

DISTRICT OF COLUMBIA OFFICE OF THE INSPECTOR GENERAL

OIG Project No. 23-I-01DB0

December 2022



DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

Evaluation of Loan Servicing Contracts



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GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Inspector General



Inspector General

December 23, 2022

Drew Hubbard
Interim Director
Department of Housing and Community Development
1800 Martin Luther King Avenue, Jr., S.E.
Washington, D.C. 20020

Dear Interim Director Hubbard:

I am writing to inform you that the Office of the Inspector General (OIG) Inspections and Evaluations Unit (I&E) has concluded its evaluation of contracts pertaining to loan servicing.

The evaluation was undertaken as part of the ongoing initiative to review contracts identified in the OIG's *Fiscal Year 2022 Audit and Inspection Plan*.¹ This letter constitutes the close-out report for the evaluation and contains four recommendations for the Department of Housing and Community Development (DHCD) to consider.²

Background

The initial objectives of this evaluation³ were to: (1) determine whether there are terms or practices unfavorable to the District or conflict with industry standards or applicable criteria; and (2) assess whether parties to the contract have adhered to contract terms and conditions, and whether DHCD maintains proper oversight of services and deliverables.

In our engagement letter, we identified the scope of our evaluation as contracts in effect on or after October 1, 2018, that pertained to loan servicing and asset management services. After the evaluation began, however, we amended its scope. We learned that DHCD now performs the asset management function in-house, so we excluded asset management service contracts. Vendor performance and compliance under the prior loan servicing contract were also excluded from this evaluation because the contract expired in early 2020 and was with a different company than presently contracted. Therefore, this evaluation focused on the Tax Credit Asset Management, LLC (TCAM) loan servicing contract (CW70389), which is currently in option year three (herein the "Contract" or "TCAM contract").

¹ The OIG's *Fiscal Year 2022 Audit and Inspection Plan* is accessible on the OIG website at: <http://oig.dc.gov/>.

² The OIG has carbon copied the Office of Contracting and Procurement (OCP) on this letter because one of the OIG's recommendations, if accepted by DHCD, would require collaboration with OCP.

³ I&E projects are conducted under the *Quality Standards for Inspection and Evaluation* promulgated by the Council of the Inspectors General on Integrity and Efficiency.

Evaluation Methodology

We reviewed and compared current and prior loan services contracts, and the contract to transition the data and service from the previous contractor to the current contractor (CW70389, CW28642, and CW81741). We reviewed and considered a bid protest filed against the Contract (CAB No. P-1111); e-mail communications about drafting the requirements for the 2018 loan services solicitation;⁴ records relating to a potential modification to the Contract; records from the Technical Evaluation Panel (TEP) convened prior to the award of the Contract; and invoices and other documentation. The OIG conducted interviews with 11 DHCD and 2 Office of Contracting and Procurement (OCP) employees.

Findings

One of DHCD's key loan servicing needs, cash flow loan analysis and servicing, is not a TCAM contract requirement.

Cash flow loans are a significant and complex subset of DHCD's loan portfolio. Although presented as one of TCAM's distinguishing capabilities in its response to the District's November 2018 solicitation, OCP did not include cash flow loan analysis and servicing as a contract requirement. Therefore, TCAM does not provide this service to DHCD.

In its January 2019 response to the solicitation, TCAM stated that “[u]nlike most servicing systems in the industry today, primarily designed to service hard/must-pay multifamily loans, the TCAM-MRI platform is uniquely structured to help agencies service and maximize collections on subordinate/cash flow contingent loans.”⁵ It explained further:

Some subordinate loans have a deferral period followed by a repayment period based on the availability of cash Other subordinate loans require cash flow contingent payments as soon as the properties achieve stabilized operations.... In addition, certain subordinate loan portfolios – like the DC DCHD portfolio – have loans with terms that vary widely – different interest rates; some have a deferral period; some have deferral periods that last until loan maturity; different positions in the cash flow waterfall; payments calculated using different percentages of available cash flow.... An effective servicing system for cash flow contingent loans must allow for precise calculations of amounts due for each unique loan so that overall collections are maximized for the

⁴ The terms “solicitation” and “contract” are used to differentiate between the pre-award and post-award timeframe of the loan services procurement that is the subject of this evaluation.

