STATE OF CONNECTICUT

AUDITORS' REPORT
CONNECTICUT HOUSING FINANCE AUTHORITY
2000 AND 2001 CALENDAR YEARS

AUDITORS OF PUBLIC ACCOUNTS
KEVIN P. JOHNSTON ♦ ROBERT G. JAEKLE
November 24, 2003

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We have made an examination of the books, records and accounts of the Connecticut Housing Finance Authority (CHFA), as provided in Section 2-90, as amended, and Section 8-260 of the General Statutes, for the 2000 and 2001 calendar years. Included in this examination is the State Housing Authority (SHA), a subsidiary of the CHFA established in accordance with Section 8-244b of the General Statutes.

SCOPE OF AUDIT:

We have relied on the financial audits, the compliance audits (required under Section 1-122 of the General Statutes), and the Section 8 audits (of Federally-assisted housing payment programs under the United States Housing Act of 1937) conducted by the CHFA's independent public accountants covering the calendar years indicated above. Such reliance was placed after having satisfied ourselves as to the firm's professional reputation, qualifications and independence, and verifying that generally accepted accounting principles and auditing standards were followed in the audits and in the preparation of the reports. Comments in the reports are presented under the heading "Other Examinations" in this report. Financial statements of the CHFA are included in its annual reports for 2000 and 2001.

In addition to reviewing the audits and related working papers prepared by the CHFA's independent public accountants, we reviewed the appropriations and expenditures of the CHFA's restricted account within the State General Fund, the CHFA's monitoring of its home mortgage servicers and residency requirements for home mortgages, and compliance with applicable State statutes. We conducted our audit in accordance with generally accepted government auditing standards for financial related audits. This report on our examination consists of the Comments and Recommendations which follow.
FOREWORD:

The Connecticut Housing Finance Authority, hereinafter referred to as the CHFA or the Authority, operates under the provisions of Chapter 134, Sections 8-241 through 8-265qq of the General Statutes. It was established by the 1972 Session of the General Assembly as successor to the Connecticut Mortgage Authority, which had been established by the General Assembly in 1969. The CHFA is a body politic and corporate, constituting a public instrumentality and political subdivision of the State. It was created to alleviate the shortage of housing for low and moderate income families, and to encourage the development of a balanced community of all income levels in the urban areas. Under Section 8-244b of the General Statutes, the CHFA established a subsidiary to be known as the State Housing Authority or hereinafter referred to as the SHA. The SHA had been established to be the successor to the Connecticut Housing Authority. It was established to assist in ensuring continued occupancy of Authority-financed developments by low and moderate-income persons and families in accordance with the statutory purpose of the Authority.

Funds for financing permanent mortgage loans were obtained by issuing bonds, the interest from which has generally been exempt from Federal income tax to the bondholder, except during the period in which the Mortgage Revenue Bond (MRB) program was temporarily discontinued, from July 1992 through August 1993. The MRB program was extended indefinitely and made permanent in August 1993. In addition, financial market conditions permitted the CHFA to sell certain issues made during the period that were not exempt from Federal income tax. Loans made from the proceeds of such bonds must be secured by a first mortgage lien. Funds obtained from the excess of interest income from loans over bond interest expenses were used to pay operating expenses of the CHFA.

Board of Directors and Administrative Officials:

Members of the CHFA Board of Directors as of December 31, 2001, were as follows:

Ex-officio members:
Denise L. Nappier - State Treasurer
John P. Burke - State Banking Commissioner
Marc S. Ryan - Secretary, Office of Policy and Management
James F. Abromaitis - Commissioner, Dept. of Economic and Community Development

Appointed members:
Arthur H. Diedrick, Chairman
Sandra J. Brown
Raymond J. Devlin, Jr.
Orest T. Dubno
Joseph H. Fisher
Thomas W. Hynes
Steven Montesano
Jorge L. Perez
Edmund F. Schmidt  
Ronald L. Smoko  

Gary E. King served as President-Executive Director during the audited period.

**Recent State Legislation:**

Notable legislative changes, which took effect during the audited period, are presented below:

Public Act 00-187, Section 26, effective July 1, 2000, codified as Section 8-265pp of the General Statutes, established a mortgage assistance program for certified teachers who are employed by priority school districts, transitional school districts, or teach in a subject matter that is in short supply.

