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In keeping with generally accepted government auditing standards and Auditor's Office policy, as authorized by city ordinance, the Audit Services Division has a responsibility to monitor and follow up on audit recommendations to ensure city agencies address audit findings through appropriate corrective action and to aid us in planning future audits.

In our follow-up effort for the “Affordable Housing” audit report issued in December 2018, we determined the Department of Housing Stability implemented most of the recommendations we made in the original audit report to the former Office of Economic Development. Additionally, we determined the Department of Community Planning and Development implemented both of the recommendations we made to it in the original audit report.

Since that original audit, the city's Office of Economic Development was renamed Denver Economic Development & Opportunity, and in October 2019, the mayor issued an executive order establishing the Department of Housing Stability. This new department took over responsibility for the city's affordable housing, which previously belonged to the Office of Economic Development at the time of our original audit. Therefore, in this report, we reference the Department of Housing Stability as acting upon the recommendations from the original audit that reference the Office of Economic Development.

However, despite the Department of Housing Stability's efforts, auditors determined the risks associated with the audit team's initial findings have not been fully mitigated. As a result, the Audit Services Division may revisit these risk areas in future audits to ensure the city takes appropriate corrective action.

The Highlights page in this report provides background and summary information about the original audit and the completed follow-up effort. Following the Highlights page is a detailed implementation status update for each recommendation.

I would like to express our sincere appreciation to the personnel at the Department of Housing Stability and the Department of Community Planning and Development who assisted us throughout the audit and the follow-up process. For any questions, please feel free to contact me at 720-913-5000.

Denver Auditor’s Office

Timothy M. O’Brien, CPA
Auditor
Affordable Housing
June 2020

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 from Original Audit
Our audit of the city’s affordable housing programs found the Office of Economic Development did not have sufficient controls to ensure its mission of providing affordable housing in Denver. In addition, while the Department of Community Planning and Development had sufficient controls to ensure developers paid affordable housing fees, we found 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 was not properly determining income eligibility to ensure monthly housing payments were 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 were 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.

FULLY IMPLEMENTED 8
PARTIALLY IMPLEMENTED 1
NOT IMPLEMENTED 2
June 4, 2020

Action Since Audit Report
Affordable Housing

11 recommendations proposed in December 2018

The Department of Housing Stability implemented six recommendations that were made to the Office of Economic Development in the original “Affordable Housing” audit report, and the Department of Community Planning and Development implemented both recommendations directed to it in that report. However, Housing Stability has not acted upon two recommendations and another is only partially implemented.

While the agencies mitigated many of the risks described in the original audit, the two recommendations Housing Stability has not implemented present some lingering risks. These risks include that maximum sale price tables for affordable homes are still not being calculated correctly and that maximum resale prices for affordable homes that their owners wish to sell are also still not being calculated correctly.

The incorrect calculations for the maximum sale price tables could prevent some individuals from obtaining affordable housing who actually could afford the home, or conversely, it could allow affordable homes to be sold to individuals who ultimately cannot afford them. Meanwhile, the incorrect calculations for the maximum resale prices could ultimately deprive individuals of appreciated value on their affordable homes that they are entitled to, and it could allow affordable homeowners to sell their homes for windfall profits at the taxpayers’ expense.
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 | 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 ACTION

Original target date for completion: March 31, 2019

The Department of Housing Stability implemented a new procedure meant to ensure the maximum sale price tables were completed annually according to the Inclusionary Housing Ordinance rules. The procedure includes a spreadsheet that automatically calculates the maximum sale price based on the information entered. We reviewed this spreadsheet to ensure it was developed as mentioned in the procedure and that it is adequate for ensuring these calculations are done according to the rules.

However, our work found the procedure is inadequate. It does not include steps telling a user how to incorporate certain pertinent information — such as homeowners insurance rates and private mortgage insurance rates.

Additionally, the Excel spreadsheet — which is an integral part of the procedure — does not use information required to perform these calculations, such as the mill levy rate, assessment rate, the homeowners insurance rate, and the private mortgage insurance rate. The Inclusionary Housing Ordinance rules require all these amounts to be considered in the calculation.

