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February 1, 2023

Honorable Heather Kimball, Council Chair
 and Members of the Hawai'i County Council
 Hawai'i County Council
 25 Aupuni Street
 Hilo, Hawai'i 96720

Dear Council Chair Kimball and Council Members,

In accordance with generally accepted government auditing standards and the Hawai'i County Charter Section 3-18(d)(2), the Office of the County Auditor conducts or causes to be conducted: performance and/or financial audits of the funds, programs, services, and operations of any county agency, executive agency, or program, as set forth by the county auditor in an annual audit plan that shall be transmitted to the county council and the mayor and file with the county clerk as a public record.

We have completed our engagement of the Affordable Housing Credits at the Office of Housing and Community Development (OHCD). The objective was to evaluate the internal controls, the efficient issuance and utilization of affordable housing credits, compliance with Chapter 11 of the Hawai'i County Code, and program efficacy.

Our review of the evidence showed that since the County's Affordable Housing Policy's inception in 1988, OHCD issued at least 1,811 credits. 638 (35.2%) credits have been sold at least once. Historically, private credit sales have varied in price from as little as \$5,000 to as much as \$75,000 each. Since program inception, 335.8 credits have been redeemed for an average of 9.87 credits per year.

Summary of Affordable Housing Credits			
Description	Total Credits Issued	Redeemed	Outstanding
Credits	1,811	335.8	1,354.2

Compiled Office of the County Auditor

While not memorialized in writing, OHCD said historically, they were advised not to interfere with private-party credit transactions. However, credits have significant potential values. When used as intended, credits provide developers with a means to liquidity, which in turn contributes to housing production. However, when bought and held, the lack of liquidity means less overall capital investing in developments, and production suffers. As public stewards, behaviors, actions, and decisions must be made in the public's best interest. OHCD should have a solid understanding of credits' impact on production.

The program has underserved communities around the island. Excess credits are bought and held for long periods rather than used to produce housing units. For OHCD to successfully achieve its mission of providing affordable housing, foundational reforms must accompany improvements to its internal control system.

While this audit discusses program deficiencies at length, our report intends to provide OHCD with meaningful recommendations that, when implemented, will provide department personnel, management, administration, elected officials, and the public with reasonable assurance that the actual performance aligns with expectations.

Our report offers seven recommendations, including clarifying county code, establishing administrative rules, updating and enforcing written policies and procedures, increasing monitoring and program oversight, using technology as a monitoring tool, segregating incompatible duties, and providing training.

In response to a draft of this report, management expressed general agreement with our audit results. A copy of management's complete response can be found in Chapter 4.

We want to express our sincere appreciation to the Office of Housing and Community Development for their assistance and cooperation during the audit process. We greatly appreciate their valuable time and effort in providing us with information.

To improve government accountability and ensure audit recommendations are implemented or resolved, we will continuously monitor the status of recommendations using our remediation tracker. To view the department's status, visit us at: <https://www.Hawai'icounty.gov/our-county/legislative/office-of-the-county-auditor>.

If you have any questions or concerns about the status of the recommendations discussed, feel free to contact me at 961-8386. Thank you.

Respectfully,


County Auditor

cc: Mitchell D. Roth, Mayor
Lee Lord, Managing Director
Jon Henricks, County Clerk
Susan Kunz, Housing Administrator
Harry Yada, Assistant Housing Administrator
Anne Bailey, Housing and Community Development Specialist VI



County of Hawai'i
Office of the County Auditor



Office of Housing and Community Development Affordable Housing Credits

Report No. 2023-01
February 1, 2023



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Executive Summary

The goal of the Office of Housing and Community Development (OHCD) is to provide for the development of viable communities in Hawai'i County by providing decent housing, suitable living environments, and the expansion of economic opportunities. The OHCD's Community Development Division is responsible for the planning, development, construction, and management of assigned housing and community-related projects in Hawai'i County. OHCD's Planning Branch administers the affordable housing policy, Hawai'i County Code (HCC), Chapter 11, through processing affordable housing agreements on rezoning.

Hawai'i County has a severe housing crisis. The lack of affordable housing often forces residents to leave the state. Chapter 11, Hawai'i County's Affordable Housing Policy, mandates the inclusion of affordable housing in and throughout various market developments. The rezoning of parcels triggers Chapter 11. Zoning is administered through Chapter 25, Article 5, Zoning Districting Regulations.

Chapter 11 provides a means for developers to satisfy their affordable housing obligation through seven options: developing finished lots, selling, or renting the required units on or off-site, conveying land or infrastructure, or purchasing affordable housing credits. At approximately 44%, purchasing has become the most often used method of satisfaction. See Table 3.

In July 2022, media outlets reported a fraud scheme committed by a now-former employee of the Office of Housing and Community Development, questioning the efficacy of Chapter 11.

In September 2022, Hawai'i County Council's Resolution No. 467-22 requested the Office of the County Auditor conduct a performance audit. The audit sought to ensure the efficient issuance and utilization of affordable housing credits, including a comprehensive accounting of all issued, outstanding, transferred, or redeemed, and recommendations to enhance program controls, efficiency, and effectiveness. We also evaluated Chapter 11 of the Hawai'i County Code and OHCD's written policies and procedures for implementing Chapter 11.

While theft and loss can and do happen, the ability to conceal and deceive for a long time is symptomatic of inadequate internal controls. Decades of neglect in monitoring the program has left the department unable to evaluate its success.

Our audit found the following:

Deficiencies before 2022	Improvements after 2022
<ul style="list-style-type: none"> • Compliance with Chapter 11 <ul style="list-style-type: none"> ○ Pre-awarded and Over-awarded Credits ○ Misinterpreted areas of the code ○ Internal Control Systems Program Oversight ○ Segregation of duties • Written policies and procedures <ul style="list-style-type: none"> ○ No Administrative Rules ○ Vetting developers' qualifications ○ Contract monitoring of Affordable Housing Agreements (AHA) ○ Maintaining complete records of credits ○ Timely recognition of DHHL credits 	<p>Improved Compliance with Chapter 11</p> <ul style="list-style-type: none"> • Worked with Corporation Counsel to develop a better understanding of the code • Increased program oversight • Clarified supervisor responsibilities • Segregated most incompatible duties • Formalized policies and procedures • Increased training • Improved records maintenance, including DHHL credits • Hired a consultant to analyze and make recommendations to amend Chapter 11 of the Hawai'i County Code

Based on these conditions, we offer the following seven recommendations:

Clarify County Code

1. We recommend OHCD work with Hawai'i County Council to revise applicable sections of Chapter 11.

Establish Administrative Rules

2. We recommend OHCD establish administrative rules to effectively administer the County's Affordable Housing Policy.

Update and Enforce Policies and Procedures

3. We recommend OHCD clarify and enforce policies and procedures to ensure consistency throughout the department and industry best practices.

Increase Monitoring and Program Oversight

4. We recommend OHCD perform ongoing monitoring of their internal control system's design and operating effectiveness as part of their operations.
5. We recommend OHCD use software and technology as a monitoring tool to improve managing affordable housing agreements and credits.

Segregate Incompatible Duties

6. We recommend OHCD management separate incompatible duties. One individual should not oversee key elements of the affordable housing process.

Provide Training

7. We recommend OHCD provide ongoing internal control training to employees involved in the affordable housing process.

Conclusion

When our recommendations are implemented in good faith, OHCD can expect the following benefits:

Clarify County Code

1. Clarifying applicable sections of Chapter 11 will make laws easier to understand and ensure compliance.

Establish Administrative Rules

2. Establishing administrative rules will help guide OHCD to effectively administer the County's Affordable Housing Policy.

Update and Enforce Policies and Procedures

3. Updating and enforcing policies and procedures will ensure consistency throughout the organization and with industry best practices.

Increase Monitoring and Program Oversight

4. Ongoing monitoring will ensure OHCD's internal control system operates effectively and efficiently as designed.
5. Using technology as a monitoring tool will improve managing affordable housing agreements and credits.

Segregate Incompatible Duties

6. Segregating incompatible duties will ensure one individual does not oversee key steps of the affordable housing process.

Provide Training

7. Ongoing training will ensure employees at all levels of the organization involved in the affordable housing process are knowledgeable and will be held accountable.

We thank the Office of Housing and Community Development for their cooperation and efforts to improve internal controls over their affordable housing program.

To improve government accountability and ensure audit recommendations are implemented or resolved, we will continuously monitor the status of pending recommendations using our remediation tracker. To view the status, visit us at: <https://www.Hawaii'icounty.gov/our-county/legislative/office-of-the-county-auditor>.

About Us

Mission

It is our mission to serve the Council and citizens of Hawai'i County by promoting accountability, fiscal integrity, and openness in local government. Through performance and/or financial audits of County agencies and programs, the Office of the County Auditor examines the use of public funds, evaluates operations and activities, and provides findings and recommendations to elected officials and citizens in an objective manner. Our work is intended to assist County government in its management of public resources, delivery of public services, and stewardship of public trust.

Audit Authority

Hawai'i County Charter §3-18 establishes an independent audit function within the Legislative Branch through the Office of the County Auditor.

Purpose

This engagement aims to evaluate affordable housing credits (AHC) issued, transferred, redeemed, and outstanding through a comprehensive accounting of credits and testing of the Office of Housing and Community Development's control environment.

Performance Audit Definition

Performance audits provide objective analysis, findings, and conclusions to assist management and those charged with governance and oversight with, among other things, improving program performance and operations, reducing costs, facilitating decision-making by parties responsible for overseeing or initiating corrective action, and contributing to public accountability.

Our objective in performance auditing is to improve public services provided by the county government. We do this by recommending specific actions to address the issues we raised and by providing valuable information to the public, the administration, program leadership, the county council, and the mayor.

Chapter 1

Introduction

What is the primary function of OHCD?

The Office of Housing and Community Development (OHCD) administers the county's housing fund. OHCD is responsible for the planning, administration, and operations of all the County of Hawai'i's housing programs. Their mission is to provide for the development of viable communities through decent housing, suitable living environments, and expanded economic opportunities. OHCD's - Community Development Division, Planning Branch drafts and executes affordable housing agreements.

