⁷ A desk review involves an Office of Economic Development official collecting tenant information—such as income, utility payments, and rent amounts—from property management companies to verify tenants receiving affordable housing assistance follow all relevant federal requirements for the program.

Federal regulations specify that the owners of HOME-funded rental

²⁷ HOME provides formula grants to states and municipalities to fund activities such as building, buying, and rehabilitating affordable housing or providing direct rental assistance to low-income individuals.

projects must provide the City with information on rents and occupancy for compliance purposes on an annual basis.²⁸ The City must then review rents for compliance with published rent limits and approve or disapprove them every year. Additionally, Housing and Urban Development's Denver office confirmed that rents should be reviewed for compliance every 12 months.

We tested 14 HOME-funded rental projects and noted that 10 of the 14 projects had not received a desk review of rents for more than a year. The Office of Economic Development's typical practice is to perform desk reviews on all rents from the previous year, so that 2014 rents were reviewed in 2015 and 2015 rents were reviewed in 2016. In contrast to this process, the 2016 rents for these 10 developments were not completed until as recently as August 2018.

When asked why desk reviews had not been conducted for more than a year, Office of Economic Development officials stated that desk reviews for 2016 rents were placed on hold because the member of the compliance team responsible for conducting desk reviews transitioned to another position in the organization. Without that member in place, there was no one trained to conduct desk reviews. Desk reviews of 2016 rents began again and were completed in 2018 after the remaining members of the compliance team were trained to conduct them. Agency officials said they are moving toward a more proactive, rolling calendar year review process and are working to automate the process as much as possible. Additionally, Office of Economic Development officials stated that Housing and Urban Development told them there was no specific timeline to complete desk reviews, contrary to information we gathered from federal officials.

Without timely monitoring of rents in affordable units, there is a potential that owners of rental projects could be charging rent in excess of maximum limits without the Office of Economic Development's knowledge. These rents would then be unaffordable to tenants.

RECOMMENDATION 1.9

Perform Annual Monitoring – The Office of Economic Development's Chief Housing Officer should perform desk reviews on a rolling, annual basis and work toward automating the process to reduce time spent performing reviews.

Agency Response: Agree, Implementation Date – June 30, 2019

²⁸ U.S. Department of Housing and Urban Development. *Code of Federal Regulations*. Section 92.252 of the regulations lists requirements for HOME-funded projects and for jurisdictions providing HOME-funding.

FINDING 2

The Department of Community Planning and Development's Process for Assessing Linkage Fees Is Effective but Could Be Improved

Linkage fees assessed and collected by the Department of Community Planning and development provide one of the two revenue sources for the Affordable Housing Permanent Fund. There are three factors that can affect the amount of revenue collected for the Linkage Fee Revenue Fund, including:

- Linkage fee payments;
- Linkage fee refunds; and
- Linkage fee exemptions.

The department is responsible for assessing and collecting linkage fees, processing refunds, and issuing exemptions. For any new development, a developer submits to the department a linkage fee application. The developer provides information on the type of development and the gross square footage of the project. How much the fee is depends on two pieces of information: 1) the zoning code, which is required to determine the applicable fee rate, and 2) the gross square footage. The fee rate is then multiplied by the gross square footage to determine the total fee.

In some instances, the project's gross square footage may decrease after the linkage fee is paid. If this occurs, the developer may submit to the Department of Community Planning and Development a refund request. Department staff, in coordination with the Office of Economic Development, verifies the validity of the refund. Similarly, in some instances, an exemption to the linkage fee is applicable. To receive an exemption, the developer applies, indicates the type of exemption they are seeking, and provides any required supporting documentation. Once Community Planning and Development receives the application, a review is conducted to verify the validity of the exemption. Community Planning and Development has the responsibility for approving seven of the 12 exemption types and coordinates with the

LINKAGE FEE

A linkage fee is a one-time fee imposed on any new gross floor area of a building—not including parking—and must be paid before building permits are issued for the following:

- Additions that add more than 400 square feet to single-family homes and duplexes
- Conversions of previously exempt space, such as a home's garage, into additional floor space
- New commercial and multi-family buildings

Office of Economic Development on the approval for the remaining five exemption types.

After analyzing the three aspects of the linkage fee collection process we found that, overall, Community Planning and Development has a thorough and effective linkage fee assessment process. During the audit period, only two refunds had been issued for linkage fee payments. In both cases, the department correctly documented and processed the refunds. Additionally, all linkage fee payment amounts tested were determined to be accurate and appropriately documented. However, the exemption testing revealed two minor issues, namely the approval of four ineligible exemptions and inconsistent application of the department's review procedures. These issues did not affect the revenue collected for the Linkage Fee Revenue Fund, but they do indicate areas that the department can improve on.

Incorrectly Approved Linkage Fee Exemptions

The Linkage Fee Rules and Regulations list the specific documentation required for each exemption type. The specific requirements vary based on the exemption selected on the linkage fee application. The application also lists the required documents for each exemption type.

We examined a total of 54 linkage fee exemptions approved by Community Planning and Development between January 1, 2017 and June 30, 2018.

Of these, four residential projects incorrectly received exemptions. In each case, the developer selected the exemption indicating the project was part of a property subject to an affordable housing plan. The housing plan was associated with a specific boundary that could be exempt from the linkage fee. The addresses of four projects identified were outside the approved affordable housing plan listed on the application. As seen in Appendix B, the addresses fell within the area labeled "62," which was outside the initial approved area for the affordable housing plan.

The addresses of four projects identified were outside the approved affordable housing plan listed on the application. As seen in Appendix B, the addresses fell within the area labeled "62," which was outside the initial approved area for the affordable housing plan.

According to Community Planning and Development, there was confusion over the specific boundary associated with the affordable housing plan listed in the application. The confusion stemmed from discussions with Office of Economic Development officials regarding plans to amend the boundary of this specific affordable housing plan. When Community Planning and Development received these four linkage fee applications, the agency assumed the amendment had been finalized and would now incorporate a larger boundary to the

MORE INFORMATION

For a map depicting the boundaries of the approved affordable housing plan in question, reference Appendix B.

plan. However, when Community Planning and Development received these four linkage fee exemption applications during the spring of 2017, the amendment had not yet been finalized.

While these exemptions were incorrectly approved at the time of processing, the affordable housing plan was amended on September 14, 2018. The amendment now incorporates the area labeled "62." Therefore, the four exemptions identified as being incorrectly granted are now correct under the amendment. As a result, there is not a monetary impact of incorrectly approving the four exemptions. However, the process of exemption approval can be improved to avoid confusion regarding boundary issues moving forward.

RECOMMENDATION 2.1

Linkage Fee Exemptions – The Executive Director of the Department of Community Planning and Development should improve the verification process for granting exemptions by creating overlays for every existing affordable housing plan boundary within its mapping function.