Public Act 01-173, Section 57, effective July 1, 2001, amended Section 8-265pp, subdivision (3) of the General Statutes, by adding regional vocational-technical certified teachers to the group of teachers eligible for the mortgage assistance program established in Public Act 00-187.

Public Act 01-8, Sections 1 and 3 of the June Special Session, effective July 1, 2001, codified as Sections 17a-485 and 17-485b of the General Statutes, established the Community Mental Health Strategy Board and the Community Mental Health Strategic Investment Fund. The purpose of the Board is to approve commitments and disbursements made from the Fund. The purpose of the Fund is to provide financial assistance for persons with mental illness. In addition, within the Community Mental Health Strategic Investment Fund there shall be two subaccounts, a Community Mental Health Restoration subaccount for the purpose of providing financial assistance for new or expanded community-based mental health facilities and services and a Supportive Housing Enhancement subaccount for the purpose of carrying out a Supportive Housing Pilot Initiative.

Public Act 01-9, Section 81 of the June Special Session, effective July 1, 2001, codified as Section 8-265qq of the General Statutes, allows a municipality to defer, for five years, any increase in assessment attributable to the rehabilitation of property improved under the Urban Rehabilitation Homeownership Program.

**CHFA Programs:**

The CHFA provides financing through several programs at interest rates below those generally available. The two most significant programs are described below. Other programs are described in the CHFA Annual Reports.

The home mortgage program finances the acquisition or rehabilitation of existing or newly constructed housing with no more than four living units, one of which is required to be occupied by the borrower. The Authority's home mortgage funds are distributed through participating lenders.

Multi-family mortgage loans provide permanent and construction financing for building
new and rehabilitated pre-existing multi-family projects. It had been the aim of the Authority to invest a major portion of its multi-family resources in mortgages of projects subsidized under the Federal "Section 8" program, which pays a portion of some tenants' rent as determined by income. While the Section 8 program is no longer available for any new projects, those who were under the program will continue to receive Section 8 subsidies.

Thirty years is the maximum maturity of all home mortgage loans. Prior to 1993, all new home mortgage loans were "growing equity" (GEMS). The CHFA turned to conventional 30-year mortgages in 1993 in response to market conditions. We were informed that future mortgage types offered would be dependent on future market conditions.

Multi-Family Housing:

The Federal "Section 8" program, which is no longer available for any new multi-family housing projects, subsidizes a portion of some tenants' rent as determined by income. Under this program, eligible tenants pay 30 percent of their income as rent. The Federal legislation permits participating projects to be withdrawn after 20 years. However, we were informed that CHFA's regulatory agreements with the owners of such projects generally prohibit such withdrawals. Section 8-253a of the General Statutes permits such prepayments and withdrawals only on a finding by the Authority that there is not an acute need for low and moderate income housing in the area and that rents would not materially escalate.

For multi-family housing mortgage loans made with the proceeds of obligations issued after September 3, 1982, the Tax Equity and Fiscal Responsibility Act of 1982 made two changes. First, the definition of individuals of low and moderate income was changed to be 80 percent of median gross income as determined under Section 8 of the United States Housing Act of 1937. Second, 20 percent of the housing units in a project (15 percent in targeted areas) were to be occupied by individuals of low or moderate income for a specified period. All of the rental units must remain as rental units for the remaining term of the obligation, or for the specified period if that is longer.

There is a Multi-Family Underwriting Unit that underwrites financing of multi-family rental housing developments, providing direct construction and/or permanent mortgage loans to private developers and not-for-profit sponsors for construction and/or rehabilitation of rental housing. The staff reviews loan proposals, analyzes sites and financial statements, and performs feasibility analyses to determine a proposal's acceptability. Also, the Multi-Family Technical Services Unit ensures that plans and specifications meet Authority standards and that construction proceeds are disbursed according to approved plans and timetables, and approves proposed changes and observes the integrity of developments. The division also verifies projected costs and reviews appraisals for accuracy and completeness. A Tax Credit Unit is responsible for the administration of State of Connecticut Low Income Housing Tax Credits (LIHTC’s). The Unit underwrites and verifies requests for LIHTC’s and conducts ongoing monitoring for verification of unit compliance and tenant eligibility.