The Office of Housing and Community Development is composed of five divisions and 14 branches:

- Administrative Services
 - Accounting, Technology, and Clerical Services
- Community Development
 - Development
 - Planning
- Community Engagement
 - Homeless Program
 - Community Services
- Existing Housing
 - Special Purpose Voucher Programs (Section 8), Housing Program, Planning, Rental Assistance, and Support Services
- Grants Management
 - Grants Administration
 - Workforce Development

Request for Performance Audit.

Beginning in July 2022, court documents and various media outlets reported a former Hawai'i County housing employee was charged with fraud and pleaded guilty after allegedly taking nearly \$2M in bribery or kickbacks for approving specific affordable housing projects. Policy and procedures were subsequently developed in response to this event.

In September 2022, Hawai'i County Council's Resolution No. 467-22 (Draft 2) requested the Office of the County Auditor conduct a performance audit to ensure the efficient issuance and utilization of affordable housing credits that included a comprehensive accounting of all credits issued outstanding, transferred, or redeemed, and recommendations to enhance program controls, efficiency, and effectiveness.

Although OHCD has several programs that receive federal grants that are routinely audited, there were no prior audits of the affordable housing program conducted. In addition to Council's request, the Office of the County Auditor determined that a thorough examination of OHCD's affordable housing processes, policies, procedures, and practices was warranted.

What is the County's Affordable Housing Policy?

In support of the county's ongoing efforts to provide adequate, affordable housing to its residents, the Hawai'i County Council established an affordable housing policy in 1998 through the adoption of Ordinance No. 98-1. "The objectives of this affordable housing policy are to:

- Implement the goals and policies of the county's general plan
- Promote and assist private development of affordable housing for senior citizens and qualified households
- Use available governmental grants and funds in the development of affordable housing and increase the capabilities of qualified households to obtain affordable housing
- Support innovative, lower-cost approaches that may be used in the development of affordable housing
- Require large resort and industrial enterprises to address related affordable housing needs as a condition of rezoning approvals based on current economic and housing conditions".¹

Why is affordable housing important?

"The need for affordable housing is immense, and the lasting impact it can have on homeowners and their families are undeniable²." A 2019 Hawai'i Housing Planning Study reported Hawaii County will need 10,795³ affordable housing units within the next five years (2020-2025). "Research shows that increasing access to affordable housing is the most cost-effective strategy for reducing childhood poverty and increasing economic mobility in the United States."⁴

The lack of affordable housing is a significant challenge facing many residents of Hawai'i, including those in Hawai'i County. To address this problem, the county legislated an affordable housing policy requiring "residential developers to include affordable housing in their projects or contribute to affordable housing off-site."

The Office of Housing and Community Development (OHCD) – Planning Branch oversees and implements the county's affordable housing policy requirements, also known as Chapter 11. Through OHCD, the county enters into affordable housing agreements (AHA) with developers. AHAs are signed by a developer, the county housing administrator, corporation counsel, and the mayor.

¹ County of Hawai'i General Plan 2005. <https://www.planning.hawaii-county.gov/general-plan-community-planning/gp/plan> Date accessed 12-2-22 (pg. 9-3).

² Habitat for Humanity. Why is affordable housing important? <https://www.habitat.org/stories/reinforcing-importance-of-our-work> Date accessed 11-21-22.

³ SMS. Hawaii Housing Planning Study, 2019. Table 34 (pg. 40). <https://records.hawaii-county.gov/WebLink/PDF/vrww4zjxdtj2zreg5po2ghr0/8/2019%20Hawaii%20Housing%20Planning%20Study.pdf> Date accessed 12-27-22.

⁴ National Low Income Housing Coalition (NLIHC). Why do affordable homes matter? Record-breaking numbers of families cannot afford decent place to call home. <https://nlihc.org/explore-issues/why-we-care#:~:text=Housing%20is%20the%20key%20to,mobility%20in%20the%20United%20States>. Date accessed 11-21-22.

Developers who agree to construct new affordable housing units in excess of any requirements required under Chapter 11-15(a) may earn “excess credits.” Initially, once the developer and OHCD recognize excess credits, they can be transferred without the administrator's approval. Developers or persons can use credits as well as excess credits to satisfy current or future affordable housing requirements. OHCD may not recognize purchased credits in satisfaction of a developer's obligations if it determines the preceding developer sold them without fulfilling an initial obligation.

What are the Long-Term Effects of Housing Regulations?

The Economic Research Organization at the University of Hawai'i (UHERO) produced *Measuring the Burden of Housing Regulation in Hawai'i*⁵, a study of the impact of regulations on housing markets across Hawai'i's four counties using the Wharton Index survey as a basis to gauge where Hawai'i ranks in comparison to similar areas across the U.S. UHERO authors Bonham, Inafuku, and Tyndall, compared counties to the nation's top 30 countries with the highest mean home prices and found:

- “One of the factors that may explain Hawai'i's high home prices are government regulations that limit the ability of the housing market to create the units necessary to meet demand.”
- “While clearly important to the production of new housing, regulatory barriers are difficult to measure.”
- “Reducing barriers to housing development is sometimes viewed as a handout for housing developers.”
- “Reforming and removing regulatory barriers to new housing production could significantly contribute to new housing production and ultimately reduce the burden that high housing costs place on local households and improve affordability in the state.”

⁵ The Economic Research Organization at the University of Hawaii (UHERO). *Measuring the Burden of Housing Regulations in Hawai'i*, April 2022. <https://uhero.hawaii.edu/measuring-the-burden-of-housing-regulation-in-hawaii/> Date accessed 11-4-22.

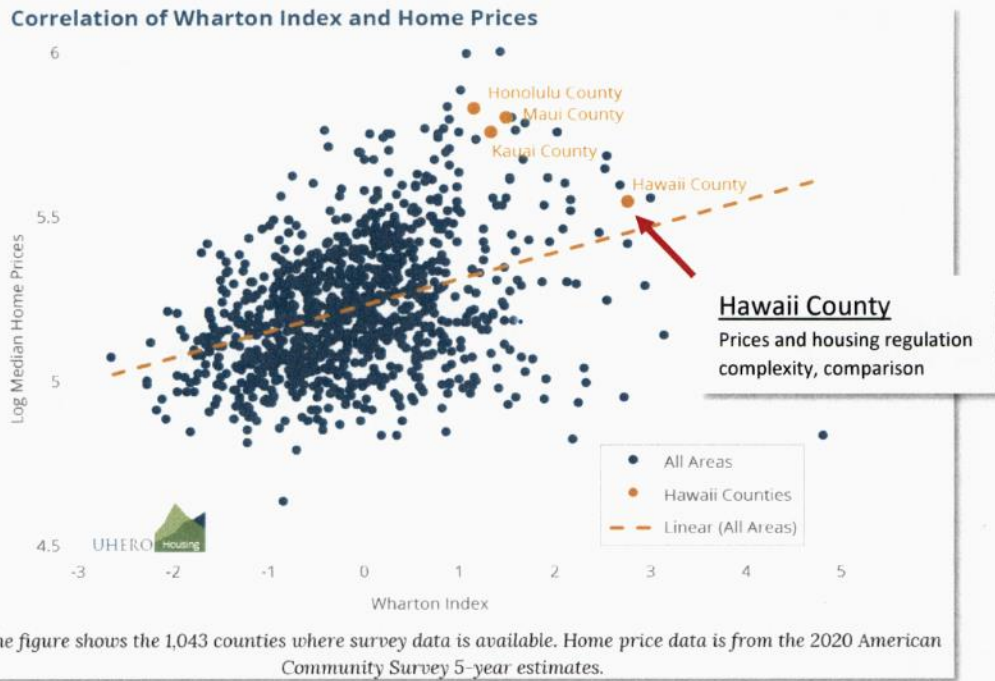


Figure 1: UHERO, Correlation of Wharton Index, *Measuring the Burden of Housing Regulations in Hawai'i*

The Department of Hawaiian Home Lands (DHHL) Credits.

As a major landowner, the state can release land for housing projects. The Department of Hawaiian Home Lands (DHHL) has become one of the largest affordable housing developers throughout the state of Hawai'i. The Hawaiian Homes Commission Act of 1920, as amended (HHCA), authorizes the DHHL to enter into project development agreements to develop available lands for homestead projects.

DHHL created the Affordable Housing Credits Policy⁶ to provide guidelines for determining the value of credits, clarifying terms and conditions applied, and subsequently transferred to other entities pursuant to Act 141, Session Laws of Hawai'i (SLH) 2009, which is codified in Hawai'i Revised Statutes (HRS) 46-15.1 (b). Act 141 is effective *[Repeal and reenactment on July 1, 2024. L2019, c80, §§1. 2.]*

HRS 46-15.1(b) requires counties to recognize housing units developed by DHHL and issue affordable housing credits to DHHL. Credits are transferable and can be applied within the same county in which the credits are earned. Counties are directed to issue credits on a one-for-one basis to DHHL for existing and future projects. Until HRS 46-15.1(b) is repealed or amended, credits will continue to be a part of the affordable housing process.

DHHL credits create obstacles for OHCD because issuance is beyond the department's control, and there is no mechanism to recognize credits continually.

⁶ Department of Hawai'iian Home Lands. HHC Affordable Housing Credits Policy. <https://dhhl.Hawai'i.gov/hhc/hhc-affordable-housing-credits-policy/> (date accessed 1-29-22)

DHHL credits don't have the same radius restrictions that county-originated projects have. This contributes to turning localized credit availability imbalances into a countywide problem as credits could be used to fulfill obligations anywhere on the island of Hawaii. In one instance, DHHL built 42 affordable housing units, obtained 42 credits, and transferred those credits to a developer in exchange for building fencing around an endangered plant preserve near La'i Opua Village, Phase 5 (2016). Several potential problems accompany non-cash forms of payment. For example, it can circumvent competitive procurement, sidestep a project's budget, carry tax implications, etc. The extent and effect are beyond the scope of this audit.

Fencing for Endangered Plant Preserve



Source: Google Earth Map

Objective, Scope, and Methodology

Objective

To evaluate if internal controls at the Office of Housing and Community Development - Planning Branch are adequate to ensure the efficient issuance and utilization of affordable housing credits and compliance with Chapter 11 of the Hawai'i County Code.