Agency Response: Agree, Implementation Date – February 15, 2019

Inconsistent Application of Review Procedures

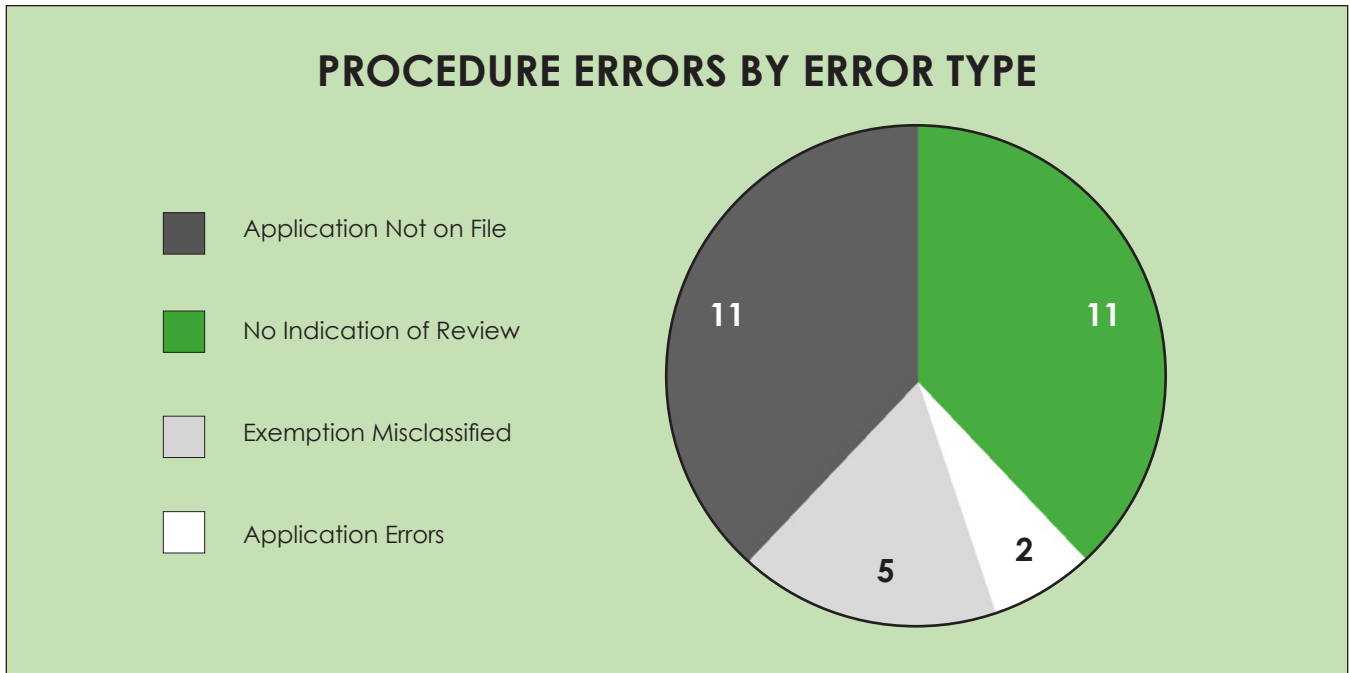
According to the Department of Community Planning and Development's linkage fee process, the department must follow specific steps to process and document linkage fee applications. The purpose of these procedures is to ensure the exemptions are correctly approved before the building permit is issued. As part of this approval, the department reviews and uploads linkage fee information into its building permit program, Accela.²⁹

Specific steps in Community Planning and Development's linkage fee procedures include the activation of a review tab, which serves as a placeholder for the project's application. Once activated, the review tab must be approved by the agency before the developer can pay for their building permit. Additionally, Community Planning and Development's procedures specify that the linkage fee application is to be scanned and attached to the project's file in Accela.

The linkage fee application is important to document because it provides information for the exemption type selected. For instance, if a project selects the exemption for a pre-existing affordable housing

²⁹ Accela is the City and County of Denver's permitting system.

FIGURE 2. Number of Errors in Linkage Fee Exemption Procedures



Source: Developed by Audit Services Division using results from audit testing.

plan, the application must contain the plan's identification number and a copy of the affordable housing plan. Community Planning and Development staff use this information to ensure the application is correctly filled out and the appropriate supporting documentation is provided.

Using the same sample from the linkage fee exemption testing, we reviewed whether exemptions were documented in accordance with the department's procedures. The testing revealed 19 of 54 linkage fee applications where Community Planning and Development did not accurately follow its review procedures. The errors with applications can be fit into four distinct categories summarized in Figure 2 above; some applications had more than one error.

The reason for the inconsistent application of Community Planning and Development's linkage fee procedures was due to confusion among department staff regarding the appropriate instances that require filing the application and exemption documentation. Significantly, none of the documentation inconsistencies resulted in an exemption being incorrectly approved. However, the lack of consistent review increases the likelihood that projects will incorrectly receive an exemption. Without the review tab activated, it is impossible to determine whether Community Planning and Development reviewed the documentation to support the exemption. Additionally, without the attachment of linkage fee applications, department staff may fail to identify the documentation required for the type of exemption sought.



RECOMMENDATION 2.2

Linkage Fee Documentation – The Executive Director of the Department of Community Planning and Development should conduct a training for all staff who process and input linkage fee applications to ensure they follow correct procedures.

Agency Response: Agree, Implementation Date – January 16, 2019

RECOMMENDATIONS

- 1.1 **Inclusionary Housing Ordinance Initial Home Sales** – The Office of Economic Development’s Chief Housing Officer should design internal controls to ensure maximum sale price tables are calculated annually according to Inclusionary Housing Ordinance rules and that the correct table is used when selling an affordable unit.

Agency Response: Agree, Implementation Date – March 31, 2019

Agency Narrative: Two of the referenced sales in Table 4, page 14, identified as selling for more than the maximum sale price in 2006 appear to be more than the published maximum allowable prices at the time the homes were sold to the initial buyers. The one referenced sale in 2012 resulted from an error in reading and approving the Affordable Housing Plan (AHP) for that development, where the unit in question was mischaracterized by the developer in the narrative as a two-bedroom unit and was priced correctly for a two-bedroom unit. However, the floor plans show a one-bedroom unit and a one-bedroom unit is what was constructed.

Since 2008, OED has regularly published maximum allowable sale prices and agrees with the recommendation that it should continue the practice. The lack of a 2007 table appears to be the result of no change in the Area Median Income (AMI) from 2006 to 2007, although the maximum allowable sale prices should have been recalculated to reflect the current interest rate. Since 2012, the agency has worked to achieve sufficient internal controls to ensure that the maximum allowable sale prices are published in a timely manner and are correct at the time that they are issued. OED and Community Planning and Development (CPD) do need to address establishing internal controls for ensuring that the required type and size of affordable units are consistent with the affordable units that are constructed.

Additionally, as part of its continuing process improvement efforts, OED is working with a third party consultant, David Paul Rosen & Associates (ORA), who will advise the agency on methods for managing the timing, tracking and use of the assorted variables needed for affordable price calculations. Mortgage interest rate fluctuations, for example, have a greater material effect on the initial price for Denver’s affordable homes than AMI changes, historically speaking. At a 5% interest rate, an affordable price might be \$200,000. That same home has an affordable price of \$179,000 at a 6% interest rate. By comparison, a 3% increase in the AMI yields an increase in the affordable price of roughly \$7,000 in this example. The inconsistent timing of the publication of these variables, as well as the retroactive adjustments that can be made to some, present program management challenges. Review and revision of how affordable prices are set is a key topic of our ongoing work on policies, rules, regulations and procedures.