⁵ MRI Real Estate Software (MRI) is TCAM's parent company and “the largest software provider for the affordable housing industry, offering a comprehensive and flexible technology that meets the unique needs of all types of capital providers in the industry including those of municipal housing agencies and other lenders.” See Letter from Allen Feliz, Director, TCAM Asset Management, to Heather Reynolds, Contracting Officer, D.C. Office of Contracting and Procurement/Dept. of Housing and Community Dev. (Jan. 3, 2019) (on file with the OIG).

portfolio while meeting all of the other requirements of the loan documents and associated regulatory agreements. The TCAM-MRI platform is uniquely designed to perform these important functions.⁶

We received conflicting opinions from DHCD interviewees as to whether TCAM should provide cash flow loan analysis and servicing under the current contract. However, based on our review of information from OCP and the language in the TCAM contract, we found no contract requirement for cash flow loan analysis and servicing. The TCAM contract references “cash flow loans” only once in the contract; the term appears in the “Definitions” section but the service is not specified in the requirements or pricing section of the contract.

DHCD should determine why the TCAM contract lacks a cash flow loan analysis requirement so as to avoid repeating this omission in future contracts. We reviewed the previous loan servicing contract and the November 2018 solicitation that resulted in the current contract with TCAM. Based on our review, along with information obtained through interviews, we learned that despite the “unique expertise, focus, and technological capabilities” and “deep knowledge of DHCD’s loan portfolio [and] debt management systems capabilities of MRI”⁷ cited in TCAM’s offer, OCP replicated the previous loan servicing contract, which did not include analysis and servicing of cash flow loans and had not been updated to reflect all of DHCD’s needs.

Therefore, without the option to draw upon TCAM and its parent company’s resources and expertise, DHCD’s Portfolio and Asset Management Division employees must analyze cash flow loan borrowers’ financial statements in-house to determine whether a payment is due.⁸

Updated Policies on Key Aspects of Loan Servicing Would Help DHCD Employees More Effectively Manage TCAM’s Work and Leverage their Technological Capabilities and Expertise

The Green Book standards for an effective internal control system require management to design “policies, procedures, techniques, and mechanisms that enforce management’s directives to achieve the entity’s objectives and address related risks.”⁹ Green Book section 10.03 states the following with regard to “[a]ppropriate documentation of transactions and internal control,” which is considered a common control activity.

Management clearly documents internal control and all transactions and other significant events in a manner that allows

⁶ *Id.* (TCAM Technical Proposal, Remittance Report at 15).

⁷ *Supra* note 5 at 1-2.

⁸ These financial statements are available to TCAM because borrowers with cash flow loans must file audited financial statements with DHCD and numerous other lenders and regulators. The percentage of financial audit reports collected by DHCD for FY20 and FY21 was 95% and 93.4% respectively, per the FY22 performance reporting filed with the Office of City Administrator. *See* <https://oca.dc.gov/sites/default/files/dc/sites/oca/publication/attachments/DHCD22.pdf> (last visited Oct. 24, 2022).

⁹ U.S. GOV’T ACCOUNTABILITY OFFICE, STANDARDS FOR INTERNAL CONTROL IN THE FEDERAL GOV’T, GAO-14-704G (Sept. 2014), Principle 10.02, <https://www.gao.gov/products/GAO-14-704G> (last visited Oct. 24, 2022).

the documentation to be readily available for examination. The documentation may appear in management directives, administrative policies, or operating manuals, in either paper or electronic form. Documentation and records are properly managed and maintained.¹⁰

Based on our review of the TCAM contract and information provided by interviewees, the following three facets of loan servicing are areas where DHCD could more effectively leverage TCAM's services and expertise if both parties were to implement clear, up-to-date written guidance.

Credit Reporting – Contract section C.5.18 states:

The Contractor shall establish procedures for reporting all loan accounts that are thirty (30) days or more delinquent to the major credit bureaus (such as TRW and Credit Bureau, Inc.). The Contractor shall report to the credit bureaus all information required by the credit bureaus to establish and maintain accurate information on the borrower's accounts.

The OIG did not identify a set of procedures as described in the TCAM contract, and interviewees indicated that credit reporting, like the other two facets of loan servicing discussed in this section, requires thoughtful consideration and application given that participants in DHCD loan programs are typically working to build or rebuild their credit history.