Scope

The audit will evaluate affordable housing credits (AHC) issued, transferred, redeemed, and outstanding through a comprehensive accounting of credits and testing of OHCD's control environment.

Developer projects that did not include credits in the affordable housing agreements were omitted from the review.

The audit was conducted from September 2022 to January 2023.

Methodology

To accomplish our objective, we:

- Developed an understanding of affordable housing credit policies, procedures, processes, and practices
- Assessed compliance with applicable laws and other relevant governance
- Performed tests of controls and transactions over affordable housing agreements, specifically credits issued, transferred, redeemed, and outstanding
- Performed tests of the control environment
- Conducted site visits to observe monitoring and oversight practices
- Corroborated information with appropriate staff and personnel
- Reviewed information pertinent to affordable housing credits
- Noted exceptions and identified areas for improvements
- Was mindful of potential fraud, waste, and abuse during the audit

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 objective.

Noteworthy Events

We are pleased to report that the Office of Housing and Community Development (OHCD) has begun to strengthen controls affecting its operations. We appreciate the cooperation exhibited by OHCD to implement our recommendations. OHCD asserted they have:

- Formalized most policies and procedures
- Segregated most incompatible duties
- Implemented independent monitoring to track credits
- Increased program oversight
- Improved records maintenance
- Provided training for those responsible for affordable housing agreements and credits
- Hired a consultant to analyze and make recommendations to amend Chapter 11 of the Hawai'i County Code

Additionally, to improve transparency, the County Council proposed Bill 9 (January 2023), requiring the housing administrator to:

- Provide affordable housing agreements within thirty calendar days following the date of execution
- Quarterly reporting:
 - A list of developers in possession of excess affordable housing credits and the number of affordable housing credits each developer has earned, transferred, redeemed, and remains in possession of as of the end of the quarterly reporting period.
 - A summary of the current affordable housing inventory.
 - An accounting of significant actions taken under Chapter 11, but not limited to:
 - For sale, affordable housing units developed and sold
 - Finished affordable housing lots constructed and sold
 - Affordable housing rental units constructed and being rented
 - Developable land conveyed
 - Infrastructure conveyed
 - Affordable housing units resold, and
 - Density bonuses granted

We will follow up at the appropriate time to determine whether and to what extent all recommendations have been completed.

Chapter 2

Audit Results

The Office of Housing and Community Development's internal control system was ineffective in ensuring affordable housing credits were properly issued, controlled, and accounted for. As a result, the Office of the County Auditor was unable to determine the total accounting of credits.

Internal controls are broadly defined as a process affected by management. Controls are designed to provide reasonable assurances on the efficiency and effectiveness of program operations, safeguarding and maintaining accountability of assets, reliability of financial reporting, and compliance with applicable laws, policies, and procedures. Internal controls can help a department achieve performance measures, prevent loss of resources, and protect the department's reputation and the employees conducting the work. The department's internal control system should include the following elements:

- **Accounting of Credits.** Management should account for all credits issued, outstanding, redeemed, and transferred, to maintain the accuracy and completeness of balances and records.
- **Monitoring and Program Oversight.** Management should document their review and approval of critical tasks performed by employees. They should take prompt corrective action when errors or discrepancies are discovered.
- **Segregation of Duties.** Duties should be segregated amongst employees so that errors and irregularities made by one employee are difficult to conceal. No single individual should have complete control over consecutive phases of a process. Job duties should be clearly defined and addressed.
- **Training.** Training should ensure that prescribed policies, rules, and regulations are followed and enforced. Effective corrective measures should be taken when deficiencies are discovered.
- **Written Policies and Procedures.** Policies and procedures should be approved by management, inclusive of all aspects of operations, and be sufficiently detailed and distributed to staff. In addition, ongoing monitoring is necessary to ensure policies, procedures, and internal controls remain effective and efficient as operations change.

Adequate internal controls reduce the risk of fraud or theft and help provide reasonable assurance that the county's objectives will be achieved. Internal controls are affected by the actions of individuals within the county and written policies and procedures. By identifying gaps in policies and procedures, management can identify where adequate controls need to be placed, where to provide sufficient detail for new and existing procedures, and clarification of procedures so that they are easier to follow and enforce.

The Department of Finance's Accounting Manual requires County departments and agencies to establish internal control systems with the further responsibility of seeing that the internal controls continue to function as designed.

Our audit evaluated OHCD's affordable housing processes over agreements and credits to ensure the efficient issuance and use of commodities such as affordable housing credits that includes a comprehensive accounting of credits issued, outstanding, transferred, or redeemed. We found prior internal controls were generally inadequate and not operating according to best practices to prevent, detect, and deter fraudulent transactions. (Figure 2)

While OHCD recently developed policies, procedures, and forms to help guide and better manage its process, no projects have advanced to include the new materials. As such, we could not determine if current internal controls have been strengthened to provide reasonable assurance that the affordable housing process can be effectively managed. We will follow up at the appropriate time to determine whether and to what extent all recommendations have been implemented.

Figure 2: Summary of Internal Controls		
OHCD Affordable Housing Internal Control	Was actual practice performed? Before 2022	Was actual practice performed? After 2022
Accounting of Affordable Housing Credits (AHC)	No	In Process
Compliance with applicable governance	Insufficient	No *No new projects available to test
Monitoring and Program Oversight	No	In Process
Segregations of Duties	No	In Process
Training	Insufficient	In Process
Written Policies and Procedures	No	No *No new projects available to test

*See Attachments 1 and 2

Figure 2: Summary of Internal Controls, compiled Office of the County Auditor

Results of Comprehensive Accounting of Credits

Overview

The Office of Housing and Community Development (OHCD) maintains its affordable housing documents in its department's Laserfiche repository or document management system. In October 2018, two of OHCD's five server drivers failed simultaneously, resulting in data loss. While some information was recovered through backups, OHCD has spent four years working to recover lost data. Some scanned data will never be recovered because the original documents were shredded. In June 2022, OHCD said they believed they had an accurate accounting of approximately 1,042 credits recorded. Two worksheets detailing only "excess credit" transactions (Table 1a and Table 1b)⁷ were prepared at the request of a Hawai'i County Councilmember and published. We found two calculation errors in OHCD's credit register tables:

The beginning excess credit balance should be 1,402 credits (Table 1a)

- 1,250 starting balance is missing 2 entries:
 - 5 credits for DJAT, LLC.
 - 147 credits for NHICORAM, Inc.

The ending excess credit balance should be 1,089 (Table 1b)

- 1,042 is missing 1 entry:
 - 47 credits for Bridge Aina Lea

In August 2022, management began internal audits, including maintaining a complete credit register and rescanning available records. Both efforts remained ongoing during the audit period.

Through the creation of AHAs, credits are recognized as either running with the land and are part of a committed obligation to fulfill a proposed project or may be identified as *excess* credits when more units are built than the code requires. Historically, OHCD has not recognized committed obligation-type credits as having been awarded because, theoretically, they are restricted from resale and are committed to a project. In some cases, credit calculations are not addressed.

Audit Activity

We relied on and assessed the information provided by OHCD to gain an understanding of their affordable housing program. We observed files did not have a standardized format, which generally provides a reasonable basis for quality control. We conducted tests of controls and transactions to and from source data. We observed some information was missing and incomplete, resulting in variances in the total count. In addition, some credits may be in the process of being transferred or redeemed.

Results

As of January 2023, our reconciliation found at least 1,811 credits from October 1988 to current. See Table 2 for a comprehensive accounting of credits.

⁷ Big Island Now. Resolution Seeks Performance Audit of Marred County Housing Agency. July 26, 2022. <https://bigislandnow.com/2022/07/26/resolution-seeks-performance-audit-of-marred-county-housing-agency/>.

**Table 1a: Office of Housing Community Development
Affordable Housing Excess Credit Balance Summary**

TMK	Current Property Owner	Development Name	AHA Date	Original Excess Credit Award Starting Balance
(3) 2-2-026:024	DJAT, LLC	Hale Haumana Student Dorm	12/10/2008	5
(3) 6-2-015:045	NHICORAM, Inc.	Kekumu Ekahi, Kekuma Elua, Ke Kumu Ekolu, Ouli Ekahi, Ouli Elua	8/23/2007	147
(3) 6-8-003-028	Luna Loa Development, LLC	Kaiaulu O Waikoloa	None	212
(3) 7-3-010:003	AAA Development/WestPro	Lokahi Kau	3/5/2008	522.0
(3) 7-4-004:014, 091,092	West View Development, LLC	Hillwood Park Estates/Honua'ula	12/17/2015	104.0
Unknown	GBH-Kai Maluna	Unknown	None	24
(3) 7-5-017:001, 019, 023, 025, 026	Suffolk Investment, LLC (FKA Westpro Development)	Pualani Estates	4/21/2003	50
(3)7-4-027: 001 - 006; :037; :039-:056; :065-068; :072 :074; :085-:103; :107-:114; :116 and :117	DHHL (Dept of Hawaiian Homelands)	Lai'opua, Lalamilo, Panewa, HCC Model Homes	Unknown	161.0
(3)7-4-027:001-017	DHHL	Laiopua Village 5	4/16/15 (48 homes), 5/7/15 (7 homes)	55.0
(4) 7-5-17:002 and :005	Lava Kuakini, LLC	Unknown	Unknown	10
(3)5-5-008:046	HICDC	Kumakua Self Help	None	7
6-2-001:009; 6-7-001:025; 6-7-2:048, 17; 6-8-001:001, and :008	Parker Ranch, Inc.	Parker Ranch	10/13/2000	105
				1250.0

DEFINITIONS:

Original Excess Credit Award Starting Balance:	This represents the number of credits earned by a developer per their Affordable Housing Agreement with the county.
Ending Balance:	This represents the remaining credits that are still available for use and/or transfer

Table 1: Affordable Housing Excess Credit Balance Summary, compiled Office of Housing and Community Development

