



## MEMORANDUM

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To: Audit Committee

From: Mary Hom  
Chief Risk Officer

Date: October 3, 2023

Re: Internal Audit Report

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Since the last report to the Audit Committee on September 27, 2023, one internal audit project was completed – Portfolio Management.

### **2023 Portfolio Management (assurance)**

#### Background:

HDC's Asset Management department monitors and manages the portfolio of properties that HDC has financed. This entails monitoring the financial health of each property and performing an annual physical inspection of each property to ensure that each property is maintained in a safe and sanitary manner. Three divisions under the Asset Management department (Engineering & Architecture (EA), Portfolio Analysis (PA), and Preservation Programs (PP)) are focused on monitoring and maintaining the overall health of HDC's portfolio of projects.

#### Objective:

There were three objectives of this audit: (1) to determine how projects in distress are managed between the E&A, PA, and PP divisions; (2) to assess management at the divisional level to determine compliance with HDC's Asset Management policies and procedures, as well as evaluate these controls; and (3) to assess the system for managing HDC's portfolio of properties across all three divisions.

#### Results:

Upon completion of the audit, we noted no matters involving internal controls that we considered material weaknesses. Opportunities exist to enhance current operations including formalizing training procedures for Portfolio Analysts and Asset Managers, formalizing coordination on projects in distress, strengthening capacity through additional hiring, and centralizing all aspects of project data.

## Portfolio Management Audit

### Objectives:

There are three objectives of this audit:

- To determine how projects in distress flow between Engineering and Architecture, Portfolio Analysis, and Preservation Programs.
- To assess management at the divisional level to determine compliance with the Corporation’s policies and procedures, as well as evaluate these controls.
- To assess the system for managing HDC’s portfolio of properties across Asset Management’s divisions.

### Scope:

This audit reviewed how information is shared between three divisions of Asset Management (Engineering and Architecture, Portfolio Analysis, and Preservation Programs). Internal Audit assessed the collaboration across teams in helping to manage “problem projects.” Internal Audit focused on projects active in 2022.

### Background:

The function of the Asset Management department is to monitor and manage the HDC portfolio of properties that we have provided financing for. This primarily entails monitoring the financial health of each property, inspecting each property on an annual basis, and structuring/restructuring financing as needed. To perform its functions, the Asset Management department has three major divisions focused on maintaining the overall health of the HDC portfolio:

- **Engineering and Architecture (E&A):** Projects financed by HDC require an annual property inspection (API) be performed by the E&A division of Asset Management. These inspections ensure that the property is maintained in a safe and sanitary way. During an inspection, HDC undertakes various prescribed procedures to monitor and assess both the exterior and interior physical condition of a project and its maintenance practices.
- **Portfolio Analysis (PA):** The PA team within Asset Management monitors projects to ensure their financial health. PA is responsible for overseeing the fiscal condition of developments by reviewing their financial statements and reports. The PA division is also responsible for managing any financial restructuring of projects (where applicable).
- **Preservation Programs (PP):** The PP team is focused on Mitchell-Lama (ML) projects within the HDC portfolio. HDC has approximately 70+ ML projects in its portfolio. These projects tend to be larger, older projects that were primarily developed in the 1950s and 1960s. They are complicated in nature and require a unique focus because of the many rules and regulations around ML housing. For ML projects that are facing physical, financial, or operational distress, PP identifies opportunities for re-development. It is the responsibility of this division to perform underwriting, guide these proposals through Credit Committee and Board approvals, close financing transactions, and help create sound financial programs to ensure the overall health of ML projects.

### Results:

Upon completion of the audit, we noted no matters involving internal controls that we considered material weaknesses. Opportunities exist to further enhance operations for Portfolio Management to ensure the most efficient use of HDC’s resources. This would include formalizing training procedures for Portfolio Analysts/Asset Managers, coordinating follow-up on projects in distress, strengthening capacity through hiring, building a proactive management structure, and ensuring all information is collected and centralized in a timely manner.

#### Portfolio Metrics Observed

Average Debt Service Coverage: >1.15  
Average Occupancy Rate: >95%  
Average Physical Rating: >Satisfactory

#### Internal Controls

- ✓ Segregation of duties based on expertise
- ✓ Information sharing between divisions
- ✓ Training for Portfolio Analysts, Asset Managers, and Engineers
- ✓ Project rating systems and metrics in place
- ✓ Annual review of financial and physical health of each property
- ✓ Divisional tracking sheets and systems
- ✓ Scheduled meetings between senior staff