Loan Forgiveness – Loan forgiveness is another facet of loan servicing where TCAM's role should be clarified. Loan forgiveness is referenced only once in the contract, in the Background section C.4.1. Interviewees stated that DHCD has policies on loan forgiveness,¹¹ but current practice is not consistent with the policy, in part due to DHCD employees' concerns with federal tax liabilities that are triggered by loan forgiveness.¹² To align policy with practice and define TCAM's role regarding loan forgiveness, DHCD should update and disseminate written guidance on the subject to its employees and TCAM.

Foreclosure – Section C.5.51 of the TCAM contract is titled "Foreclosure Procedures." Section C.5.51.2 states that TCAM shall submit to DHCD's Office of the Chief Financial

¹⁰ *Id.* Principle 10.03 at 48.

¹¹ D.C. DEPT. OF HOUSING AND COMMUNITY DEV., SUBORDINATION, MODIFICATION & FORGIVENESS POLICY ADMINISTRATIVE INSTRUCTION (Jan. 29, 2013).

¹² Some interviewees stated DHCD policy is considered outdated and ignored because of the belief that it is unwise to saddle low- and moderate-income borrowers with a tax bill that would arise from loan forgiveness. DHCD's current practice is simply "forgiving" the loan by stopping enforcement actions. The logic being that by avoiding the formalities of loan forgiveness, the borrower pays no tax on the loan amount forgiven.

Officer “a list of all loans that are one hundred and twenty (120) days delinquent, along with recommendations for the execution of foreclosure action”

Further, Sections C.5.51.3 and C.5.51.4 state:

The Contractor’s written foreclosure recommendations to DHCD shall include a summary of collection history and justification for recommending foreclosure proceedings. **The Contractor shall not begin foreclosure proceedings until it receives written approval from DHCD.** (emphasis added)

Upon receipt of DHCD’s written approval for foreclosure, the Contractor shall conduct foreclosure proceedings on all loans which are over one hundred and twenty (120) days delinquent.

DHCD personnel stated they do not have policies to define when it is appropriate to foreclose on a delinquent loan, but it is their practice not to foreclose. Based on this information, DHCD leadership should provide its employees explicit, up-to-date, written guidance on how to respond to TCAM’s foreclosure recommendations. Without a clear policy and strategy for engaging TCAM’s services and expertise to sell a property that should be foreclosed upon, a vital element of the loan servicing contract will remain unutilized under the current contract.

Recommendations

The following recommendations are intended to improve the quality of services DHCD receives from TCAM under the existing contract in the near-term, as well as address the conditions noted above and improve the quality of loan servicing work performed under future contracts in the long-term:

1. Convene a working group to update internal DHCD written guidance on key components of loan servicing policy, to include credit reporting, loan forgiveness, and foreclosure.

DHCD December 2022 Response to Recommendation:

Agree. The agency concurs with this recommendation and will convene subject matter experts for updated internal written guidance on loan servicing policy.

2. Work with TCAM to determine how to implement the updated guidance in accordance with the terms, requirements, and pricing of the existing contract.

DHCD December 2022 Response to Recommendation:

Agree. The agency concurs with this recommendation and will engage the current loan servicer to implement the updated guidance upon the finalization of the agency working group's recommendations.

3. Transmit to OCP, within the next 90 days, a redlined version of DHCD's current contract with TCAM specifying all terms, requirements, and deliverables that are outdated or do not satisfy DHCD's current and/or anticipated loan servicing needs.

DHCD December 2022 Response to Recommendation:

Agree, but with alternative implementation. The agency will engage with OCP within 90 days to attempt to execute a modification of the current contract. If a modification is not possible, the agency will work with OCP to determine the most efficient and expedient manner to address the current gaps in its loan servicing needs. Additionally, should no solutions be available sooner, the agency will incorporate a revision exercise in the course of drafting a new solicitation for the agency's next loan servicing contract. A new solicitation is required as Fiscal Year 2024 is the final option year of the current contract. This revision exercise will clearly identify outdated terms, requirements, and deliverables in the current contract and will be undertaken with OCP to reinforce the agency's current and anticipated loan servicing needs. This revision exercise will not occur within 90 days but during the planning period for the new solicitation, which will begin within 180 days.

4. Collaborate with OCP, within the next 180 days, to establish a comprehensive plan of action with corresponding milestone dates and assigned responsibilities to help ensure that adequate time and subject matter expertise are allocated to developing the scope of work and solicitation for DHCD's next loan servicing contract.

