



Commonwealth of Massachusetts
Office of the State Auditor
Suzanne M. Bump

Making government work better

Official Audit Report – Issued December 20, 2021

Massachusetts Housing Finance Agency

For the period July 1, 2018 through June 30, 2020





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Ms. Chrystal Kornegay, Executive Director
Massachusetts Housing Finance Agency
One Beacon Street
Boston, MA 02108

Dear Ms. Kornegay:

I am pleased to provide this audit of the Massachusetts Housing Finance Agency. This report details the audit objectives, scope, methodology, findings, and recommendations for the audit period, July 1, 2018 through June 30, 2020. My audit staff discussed the contents of this report with management of the agency, whose comments are reflected in this report.

I would also like to express my appreciation to the Massachusetts Housing Finance Agency for the cooperation and assistance provided to my staff during the audit.

Sincerely,

A handwritten signature in blue ink, appearing to read "SMB", written over a light blue circular background.

Suzanne M. Bump
Auditor of the Commonwealth

cc: Michael Dirrane, Chair of the Board of Directors, Massachusetts Housing Finance Agency

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LIST OF ABBREVIATIONS

AMI	area median income
AMR	asset management review
HUD	United States Department of Housing and Urban Development
IRC	Internal Revenue Code
MassHousing	Massachusetts Housing Finance Agency
MOR	management and occupancy review

EXECUTIVE SUMMARY

In accordance with Section 12 of Chapter 11 of the Massachusetts General Laws, the Office of the State Auditor has conducted a performance audit of the Massachusetts Housing Finance Agency (MassHousing) for the period July 1, 2018 through June 30, 2020. In this performance audit, we examined whether MassHousing, before financing loan commitments for affordable housing projects, ensured that 20% of the units in each project were for people and families with low incomes¹ in accordance with Section 5(g)(1) of Chapter 708 of the Acts and Resolves of 1966. We also examined whether MassHousing monitored the management companies responsible for the oversight of the projects it financed to ensure that affordability restrictions were sustained in accordance with its “Asset Management Review Policy.”

Our audit revealed no significant instances of noncompliance by MassHousing that must be reported under generally accepted government auditing standards. However, in the “Other Matters” section of this report, we provide some recommendations to improve internal controls over MassHousing’s asset management review process.

1. According to Chapter 708 of the Acts and Resolves of 1966, as amended, “‘Low income persons or families’ shall mean those persons and families whose annual income is equal to or less than the maximum amount which would make them eligible for units owned or leased by the housing authority in the city or town in which the project or the residence for which the mortgage loan is sought is located or, in the event that there is no housing authority, that amount which is established as the maximum for eligibility for low-rent units by the [Department of Housing and Community Development].”

OVERVIEW OF AUDITED ENTITY

The Massachusetts Housing Finance Agency (MassHousing) was established as an independent, quasi-public agency by Chapter 708 of the Acts and Resolves of 1966, as amended. According to its website, MassHousing's mission is as follows: "MassHousing will confront the housing challenges facing the Commonwealth to improve the lives of its people."

MassHousing does not receive state funding for its operations. According to its website,

[MassHousing] raises capital by selling bonds and lends the proceeds to low- and moderate-income homebuyers and homeowners, and to developers who build or preserve affordable and/or mixed-income rental housing. MassHousing does not use taxpayer dollars to sustain its operations, although it administers some publicly funded programs on behalf of the Commonwealth.

MassHousing is governed by a nine-member board of directors. Board members are appointed by the Governor.

Multifamily Housing Loan Processing

The typical multifamily housing loan from MassHousing goes through six phases: pre-application, rental underwriting, commitment, initial closing, construction/lease-up, and final closing.

Pre-application

During the pre-application phase, developers submit a Department of Housing and Community Development One-Stop Application to MassHousing. Using a One-Stop Application Checklist, an assigned MassHousing originator and an assigned MassHousing underwriter review the application. Once the application is deemed complete, the originator prepares a conceptual loan proposal that is sent to MassHousing's Rental Underwriting Department.

Rental Underwriting

During the rental underwriting phase, the Rental Underwriting Department works with third parties (e.g., appraisers, environmental professionals, and capital needs engineers) to review the components of the application and prepare an assessment report. The underwriter determines whether the loan is an appropriate credit risk for MassHousing. If the credit risk is appropriate, the underwriter prepares a document called a proposed transactions underwriting model and sends it

to the originator. Using the underwriter's recommendation, the originator completes a loan commitment proposal and sends it to MassHousing's staff loan committee for review.

Commitment

During the commitment phase, the staff loan committee reviews the loan commitment proposal and makes recommendations to the board of directors' loan committee. During monthly board meetings, the board of directors votes on pending loan commitment proposals. If a proposal is approved, the board of directors issues a commitment letter, which is a legal document that establishes a contract between MassHousing and the borrower.

Initial Closing

During the initial closing phase, the borrower and MassHousing must complete, sign, and submit several documents, described below, that ensure that the project complies with MassHousing's policies.