Because the procedure does not tell a user all the information that must be entered into the spreadsheet and because the spreadsheet does not use the correct information to calculate the maximum sale price tables, we consider this recommendation not implemented.

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 ACTION

Original target date for completion: The agency said at the time of the original audit in December 2018 that this was already completed.

The Department of Housing Stability implemented a new procedure and spreadsheet for calculating applicants’ maximum monthly payments. We examined a small sample of these maximum monthly payments, and we found the amounts were properly calculated based on household monthly gross income as specified in Recommendation 1.2. As a result, we consider this recommendation implemented.

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 ACTION

Original target date for completion: May 31, 2019

The Department of Housing Stability implemented a new procedure that requires various documents — such as agreements, amendments, covenants, notices, releases, etc. — to be hand-delivered to the Clerk and Recorder’s Office with a cover sheet indicating the document type for each item to be recorded.

While this new procedure appears to improve the internal control for recording, the department does not perform a final review, as called for in Recommendation 1.3.

We also asked the department about its progress on remediating the existing errors mentioned in Recommendation 1.3. Housing Stability officials provided us with the following reasons for not remediating the errors:

- They believe memoranda of acceptance do not provide additional legal protections.
- They believe the memoranda do not increase their ability to enforce the terms of affordable housing covenants.
They believe changing the document types will not make them any more likely to be found or noted as a result of a title search, because the memoranda will not encumber the deed or title to a home.

For these reasons, department officials do not believe there is any value to changing the document types on the memoranda of acceptance and they believe it would be a waste of taxpayer resources. The department is researching a specific, new document type for restrictive affordable housing documents that will be legally enforceable to better protect the city’s interests in deed-restricted affordable homes.

While Housing Stability did design an appropriate internal control for accurately recording covenants and memoranda of acceptance as recommended in the original audit, it is missing the final review also mentioned in Recommendation 1.3. Additionally, the department has not remediated existing errors as recommended, because the department believes it would be a waste of taxpayer resources.

Errors in the covenants and memoranda of acceptance increase the risk that an affordable home may be sold to an ineligible homebuyer. Further, this can increase the likelihood that a future homebuyer is unaware of affordability restrictions attached to a prospective home purchase.

Because of these factors, we consider this finding only partially implemented.

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 ACTION

Original target date for completion: May 31, 2019

During our follow-up work, we reviewed a memo the chief housing officer sent to the Department of Housing Stability’s policy review committee in October 2018, which summarized their research into using secondary liens and other legal protections to prevent the improper resale of affordable homes.

The memo specifically recommended an amendment to city ordinance that would allow the City and County of Denver to assert property interest through performance deeds of trust. The memo said research on using secondary liens indicates such liens are possible, but there are some potential challenges. The memo also indicates that, after doing the research, the Department of Housing Stability believes a performance deed of trust
is a better solution and that the department plans to use these deeds of trust in conjunction with existing covenants to more effectively prevent the improper resale of affordable homes and to better protect the city's interest in these homes.

Because the chief housing officer completed the research, we consider this finding fully implemented.

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**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.

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**NOT IMPLEMENTED**

**AGENCY ACTION**

**Original target date for completion: March 1, 2019**

Our team reviewed a copy of a new procedure the Department of Housing Stability implemented in its policies and procedures manual to address Recommendation 1.5. To determine whether this new procedure was working as intended, we reviewed a sample of maximum resale price calculations, and we found the procedure is ineffective.

First, while the new procedure includes a review process for these calculations, Housing Stability officials said they do not formally check the calculations as required by the procedure.

The procedure requires the calculation to be sent to an analyst for review once completed. However, officials say the current practice is for a staff member who completes the calculation to ask another staff member to review it or to discuss it in a staff meeting. This lack of a formalized review process is especially concerning as many of these calculations are now performed automatically by software, and we noted numerous issues when we tried to recalculate the maximum resale price amounts in our sample.