**Table 1b: Office of Housing Community Development
Affordable Housing Excess Credit Balance Summary**

TMK	Current Property Owner	Development Name	AHA Date	Ending Balance
(3) 2-4008:014	Moaniala Holdings, LLC	Hilo Hillside Estates Subdivision	June 29, 2009	1
(3) 6-8-003:028	K-00674 Waikoloa, LP	Kaiaulu O Waikoloa	4/24/2015	51.0
(3) 6-8-003-028	D.R. Horton - Schuler Homes, LLC	Kaiaulu O Waikoloa	4/24/15	24.0
(3) 7-3-010:003	AAA Development/WestPro	Lokahi Kau	3/5/2008	522.0
(3) 7-3-05:95, 85 and 31	Kahaolini Partners, LLC	Kahaolino Subdivision	9/21/2005	7
(3) 7-4-004:014, 091,092	US Marshal Service	Hillwood Park Estates/Honua'ula	12/17/2015	47.0
(3) 7-5-010:052, 065	CL&D Nine, LLC	Meilani Subdivision	N/A	5
(3) 7-5-010-061	GBH-Kai Maluna	Unknown	None	23
(3) 7-5-017:001, 019, 023, 025, 026	Suffolk Investment, LLC (FKA Westpro Development)	Pualani Estates	4/21/2003	40
(3) 7-8-010:101	Kona Country Club	Unknown-3	Unknown	6
(3)6-8-003-028	Big Island Housing Foundation	LunaLoa/Kaiaulu O Waikoloa	4/24/2015	22.0
(3)7-4-004:014, 091, 092	Gretchin Osgood, Hawaiian Island Real Estate	Hillwood Park Estates/Honua'ula	11/13/15	41
(3)7-4-027: 001 - 006; :037; :039-:056; :065-068; :072 :074; :085-:103; :107-:114; :116 and :117	DHHL (Dept of Hawaiian Homelands)	Lai'opua, Lalamilo, Panewa, HCC Model Homes	Unknown	113.0
(3)7-4-027:001:017	Armstrong Builders	DHHL Laiopua	None	12
(3)7-4-027:001-017	DHHL	Laiopua Village 5	4/16/15 (48 homes), 5/7/15 (7 homes)	13.0
6-2-001:009; 6-7-001:025; 6-7-2:048, 17; 6-8-001:001, and :008	Parker Ranch, Inc.	Parker Ranch	10/13/2000	103.0
7-5-020:071, 072	Pinn Bros Construction, Inc.	Alii Palms Subdivision	Unknown	12.0
Nos. (3) 6-8-001-025, 36, 37, 38, 39 and 40	Bridge Aina Lea	Puako		47.0
				1042

DEFINITIONS:

Original Excess Credit Award Starting Balance:	This represents the number of credits earned by a developer per their Affordable Housing Agreement with the county.
Ending Balance:	This represents the remaining credits that are still available for use and/or transfer

Table 1: Affordable Housing Excess Credit Balance Summary, compiled Office of Housing and Community Development

Table 2: Our reconciliation found at least 1,811, credits from October 1988 to current.

Table 2: Comprehensive Accounting of Credits						
Count	Initial Developer	Obtained	Sold	Purchase	Redeemed	Outstanding
1	AAA Development, LLC	522	0	0	0	522
2	Armstrong Companies LLC	0	18	42	0	24
3	Big Island Housing Foundation	0	0	22	0	22
4	Bridge Aina Lea, LLC	0	0	47	0	47
5	Chalon International	98	21	0	7	70
6	CL&D Nine, LLC	0	0	2	2	0
7	CLW Hawaii Investments, LLC	0	0	1	1	0
8	D.R. Horton Schuler Homes, LLC	0	6	30	0	24
9	DePonte Brothers	2	0	0	2	0
10	DHHL	149	42	0	0	107
11	DJAT, LLC	9	5	0	4	0
12	GBH-Kai Maluna, LLC	0	24	24	0	0
13	Gentry Pacific, Ltd.	0	0	5	5	0
14	Glori Nani Mau, LLC	0	0	5	5	0
15	Hawaiian Island Real Estate LLC	0	0	41	0	41
16	Hanaula Village Partners, LLC	0	0	7	7	0
17	HICDC	89	15	0	0	74
18	HILCO IP Services, LLC	0	20	20	0	0
19	Hilo One, Inc.	0	0	6	6	0
20	Hualalai Health, LLC	0	0	23	0	23
21	Jon Gomes & Associates	5	5	0	0	0
22	Kahaolino Partners, LLC	0	0	7	7	0
23	Kohala Aina Partners, LLC	0	0	21	21	0
24	Kona Country Club Inc.	0	0	6	0	6
25	Kona Three, LLC	0	0	67	0	67
26	Kukui Development, LLC	0	0	5	5	0
27	KW Kohanaiki, LLC	0	0	100	100	0
28	Lanihau Properties, LLC	192	0	0	32	160
29	Lava Kuakini, LLC	10	7	0	0	3
30	Luna Loa Development, LLC	212	216	4	0	0
31	Moaniala Holdings, LLC	0	0	30	29	1
32	NHICORAM, Inc.	147	147	0	0	0

Table 2: Comprehensive Accounting of Credits, compiled Office of the County Auditor

Table 2 continued.

Table 2: Comprehensive Accounting of Credits						
Count	Initial Developer	Obtained	Sold	Purchase	Redeemed	Outstanding
33	Parker Ranch, Inc.	105	0	0	20.8	84.2
34	Pinn Bros Construction, Inc.	0	0	12	0	12
35	Plant-Mason Family Trust	0	0	2	0	2
36	Redwood Capital Finance Co (RCFC)	0	0	4	0	4
37	Renaissance Development, LLC	4	0	3	7	0
38	RJL, LLC	6	0	0	6	0
39	Ronald A. Brown	0	46	46	0	0
40	RS10 Kalaoa LLC	3	0	0	0	3
41	SCD Kona 108 LLC	0	0	10	0	10
42	Seascape Development, LLC	54	54	0	0	0
43	Suffolk Investment, LLC	0	10	50	0	40
44	Ulu Wehi Properties	0	0	2	2	0
45	Volcano Fairway Development Corp	0	0	8	8	0
46	WB KD Acquisitions, LLC	0	0	8	0	8
47	West View Development, LLC	104	95	0	9	0
48	Westpro Development, Inc.	50	50	0	0	0
49	White Hat Development	50	0	0	50	0
	Subtotal	1,811	781	660	335.8	1,354.2

Table 2: Comprehensive Accounting of Credits, compiled Office of the County Auditor

Additional information can be accessed on our website, where we house an interactive dashboard, [Auditor Dashboard](#) (Ctrl + Click), compiled courtesy of the Office of the County Auditor.

Auditor Notes:

Although not defined on OHCD's policies and procedures, we determined the following definitions:

Obtained: Includes unfulfilled obligations, credits awarded, pre-awarded, awarded as "bonus credits" (credits issued prior to Chapter 11). In exchange for conveyance of land or gifted and does not necessarily indicate successful project completion.

Sold: Includes credits sold, transferred, confiscated, dissolved, or brokered.

Purchased: Includes credits purchased, unfulfilled obligations, and awarded through civil judgments from another developer or broker; **Redeemed:** Includes credits recouped on projects to satisfy development obligations.

Outstanding: Includes those credits available for existing or future projects.

Sold should equal purchased. Committed obligations, seized, and adjustments account for the difference (781 and 660). For sold, 781 + 67 Kona Three (commitment to purchase) = 848. For purchase, 660 +45 (US Marshal Seizure), + 143 Luna Loa credits dissolved = 848.

*The status of some projects may be pending administrative review by the Office of the Corporation Counsel and is subject to change.

Visual Flow of Credits

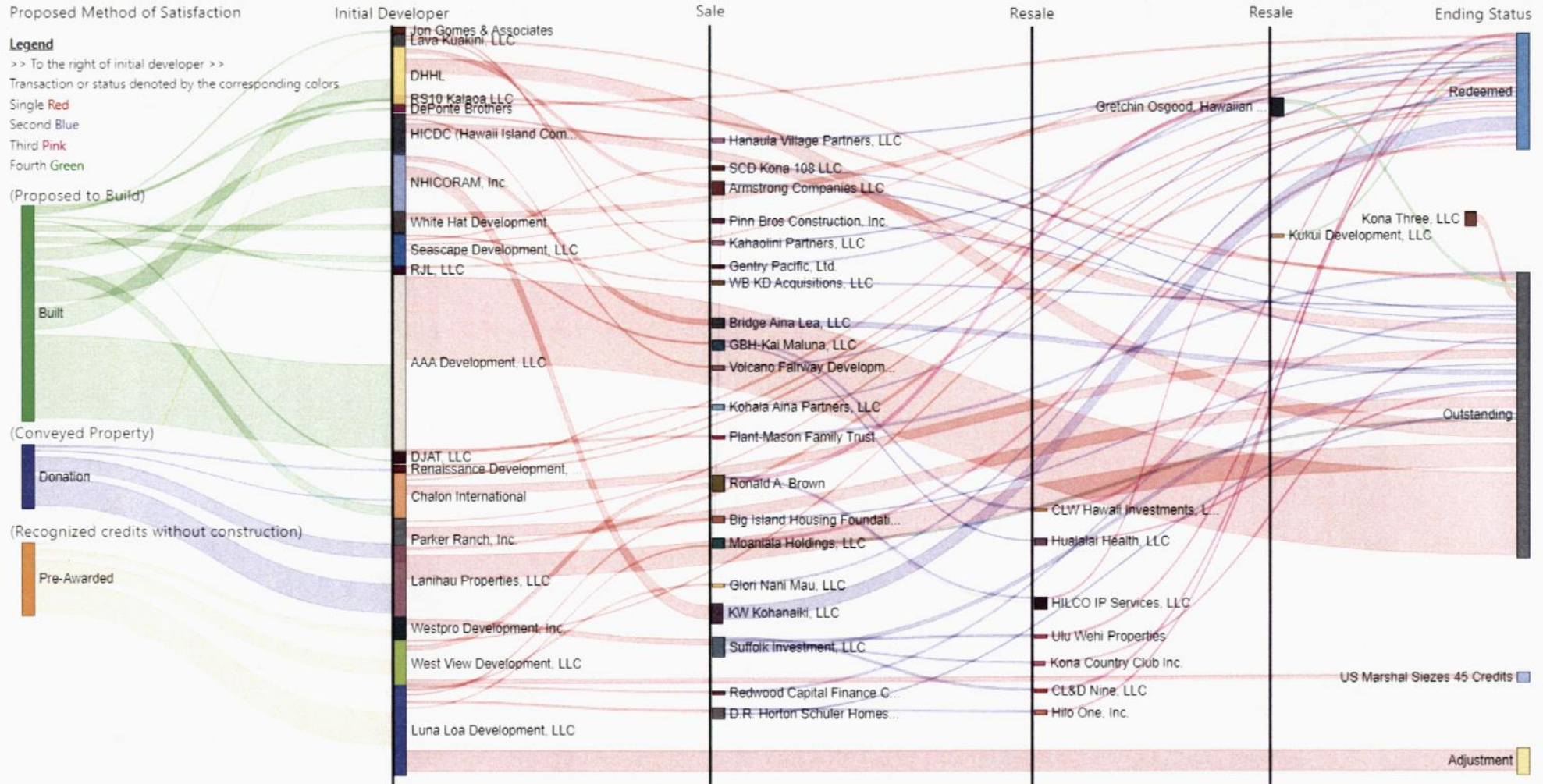


Figure 3: Visual Flow of Credits, compiled County Auditor

Complex County Code

Overview

The purpose of Chapter 11, the County's Affordable Housing, requires residential, industrial, and hotel projects to include affordable housing in their developments or contribute to affordable housing off-site. Chapter 11 is complex. Elements include rezoning triggers, satisfaction methods, credit awards based on Area Median Income (AMI) scales, and short and long-term monitoring obligations related to sales, conveyance, buyers, rentals, eligibility, and resales.