Additional Proposed Actions:

- *Date published prices and more clearly document for audit purposes the price sheets used when issuing maximum allowable sale prices starting first quarter of 2019;*
- *OED will more clearly document for audit purposes the date when new AMIs are received*

by HUD each year and which AMLs are in effect and used in the initial price calculation starting with 2019 AMLs;

- Review and revise how initial affordable sale prices are set and the timing at which such prices are set as part of the revisions to the rules and regulations for the IHO and dedicated housing fund scheduled for review November 2018 through March 2019; and
- Establish an internal process whereby OED staff check building permits for new affordable housing units to ensure that the developer accurately represented the size and type of units being constructed.

Auditor's Addendum: At the time of our audit work, there were a total of 82 initial sales that took place under the Inclusionary Housing Ordinance from 2002 through 2016. Of those 82, there were only two units that were sold subsequent to 2012. Our audit work found that the lack of internal controls that existed in 2012 still remains to this day. The same process for calculating the maximum allowable sale price that was in place prior to 2012 is also still currently in place.

- 1.2 **Design Internal Controls for Income Verification** – The Office of Economic Development's Chief Housing Officer should design internal controls to ensure applicants' maximum monthly payments are calculated based on household monthly gross income.

Agency Response: Agree, Implementation Date – Completed

Agency Narrative: Housing is considered "affordable" if a household pays no more than 30% of its gross income for a housing payment. This 30% amount, also known as a "front end ratio," is stated in the IHO Rules and Regulations. It has been historically applied to applicants who did not have sufficient income to meet the minimum income requirement but used their cash assets to buy the affordable housing unit. Application of this standard is now included in the income verification process for all affordable housing applicants.

Additional Proposed Actions — As part of OED's continuing efforts to improve its operating processes and procedures, staff will:

- Continue researching industry best practices regarding the use of a front or back end ratio as an element of income verification for affordable housing units. (A front end ratio is the total housing payment as a percent of gross income; a back end ratio is the total of all household installment debt, including the housing payment, as a percentage of gross income.)
- Make a determination regarding the use of a ratio for purposes of ensuring an affordable housing payment. This may result in revisions to the IHO Rules and Regulations to reflect the staff determination or, if no changes to the current rules are recommended, the language regarding the current rule will be clarified to facilitate its continued implementation.

- 1.3 **Design Internal Controls for Recording** – The Office of Economic Development's Chief Housing Officer should design internal controls so that recorded covenants and memoranda of acceptance are accurate, including incorporating a final review. Additionally, the Housing Officer should coordinate with the Clerk and Recorder's Office to remediate existing errors.

Agency Response: Agree, Implementation Date – May 31, 2019

Agency Narrative: A covenant is what is recorded against the title of a given affordable housing property. A Memorandum of Acceptance (MOA) is a document that evidences that an affordable homebuyer understands and accepts the affordability restrictions in the covenant that apply to the affordable property. An MOA does not secure the City's interest in an affordable unit. In any dispute or compliance enforcement action, it is the recorded covenant that secures the City's enforceable interest in an affordable housing unit.

OED staff has researched all recorded MOAs and included the reception numbers for each in a detailed spreadsheet that catalogues the essential transactional information about each restricted homeownership unit. OED staff is also working to get missing MOAs executed and recorded as part of the Compliance Resolution Program. This work began in May of 2018 and is expected to be completed by May of 2019, depending upon the outcomes of the formal violation process.

Through the 2018 compliance resolution process, staff have improved MOA templates and a process for reviewing draft MOAs. Incorrect information on existing MOAs does not affect the City's legal interest in affordable housing nor its ability to enforce that interest. As affordable housing units are resold, the new form of MOAs will be issued and recorded.

The IHO Rules and Regulations state that OED is responsible for recording affordable housing covenants. The rules and regulations are silent on responsibility for recording MOAs. The practice has been to include the signing and recordation of an MOA as part of the closing instructions issued to title companies for the sale of each affordable housing unit. Title companies typically record all real estate transaction documents. Further, in those instances where agency staff has recorded MOAs, both with and without instructions to the Clerk and Recorder staff conducting the recordation, the result has been inconsistent assignment of document type by the Clerk and Recorder to the recorded documents.

Proposed Actions — Staff will:

- *Use updated MOA form for all new sale and resale transactions;*
- *Continue robust outreach program to assist title companies on the affordable housing closing process;*
- *Follow up with title companies after a closing to ensure we receive copies of the recorded MOAs; and*
- *Begin attending closings in the first quarter of 2019 to help facilitate uniform compliance with the City's closing instructions on the part of title company closers and ensure that all applicable affordable housing documents are executed and recorded appropriately.*

OED and Clerk & Recorder staff have met to establish improved internal controls to ensure that the correct "Document Type" column reference is assigned to recorded affordable housing documents. The agreed standard operating procedures include:

- *The provision of written instructions by OED to Clerk & Recorder staff;*

- Agreement to correct the document type reference on documents as errors are discovered; and
- Staff cross training and meeting quarterly to review the effectiveness of the coordinated efforts.

1.4 **Research Use of Secondary Liens** – The Office of Economic Development’s Chief Housing Officer should research the feasibility of using secondary liens to prevent improper resales of affordable homes.

Agency Response: Agree, Implementation Date – May 31, 2019

Agency Narrative: Liens are monetary obligations which are regulated by State and Federal laws. A performance deed of trust is currently being reviewed and evaluated as an option for securing the City’s affordable housing interest. A performance deed of trust is the same type of document as a regular deed of trust for securing a financial obligation and would easily be found through standard title search work. It could provide an additional type of notification during a real estate transaction, and thus protection, that the terms of a given affordable home’s covenant are being adhered to. Adding a second instrument, such as a deed of trust, may enhance the City’s ability to enforce its interest in affordable housing units. However, adding a lien to a deed of trust would also add a City financial ownership interest in an affordable home which may impact the financial credit of an affordable homeowner. Adding a deed of trust, with or without a financial lien, would require Ordinance revision and approval by City Council to implement.

Proposed Actions — *Staff will complete its research on options that may enhance the City’s ability to enforce its affordable housing interests embodied in the covenants recorded against affordable housing properties.*

1.5 **Design Internal Controls for Review** – The Office of Economic Development’s Chief Housing Officer should design internal controls to ensure maximum resale pricing calculations are accurate and reviewed before issuing final quotes to prospective home sellers.

Agency Response: Agree, Implementation Date – March 1, 2019

Agency Narrative: We agree in part with this recommendation. OED staff reviewed the existing documentation for the eight referenced sales where errors are alleged. Of those, we believe that three were issued the correct resale price based upon the covenant terms and applicable resale formula variables in effect at the time of the resale price calculation request. The referenced sales in which we agree that errors occurred, were prior to 2014. Agreement is “in part” because OED believes it has correctly calculated resale prices since 2014.