Single-Family Housing:

The Authority adopts at various times sales price and family income limitations for eligibility in
its home mortgage programs.

The Authority requires owners to complete an occupancy certificate, in which borrowers must certify their intent to occupy the mortgaged premises, and acknowledge the calling of the loan should the borrower cease to reside on the premises. This occupancy requirement is only enforceable on loans made after 1983.

The CHFA also operates an Urban Area Mortgage Program for home mortgages. Under this program, the CHFA may finance mortgage loans in certain legislatively designated urban areas of the State without regard to the borrower's income, but such loans may not be made by the CHFA if otherwise available on "reasonable terms". Prior to Public Act 95-202, this requirement was deemed satisfied when the applicant showed that they had been refused mortgage loans by not less than two financial institutions that are making residential mortgage loans in the area in which the housing is located, and that such refusal was for at least one of the reasons indicated in the CHFA's written procedures. Currently, the requirement that the applicant show refusal by not less than two financial institutions has been eliminated. The CHFA regulations require that all urban area mortgage loans be insured and that the owners live on the premises. Generally, applicable purchase price limitations apply to urban area mortgages.

**Mortgage Insurance:**

Section 8-251 of the General Statutes currently permits the Authority to purchase or make $750,000,000 of mortgage loans which are uninsured or not guaranteed by a Federal agency, a Federally chartered corporation, a private mortgage insurance company, or the State or the Authority itself. As of December 31, 2001, the Authority had financed or firmly committed to finance approximately $395,464,000 of such mortgage loans, representing 53.0 percent of this maximum.

After January 1, 1978, most of the CHFA's multi-family housing was uninsured, although subsidized under HUD's Section 8 Program. Developments covered by Section 8 subsidies were considered to be secure even in the absence of mortgage insurance. As noted earlier in this report, the Section 8 Program has been discontinued. This marked the end of Federal subsidies, but not affected is the existing portfolio of multi-family development loans. New multi-family projects have been at below-market rate rents based on Internal Revenue Service requirements for tax-exempt funding and most are uninsured. The CHFA has been undertaking the risk of such uninsured loans in order to keep costs and, accordingly, rents as low as possible.

**RÉSUMÉ OF OPERATIONS:**

During the audited period (calendar years ended December 31, 2000 and 2001) the CHFA
Auditors of Public Accounts

maintained three funds in accordance with the provisions of Section 8-258 of the General Statutes: a Housing Mortgage General Fund (including its Capital Reserve), an Investment Trust Fund (formerly known as the Investment Trust Surplus Fund), and a Housing Mortgage Insurance Fund. In addition, the CHFA established a Group Home Fund and a Group Home Capital Reserve Fund (also referred to as the Indenture Capital Reserve Fund) and a Group Home Renewal and Replacement Fund. As mentioned earlier in this report, the scope of our audit did not include a review of these funds, as they were reviewed and reported on by the CHFA's independent auditors, and reliance will be placed on their audits. Separate comments follow in this report under the caption for each fund mentioned for informational purposes only. Detailed financial data concerning these funds is presented in the CHFA's Annual Reports.

Housing Mortgage General Fund:

With the exception of the initial $50,000 appropriation made by the General Assembly in the 1969-1970 fiscal year, no appropriations have been requested of or made by the General Assembly for the general operations of the Authority. The only exception to this is the $4,000,000 appropriated for the Emergency Mortgage Assistance program. In order to use the services of the State for payrolls and related employee benefits, the CHFA issued wire transfers to the State Treasurer's Office in the total amount of $9,010,297 and $8,883,340 to provide for such costs, during the fiscal years ended June 30, 2000 and 2001, respectively. Our examination of the records of the State Comptroller and Treasurer indicated that these amounts were received and deposited as receivable collections against grant agreements deemed appropriated for the purposes of the Authority in accordance with the provisions of Section 3-39a of the General Statutes. Expenditures processed through this contribution account were $9,007,905 and $8,885,159 for the corresponding periods. These expenditures are only a small part of the total operating expenses of the Housing Mortgage General Fund. Most of the revenue received and expenses incurred by the CHFA are applicable to its own General Fund. During the period of this examination, monthly mortgage payments, including principal and interest, were made directly to as many as 20 financial institutions which acted as servicing agents for the CHFA. The servicers deducted their service fees and wired the balance of their collections to the CHFA's credit at a Hartford bank. The monthly servicing fee for the CHFA's individual home mortgages is 1/12 of 3/8 of one percent of the unpaid balance.