There are many different types of covenants for affordable properties with different maximum resale price calculations — some of which are very complex. The level of complexity in these calculations does not lend itself to automatic calculations of these amounts, especially without being reviewed in this newly automated system. Because of the complexity, these amounts could be easily miscalculated by automated software or by department employees due to unique components of each covenant's maximum resale price calculation.

Department staff said that they are looking at some samples of the
automatic calculations every month. However, the informal review process for manual calculations and only sampling the automated calculations monthly allows for improperly calculated maximum resale prices to be provided to affordable homeowners. This potentially causes them to lose appreciation to which they are entitled or to make windfall profits on affordable homes at the taxpayers’ expense.

When reviewing these sample calculations for our follow-up, we found they were all in the same housing development that was subject to a covenant that changes the maximum resale price calculation to a different formula than the one in the city’s affordable housing ordinances.

We asked Housing Stability officials if we could get a sample of properties that had a maximum resale price calculation subject to the ordinances. Department officials said that would be difficult because only a small amount of properties are subject to the ordinances. They estimated that out of about 5,000 affordable housing units in the city, only about 100 did not have a separate covenant that changed this calculation. As a result, we picked three properties subject to different covenants so we could review the calculations.

We noted two of the three maximum resale price calculations we reviewed were incorrect. Housing Stability did not properly follow its procedure for calculating maximum resale prices for these properties.

However, even if Housing Stability had not made these errors, we would still not have been able to determine whether these amounts were calculated correctly. The covenants we reviewed were poorly written and do not give definitive explanations of how to calculate maximum resale prices. For example:

- One covenant includes an error: One part of the calculation limits the amount of the maximum resale value to 5% of the original purchase price (plus the original transfer fee) for each year an individual owns the home.

  For example, if someone purchased a home for $100,000 and owned it for one year, the covenant restricts their maximum resale price for this part of the calculation to $5,000. But department employees calculated this as 100% of the purchase price in addition to the 5% of the purchase price per year specified by the covenant. We agree this was what was likely intended by this covenant. However, that is not what the covenant says.

  Housing Stability told us this covenant applies to many properties in that particular development.

- That same covenant also contains the following sentence with a grammatical error: "Original purchase price plus any Transfer Fee paid paid by an Owner for the MPDU." While this is not a serious error, or even an error that would impact the ultimate calculation, it
shows the review of this important language was not robust.

In addition to the issues with the covenant noted above, the other two covenants our team reviewed did not say how to calculate amounts for partial years of ownership. Additionally, these two covenants relied on two different indexes — one relied on the Case/Shiller index and the other relied on the consumer price index. These calculations use the change in these indexes every year as a component of the maximum resale price calculation. But these covenants do not specify which number to use for the year.

For example, the number could be the number at the beginning of the year, the number at the end of the year, the number for the month in which the purchase and/or sale took place, etc. The covenant that uses the consumer price index does not say whether to use the Denver metro consumer price index or the nationwide index.

Further, consumer price index data used to be published only semiannually for the Denver metro area, and it is now published every other month. The covenant that uses this index does not indicate what to do if a home is purchased during a month with no index. It is unclear whether the calculation should use the closest month, one of the semiannual rates, or an average.

Lastly, another complication in these covenants is exemplified by the covenant that used the Case/Shiller index. The home sale date was in April 2020. However, at the time we reviewed this calculation, the most recent index was published in January 2020. This home’s covenant does not say what to do in these scenarios, which would be typical because the Case/Shiller index takes several months to report after the end of a month. Additionally, these monthly indexes change over time as more home sale data is reported — meaning the same calculation has different results depending on when the calculation was performed.

Not only are the covenants unclear in many instances, they are also unnecessarily complex, especially when compared to the default calculation in Denver’s Inclusive Housing Ordinance.

For example, one of the covenants states:

“Start with the purchase price paid by the selling Owner, approved by the City and for which such Owner purchased the Unit according to the Owner's purchase contract for the Unit; provided, however, that for one-bedroom Units, the purchase price paid for the Unit in the original purchase of that Unit from the Developer shall be reduced for purposes of this calculation by the amount of any HOME funds provided as down payment assistance to the original Qualified Buyer.”