OHCD said that developers grow frustrated with the complexity of the overall process and want the easiest way to fulfill the obligation. Purchasing has become the preferred method of satisfaction.

Audit Activity

We gained an understanding of Chapter 11 requirements and reviewed and compared affordable housing agreements (AHA), re-zone ordinances, OHCD's Affordable Housing Credit Transfer Register, and other supporting documents. Initially, we examined 70 developers, or 100% of the population, provided by OHCD. We removed projects based on non-executed agreements, missing project details, or credits not mentioned. These conditions resulted in an adjustment to the population totaling 49 developers and 56 projects.

Table 3 - Methods of Satisfaction

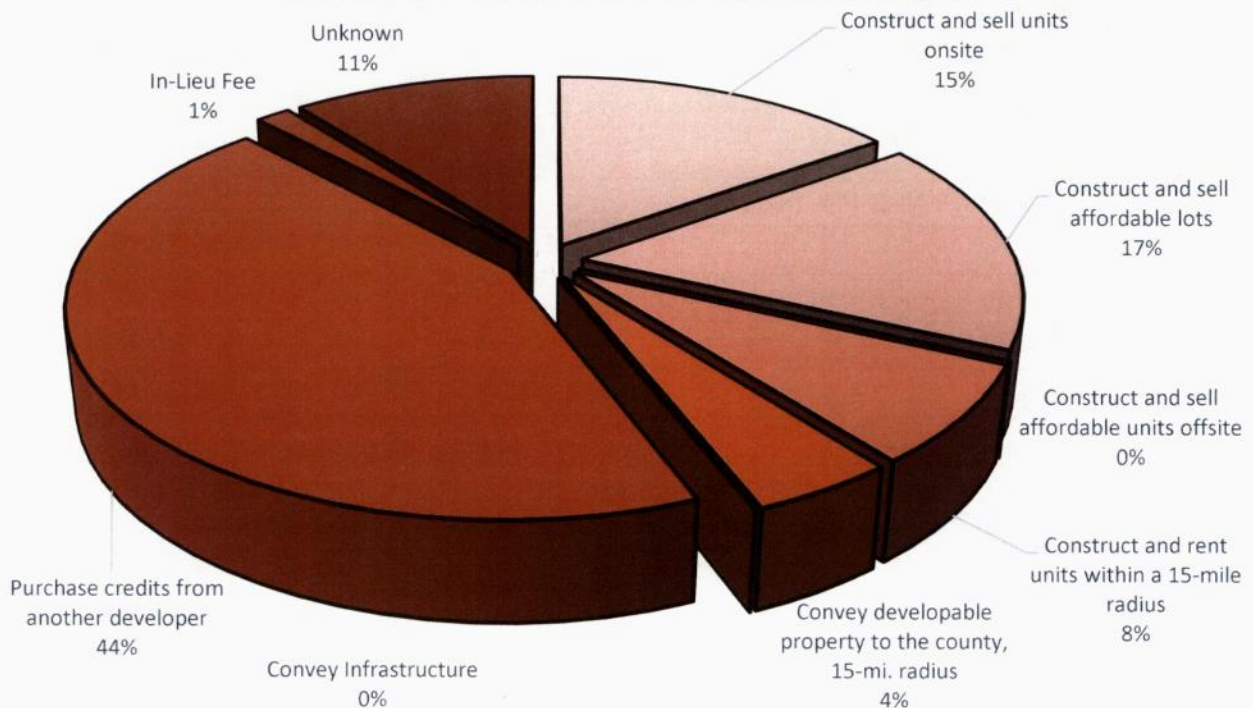


Table 3: Methods of Satisfaction, compiled Office of the County Auditor

In 24 cases, executed AHAs were missing from project files (40.7%). Of the remaining projects, we noted four instances where required signatures were missing.

We note 22 instances where the Bureau of Conveyance (BOC) recordation could not be confirmed between missing AHAs or incomplete project files. (37.3%) Furthermore, we noted 12 instances of AHA were not recorded with the BOC.

Before 2019, we observed questionable internal control practices:

- No periodic reports were submitted pursuant to Hawai'i County Code Section 11-19 Reports by the housing administrator
- Partial and/or early release based on verbal or written requests without performing an independent verification
- 3 instances, erroneously used critical housing need determination
 - 2 instances, 15-mile restriction
 - 1 instance, 30-mile waiver
- 1 instance, applied housing subsidy in-lieu of Chapter 11-5(1-7)
- 7 developers were pre-awarded credits
- 6 developers resold, pre-awarded credits
- 4 developers resold pre-awarded credits without affordable units constructed

Credits Pre-Awarded and Resold			
Developer	Pre-Awarded by OHCD	Re-Sold	Affordable Units Constructed
AAA Development	Yes	No	Yes
HICDC	Yes	Yes	Yes
Lava Kuakini	Yes	Yes	No
Luna Loa	Yes	Yes	No
Seascape	Yes	Yes	Yes
Suffolk	Yes	Yes	No
West View	Yes	Yes	No

Auditor Note: Assessment based on a review of Affordable Housing Agreements and aerial maps.

- 2 instances of credit over-awards:

Credits Over Awarded			
Developer	Credits to be Awarded	Credits Awarded	Difference
Seascape	43	54	+ 14
AAA+	488	522	+34

Auditor Note: Assessment is based on the number of affordable units built, not on the Affordable Housing Agreement.

As required by HRS 46-15. (b) all counties recognize housing units developed and credits issued by DHHL. Other jurisdictions use a combination of in-lieu fees and land conveyance to satisfy all or a portion of housing obligations. Hawai'i County is the only county within the State of Hawai'i that awards "excess" credits and does not charge in-lieu fees.

Example of Methods of Satisfaction		
Jurisdiction	In-Lieu Fees	Land Conveyance
City & County of Honolulu	Yes	Yes
County of Hawai'i	No	Yes
County of Kauai	Yes	Yes
County of Maui	Yes	Yes

Auditor Note: Fees/in-lieu fees or land conveyance based on a comparable City and County Code and Administrative Rules review.

Cause of the Condition

A complicated Chapter 11 and a lack of systems to manage and maintain developments increased OHCD's risk of misinterpretations and non-compliance.

Effect of the Condition

OHCD misinterpreted and did not always consistently comply with Chapter 11.

Finding 1 Complex County Code

Recommendation 1: Clarify County Code

We recommend OHCD work with Hawai'i County Council to revise applicable sections of Chapter 11, including the following elements:

- **Section 11-2(5). Objectives.**
 - Account for future conditions
- **Section 11-3. Definitions.**
 - Define "eligible applicant."
 - Other Hawai'i counties currently use language predicated on HRS

- **Sections 11-5(a) (1:7) Satisfaction of affordable housing requirements.**
 - Replace ineffective methods with straightforward options.
 - Establish limits on credit's ability to satisfy project obligations.
 - Consider methods used by other Hawai'i counties to satisfy workforce housing projects
 - Create incentive structures to participate that is financially viable for the developer while not being overly generous and can be administered fairly, reasonably, and consistently. This can include items like:
 - Expedited permitting
 - Other low-risk incentives, as determined by the department
- **Section 11-5(c) (1:12) Satisfaction of affordable housing requirements.**
 - Discontinue ineffective calculations of credits earned
- **Section 11-5(d)(1)(A)(B), (2)(A)(B) Satisfaction of affordable housing requirements.**
 - Discontinue ineffective housing percentage requirements
 - Consider an in-lieu fee matrix where amounts paid mirror the desired housing composition
- **Section 11-9(a)(b)(c)(d)(e)(f) Sale of lots and units.**
 - Consider the department's capacity to monitor, follow and enforce this code section and revise it as necessary
- **Section 11-10. Buyer of finished lots.**
 - Consider the department's capacity to monitor, follow and enforce this code section and revise it as necessary
- **Section 11-11(b). Rental units.**
 - Consider lengthening the period under which rental prices on the units shall be under controlled pricing
- **Section 11-15(a)(b)(c)(d)(e)(f). Transfer of excess credits.**
 - Discontinue ineffective excess credit transfer policies and replace them with policies designed to manage and maintain the chain-of-custody
- **Section 11-19. Reports by the housing administrator.**
 - Re-establish language, making reports by the housing administrator to Council compulsory. For continuity of credit balances over time, each report should include the ending balances of the agreed-upon data points reported in the last reporting period and all subsequent changes that bring the data points currently.
- **Applicable new section**
 - Create incentive structures to participate that is financially viable for the developer while not being overly generous and can be administered fairly, reasonably, and consistently. Some examples include:
 - Expedited permitting
 - Other low-risk incentives, as determined by the department

No Administrative Rules

Overview

Rules are created to regulate behavior, ensure compliance, and maintain discipline throughout the organization. Rules are promulgated to help the agency fulfill its purpose. Once adopted, administrative rules have the force and effect of the law. In contrast, management-formulated policies guide the decision-making processes and ensure uniformity and consistency.