Investment Trust Fund (formerly the Investment Trust Surplus Fund):

Under Section 8-258 of the General Statutes, the CHFA established this fund to account for assets which it determined "surplus funds" in accordance with the terms of its General Housing Mortgage Finance Program Bond Resolution of September 27, 1972, hereafter referred to as GBR.

As defined in Section 505, subsection (3), of the GBR, surplus funds represent the monthly excess of pledged receipts over funds required for the payment of operating expenses, principal and interest and the requirements of the Capital Reserve Fund. These amounts are to be deposited monthly in the General Fund surplus account. Section 506, subsection (1), of the GBR, provides that the amount in the General Fund surplus account may be transferred annually to the Investment Trust Surplus Fund. If these requirements and/or options are not executed on time, the amounts in the General Fund surplus account automatically revert to the redemption account. One of these options, which is set forth in Section 506, subsection (1) (c) (ii) of the GBR, authorizes the establishment of a separate account which is unrestricted and can be used by the CHFA for any
Auditors of Public Accounts

purpose authorized by the General Statutes. The CHFA had called this separate account its Investment Trust Surplus Fund.

Housing Mortgage Insurance Fund:

As provided for under Section 8-258, subsection (d), of the General Statutes, the CHFA is authorized to also establish a Housing Mortgage Insurance Fund. This fund shall consist of mortgage insurance premium receipts; money or assets received from loan defaults or delinquencies (including sales, lease or rental of real property); moneys lent or paid by the State for inclusion in this fund; and any other moneys available to the Authority which it determines to include therein. Loans and advances may be made from said funds as provided by Section 8-250 (purpose and powers of the Authority).

Connecticut Housing Finance Authority Bonds:

In accordance with the provisions of Sections 8-250, subsection (12), and 8-252 of the General Statutes, the Authority is authorized to issue bonds as, in its opinion, are necessary to provide sufficient funds for carrying out the purposes of the Authority. Except for bonds issued between July 1992 and August 1993, the period in which the Mortgage Revenue Bond Program was discontinued, most of the CHFA's bonds have been tax-exempt. The tax-exempt bonds are not backed by the full faith and credit of the State of Connecticut. However, the State, on or before December 1, of each year without further legislative approval, must appropriate from the State General Fund whatever amount is certified by the Chairman of the Authority as necessary to restore the Capital Reserve Fund to the required minimum capital reserve. Such amounts must be repaid by the Authority and credited to the State's General Fund as soon as possible from any moneys in excess of the amounts which the Authority determines will keep it self-supporting. The CHFA has determined that such amounts may be paid from the Surplus Account. As of December 31, 2001, the amount on deposit in the Bond Resolution Capital Reserve Fund, valued in accordance with the Act, was $362,725,000, which was in excess of the Bond Resolution Capital Reserve Fund minimum requirement of $284,168,000. The amount on deposit in the Indenture Capital Reserve Fund, valued in accordance with the Act, was $1,590,000, which was in excess of the Indenture Capital Reserve Fund minimum requirement of $1,512,000. For both of these capital reserve funds, the minimum is the amount of debt service due in the following year and the maximum is the greatest amount of debt service due in any succeeding year.

As disclosed in the CHFA's annual reports, 105 Housing Mortgage Finance Program bond issues were made prior to this examination and bonds totaling $7,968,625 had been issued prior to December 31, 1999. During the period of this examination, 6 additional Housing Mortgage Finance bond issues totaling $595,270,000 were made. As of December 31, 2001, $3,206,660 in Housing Mortgage Finance Program bonds were outstanding. It was noted that as of December 31, 1999, four Group Home Mortgage Finance Program Special Obligation bonds had been issued totaling $12,975,000. Two additional special obligation bonds were issued during 2000. The $7,440,000 and $480,000 bonds brought the total to $20,895,000. As of December 31, 2001, $19,845,000 of these bonds were outstanding. The CHFA had obtained a "top tier" designation by Standard and Poor's with a rating of "AAA" and was rated "Aaa" by Moody's Investor Services. Detailed bond information is included in the CHFA's annual reports.
Temporary Investments:

Temporary investments are those made with funds not needed for immediate use. The nature of such investments is limited by Section 8-250, subsection (18), of the General Statutes to obligations issued by or guaranteed by the United States of America or the State of Connecticut or to obligations which are legal investments for savings banks in this State. This area was reviewed by the CHFA's independent public accountants, and the CHFA was found to be in compliance with the applicable limitations.

Authority Staffing Levels:

According to the CHFA's monthly personnel status reports, the number of full-time employees remained constant from December 1999 to December 2001, as shown below:

<table>
<thead>
<tr>
<th>Pay Period Ended Dates</th>
<th>12/31/99</th>
<th>12/31/00</th>
<th>12/31/01</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total number of employees</td>
<td>105</td>
<td>105</td>
<td>105</td>
</tr>
</tbody>
</table>

Personal services costs, including fringe benefits, increased by approximately $980,216 from calendar year 1999 to calendar year 2001 as a result of merit bonuses and the filling of positions vacant during 1998 and part of 1999.

Other Examinations:

As noted previously in this report, the CHFA has been subject to annual audits by independent public accountants (IPAs) covering its financial operations, its loan servicing function, the Section 8 Federally assisted housing payments program under the United States Housing Act of 1937, and the compliance matters described in Section 1-122 of the General Statutes. Discussed below are the summaries of findings arising from the IPA audits for the calendar years ended December 31, 2000 and 2001.

2000 Audit:

The 2000 IPA audit resulted in the following findings, as reported to the Finance/Audit Committee of the CHFA, by the IPA, in a letter dated March 27, 2001:

- A recommendation that the Authority give very high priority to the implementation of
new/upgraded general ledger software.

- A recommendation that a thorough Information Technology Security Program be developed that provides for ongoing system review.

- A recommendation that the allowance for loan loss be computed quarterly by the asset management department and the single family housing department, with the finance department acting in a review capacity.

- A recommendation that the Authority prepare for the implementation of GASB 34 by preparing draft reports prior to year end so as to ensure timely completion.

2001 Audit:

The 2001 IPA audit resulted in the following findings, as reported to the Finance/Audit Committee of the CHFA, by the IPA, in a letter dated April 22, 2002:

- Due to the amount of two to four family dwelling loans outstanding and the recent increased frequency of Chapter 13 bankruptcy losses, the Authority should perform an analysis to ascertain if any additional defensive actions can be taken.

- Consideration should be given to assigning both the asset management department and the single family housing department the responsibility of computing their portion of the allowance for loan losses at the end of each calendar quarter. This would allow the finance department to act in a review capacity.

- A recommendation that the Authority prepare its financial statements without necessarily relying upon the Treasurer.

We have commented on two of the findings noted above in the Condition of Records section of this report.
CONDITION OF RECORDS

Our limited examination of the records of the Connecticut Housing Finance Authority disclosed certain areas requiring attention, which are detailed in this section of the report.

Collection of Mortgage Insurance Proceeds

**Background:** The Connecticut Housing Finance Authority (CHFA) utilizes several banks to provide financial services. These banks are referred to as “servicers”. One of the services provided is the collection of CHFA funds.

**Criteria:** Funds due to the CHFA should be deposited in an expeditious manner in order to maximize potential interest earnings.

**Condition:** Mortgage insurance proceeds from the Housing and Urban Development Department (HUD) are collected by the servicer banks and remitted to the CHFA for subsequent deposit. There are often delays in this process resulting in the loss of float on the proceeds and loss of potential interest. An examination of delayed fund transfers showed that the average delay in the transfer of funds sent from the servicer banks to the CHFA was 17 days. The servicer banks may notify HUD that funds be sent directly to the investor (CHFA). A form executed by the servicer banks and sent to HUD is considered notification. The CHFA has instructed the servicer banks to prepare and distribute the form designating the CHFA as the recipient of the funds. The servicer banks are not routinely carrying out this instruction.