- The disposition agreement, signed by the borrower and MassHousing, indicates that the borrower has ensured that at least 20% of the units will be rented to people or families whose income is no more than 80% of the area median income (AMI), at rents equal to 30% of that income limit.
- The residential compliance agreement, signed by the borrower and MassHousing, ensures that the project will be financed, used, and operated in accordance with the Internal Revenue Code (IRC). Under the IRC, the borrower makes an irrevocable election at the time of the financing for either 20% of the units to be rented to tenants earning no more than 50% of the AMI or 40% of the units to be rented to tenants earning no more than 60% of the AMI.
- The tenant selection plan sets out a procedure for processing and selecting applicants for subsidized units, including the establishment of preferences and priorities, occupancy standards, reviews and appeals for rejection decisions, and notice requirements.
- MassHousing's regulatory agreement includes requirements for tenant selection and approval, ongoing management of the project, protections and procedures intended to preserve affordable rents for low-income tenants, and profit limitations for the borrower.
- If a multifamily project is receiving assistance under the Federal Housing Administration–Housing Finance Authority Risk-Sharing Program,² it must further fair housing in accordance with United States Department of Housing and Urban Development (HUD) regulations by

2. This is a federal program that allows state and local housing finance agencies that meet certain Federal Housing Administration standards to underwrite Federal Housing Administration multifamily loans in return for sharing the risk of losses with the United States Department of Housing and Urban Development.

executing an affirmative fair housing marketing plan. The purpose of such a plan is to help owners market available housing units to individuals regardless of their race, color, national origin, religion, sex, familial status, or disability.

Construction/Lease-up

Throughout the construction of the project, MassHousing closely monitors the developer's progress. When the project is 70% complete, MassHousing's Appraisal and Marketing Department begins monitoring ongoing occupancy with the project's property management company.

Final Closing

The final closing phase occurs once the project has achieved stabilized operations, which means it has sustained a 90% occupancy rate and maintained a defined debt-service coverage ratio³ for three months.

Rental Management

MassHousing does not own or manage any multifamily rental housing projects. Such projects are owned by third-party developers. However, MassHousing's Rental Management Division is responsible for monitoring the property management companies that manage MassHousing's multifamily rental portfolio. According to MassHousing management, there are more than 200 property management companies managing the portfolio.

During the pre-application phase, MassHousing conducts an extensive review of the property management companies proposed by the developer to qualify each new company. Each company is required to perform an annual review of tenant rents that are kept on file at the project site. This annual review includes a recertification of household incomes and recomputation of all affordable-unit rents and assistance payments. Records related to the annual review are readily available to MassHousing staff members on request.

MassHousing asset managers review all financed properties after one year of operation. Rental Management Division employees schedule subsequent reviews, referred to as asset management reviews (AMRs), using risk-based criteria. As we performed our audit work, we noted that although

3. This is a financial measurement of the cash flow an entity has available to pay current debt liabilities (net operating income divided by total debt service).

MassHousing's "Asset Management Review Policy" was the only policy that described the process, there were variations in the process that were not clearly included in the policy.

During an AMR, using a sample of tenant files, the asset manager confirms that the required affordable units exist, with the applicable rents. The tenant file sample size is based on the project's size and number of units and may also be influenced by prior AMR results or noted violations.

If a project is subsidized by HUD, an asset manager conducts a management and occupancy review (MOR) instead of an AMR. An MOR is very similar to an AMR, but requires a more detailed tenant file review to ensure that tenant rents comply with HUD requirements.

AUDIT OBJECTIVES, SCOPE, AND METHODOLOGY

In accordance with Section 12 of Chapter 11 of the Massachusetts General Laws, the Office of the State Auditor has conducted a performance audit of certain activities of the Massachusetts Housing Finance Agency (MassHousing) for the period July 1, 2018 through June 30, 2020.

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

Below is a list of our audit objectives, indicating each question we intended our audit to answer; the conclusion we reached regarding each objective; and, if applicable, where each objective is discussed in this report.

Objective	Conclusion
1. Before financing a loan commitment for an affordable housing project, does MassHousing ensure that 20% of the units in the project are for people and families with low incomes in accordance with Section 5(g)(1) of Chapter 708 of the Acts and Resolves of 1966?	Yes
2. Does MassHousing monitor the management companies responsible for oversight of the projects it finances to ensure that affordability restrictions are sustained as required by its "Asset Management Review Policy"?	Yes; see <u>Other Matters</u>

To achieve our objectives, we gained an understanding of MassHousing's internal control environment related to the objectives by reviewing applicable agency policies and procedures, as well as conducting inquiries with MassHousing staff members and management. We evaluated the design, and tested the operating effectiveness, of internal controls used by MassHousing to approve loan commitments for affordable housing projects.

To obtain sufficient, appropriate audit evidence to address our audit objectives, we conducted the following procedures.

Financing Loan Commitments

To determine whether MassHousing, before financing a loan commitment for any affordable housing project, ensured that 20% of the units in the project were for people and families with low incomes, we identified the total population of 42 MassHousing-financed affordable housing projects that were approved during the audit period. We selected a random, nonstatistical sample of 10 of the 42 projects. We reviewed the loan commitment proposals, the disposition agreements or residential compliance agreements (whichever was applicable⁴), the commitment letters, and the board of directors' meeting minutes for these 10 projects to determine whether the board approved them and whether 20% of the units in each project were set aside for people and families with low incomes.