DHCD December 2022 Response to Recommendation:

Agree. The agency concurs with this recommendation and will begin coordination with OCP within 180 days to adequately plan for a new solicitation that will meet the current and anticipated loan servicing needs of the agency. Research regarding appropriate benchmarks, best practices, and subject matter experts will be part of the pre-solicitation process.

Conclusion

Our review concluded that the TCAM contract's scope of work and requirements do not fully meet DHCD's needs, in particular regard to cash flow loan analysis and servicing. The OIG's recommendations are intended to prompt and facilitate productive dialog between DHCD and OCP so that they are informed and prepared to either modify the existing contract with TCAM before exercising the final option year, or substantively revise the scope of work and

requirements for the next loan servicing contract that OCP begins to negotiate on DHCD's behalf. Updated policies on key aspects of loan servicing would not only help DHCD employees to more effectively guide and manage TCAM's work under the current contract, but also inform the scope of work development and requirements for the next loan servicing contract.

We appreciate the cooperation and courtesies extended by your staff during this evaluation. If you have questions concerning this letter, please contact me or Edward Farley, Assistant Inspector General for Inspections and Evaluations, at (202)727-9249 or edward.farley@dc.gov.

Sincerely,



Daniel W. Lucas
Inspector General

DWL/ef

cc: See Distribution List

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



December 9, 2022

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

Re: OIG Letter regarding DHCD's Loan Servicing Contracts

Dear Inspector General Lucas:

Thank you for your November 7, 2022 letter constituting the close-out report for the evaluation of the Department of Housing and Community Development's (DHCD) contracts pertaining to loan servicing. As the implementing agency of the District's most impactful affordable housing finance loan tools, DHCD, through the Office of Contracting and Procurement (OCP), contracts with Tax Credit Asset Management (TCAM) to service loans that have been made by the agency to produce, preserve, and rehabilitate affordable housing and assist District residents pursuing homeownership opportunities. We appreciate the Office of the Inspector General's (OIG) recommendations with respect to DHCD's contract with TCAM. Enclosed, please find our responses to the four recommendations. Should you have any questions or require further information, please do not hesitate to reach out to me at drew.hubbard@dc.gov or (202) 442-7242.

Sincerely,

Drew Hubbard

Drew Hubbard

Interim Director

DHCD Responses to OIG's Recommendations

1. *Convene a working group to update internal DHCD written guidance on key components of loan servicing policy, to include credit reporting, loan forgiveness, and foreclosure.*

Agree. The agency concurs with this recommendation and will convene subject matter experts for updated internal written guidance on loan servicing policy.

2. *Work with TCAM to determine how to implement the updated guidance in accordance with the terms, requirements, and pricing of the existing contracts.*

Agree. The agency concurs with this recommendation and will engage the current loan servicer to implement the updated guidance upon the finalization of the agency working group's recommendations.

3. *Transmit to OCP, within the next 90 days, a redlined version of the DHCD's current contract with TCAM specifying all terms, requirements, and deliverables that are outdated or do not satisfy DHCD's current and/or anticipated loan servicing needs.*

Agree, but with alternative implementation. The agency will engage with OCP within 90 days to attempt to execute a modification of the current contract. If a modification is not possible, the agency will work with OCP to determine the most efficient and expedient manner to address the current gaps in its loan servicing needs. Additionally, should no solutions be available sooner, the agency will incorporate a revision exercise in the course of drafting a new solicitation for the agency's next loan servicing contract. A new solicitation is required as Fiscal Year 2024 is the final option year of the current contract. This revision exercise will clearly identify outdated terms, requirements, and deliverables in the current contract and will be undertaken with OCP to reinforce the agency's current and anticipated loan servicing needs. This revision exercise will not occur within 90 days but during the planning period for the new solicitation, which will begin within 180 days.

4. *Collaborate with OCP, within the next 180 days to establish a comprehensive plan of action with corresponding milestone dates and assigned responsibilities to help ensure that adequate time with subject matter experts are allocated to developing the scope of work and solicitation for DHCD's next loan servicing contract.*

Agree. The agency concurs with this recommendation and will begin coordination with OCP within 180 days to adequately plan for a new solicitation that will meet the current and anticipated loan servicing needs of the agency. Research regarding appropriate benchmarks, best practices, and subject matter experts will be part of the pre-solicitation process.