New staff members have also been trained in how to calculate the various resale formulas in effect for existing affordable housing units, enabling them to provide reviews of calculated maximum resale prices.

Additional Proposed Actions — Staff will:

- Establish standard operating procedures that document more clearly the indices used to calculate prices at the time that they are done;
- Establish a document management system for retaining resale price calculation information for audit purposes; and
- Continue to work with the City Attorney's Office to research options for updating and standardizing covenant terms in order to accurately track the wide variation of formulas in use and to keep current with best practices.

Auditor's Addendum: Our audit work revealed eight instances out of 19 sampled resales that contained errors within the Office of Economic Development's process for calculating a maximum sales price quote. Seven of those eight occurred prior to 2014, but we still found one instance of incorrect Case-Shiller Index rates being applied during a 2016 sale. Therefore, we disagree with the Office of Economic Development's belief that this process has been corrected since 2014 and encourage them to implement stronger operating procedures and internal controls surrounding this process.

- 1.6 **Cash-in-Lieu Payments** – The Office of Economic Development's Chief Housing Officer should rectify the overpayment the office received in 2014.

Agency Response: Agree, Implementation Date – January 31, 2019

The AMI Table ("AMIs"), one factor in calculating affordable prices, can be issued by HUD at any time during the calendar year, but generally they are received during the first half of a given calendar year. Until new AMIs are received, the previous year's AMIs are used. The 2014 AMIs were issued in late 2013. It appears that the table for 2014 may not have been updated in a timely manner and the 2013 AMI prices were used for the calculation.

The \$1.5M cash-in-lieu payment was not a normal IHO transaction but rather the payment was a result of a legally negotiated settlement of a violation and enforcement of the decision of a Final Hearing Order. A series of events, both within different City departments as well as actions taken by the developers, resulted in the developers constructing the project without having paid the required cash-in-lieu amount. OED pursued a violation against the developer. OED also does not issue building permits as those are issued by CPD Development Services. Additionally, the City did receive full payment of the final settlement amount.

Auditor's Addendum: Our audit work found that this transaction began as a normal cash-in-lieu transaction until the Office of Economic Development deviated from the Inclusionary Housing Ordinance's Rules and Regulations. The deviation occurred when the Office of Economic Development allowed the Department of Community Planning and Development to issue the developer a building permit prior to paying its cash-in-lieu fee. Additionally, the Office of Economic Development compounded the problem when it also allowed Community Planning and Development to issue a certificate of occupancy to the developer before the cash-in-lieu fee was paid.

Section 2, Paragraph T of the rules and regulations specifically state that a building permit shall not be issued until the Office of Economic Development has verified to Community Planning and Development that an approved cash-in-lieu payment has been made. Similarly, no certificate of occupancy shall be issued until full payment has been made and the Office of Economic Development has signed a release of any security interest.

- 1.7 **Design Internal Controls for Data Accuracy** – The Office of Economic Development's Chief Housing Officer should design internal controls to ensure a complete and accurate inventory of affordable units is maintained.

Agency Response: Agree, Implementation Date – Fourth Quarter 2019

Agency Narrative: OED does have a complete and accurate inventory of affordable units, however we agree improvements can be made to the technology system currently in use. OED manages this data in an Access database that is updated monthly with new information and maintained by the Housing Programs division. The (non-Access database) spreadsheets are used for day-to-day compliance tracking work and were initially constructed using the unit information in the Access database. Data validation features have been added to the spreadsheet to help standardize the input of data.

There are two compliance staff members that routinely check for these changes and the monthly reconciliation with the Access database is used to maintain the accuracy of the inventory. However, we are working to have more modern technology to support this work.

OED is partnering with Technology Services to design and obtain a comprehensive database solution that can support all of the necessary compliance activities while maintaining data integrity. The objective is to develop and implement a software solution that can support compliance, management and loss prevention of the city's affordable housing assets, as well as standard communications with affordable home owners and rental housing partners. This is a longer-term project that is anticipated to be completed and fully implemented in late 2019.

Proposed Action

- *Develop and implement a comprehensive affordable housing asset and homebuyer applicant management system that is queryable, integrated, secure and capable of issuing the reports necessary to demonstrate compliance across the variety of affordable housing programs.*

- 1.8 **Incentive Payments** – The Office of Economic Development's Chief Housing Officer should design internal controls to ensure future Inclusionary Housing Ordinance incentive payments are processed, accounted for, and disbursed in a timely and accurate manner.

Agency Response: Agree, Implementation Date – Completed

Agency Narrative: There are currently sufficient staff resources to enable at least two staff to perform accuracy checks on IHO incentive payment calculations and requests.

- 1.9 **Perform Annual Monitoring** – The Office of Economic Development's Chief Housing Officer

should perform desk reviews on a rolling, annual basis and work toward automating the process to reduce time spent performing reviews.

Agency Response: Agree, Implementation Date – June 30, 2019

Agency Narrative: We agree with this recommendation. We agree that desk reviews are needed, and automation will help our process. However, we are working to specifically define best practices/timing for the work and believe “regular basis” rather than “annual basis” is most appropriate.

As OED’s housing funds were initially all federal funds, our policies were designed to address federal requirement. Specifically, the Agency’s internal Annual Monitoring Guide, submitted to HUD, is the guiding document for defining how and when long term affordable housing units will be monitored. The Monitoring Guide takes into account the minimum standards that HUD expects, including the type and timing of monitoring activities. The range of monitoring activities can be based upon a risk analysis. At minimum, HUD requires for HOME units that a desk review is performed for each year of affordability, however the HUD and HOME regulations do not specify when that review must be performed. Additionally, CDBG, HOPW A, and NSP regulations from HUD are silent on the requirement of an annual review outside the initial year of affordability. The City’s general housing funds and dedicated fund rules and regulations are also silent. The OED Monitoring Guide mirrors the HOME requirement (the most restrictive) but goes above and beyond that required for CDBG, HOPWA, NSP, and City housing funds; it specifies that rental properties “annually must verify” their compliance with affordability restrictions and other requirements per their loan or grant agreement with OED.

Now that the City has more local funding than federal, we are working to determine the best processes moving forward, which will be informed by the federal requirements.

Auditor’s Addendum: The applicable section of the Federal Code of Regulations—Section 92.252(f)(2)—states that “participating jurisdictions must review rents for compliance and approve or disapprove them every year.” We reached out to the U.S. Department of Housing and Urban Development official that the Office of Economic Development identified, and that official confirmed our interpretation that Denver should be conducting desk reviews annually. Specifically, the HUD official stated that they “expect that Denver would review the rents of HOME assisted units for compliance every 12 months (once a year). There is no other timeline.”

- 2.1 **Linkage Fee Exemptions** – The Executive Director of the Department of Community Planning and Development should improve the verification process for granting exemptions by creating overlays for every existing affordable housing plan boundary within its mapping function.