Even though these covenants are vague in many areas, Housing Stability’s miscalculated amounts were not because of these vague explanations; they
were caused by not following instructions in the covenants that were, in fact, clear.

These unnecessarily complex calculations — in addition to so many properties having different calculations — makes it impractical, if not impossible, for Housing Stability to calculate these amounts consistently and correctly while providing appropriate oversight of Denver’s affordable housing market even if Housing Stability had developed an effective procedure. This means that sellers could walk away with windfall profits at Denver taxpayers' expense. Therefore, we determined this recommendation was not implemented.

**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 ACTION**
Original target date for completion: Jan. 31, 2019

During our follow-up work, we reviewed documentation from the Department of Housing Stability showing the department rectified this overpayment in January 2019. As a result, we consider this recommendation fully implemented.

**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 ACTION**
Original target date for completion: Fourth Quarter 2019

During our follow-up work, staff in the Department of Housing Stability showed us a database they developed in their Salesforce system, which is used to track the city's inventory of affordable units. Department personnel showed us the list they use to track the affordable units.

The system has automated controls designed to ensure a complete and accurate inventory of affordable units. The controls are also designed to prevent human error.
Our review found Housing Stability staff periodically email the list to the Assessor's Office, and the Assessor's Office checks for discrepancies. Appropriate internal controls were developed by the department as originally recommended in Recommendation 1.7. As a result, we consider this recommendation fully implemented.

**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 ACTION**

Original target date for completion: The agency said at the time of the original audit in December 2018 that this was already completed.

To implement Recommendation 1.8, the Department of Housing Stability implemented a new procedure that requires tracking the amounts paid to developers for incentive payments. This procedure includes steps to remind department staff who process these payments of the maximum incentive payments and when the ordinance allows these incentive payments to exceed these limits. These steps prevent improper payments from recurring.

To test the effectiveness of the new procedure, our team reviewed a list of all incentive payments made since the release of our audit report in December 2018. We found no incentive payments for amounts greater than permitted by law. Therefore, we determined appropriate controls are, in fact, in place and the procedure is working as intended. As a result, we consider this recommendation fully implemented.

**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 ACTION**

Original target date for completion: June 30, 2019

To follow up on the first part of Recommendation 1.9, we performed steps
to determine whether desk reviews were done on an annual basis as recommended. We reviewed a random, limited sample of rental projects that were funded by the federal Home Investment Partnership Program, also known as HOME. We found all properties in this limited sample had timely desk reviews.

Going forward, desk reviews will be automated in a module in the Salesforce system the Department of Housing Stability uses. The department has not used this specific module yet; it is expected to go live in September 2020. However, our team did review evidence that the module was developed — including email messages between department employees and Salesforce consultants who developed the module.

This module was developed to automate desk reviews, and our limited examination of desk reviews for 2019 found these reviews are being done annually as instructed by Recommendation 1.9. As a result, we consider this recommendation fully implemented.
Finding 2 | The Department of Community Planning and Development’s Process for Assessing Linkage Fees Is Effective but Could Be Improved

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 ACTION**  
Original target date for completion: Feb. 15, 2019

Department of Community Planning and Development staff said the overlays were created in their mapping function as instructed in Recommendation 2.1. We determined the overlays were, in fact, created and present. We tested addresses to check whether they appeared inside or outside the boundaries of the affordable housing plan, and we found the tested addresses were in the proper boundaries.

This new functionality improves the verification process for granting exemptions as mentioned in the original finding. As a result, we consider this recommendation fully implemented.

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 ACTION**  
Original target date for completion: Jan. 16, 2019

Our follow-up work determined the Department of Community Planning and Development held trainings as recommended in Recommendation 2.2. We reviewed evidence of these trainings and found the trainings covered the issues we identified in the linkage fee applications during the original audit, including:

- Applications not being on file
• Indication of review not being present for applications; and
• Exceptions being misclassified.

As a result, we consider this recommendation fully implemented.
Office of the Auditor

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