**Effect:** During the first six months of calendar year 2001, $4,400,000 was wired to the servicing banks and then remitted by check to the CHFA. The estimated loss of interest proceeds on these funds calculated at three percent is $12,000, annualized the estimated loss of interest is $24,000.

**Cause:** Several of the servicer banks are not directing HUD to remit insurance proceeds directly to the CHFA. Due to delays in deposit, interest earnings are not maximized.

**Recommendation:** The Connecticut Housing Finance Authority should further direct the servicer banks to formally notify the Department of Housing and Urban Development to wire funds directly to the Authority. Noncompliant servicer banks should be charged for lost interest on any funds not directly remitted to the Authority. (See Recommendation 1.)
Authority Response: “This condition was also brought to the attention of the Authority’s Board by the Authority’s Internal Auditor and was addressed last year. As noted at that time, the Authority’s largest servicer had been filing forms incorrectly, which accounted for over 80% of the improper filings for the first half of 2001. At a meeting with that servicer, in May of 2002, they agreed to correct their processing. They have filed correctly since. Other servicers have also been notified. The Authority will continue to require and enforce correct servicing, and will charge late fees for delays as a result of incorrect processing.”

Federal Family and Medical Leave Act

Criteria: The Federal Family and Medical Leave Act (FMLA) states that group health plan benefits must be maintained on the same basis as coverage would have been provided if the employee had been continuously employed during the FMLA leave period. Therefore, the employer must continue to pay its share of employee health benefit premiums during the FMLA leave period. The FMLA provides that the employer may request employee reimbursement for the health benefit premiums in certain instances. One instance specified is if an employee fails to return to work, any health benefit premiums are a debt owed by the non-returning employee to the employer. An employee who returns to work for at least 30 calendar days is considered to have “returned” to work.

Condition: An Authority employee requested and was granted a Family and Medical Act leave of absence. The leave began February 2, 2000, the employee returned to work on August 9, 2000, and resigned effective September 21, 2000. The executed CHFA leave request provided for reimbursement to the Authority for expenses paid on behalf of the employee during the leave if the employee did not return to work for a period at least as long as the term of the approved leave (six months). The CHFA continued to pay the employer portion of the health benefit premiums while the employee was on leave. These payments totaled $3,152. The employee returned to work for more than 30 days but less than the term of the six month leave. By returning to work for at least 30 days the employee appears to have fulfilled the return to work requirements under federal law. However, according to the terms of the signed CHFA leave request, it is the employee’s responsibility to reimburse the Authority for the $3,152 paid by the employer. On October 25, 2000, a letter was sent to the employee demanding reimbursement in the amount of $3,152. The employee has not reimbursed the Authority.

Effect: According to the FMLA, if an employee returns to work for 30
calendar days they are no longer liable for health benefit premiums paid on their behalf while out on leave. The attempts to collect the employer portion of health benefit premiums paid appear to be in conflict with the FMLA.

**Cause:**
It appears that the CHFA incorrectly interpreted the Family and Medical Leave Act. The Authority’s leave request form inaccurately defined the return to work period as being equal to the duration of the approved leave, when in fact the Federal Act definition of return to work is 30 calendar days. Further, the form contained a clause requiring reimbursement if the employee does not return to work for a period at least as long as the leave. Subsequent to our inquiry the CHFA acknowledged the inaccuracy in the Family or Medical Leave request form and redesigned it.

**Recommendation:**
The Connecticut Housing Finance Authority should cease its attempts to collect reimbursement in the case cited and clarify its policy on the payment of health benefit premiums during Family and Medical Leave Act approved leave. (See Recommendation 2.)

**Authority Response:**
“The policy has been clarified. The employee was determined to be in compliance with the terms of the policy and actions to collect reimbursement were terminated.”

### Segregation of Duties

**Criteria:**
Accurate, timely preparation of financial statements by qualified staff is essential for fiscal stability. Segregation of duties is an internal control intended to prevent or decrease the occurrence of innocent errors or intentional fraud.

**Condition:**
The Independent Public Accountant (IPA) has repeatedly commented on the Authority’s reliance on one key financial person to prepare its annual financial statements. The Authority has recently undergone two complete computer system changes related to the financial systems. An increased amount of responsibility has been placed on one key financial person.