There are at least three laws authorizing OHCD management to establish rules:

- Hawai'i County Code, Chapter 11-18 Adoption of rules
- Hawai'i Revised Statutes Section 46-15.1(c)(6) Housing; county powers
- Hawai'i Administrative Procedure Act, Chapter 91, Hawai'i Revised Statutes, as amended, establishes the method by which rules and consequences can be created

Audit Activity

We reviewed the following criteria to benchmark the adoption of rules:

- HRS 201H Hawai'i Housing Finance and Development Corporation
 - HRS 201H-32 Definitions
- 7A Administrative Rules for the Kaua'i County Housing Agency
 - Sections 1.3(e)(g)(q) Definitions
 - Section 2.2 Confirmation of Applicability
 - Subchapter 4 Workforce Housing Agreement
- Department of Planning and Permitting City and County of Honolulu
 - Title 20 Administrative Rules 201H Housing Program Rules
 - Section 20-25-7 Eligible Applicant
 - Section 20-25-12 Development Agreement
 - Rules to Implement City's Affordable Housing Requirements Effective March 31, 2019
 - Section 1-9 Contracts

We found OHCD does not have administrative rules to effectively administer Chapter 11.

Cause of the Condition

Management did not establish rules to effectively administer Chapter 11.

Effect of the Condition

OHCD had questionable practices and variances between projects.

Finding 2: No Administrative Rules

Recommendation 2: Establish Administrative Rules

We recommend OHCD establish administrative rules to effectively administer the County's Affordable Housing Policy.

Administrative Rules should include but not be limited to the following:

- **Define Developer, Eligible Developer, and Project.**

- **Developer.** A landowner or authorized agent of a landowner of real property that:
 - Seeks any County approval for the development or subdivision of real property;
 - Apply to the county for a State Land use district boundary amendment, a zoning district boundary amendment, or an applicable amendment
 - Obtain from the County a State Land Use district boundary amendment or zoning district boundary amendment but has not yet satisfied an existing housing condition, or the county has not yet executed a written housing agreement specifying the means to satisfy all or any portion of an existing housing condition.
- **Eligible Developer.** Any person, association, partnership, or cooperative, including limited-equity housing cooperatives as defined in Chapter 201H, firm, nonprofit or for-profit entity, or public agency determined by OHCD:
 - To be qualified by experience, financial responsibility, and support construction housing of the described type and of the magnitude of the given project.
 - To have submitted plans for a housing project adequately meeting objectives of Chapter 201H, HRS, the maintenance of aesthetic values in the project's locale, and the requirements of all applicable environmental statutes and rules.
 - To meet all other requirements the county deems to be just and reasonable, such as:
 - To be licensed or otherwise authorized by all applicable laws to do business in the State of Hawai'i.
 - To have reasonable experience in the type of work it proposes.
 - To obtain control of the project site.
- **Project.** The lots or parcels and any development are included and approved in a developer's application for zoning or building permit, subdivision or consolidation, State Land Use district boundary amendment, zoning amendment, or applicable amendments.

OHCD should develop definitions to align with actual affordable housing policies, procedures, and practices.

- **Drafting of Affordable Housing Agreement (AHA).** The agreement should include:

General

- Use standardized templates with permission-restricted access.

Project specifications - OHCD's subject matter expert

- The purpose of the agreement.
- A description of the role and responsibilities of OHCD, the developer, and other parties to the agreement.
- The number of units for each household Area Median Income (AMI) category and a minimum period during which the affordability will be maintained.
- Sales or rental periods for affordable housing units, which specify procedures for the release of units from affordable housing requirements should units not be sold or rented following the expiration of the sales or rental periods.
- If applicable, payment of in-lieu fees or provision of in-lieu land
- Resale restrictions may include buy-back provisions, shared equity, and encumbrances.

Enforcement elements - Corporation Counsel subject matter expert(s)

- Standard clauses for indemnity, severability, termination, assignability, breach, and remedy.
- The right to enforce the agreement should be granted to the county. The county should have strong performance, enforcement, and recourse clauses. The contract should be subject to the approval of the Corporation Counsel of the County as to form and legality.

By establishing written rules, management could better achieve its mission of providing affordable housing units and comply with the County's Affordable Housing Policy.

Incomplete Written Policies and Procedures

Overview

The Government Accountability Office's Green Book recommends establishing written policies and procedures to document internal controls and responsibilities. "Internal control comprises the plans, methods, policies, and procedures used to fulfill the entity's mission, strategic plan, goals, and objectives. Internal control serves as the first line of defense in safeguarding assets. In short, internal control helps managers achieve desired results through effective stewardship of public resources⁸." Developing written departmental policies and procedures is an effective way to maintain a robust internal control system.

The Office of Housing and Community Development (OHCD) had limited policies and procedures (Attachment 1 and 2) in August 2019. Policies and procedures were subsequently developed when fraud was found. Detailed policies and procedures for implementing Chapter 11 were created in August 2022.

Best practices recommend that management evaluate written policies and procedures annually and update them periodically. At the county, it is also a requirement for each department and agency to be responsible for creating and maintaining its policies and procedures. One example of an adequate system of internal controls can be found in the Department of Finance's Accounting Manual⁹.

An organization's management should incorporate controls into written policies and procedures. These policies and procedures should cover all aspects of operations, be sufficiently detailed, and be distributed to staff. In addition, ongoing monitoring is necessary to ensure policies and procedures, and internal controls remain effective and efficient as operations change.

The Department of Finance's Accounting Manual defines:

- **Control Environment.** The collective effect of various factors on establishing, enhancing, or mitigating the effectiveness of specific policies and procedures. Including:
 - Management philosophy and operating style
 - Organizational structure
 - Methods of assigning authority and responsibility
 - Managing control methods
 - The internal audit functions
- **Control Procedures.** In addition to the control environment and accounting system, management has established policies and procedures to achieve its objectives.

⁸ United States Government Accountability Office. Standards for Internal Control in the Federal Government (Green Book) Definition of Internal Control OV1.03, pg. 5 (Date accessed 1-29-22)

⁹ Accounting Manual Part 1 County of Hawaii Department of Finance. Departmental Internal Control Systems. June 7, 1999.

OHCD's internal control system should be designed to include the following:

- **Timely Reconciliation.** Existing procedures do not address the timely reconciliation of AHC. Policies and procedures should require timely reconciliation, adjustments, and administrative reviews.
- **Close Out Process.** Existing procedures do not address the close-out process. Policies and procedures should require a close-out process to verify deliverables and credits.
- **Management Review.** Existing procedures do not detail management's review and oversight. Policies and procedures should establish role expectations for management at all stages of the review process to ensure compliance with Chapter 11.
- **Fraud Reporting Procedures.** Existing procedures do not address fraud reporting. Policies and procedures should require a fraud reporting process to aid in detecting and preventing fraud. By providing fraud reporting procedures, everyone within the department will be aware of the fraud risk policy, including types of fraud and the consequences associated with them. If fraud or theft does occur, the records cannot easily be taken, destroyed, or modified. Fraud reporting procedures act as a strong deterrent. Employees will be better educated to identify possible signs of fraud or theft and how to report red flags.

Audit Activity

To determine if policies and procedures were followed and enforced, we compared written policies and procedures to best practices and found:

- No new projects were available during the audit to test compliance with new procedures
- Policies and procedures were not written until August 2022
- 2022 forms do not align with OHCD's current practices
- Insufficient monitoring practices
- Monitoring procedures not sufficiently addressed in policies and procedures

By identifying gaps in written guidance, management can identify where effective controls need to be placed, where to provide sufficient detail for new and existing procedures, and clarify unclear procedures.

Cause of the Condition

Management did not provide clear expectations through written policies and procedures.

Effect of the Condition

The lack of policies and procedures promoted weak internal controls.

Finding 3: Incomplete Written Policies and Procedures

Recommendation 3: Update and Enforce Policies and Procedures

We recommend OHCD clarify and enforce policies and procedures to ensure consistency throughout the department and industry best practices.

Minimal Monitoring and Program Oversight

Overview

Monitoring is a key component of internal control. Unmonitored controls deteriorate over time. When monitoring is designed and implemented appropriately, organizations are more likely to identify and correct problems on a timely basis. Ongoing monitoring can occur during daily operations, including regular management and supervisory activities involving comparisons, analysis, reconciliations, and other routine activities.

Management must ensure all documents prepared by their office are authentic, accurate, and complete. Knowledgeable persons with proper authority and subject matter expertise should perform various levels of review and approval. A thorough examination of the processes will help with accuracy, completeness, and timeliness.

Ongoing monitoring and review by management can determine the following:

- Prescribed policies, rules, and regulations are being carried out as intended
- Changes in operations have not made the procedures inefficient or obsolete
- Effective corrective measures are being taken promptly when deficiencies are discovered

Technology could help the county streamline the management of various affordable housing processes and identify potential red flags. Better use of technology, including software, document portals, or data visualizations, could improve current practices of managing agreements, affordability periods, and credits through data management and analysis, monitoring controls, and query reports.

Audit Activity

To determine if there was sufficient program oversight, we evaluated OHCD's monitoring practices, and control environment, conducted site visits, interviewed appropriate staff, compared current practices to written policies, procedures, and flowcharts, and found:

- Existing 2022 procedures do not sufficiently address management's role in reviewing agreements and credits.
- Prior to September 2022, affordable housing agreements and credits were not routinely monitored by management.
- OHCD does not have a complete accounting of affordable housing credits issued outstanding, transferred, or redeemed.
- OHCD management said before December 2018, a housing specialist worked independently without much supervision. Management also said they depended on this person's prior professional expertise.

- Insufficient contract monitoring to ensure compliance with:
 - 4 required signatures to execute a contract
 - Contract terms and conditions
 - Rental and sale details
 - Recordation with Bureau of Conveyance, State of Hawai'i

Cause of the Condition

- Management trusted but did not verify the work compiled or scrutinize the final contract, creating an opportunity for fraud
- Management reviews of the affordable housing agreement were inadequate to ensure compliance with Chapter 11
- The practice of issuing and tracking credits was ineffective, resulting in errors and irregularities

Effect of the Condition

- Employees learn to exploit weaknesses in the control environment.
- OHCD did not prioritize the vital role management oversight plays in quality control.
- The system was ineffective at safeguarding credits and ensuring credits were properly issued, controlled, and accounted for.