Agency Response: Agree, Implementation Date – February 15, 2019

Agency Narrative: Upon passage of the linkage fee, Community Planning and Development (CPD) engaged with the Office of Economic Development (OED) to create an affordable housing plan map layer in MapIt. CPD is committed to working with OED to outline a process and procedure to ensure that layer stays up to date with any affordable housing plans that OED approves. Our first meeting on this topic was on December 5, 2018. CPD will work with

OED to develop processes and procedures to ensure the layer is maintained and updated by February 15, 2019.

- 2.2 **Linkage Fee Documentation** – The Executive Director of the Department of Community Planning and Development should conduct a training for all staff who process and input linkage fee applications to ensure they follow correct procedures.

Agency Response: Agree, Implementation Date – January 16, 2019

Agency Narrative: Community Planning and Development agrees with this recommendation.

CPD will host a training session open to all employees on January 16, 2019. Additionally, supervisors will be made aware that trainers are available to attend their staff meetings to help answer questions as they arise. CPD will also continually update a question and answer list on its internal shared drive. The shared drive contains a manual that includes the process for determining affordable housing fees and exemptions. This training will also provide information on the affordable housing plan layer that exists in MapIt.

AGENCY RESPONSES TO AUDIT RECOMMENDATIONS



December 10, 2018

Eric Hiraga, Executive Director
Office of Economic Development
201 W. Colfax Ave., 7th floor/101 W.
Colfax Ave, 8th floor | Denver, CO
80202

www.denvergov.org/oed

Auditor Timothy O'Brien, CPA
Office of the Auditor
City and County of Denver
201 West Colfax Avenue, Dept. 705
Denver, Colorado 80202

Dear Mr. O'Brien,

The Office of the Auditor has conducted a performance audit of Affordable Housing.

This memorandum provides a written response for each reportable condition noted in the Auditor's Report final draft that was sent to us on November 14, 2018. This response complies with Section 20-276 (c) of the Denver Revised Municipal Code (D.R.M.C.).

AGENCY INTRODUCTION

I would first like to express my appreciation for the thorough and professional work done by the audit team on our affordable housing program. Your insights and recommendations are a valuable addition to our current efforts to improve our operating standards as we bring all responsibilities for Denver's affordable housing compliance into one team.

Since 2002, Denver's regulatory and financial efforts to create affordable homeownership opportunities have created nearly 2,000 units with resale restrictions in the form of covenants. These include 1,400 units created through regulatory action and 560 units assisted through local financial investment of HOME and other funds. The City continues to create new affordable units through investment of its dedicated housing fund, created by City Council in September 2016, investment of available HOME funds, as well as the build out of the few remaining developments subject to Denver's Inclusionary Housing Ordinance, which sunsetted on December 31, 2016.

When the program was created, the City relied on the private sector housing partners to adhere to the program requirements and terms of the legal documents recorded against affordable housing properties. In most cases this worked, but we did identify compliance issues, and the need for additional staffing in 2017 and have been working on improvements to the compliance space since that time.

AUDIT FINDING 1

The Office of Economic Development's Lack of Proper Implementation and Enforcement of Regulations Is Not Ensuring Affordability of Housing

RECOMMENDATION 1.1

The Office of Economic Development's Chief Housing Officer should design internal controls to ensure maximum sale price tables are calculated annually according to Inclusionary Housing Ordinance rules and that the correct table is used when selling an affordable unit.

Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
Agree	March 31, 2019	Rick Padilla 720.913.1660

Narrative for Recommendation 1.1

Two of the referenced sales in Table 4, page 14, identified as selling for more than the maximum sale price in 2006 appear to be more than the published maximum allowable prices at the time the homes were sold to the initial buyers. The one referenced sale in 2012 resulted from an error in reading and approving the Affordable Housing Plan (AHP) for that development, where the unit in question was mischaracterized by the developer in the narrative as a two-bedroom unit and was priced correctly for a two-bedroom unit. However, the floor plans show a one-bedroom unit and a one-bedroom unit is what was constructed.

Since 2008, OED has regularly published maximum allowable sale prices and agrees with the recommendation that it should continue the practice. The lack of a 2007 table appears to be the result of no change in the Area Median Income (AMI) from 2006 to 2007, although the maximum allowable sale prices should have been recalculated to reflect the current interest rate. Since 2012, the agency has worked to achieve sufficient internal controls to ensure that the maximum allowable sale prices are published in a timely manner and are correct at the time that they are issued. OED and Community Planning and Development (CPD) do need to address establishing internal controls for ensuring that the required type and size of affordable units are consistent with the affordable units that are constructed.

Additionally, as part of its continuing process improvement efforts, OED is working with a third party consultant, David Paul Rosen & Associates (DRA), who will advise the agency on methods for managing the timing, tracking and use of the assorted variables needed for affordable price calculations. Mortgage interest rate fluctuations, for example, have a greater material effect on the initial price for Denver's affordable homes than AMI changes, historically speaking. At a 5% interest rate, an affordable price might be \$200,000. That same home has an affordable price of \$179,000 at a 6% interest rate. By comparison, a 3% increase in the AMI yields an increase in the affordable price of roughly \$7,000 in this example. The inconsistent timing of the publication of these variables, as well as the retroactive adjustments that can be made to some, present program management challenges. Review and revision of how affordable prices are set is a key topic of our ongoing work on policies, rules, regulations and procedures.

Additional Proposed Actions

- Date published prices and more clearly document for audit purposes the price sheets used when issuing maximum allowable sale prices starting first quarter of 2019;
- OED will more clearly document for audit purposes the date when new AMIs are received by HUD each year and which AMIs are in effect and used in the initial price calculation starting with 2019 AMIs;
- Review and revise how initial affordable sale prices are set and the timing at which such prices are set as part of the revisions to the rules and regulations for the IHO and dedicated housing fund scheduled for review November 2018 through March 2019; and
- Establish an internal process whereby OED staff check building permits for new affordable housing units to ensure that the developer accurately represented the size and type of units being constructed.

RECOMMENDATION 1.2 The Office of Economic Development’s Chief Housing Officer should design internal controls to ensure applicants’ maximum monthly payments are calculated based on household monthly gross income.		
Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
Agree	Completed	Rick Padilla 720.913.1660

Narrative for Recommendation 1.2

Housing is considered “affordable” if a household pays no more than 30% of its gross income for a housing payment. This 30% amount, also known as a “front end ratio,” is stated in the IHO Rules and Regulations. It has been historically applied to applicants who did not have sufficient income to meet the minimum income requirement but used their cash assets to buy the affordable housing unit. Application of this standard is now included in the income verification process for all affordable housing applicants.

Additional Proposed Actions

As part of OED’s continuing efforts to improve its operating processes and procedures, staff will:

- Continue researching industry best practices regarding the use of a front or back end ratio as an element of income verification for affordable housing units. (A front end ratio is the total housing payment as a percent of gross income; a back end ratio is the total of all household installment debt, including the housing payment, as a percentage of gross income.)
- Make a determination regarding the use of a ratio for purposes of ensuring an affordable housing payment. This may result in revisions to the IHO Rules and

Regulations to reflect the staff determination or, if no changes to the current rules are recommended, the language regarding the current rule will be clarified to facilitate its continued implementation.