Monitoring of Management Companies

To determine whether MassHousing monitored the management companies responsible for oversight of the projects it financed to ensure that affordability restrictions were sustained, we interviewed MassHousing staff members and management and reviewed MassHousing's "Asset Management Review Policy." We received a list of all 497 asset management reviews (AMRs) completed during our audit period and selected a random, nonstatistical sample of 40 reviews. Our sample of 40 reviews included 29 AMRs and 11 management and occupancy reviews (MORs).

We reviewed all 29 AMR reports to determine whether (1) the asset manager signed to attest that s/he conducted the AMR, (2) the portfolio manager signed to attest that s/he reviewed the AMR, (3) the affordability restrictions were documented in Section III of the AMR report, and (4) the rents charged to tenants (as noted on the rent roll⁵) were in line with the affordability restrictions in Section III of the AMR report. Because of state restrictions related to the coronavirus pandemic, site visits by the asset manager were suspended as of March 10, 2020. Four of the AMR reports in our sample were filed after March 10, 2020 (two in March, one in May, and one in June), so the asset manager could not review the related rent rolls. We did not consider these exceptions, since MassHousing did perform all other monitoring activities.

We reviewed all 11 MOR reports to determine whether (1) the asset manager signed to attest that s/he conducted the MOR, (2) the portfolio manager signed to attest that s/he reviewed the MOR, (3) the

4. A residential compliance agreement is substituted for the disposition agreement when tax-exempt obligations are used to finance the project.

5. This is a list of rental units in each development and the rent charged for each unit.

affordability restrictions were documented in Section III of the MOR report, and (4) the tenant file worksheets demonstrated that tenant rents were in line with the affordability restrictions in Section III of the MOR report.

Whenever sampling was used, we applied a nonstatistical approach, and as a result, we did not project our results to the entire populations.

Data Reliability

To determine the reliability of the list of 383 MassHousing-financed multifamily rental properties from the audit period (provided to us by MassHousing), we interviewed members of MassHousing's management who were responsible for the source data and reconciled the list to Schedule 2 of MassHousing's audited financial statements⁶ for fiscal years 2018, 2019, and 2020. Based on the procedures performed, we determined that the population of MassHousing-financed multifamily rental properties that we obtained from MassHousing was sufficiently reliable for the purposes of this audit.

To determine the reliability of the list of 42 MassHousing-financed multifamily rental property closings with commitment letters from the audit period (provided to us by MassHousing), we recomputed the list. To do this, we requested and received a list of all MassHousing commitments and closings that occurred from 2017 through the end of our audit period. We filtered the list to include only closings that occurred during our audit period and removed any duplicates. We compared this list to our total population of 383 projects and excluded all projects that were not multifamily housing. Finally, we compared this list to the list of 42 MassHousing-financed multifamily rental property closings with commitment letters from the audit period and noted agreement. Based on these procedures, we determined that the list of closings with commitment letters that we obtained from MassHousing was sufficiently reliable for the purposes of this audit.

To determine the reliability of the list of AMRs of MassHousing projects (provided to us by MassHousing), we interviewed agency officials who were knowledgeable about the data and inspected the list for missing data, hidden rows or columns, or worksheets containing data. We filtered the list to identify only AMRs of MassHousing-financed multifamily rental properties during the audit period. Based on the procedures conducted, we determined that the list of AMRs we obtained from MassHousing was sufficiently reliable for the purposes of this audit.

6. This schedule supports the annual financial statements. It details all of MassHousing's mortgage loan accounts receivable.

OTHER MATTERS

The Massachusetts Housing Finance Agency should strengthen the documentation of the asset management review process.

During our review, we noted that the Massachusetts Housing Finance Agency's (MassHousing's) "Asset Management Review Policy" did not provide details regarding process variations for the different types of project in MassHousing's rental property portfolio, such as projects subsidized by the United States Department of Housing and Urban Development (HUD).

Our testing indicated that although MassHousing is supposed to conduct asset management reviews (AMRs) annually, it did not do so for all financed multifamily rental housing projects. Instead, it uses a risk-based approach to prioritize and determine which projects receive an AMR annually, and it reviews group housing projects every three to five years.

Additionally, although MassHousing performs management and occupancy reviews (MORs), instead of AMRs, for HUD-subsidized projects, its "Asset Management Review Policy" does not explain when an MOR should be completed instead of an AMR. The policy states,

The Asset Management Review (AMR) is the primary means of monitoring property operations to determine whether management is providing decent, safe and sanitary housing, carrying out the objectives, policies and procedures of applicable federal, state and MassHousing requirements and regulations; and maintaining the financial viability of the asset. In assessing the property, the asset manager will analyze the financial and operating performance, determine compliance with established affordability restrictions, and evaluate the overall physical condition.

To ensure that employees have the required information to successfully monitor the operations of the management companies that operate MassHousing-financed properties, MassHousing's "Asset Management Review Policy" should clearly define the processes associated with conducting AMRs and MORs for the different types of properties in its rental property portfolio.