**Effect:**
One key financial person is responsible for both the preparation and review of the Authority’s financial statements. The Authority may not have an adequate segregation of duties.

**Cause:**
The Authority has continued to solely rely on one individual in the preparation of its annual financial statements. In addition, a CHFA senior financial position remained vacant during the period audited.
Auditors of Public Accounts

Recommendation: The Authority should take the steps necessary to reduce the singular reliance placed on the key financial person in the preparation of the Authority’s financial statements. (See Recommendation 3.)

Authority Response: “As noted by the Auditor, the Authority’s reliance on its Treasurer was also a subject of comment in the Independent Public Accountant’s management letter in April 2002. As noted at that time, the modifications in the Authority’s financial software systems have reduced the role of the Treasurer in data input and information processing, staff has been added and certain financial responsibilities reassigned. In the preparation of financials, the role of the treasurer is to review the work of the controller and other senior staff for accuracy. Since producing financial reports is the primary responsibility of the treasurer’s position, the Authority believes their diligent review by the treasurer is an appropriate role. It should be noted that because the Authority has an Independent Public Accountant, all of the Authority’s financial transactions, as well as its financials, are also subject to his review. The Authority will continue to work to strengthen backup for the Treasurer’s position, and the vacant senior position will be filled.”

Losses Due to Bankruptcy Cramdowns

Background: A certain percentage of properties mortgaged by the Connecticut Housing Finance Authority (CHFA) under Federal Housing Administration (FHA) guidelines become part of personal bankruptcy action in the Federal Bankruptcy Court system. These CHFA mortgaged properties are required to carry FHA mortgage insurance. The FHA mortgage insurance is issued for the mortgage principal, the amount financed. The amount financed is approved based on appraisals of the property’s current market value at the time of purchase.

Criteria: FHA guidelines regard single family and multiple family (two to four family) dwellings in a similar manner for mortgage insurance purposes. Bankruptcy Court considers multiple family mortgages to be commercial loans. Single family mortgages are treated as noncommercial loans.

Properties are appraised prior to mortgage approval to protect the investment of the financier. For the last ten years multiple family properties have generally been increasing in value in Connecticut.
Condition: Commercial loans are afforded certain treatment in Bankruptcy Court in Connecticut that is not afforded to noncommercial loans. An appraisal of the multiple family property is done at the time of bankruptcy to determine if the property has decreased in market value subsequent to its purchase. This treatment in Bankruptcy Court allows for reduction of the multiple family mortgage principal from the amount owed to an amount equal to the property’s current market value, if the current market value is less. This is termed a “cramdown” of the mortgage. As a result of bankruptcy cramdowns, the Authority recorded losses of approximately $1,000,000, during calendar year 2001.

The Bankruptcy Court treatment of multiple family dwelling loans as commercial loans potentially allows the borrower to obtain a significant write down of the loan. The FHA regulations do not allow the CHFA to claim a partial loss against the mortgage insurance for the difference between the mortgage principal balance owed prior to Bankruptcy Court and the new Court designated cramdown mortgage principal. The cramdown amount may represent a substantially lower amount than the principal balance due (original loan).

Effect: The personal bankruptcy action in the case of multiple family dwellings allows the borrower to have the mortgage principal reduced to the property’s current market value. As a result the remaining mortgage payments to the Authority are based on the reduced principal. In this case, the revenue from the mortgages was significantly reduced, causing the Authority to recognize a loss on the mortgages.

Cause: There is an inconsistency in the treatment of single family and multiple family dwellings by the Federal Bankruptcy Court. In a personal bankruptcy involving a single family dwelling mortgage, the borrower may keep the home but can not have the mortgage principal owed on the property reduced or crammed down. The Federal Bankruptcy Court commercial loan designation on multiple family mortgages affords the owner an advantage by allowing a reduction of the amount of mortgage principal owed. Mortgage insurance premiums may have been paid on the property, but the FHA regulations do not allow for a partial loss to be paid to the CHFA in these situations. It appears that the current market value appraisals of the multiple family properties were lower at the time of the bankruptcy action than the appraisals associated with the original purchase and the amount financed.