RECOMMENDATION 1.3		
The Office of Economic Development’s Chief Housing Officer should design internal controls so that recorded covenants and memoranda of acceptance are accurate, including incorporating a final review. Additionally, the Housing Officer should coordinate with the Clerk and Recorder’s Office to remediate existing errors.		
Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
Agree	May 31, 2019	Rick Padilla 720.913.16607

Narrative for Recommendation 1.3

A covenant is what is recorded against the title of a given affordable housing property. A Memorandum of Acceptance (MOA) is a document that evidences that an affordable homebuyer understands and accepts the affordability restrictions in the covenant that apply to the affordable property. An MOA does not secure the City’s interest in an affordable unit. In any dispute or compliance enforcement action, it is the recorded covenant that secures the City’s enforceable interest in an affordable housing unit.

OED staff has researched all recorded MOAs and included the reception numbers for each in a detailed spreadsheet that catalogues the essential transactional information about each restricted homeownership unit. OED staff is also working to get missing MOAs executed and recorded as part of the Compliance Resolution Program. This work began in May of 2018 and is expected to be completed by May of 2019, depending upon the outcomes of the formal violation process.

Through the 2018 compliance resolution process, staff have improved MOA templates and a process for reviewing draft MOAs. Incorrect information on existing MOAs does not affect the City’s legal interest in affordable housing nor its ability to enforce that interest. As affordable housing units are resold, the new form of MOAs will be issued and recorded.

The IHO Rules and Regulations state that OED is responsible for recording affordable housing covenants. The rules and regulations are silent on responsibility for recording MOAs. The practice has been to include the signing and recordation of an MOA as part of the closing instructions issued to title companies for the sale of each affordable housing unit. Title companies typically record all real estate transaction documents. Further, in those instances where agency staff has recorded MOAs, both with and without instructions to the Clerk and Recorder staff conducting the recordation, the result has

been inconsistent assignment of document type by the Clerk and Recorder to the recorded documents.

Proposed Actions

Staff will:

- Use updated MOA form for all new sale and resale transactions;
- Continue robust outreach program to assist title companies on the affordable housing closing process;
- Follow up with title companies after a closing to ensure we receive copies of the recorded MOAs; and
- Begin attending closings in the first quarter of 2019 to help facilitate uniform compliance with the City’s closing instructions on the part of title company closers and ensure that all applicable affordable housing documents are executed and recorded appropriately.

OED and Clerk & Recorder staff have met to establish improved internal controls to ensure that the correct “Document Type” column reference is assigned to recorded affordable housing documents. The agreed standard operating procedures include:

- The provision of written instructions by OED to Clerk & Recorder staff;
- Agreement to correct the document type reference on documents as errors are discovered; and
- Staff cross training and meeting quarterly to review the effectiveness of the coordinated efforts.

RECOMMENDATION 1.4		
The Office of Economic Development’s Chief Housing Officer should research the feasibility of using secondary liens to prevent improper resales of affordable homes.		
Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
Agree	May 31, 2019	Rick Padilla 720.913.1660

Narrative for Recommendation 1.4

Liens are monetary obligations which are regulated by State and Federal laws. A performance deed of trust is currently being reviewed and evaluated as an option for securing the City’s affordable housing interest. A performance deed of trust is the same type of document as a regular deed of trust for securing a financial obligation and would easily be found through standard title search work. It could provide an additional type of notification during a real estate transaction, and thus protection, that the terms of a given affordable home’s covenant are being adhered to. Adding a second instrument, such as a deed of trust, may enhance the City’s ability to enforce its interest in affordable housing units. However, adding a lien to a deed of trust would also add a City financial ownership interest in an affordable home which may impact the financial credit of an affordable

homeowner. Adding a deed of trust, with or without a financial lien, would require Ordinance revision and approval by City Council to implement.

Proposed Actions

Staff will complete its research on options that may enhance the City’s ability to enforce its affordable housing interests embodied in the covenants recorded against affordable housing properties.

RECOMMENDATION 1.5 The Office of Economic Development’s Chief Housing Officer should design internal controls to ensure maximum resale pricing calculations are accurate and reviewed before issuing final quotes to prospective home sellers.		
Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
Agree	March 1, 2019	Rick Padilla 720.913.1660

Narrative for Recommendation 1.5

We agree in part with this recommendation. OED staff reviewed the existing documentation for the eight referenced sales where errors are alleged. Of those, we believe that three were issued the correct resale price based upon the covenant terms and applicable resale formula variables in effect at the time of the resale price calculation request. The referenced sales in which we agree that errors occurred, were prior to 2014. Agreement is “in part” because OED believes it has correctly calculated resale prices since 2014.

New staff members have also been trained in how to calculate the various resale formulas in effect for existing affordable housing units, enabling them to provide reviews of calculated maximum resale prices.

Additional Proposed Actions

Staff will:

- Establish standard operating procedures that document more clearly the indices used to calculate prices at the time that they are done;
- Establish a document management system for retaining resale price calculation information for audit purposes; and
- Continue to work with the City Attorney’s Office to research options for updating and standardizing covenant terms in order to accurately track the wide variation of formulas in use and to keep current with best practices.

RECOMMENDATION 1.6 The Office of Economic Development's Chief Housing Officer should rectify the overpayment the office received in 2014.		
Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
Agree	January 31, 2019	Rick Padilla 720.913.1660

Narrative for Recommendation 1.6

The AMI Table ("AMIs"), one factor in calculating affordable prices, can be issued by HUD at any time during the calendar year, but generally they are received during the first half of a given calendar year. Until new AMIs are received, the previous year's AMIs are used. The 2014 AMIs were issued in late 2013. It appears that the table for 2014 may not have been updated in a timely manner and the 2013 AMI prices were used for the calculation.

The \$1.5M cash-in-lieu payment was not a normal IHO transaction but rather the payment was a result of a legally negotiated settlement of a violation and enforcement of the decision of a Final Hearing Order. A series of events, both within different City departments as well as actions taken by the developers, resulted in the developers constructing the project without having paid the required cash-in-lieu amount. OED pursued a violation against the developer. OED also does not issue building permits as those are issued by CPD Development Services. Additionally, the City did receive full payment of the final settlement amount.

RECOMMENDATION 1.7 The Office of Economic Development's Chief Housing Officer should design internal controls to ensure a complete and accurate inventory of affordable units is maintained.		
Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
Agree	4 th Quarter 2019	Rick Padilla 720.913.1660

Narrative for Recommendation 1.7

OED does have a complete and accurate inventory of affordable units, however we agree improvements can be made to the technology system currently in use. OED manages this data in an Access database that is updated monthly with new information and maintained by the Housing Programs division. The (non-Access database) spreadsheets are used for day-to-day compliance tracking work and were initially constructed using the unit information in the Access database. Data validation features have been added to the spreadsheet to help standardize the input of data.

There are two compliance staff members that routinely check for these changes and the monthly reconciliation with the Access database is used to maintain the accuracy of the inventory. However, we are working to have more modern technology to support this work.

OED is partnering with Technology Services to design and obtain a comprehensive database solution that can support all of the necessary compliance activities while maintaining data integrity. The objective is to develop and implement a software solution that can support compliance, management and loss prevention of the city’s affordable housing assets, as well as standard communications with affordable home owners and rental housing partners. This is a longer-term project that is anticipated to be completed and fully implemented in late 2019.