Finding 4 and 5: Minimal Monitoring and Program Oversight

Recommendation 4: Increase Monitoring and Program Oversight

We recommend OHCD perform ongoing monitoring of their internal control system's design and operating effectiveness as part of their operations. Continuous monitoring includes reviews of:

- Adjustments and discrepancies
- Reconciliations of credit inventory
- Regular management and supervisory activities
- Comparisons
- Final AHA
- Other routine activities

Recommendation 5: Use Software and Technology

We recommend OHCD use software and technology as a monitoring tool to improve managing affordable housing agreements and credits.

Insufficient Segregation of Duties

Overview

Segregation of duties is a key internal control. Its primary objective is to minimize risk by ensuring that no employee or group can have complete control or be solely responsible for multiple steps in a process. Generally, the primary incompatible duties that need to be segregated are:

- Authorizing transactions
- Processing and recording transactions
- Reviewing transactions
- Handling any related assets, including commodities
- Reconciliations
- Other control activities, when applicable

Knowledgeable personnel should be involved in drafting affordable housing contracts, authorization or approval, and reconciliation of affordable housing credits. No single individual should have complete control over consecutive phases of a process.

When duties cannot be segregated due to the small size of the division, compensating controls should be considered. These compensating controls should include monitoring activities such as a performance review of the AHA deliverables.

Audit Activity

To verify segregation of duties, we reviewed flowcharts, conducted site visits, interviewed appropriate staff, compared current practices to written policies and procedures, and found:

- Before December 2018, there was limited segregation of duties.
- Existing 2022 procedures still place the responsibility of multiple steps with the housing specialist. This increases the risk exposure to the employee.
- While we acknowledge the existing 2022 procedures do provide some segregation of duties, we found that housing specialist duties are defined and specific, while management duties are unclear.

Cause of the Condition

One individual had control over multiple steps. The same individual compiles, drafts, revises, routes, files, and monitors projects.

Effect of the Condition

Employee(s) learn to exploit weaknesses in the control environment.

Finding 6: Insufficient Segregation of Duties**Recommendation 6: Segregate Incompatible Duties**

We recommend OHCD management separate incompatible duties. One individual should not oversee key elements of the affordable housing process. Compensating controls should be implemented to reduce the risk if duties cannot be sufficiently segregated.

No Training

Overview

Training gives employees a better understanding of their responsibilities and the knowledge and skills they need to do their job. Training leads to better processes, builds confidence, and improves overall performance. Ongoing training enables organizations to further strengthen their employees' skills and increases knowledge where it is lacking. "Ongoing training can be considered the best insurance policy against all sorts of the inevitable changes and the unforeseeable needs that arise in your organization from time to time."¹⁰

Training has several benefits, including:

- Increases
 - Accountability
 - Competency
 - Productivity and performance
 - Uniformity of work processes
- Communicates role expectations
- Improves
 - Compliance
 - Work culture
- Protects
 - County from liability
 - Employees from error and omissions

Additionally, the County's Code of Ethics (Hawai'i County Code, Chp. 2, Art. 15, Sections 2-79, 2-83, and 2-84) prescribes standards of conduct for the guidance of County officers and employees as well as prohibiting certain conduct. County employees are not allowed to use or attempt to use their official position to secure or grant unwarranted privileges, exemptions, advantages, contracts, or treatment, for themselves or others.

Such prohibited conduct includes but is not limited to:

- Accepting, receiving, or soliciting compensation or other consideration for the performance of the officer's or employee's official duties or responsibilities except as provided by law.
- Using County property, facilities, equipment, time, or personnel for private business or for any purpose other than for a public purpose.

¹⁰ The Importance of Training. <https://seismic.com/enabement-explainers/the-importance-of-training/> date accessed 11-30-2022

- County employees are not allowed to acquire financial interests in any business or other undertaking that they have reason to believe may be directly involved in official action to be taken by them.
- Similarly, County employees are not allowed to take any official action directly affecting:
 - A business or other undertaking in which they have a substantial financial interest.
 - A private undertaking in which they are engaged as a consultant.

Audit Activity

To determine if OHCD provided sufficient training, we reviewed policies and procedures, interviewed appropriate staff, conducted site visits, made observations, and found:

- Because there were limited written policies and procedures, training schedules were not addressed.
- AHA's were not reviewed or monitored for completeness and accuracy.
- Housing specialist uses prior approved AHA as a basis for drafting contracts.

Cause of the Condition

Because management relied on one employee and did not provide continuous training, there were many problems that went undetected, and AHA's were not appropriately reviewed for completeness and accuracy.

Effect of the Condition

A former government employee used their official position to circumvent the department's internal control system.

Finding 7: No Training

Recommendation 7: Provide Training

We recommend OHCD provide ongoing training to employees involved in affordable housing, including specialized training to support competency.

Chapter 3

Fraud, Waste, and Abuse

What is Fraud?

“Fraud” is any activity that relies on deception to achieve a gain. Fraud becomes a crime when it is a “knowing misrepresentation of the truth or concealment of a material fact to induce to act to his or her detriment” (Black’s Law Dictionary). In other words, if you lie in order to deprive a person or organization of their money or property, you’re committing fraud.¹¹ (ACFE)

How is Fraud Different from Theft?

Theft is taking something that belongs to someone else without their consent. Fraud is using deceit or trickery to gain an advantage or unfair profit. To be convicted of fraud, the deception must be proven as intentional. Typically, fraud is used to get money or something of value to which the person would not typically get access. “Ultimately, the biggest difference between fraud and theft is that fraudsters will work to ensure that the deceived person does not find out they have been duped. As long as the person does not realize they have been deceived, no case can be made regarding intentional fraud.”¹²

Fraud Triangle.

Generally, why some people commit fraud is known as the Fraud Triangle. The Fraud Triangle hypothesizes that if all three components are present: financial pressure, opportunity, and rationalization, a person is very likely to pursue fraudulent activities.



Graphic: Fraud Triangle, courtesy Office of the County Auditor

¹¹ Fraud 101: What is Fraud? <https://www.acfe.com/fraud-resources/fraud-101-what-is-fraud#:~:text=The%20Fraud%20Triangle%20hypothesizes%20that,likely%20to%20pursue%20fraudulent%20activities>. (Date accessed 11-30-22)

¹² The Difference Between Fraud and Theft. <https://www.felonydefenseattorney.com/blog/2021/01/the-difference-between-fraud-and-theft/> (date accessed 11-30-22)

As a practice, we remain mindful and document instances of fraud, waste, and abuse within the scope of the audit objective and not specifically Countywide.

Management reported actual fraud, ongoing investigations and pending litigation. We will work with corporation counsel or appropriate law enforcement if it impacts the audit results.

We noted internal controls deficiencies and instances of non-compliance with provisions of Hawai'i County Code Chapter 11 Affordable Housing Policy and Affordable Housing Agreements (contracts). See Chapter 2, Audit Results.

Conclusion

We appreciate the Office of Housing and Community Development's commitment to continual improvement, providing fair housing and equal housing opportunities consistent with public expectations.

We thank the Office of Housing and Community Development for unrestricted access to sites, information personnel, and cooperation throughout the audit. Their cooperation was exceptional.

When our recommendations are implemented in good faith, OHCD can expect the following benefits:

Clarify County Code

1. Clarifying applicable sections of Chapter 11 will make laws easier to understand and ensure compliance.

Establish Administrative Rules

2. Establishing administrative rules will help guide OHCD authority to effectively administer the County's Affordable Housing Policy.

Update and Enforce Policies and Procedures

3. Updating and enforcing policies and procedures will ensure consistency throughout the organization and with industry best practices.

Increase Monitoring and Program Oversight

4. Ongoing monitoring will ensure OHCD's internal control system operates effectively and efficiently as designed.
5. Using technology as a monitoring tool will improve managing affordable housing agreements and credits.

Segregate Incompatible Duties

6. Segregating incompatible duties will ensure one individual does not oversee key steps/elements of the affordable housing process.

Provide Training

7. Ongoing training will ensure employees at all levels of the organization involved in the affordable housing process are knowledgeable and will be held accountable.

To improve government accountability and ensure audit recommendations are implemented or resolved, we will continuously monitor the status of pending recommendations using our remediation tracker. To view the status, visit us at: <https://www.hawaiicounty.gov/our-county/legislative/office-of-the-county-auditor>.

In closing, the improper use of government resources or positions is often discovered thanks to employees and the public, and we encourage you to report concerns through our fraud and whistleblower hotlines:

Fraud and waste hotline: (808) 480-8213

Whistleblower hotline: (808) 480-8279

Email: concern@hawaiicounty.gov

Fax: (808) 961-8905

Mail: Office of the County Auditor, 120 Pauahi St., Hilo, HI 96720

To access the complaints directory:

<https://www.hawaiicounty.gov/our-county/legislative/office-of-the-county-auditor/inquiry-and-complaint>

Submit a claim:

<https://www.hawaiicounty.gov/our-county/legislative/office-of-the-county-auditor/inquiry-and-complaint/intake-form>

Chapter 4

Management Response

Mitchell D. Roth
Mayor

Lee E. Lord
Managing Director

Robert H. Command
Deputy Managing Director



Susan K. Kunz
Housing Administrator

Harry M. Yada
Assistant Housing Administrator

County of Hawai'i
Office of Housing and Community Development
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Existing Housing: (808) 959-4642 • Fax (808) 959-9308
Kona: (808) 323-4300 • Fax (808) 323-4301

January 30, 2023

MEMORANDUM

TO: Tyler Benner
Hawai'i County Auditor

FROM: Susan K. Kunz
Housing Administrator

**SUBJECT: RESPONSE TO THE COUNTY AUDITOR'S REPORT ON THE
OFFICE OF HOUSING AND COMMUNITY DEVELOPMENT
AFFORDABLE HOUSING CREDITS**

.....
The Office of Housing and Community Development (OHCD) would like to express our sincere appreciation for the audit staff and their cooperation and consideration during the entire process.