Recommendation: The Connecticut Housing Finance Authority should conduct an examination of the losses of approximately $1,000,000, that occurred during calendar year 2001 as a result of bankruptcy cramdowns. The
Auditors of Public Accounts

examination should include identification of the factors involved in the decline in the appraised value of the multiple family properties subject to bankruptcy proceedings and explain the decline in relation to property values that have generally increased Statewide. (See Recommendation 4.)

Authority Response: “This condition was also noted in the Independent Public Accountant’s management letter in April of 2002. The appraisal process for underwriting FHA loans is prescribed by FHA and for loans in bankruptcy by federal bankruptcy law. All appraisers are certified and licensed in a standard process. There may be different opinions and markets change, but the appraisals are standard real estate appraisals by licensed appraisers of then current market values. As a public lending institution, the CHFA cannot alter such appraisals to modify its underwriting. As noted in the response to the Independent Public Accountant’s management letter, one option is to stop making this type of loan until the anomaly between the two federal agencies is eliminated. Since these loans are almost entirely in the very urban areas that both Administration and Legislative policy have targeted for more homeownership, for the CHFA to step back from this type of lending at this time would flout those worthwhile policy goals. The second option is to pursue a change in the FHA regulations or in federal bankruptcy law. The CHFA is currently pursuing such changes.”

Auditors Concluding

Comment: It would be prudent of the Connecticut Housing Finance Authority to take action to conduct an examination of the losses of approximately $1,000,000, as recommended. The Connecticut Housing Finance Authority plan to achieve changes to regulations of the FHA or Bankruptcy court on the Federal level may be hard to attain.
RECOMMENDATIONS

Our prior audit included three recommendations. The status of those recommendations is presented below.

Status of Prior Audit Recommendations:

• The Authority should comply with Section 1-123 of the General Statutes, and report all outside firms and individuals that receive more than $5,000 during the year. The Authority has substantially complied with this recommendation.

• The Authority should increase supervisory oversight over payroll computations. This recommendation is resolved.

• The Authority’s Internal Audit Unit should increase efforts to perform compliance audits on loan servicers as intended and allowed by existing agreements. The Authority should also consider transferring the responsibility to review independent audit reports of loan servicers to the Internal Audit Unit, since they would appear more qualified in assessing the results of such audits and performing follow-up on reported findings. This recommendation is resolved.

Current Audit Recommendations:

1. The Connecticut Housing Finance Authority should further direct the servicer banks to formally notify the Department of Housing and Urban Development to wire funds directly to the Authority. Noncompliant servicer banks should be charged for lost interest on any funds not directly remitted to the Authority.

Comment:

We noted that the Authority appeared to lose interest on the transfer of mortgage insurance proceeds due to inconsistencies in the filing of notification forms.

2. The Connecticut Housing Finance Authority should cease its attempts to collect reimbursement in the case cited and clarify its policy on the payment of health benefit premiums during Family and Medical Leave Act approved leave.

Comment:

The Authority improperly billed an employee for reimbursement of health benefit premiums based on an inaccurate interpretation of the Family and Medical Leave Act.

3. The Authority should take the steps necessary to reduce the singular reliance placed on
Comment:

The Authority continues to place reliance on one key financial person to prepare its annual financial statements. The result is the appearance of a lack of adequate segregation of duties.

4. The Connecticut Housing Finance Authority should conduct an examination of the losses of approximately $1,000,000, that occurred during calendar year 2001 as a result of bankruptcy cramdowns. The examination should include identification of the factors involved in the decline in the appraised value of the multiple family properties subject to bankruptcy proceedings and explain the decline in relation to property values that have generally increased Statewide.

Comment:

The Authority recorded losses of approximately $1,000,000, during calendar year 2001, as a result of bankruptcy cramdowns. The losses appeared to be related to the decrease in appraised value of multiple family properties from the time of purchase to the time of bankruptcy.
CONCLUSION

In conclusion, we wish to express our appreciation for the cooperation and courtesies extended to our representatives by the personnel of the Connecticut Housing Finance Authority during the course of our examination.

Josepha M. Brusznicki
Principal Auditor

Approved:

Kevin P. Johnston
Auditor of Public Accounts

Robert G. Jaekle
Auditor of Public Accounts