Proposed Action

- Develop and implement a comprehensive affordable housing asset and homebuyer applicant management system that is queryable, integrated, secure and capable of issuing the reports necessary to demonstrate compliance across the variety of affordable housing programs.

RECOMMENDATION 1.8 The Office of Economic Development's Chief Housing Officer should design internal controls to ensure future Inclusionary Housing Ordinance incentive payments are processed, accounted for, and disbursed in a timely and accurate manner.		
Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
Agree	Completed	Rick Padilla 720.913.1660

Narrative for Recommendation 1.8

There are currently sufficient staff resources to enable at least two staff to perform accuracy checks on IHO incentive payment calculations and requests.

RECOMMENDATION 1.9 The Office of Economic Development’s Chief Housing Officer should perform desk reviews on a rolling, annual basis and work toward automating the process to reduce time spent performing reviews.		
Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation

Agree	June 30, 2019	Rick Padilla 720.913.1660
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Narrative for Recommendation 1.9

We agree with this recommendation. We agree that desk reviews are needed, and automation will help our process. However, we are working to specifically define best practices/timing for the work and believe “regular basis” rather than “annual basis” is most appropriate.

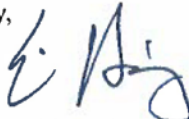
As OED’s housing funds were initially all federal funds, our policies were designed to address federal requirement. Specifically, the Agency’s internal Annual Monitoring Guide, submitted to HUD, is the guiding document for defining how and when long term affordable housing units will be monitored. The Monitoring Guide takes into account the minimum standards that HUD expects, including the type and timing of monitoring activities. The range of monitoring activities can be based upon a risk analysis. At minimum, HUD requires for HOME units that a desk review is performed for each year of affordability, however the HUD and HOME regulations do not specify when that review must be performed. Additionally, CDBG, HOPWA, and NSP regulations from HUD are silent on the requirement of an annual review outside the initial year of affordability. The City’s general housing funds and dedicated fund rules and regulations are also silent. The OED Monitoring Guide mirrors the HOME requirement (the most restrictive) but goes above and beyond that required for CDBG, HOPWA, NSP, and City housing funds; it specifies that rental properties “annually must verify” their compliance with affordability restrictions and other requirements per their loan or grant agreement with OED.

Now that the City has more local funding than federal, we are working to determine the best processes moving forward, which will be informed by the federal requirements.

Thank you for the opportunity to comment on your findings. We look forward to discussing them in more detail at the Audit Committee on December 20th.

Please contact Rick Padilla, Compliance Director at 720-913-1660 with any specific questions.

Sincerely,



Eric Hiraga, Executive Director
Office of Economic Development

cc: Valerie Walling, Deputy Auditor, CPA,CMC
Dawn Wiseman, Audit Manager, CRMA
Jared Miller, Audit Supervisor, CISA, CFE



December 6, 2018

Auditor Timothy O'Brien, CPA
Office of the Auditor
City and County of Denver
201 West Colfax Avenue, Dept. 705
Denver, Colorado 80202

Dear Mr. O'Brien,

The Office of the Auditor has conducted a performance audit of Affordable Housing.

This memorandum provides a written response for each reportable condition noted in the Auditor's Report final draft that was sent to us on November 14, 2018. This response complies with Section 20-276 (c) of the Denver Revised Municipal Code (D.R.M.C.).

Community Planning and Development is only responding to Audit Finding 2, and references to Audit Finding 1 have been removed from this response. Thank you for allowing us to comment.

AUDIT FINDING 2

The Department of Community Planning and Development's Process for Assessing Linkage Fees Is Effective but Could Be Improved

RECOMMENDATION 2.1

The Executive Director of the Department of Community Planning and Development should improve the verification process for granting exemptions by creating overlays for every existing affordable housing plan boundary within its mapping function.

Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
Agree	February 15, 2019	Jill Jennings Golich 720-865-2909

Narrative for Recommendation 2.1

Upon passage of the linkage fee, Community Planning and Development (CPD) engaged with the Office of Economic Development (OED) to create an affordable housing plan map layer in MapIt. CPD is committed to working with OED to outline a process and procedure to ensure that layer stays up to date with any affordable housing plans that OED approves. Our first meeting on this topic was on December 5, 2018. CPD will work with OED to develop processes and procedures to ensure the layer is maintained and updated by February 15, 2019.

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RECOMMENDATION 2.2		
The Executive Director of the Department of Community Planning and Development should conduct a training for all staff who process and input linkage fee applications to ensure they are following correct procedures.		
Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
Agree	January 16, 2019	Jill Jennings Golich 720-865-2909

Narrative for Recommendation 2.2

Community Planning and Development agrees with this recommendation.

CPD will host a training session open to all employees on January 16, 2019. Additionally, supervisors will be made aware that trainers are available to attend their staff meetings to help answer questions as they arise. CPD will also continually update a question and answer list on its internal shared drive. The shared drive contains a manual that includes the process for determining affordable housing fees and exemptions. This training will also provide information on the affordable housing plan layer that exists in MapIt.

Please contact me at 720-865-2909 with any questions.

Sincerely,

Jill Jennings Golich
Interim Executive Director
Community Planning and Development

- cc: Valerie Walling, Deputy Auditor, CPA,CMC
- Dawn Wiseman, Audit Manager, CRMA
- Jared Miller, Audit Supervisor, CISA, CFE

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OBJECTIVE

To examine internal controls in place over the creation and maintenance of affordable homes through the City's Affordable Housing Permanent Fund Ordinance, the Inclusionary Housing Ordinance, and City financing to developers.

SCOPE

The audit assessed the effectiveness of the Office of Economic Development's efforts to implement and enforce rules surrounding the City's affordable housing program. The audit focused on evaluating the internal controls in place for the Inclusionary Housing Ordinance, Affordable Housing Permanent Fund Ordinance, and gap-financed housing projects. The areas evaluated included the Office of Economic Development's calculation of initial sale prices and resale prices of affordable homes, the process for determining eligibility for prospective home buyers, and how the agency records restrictive covenants for affordable homes. Additionally, we assessed how the Office of Economic Development inventories and tracks affordable homes, as well as how it calculates cash-in-lieu fees and developer incentive payments. Lastly, we evaluated the Department of Community Planning and Development's process for calculating and collecting linkage fees.

METHODOLOGY

During the course of the audit, we performed the following steps to achieve the audit objective:

- Reviewing the rules and regulations of the Inclusionary Housing Ordinance and the Affordable Housing Permanent Fund Ordinance;
- Interviewing key personnel from the Office of Economic Development's Housing Division and from the Department of Community Planning and Development;
- Performing random and judgmental sampling techniques related to income eligibility, covenant recording, linkage fee calculations, initial sale pricing, and resale compliance;
- Comparing income-verification documents from a sample of affordable units to the Office of Economic Development's Inclusionary Housing Ordinance Administrative Rules and Regulations;
- Recalculating monthly housing payments to verify payments were under the 30 percent of gross income requirement in the Inclusionary Housing Ordinance Administrative Rules and Regulations;
- Analyzing covenants for recording errors by comparing the Office of Economic Development's compliance spreadsheet to Office of the Clerk and Recorder's records;
- Assessing the completeness and accuracy of the Office of Economic Development's inventory of affordable homes;
- Testing a sample of HOME-funded rental projects against U.S. Department of Housing and Urban Development regulations for timely compliance monitoring;
- Testing a population of cash-in-lieu remittances for accuracy and compliance;
- Testing loan documentation related to gap-financed housing projects for compliance; and
- Testing a population of incentive payments to developers for accuracy and compliance.