OHCD is generally in agreement with the conclusions and recommendations contained in the report. We take this opportunity to specifically address each recommendation and our current and planned efforts in implementation.

MANAGEMENT RESPONSE TO AUDIT RECOMMENDATIONS

Clarify County Code

- Recommendation 1. We recommend Hawai'i County revise applicable sections of Chapter 11.

Management Response to Recommendation 1

OHCD concurs with this recommendation.

- OHCD has already engaged a consultant to conduct a review of Chapter 11 of the Hawai'i County Code and to provide recommendations for changes. The final report of the consultant should be available within the next two months which can be shared with

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the public and County Council. **It should be emphasized that authority to make any changes to Chapter 11 rests with the County Council.**

Establish Administrative Rules

- Recommendation 2. We recommend OHCD establish administrative rules to give itself the authority to administer the County's Affordable Housing Policy effectively.

Management Response to Recommendation 2.

OHCD concurs with this recommendation on the establishment of administrative rules. Upon the completion of the consultant's report on Chapter 11 and any changes to Chapter 11 that may be approved by the County Council as a result of this audit, OHCD will diligently pursue the establishment of administrative rules pursuant to the process specified in Chapter 91, HRS.

Update and Enforce Policies and Procedures

- Recommendation 3. We recommend OHCD clarify and enforce policies and procedures to ensure consistency throughout the department and industry best practices.

Management Response to Recommendation 3.

OHCD concurs with this recommendation.

- Prior to the audit, OHCD had already begun to establish written policies and procedures together with flow charts to document workflow on all processes associated with the implementation of Chapter 11. OHCD will revise these accordingly upon any changes to Chapter 11 by the County Council and with the administrative rules that are established.
- OHCD will continue to update and enforce any and all established policies and procedures on a regular basis.

Increase Monitoring and Program Oversight

- Recommendation 4. We recommend OHCD perform ongoing monitoring of their design system and operating effectiveness of their internal control system as part of their ordinary course of operations.

Management Response to Recommendation 4.

OHCD concurs with this recommendation.

- OHCD will establish ongoing monitoring and program oversight in its implementation of Chapter 11. OHCD will regularly evaluate the effectiveness and efficiency of such ongoing monitoring and oversight and will implement changes/improvements as appropriate.

- Recommendation 5. We recommend OHCD use Software and Technology as a monitoring tool and improve managing affordable housing agreements and credits.

Management Response to Recommendation 5.

OHCD concurs with this recommendation with reservations.

- In accordance with the audit's recommendation, OHCD will look into software options within the limits of available resources and in consideration of any revisions to Chapter 11. OHCD is currently researching various records management systems to allow for tracking of documents associated with its various processes.

Segregate Incompatible Duties.

- Recommendation 6. We recommend management separate incompatible duties. One individual should not oversee key elements of the affordable housing process.

Management Response to Recommendation 6.

OHCD concurs with this recommendation.

- OHCD has begun to separate duties by establishing policies, procedures, flow charts and internal controls that will ensure that all processes involve separate staff reviews and will continue to update these processes in accordance with any changes to Chapter 11 and consistent with administrative rules that are established.

Providing Training

- Recommendation 7. We recommend OHCD provide ongoing internal control training to employees involved in the affordable housing process.

Management Response to Recommendation 7.

OHCD concurs with this recommendation.

- OHCD will ensure that its employees are allowed to attend appropriate training sessions that are regularly provided by the County such as ethics training.
- Through its bi-weekly staff meetings, the Community Development Division staff share the status of various assigned projects island-wide.
- Through these bi-weekly meetings, OHCD will schedule regular training sessions to train staff on differing aspects of Chapter 11, related administrative rules and any changes to its policies and procedures.

Based on the Audit Report, it is clear that the system of Affordable Housing Credits is complex and difficult to understand without knowledge of its history dating back prior to the

establishment of Chapter 11. Prior to Chapter 11, developers that constructed affordable housing units beyond any requirements by the Land Use Commission or County rezoning actions, were provided “bonus credits” that could be utilized to fulfill requirements on future development of their other properties. These “bonus credits” were typically granted to large landowners and were not marketable or transferrable to other developers for value.

Upon the initial establishment of Chapter 11, affordable housing requirements were imposed at the time of rezoning and developers were provided several options to meet their requirements including building the required affordable housing units or pay an in-lieu fee to fulfill their obligation. Subsequent changes to Chapter 11 eliminated the in-lieu fee option and established the concept of “excess credits”. These provided an incentive for developers to build more than their required number of affordable housing units as well as providing a mechanism for rewarding non-profit developers for their development of affordable housing units through the sale of these “excess credits” for other developers to fulfill their affordable housing requirements.

Adding to this complexity, the State Legislature established by statute, HRS 46-15.1(b), the requirement that the Department of Hawaiian Home Lands be provided credits on a “one for one” basis, regardless of AMI, for all housing units developed by their program. These credits were similar to “excess credits” that provided a financial benefit to DHHL through the sale of these credits to developers to fulfill their own affordable housing requirements.

The Audit Report makes a clear recommendation that the County needs to make significant changes to Chapter 11 and the current system of credits. OHCD agrees with the Audit Report and will work with the consultant that is already on contract for a review of Chapter 11 and ensure that the Audit Report’s recommendations are considered before finalizing their review and suggested changes to Chapter 11.

OHCD has enjoyed working with you and your staff in the preparation of this audit and looks forward to the improvements that will result from the implementation of its recommendations.

Chapter 5

Attachments

Attachment 1: OHCD Written Policies and Procedures.

ASSIGNMENT OF AFFORDABLE HOUSING CREDITS EXISTING POLICIES AND PROCEDURES – EFFECTIVE 08/29/2019

To complete the Assignment of Affordable Housing Credit(s) (“Assignment”) the following steps shall be completed:

1. The Assignor shall provide an accounting of Credits to the Housing Administrator before the Assignment.
2. The OHCD shall verify the Assignor has Credits available to assign to another party.
3. The Assignor and Assignee shall provide a Corporate Resolution or Bylaws for signing authority of contracts on behalf of the Corporation or LLC to the Housing Administrator.
4. The Assignor and Assignee shall complete the attached Assignment of Affordable Housing Credit (“Assignment”) Form, and attach all required Exhibits, and all Corporate Resolutions.
5. The Assignor shall submit an original copy of the Assignment to the Housing Administrator to approve and execute.
6. The Housing Administrator shall return the executed Assignment within five (5) working days via Certified Mail, Receipt Requested to the Assignor.
7. The Assignor shall record the Assignment with the Bureau of Conveyance (BOC) or Land Court of the State of Hawaii as applicable within thirty (30) days of its execution by all parties effective upon execution. Failure to record the Assignment within thirty (30) days will void this transaction.
8. The Assignor shall provide an accounting of Credits after the Assignment is recorded with the State of Hawaii Bureau of Conveyance to OHCD within (10) days.
9. The Assignor shall return a true copy of the recorded Assignment with the BOC within ten (10) working days via Certified Mail, Receipt Requested to the Housing Administrator.

Source: Office of Housing and Community Development

Attachment 2: OHCD Transfer of Affordable Housing Credits Letter.

Harry Kim
Mayor

Wil Okabe
Managing Director

Barbara J. Kossow
Deputy Managing Director



Neil S. Gyotoku
Housing Administrator

Duane Hosaka
Assistant Housing Administrator

County of Hawai'i Office of Housing and Community Development

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September 9, 2022

Via Electronic Mail

Developer Name
Title
Entity Address
Email

**EXISTING PROCEDURES
SAMPLE LETTER
(EFFECTIVE 8/29/2019)**

Re: Transfer of Affordable Housing Credits

Dear Developer:

The Office of Housing and Community Development (OHCD) has received your email request dated X/X/20XX regarding selling and transferring Affordable Housing Credits ("Credits") earned in the County of Hawai'i ("County") to another party and the proper assignment form required by the OHCD to file and effectuate the sale and transfer of Credits.

To complete the Assignment of Affordable Housing Credit(s) ("Assignment") the following steps shall be completed:

1. The Assignor shall provide an accounting of Credits to the Housing Administrator before the Assignment.
2. The OHCD shall verify the Assignor has Credits available to assign to another party.
3. The Assignor and Assignee shall provide a Corporate Resolution or Bylaws for signing authority of contracts on behalf of the Corporation or LLC to the Housing Administrator.
4. The Assignor and Assignee shall complete the attached Assignment of Affordable Housing Credit ("Assignment") Form, and attach all required Exhibits, and all Corporate Resolutions.
5. The Assignor shall submit an original copy of the Assignment to the Housing Administrator to approve and execute.

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EQUAL HOUSING OPPORTUNITY
HAWAII COUNTY IS AN EQUAL
OPPORTUNITY PROVIDER AND
EMPLOYER

Source: Office of Housing and Community Development

Attachment 2: continued.

September 9, 2022

Page 2

6. The Housing Administrator shall return the executed Assignment within five (5) working days via Certified Mail, Receipt Requested to the Assignor.
7. The Assignor shall record the Assignment with the Bureau of Conveyance (BOC) or Land Court of the State of Hawaii as applicable within thirty (30) days of its execution by all parties effective upon execution. Failure to record the Assignment within thirty (30) days will void this transaction.
8. The Assignor shall provide an accounting of Credits after the Assignment is recorded with the State of Hawaii Bureau of Conveyance to OHCD within (10) days.
9. The Assignor shall return a true copy of the recorded Assignment with the BOC within ten (10) working days via Certified Mail, Receipt Requested to the Housing Administrator.

As always, should you have any questions with regard to these procedures please do not hesitate to contact our office. Thank you.

Very Truly Yours,

Housing Administrator

Enc.

Source: Office of Housing and Community Development

Tyler J. Benner
County Auditor

County of Hawai'i
Office of the County Auditor

120 Pauahi St., 309
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The Office of the County Auditor is tasked with promoting accountability, fiscal integrity, and openness in local government. Our work is intended to assist County government in its management of public resources, delivery of public services, and stewardship of public trust. Copies of this audit report can be obtained by contacting the Office of the County Auditor or visiting our website: <https://www.hawaiicounty.gov/our-county/legislative/office-of-the-county-auditor/audit-reports>