APPENDICES

Appendix A – 2018 Area Median Income for Denver

TABLE 6. Denver Area Median Income for 2018

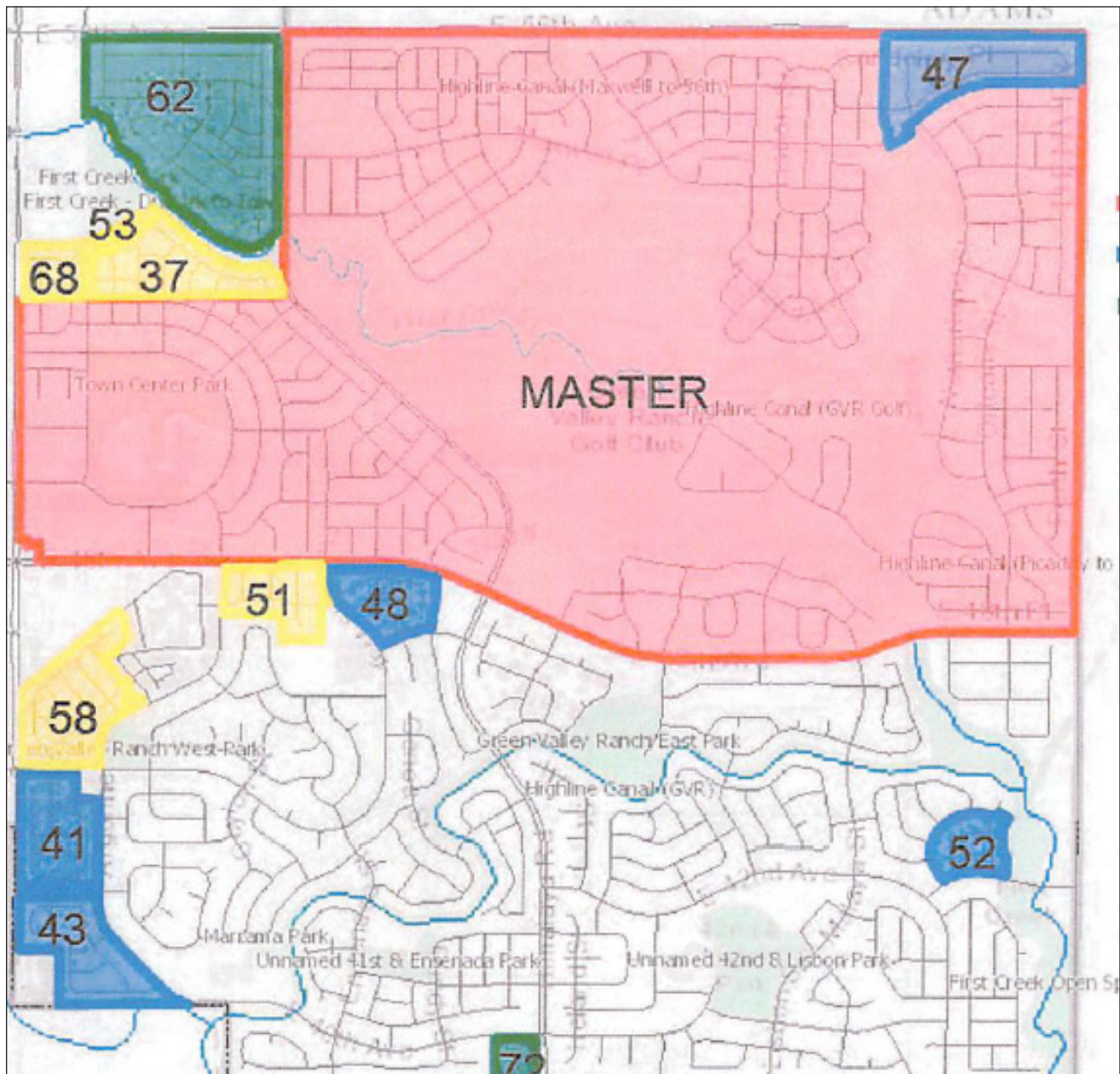
Percent of AMI	1 Person	2 People	3 People	4 People	5 People	6 People
30%	\$18,900	\$21,600	\$24,300	\$26,950	\$29,420	\$33,740
50%	\$31,500	\$36,000	\$40,500	\$44,950	\$48,550	\$52,150
60%	\$37,800	\$43,200	\$48,600	\$53,940	\$58,260	\$62,580
80%	\$50,350	\$57,550	\$64,750	\$71,900	\$77,700	\$83,450
95%	\$59,850	\$68,400	\$76,950	\$85,405	\$92,245	\$99,085
100%	\$63,000	\$72,000	\$81,000	\$89,900	\$97,100	\$104,300
110%	\$69,300	\$79,200	\$89,100	\$98,890	\$106,810	\$114,730
115%	\$72,450	\$82,800	\$93,150	\$103,385	\$111,665	\$119,945
120%	\$75,600	\$86,400	\$97,200	\$107,880	\$116,520	\$125,160

Source: Office of Economic Development.

Appendix B – Affordable Housing Plan Boundary

The map below provides a visual depiction of the issue discussed under Finding 2. Located in the top left corner of the map, area “62” caused confusion during the exemption process. During the audit period, area “62” was not included in the affordable housing plan boundary. Thus, the four homes located in this area, which received exemptions before the amendment, were incorrectly approved. However, once area “62” was incorporated into the plan’s boundary, the four homes are now considered in compliance with the linkage fee exemption.

FIGURE 3. Map of Green Valley Ranches Boundaries



Source: Department of Community Planning and Development.

Office of the Auditor

The **Auditor** of the City and County of Denver is independently elected by the citizens of Denver. He is responsible for examining and evaluating the operations of City agencies and contractors for the purpose of ensuring the proper and efficient use of City resources. He also provides other audit services and information to City Council, the Mayor, and the public to improve all aspects of Denver's government.

The **Audit Committee** is chaired by the Auditor and consists of seven members. The Audit Committee assists the Auditor in his oversight responsibilities regarding the integrity of the City's finances and operations, including the reliability of the City's financial statements. The Audit Committee is structured in a manner that ensures the independent oversight of City operations, thereby enhancing citizen confidence and avoiding any appearance of a conflict of interest.



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Our Mission

We deliver independent, transparent, and professional oversight in order to safeguard and improve the public's investment in the City of Denver. Our work is performed on behalf of everyone who cares about the City, including its residents, workers, and decision-makers.
