TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS
An Internal Audit of the Multifamily Bond Program
Audit Report # 20-001

Executive Summary

The Office of Internal Audit (OIA) reviewed TDHCA's Multifamily Bond program, its internal controls, and policies and procedures that are currently in place. Based on our reviews and testing, the OIA concludes that he Multifamily Bond program operates in compliance with applicable rules. The OIA has identified the following improvement areas to improve transparency and efficiency of operation, as well as business continuity.

Observations and Recommendations

1. OIA recommends that the Multifamily Bond program establish signed and dated SOPs to create consistency and efficiency for all parties involved in the program.
2. Internal Audit recommends that a secondary staff be cross trained in the duties and responsibilities of the Director of Multifamily Bond program for the purpose of consistency and continuity of operation of the program.
3. Internal Audit recommends that Financial Administration continue its efforts to cross train others on the key processes such as monthly reconciliation and document the procedures in detailed and approved SOPs.
4. Internal audit recommends that the Multifamily Bond program establish communication with Financial Administration division to be kept apprised of the results of SOC1 reports
5. Internal Audit recommends that the evaluation criteria be expanded and additional criteria, such as previous history and relationship of the firm with the Department, be added to the evaluation criteria and scoring.
6. When implementing the new GASB standard, the Financial Administration team should review the entire process that it completes to determine how best to comply with the standard along with any regulatory requirement in the most efficient manner

Response:
Management agreed with our recommendations, except for recommendation number five. Detailed responses are included in the body of the report.

Objective, Scope and Methodology

Our scope included a review of the Texas Government Code (TGC), as well as the Texas Administrative Code (TAC) applicable to the program. Based upon our preliminary understanding of the Multifamily Bond program, we identified critical points and risks, and developed our audit objectives accordingly.

Mark Scott

Mark Scott, CPA, CIA, CISA, CFE, MBA
Director, Internal Audit

3/13/2020
Date Signed

Texas Department of Housing and Community Affairs

www.tdhca.state.tx.us

Greg Abbott
Governor

March 13, 2020

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Board Members of the Texas Department of Housing and Community Affairs ("TDHCA")

RE: Internal Audit of the Multifamily Bond Program

Dear Board Members:

This report presents the results of the Office of Internal Audit ("OIA") "*Review of the Multifamily Bond Program*." This audit was conducted in accordance with applicable audit standards. It included the objectives to evaluate and explain the Multifamily *Bond Program* and to evaluate the administrative and internal control procedures related to the program.

The Multifamily Bond Program rated high on the risk assessment and was included in the approved Fiscal Year 2019 audit work plan due to its level of complexity of transactions and processes, in addition to interest expressed by Committee members.

This report is divided into the following sections:

A. Background
B. Scope and methodology
C. Roles and responsibilities of each party in the Multifamily Bond program
D. Processes and flow of transactions
E. Testing and review
F. Other audit work

A) Background

In recognition of the need for a larger pool of affordable housing in the United States, The Community Reinvestment Act (CRA) was enacted in 1977 and requires the Federal Reserve and other federal banking regulators to encourage financial institutions to help meet the credit needs of the communities in which they do business, including low- and moderate-income neighborhoods. Banks are reviewed for their performance against the requirements of the CRA and this performance is considered in context with other supervisory information when analyzing applications for mergers, acquisitions and branch openings.

Another key legislative initiative was enacted as part of the 1986 Tax Reform Act, the Low-Income Housing Tax Credit (HTC). These credits are issued to the States which then allocate them to developers based on state-created Qualified Allocation Plans (QAP). Projects financed by private activity tax-exempt bonds (such as those issued by the Multifamily Bond Division) utilize the 4% Noncompetitive HTC in addition to providing very low cost financing. The QAP establishes the eligibility and threshold requirements relating to 4% HTC applications.

Developers sell the tax credits to investors, who are able to use the tax credits and other tax benefits of the housing project (e.g., depreciation, interest paid, net operating losses). Investors also contribute equity, often through syndication or a partnership. The investors or limited partners usually play a passive role, receiving the tax benefits associated with the project but not participating in day-to-day management and oversight.

Most investors in Low Income Housing Tax Credit (LIHTC) projects are corporations that have an income tax liability that would make the tax credits beneficial. Financial institutions can be major investors in these developments, because they have substantial income tax liabilities, have a long planning horizon, and may receive Community Reinvestment Act credit from their regulators for such investments.

The Department's authority to issue Mortgage Revenue Bonds (MRBs) is derived from its enabling legislation, along with provisions of Section 142 of the Internal Revenue Code and Chapters 1371 and 1372 of the Texas Government Code. The Department's capacity to issue MRBs for multifamily projects is subject to the Texas Bond Review Board's (BRB) allocation for private activity volume cap. The Multifamily Bond program issues taxable and tax-exempt MRBs to fund loans to nonprofit and for-profit developers. The proceeds of the bonds are used to finance the construction, acquisition, or rehabilitation of multifamily properties, with the targeted beneficiaries being low income households.

From the 2019 audited Financial Statement, the Revenue Bond Program has total assets of $2.4 billion, most of which is held in trust. The statements report total liabilities of $2.13 billion. Of that, $1.8 billion is Revenue Bonds and Notes payable. Of that amount, $938 million is Multifamily Bonds and Notes (see Appendix A). These bonds and notes are payable solely from the revenues and funds pledged for the payment and do not utilize any General Revenue of the State. Because of the various legal documents which define assignments of rights, duties and responsibilities for each transaction, the MRBs create no liability to TDHCA or the State of Texas.

B) Scope and Methodology

Our scope included a review of applicable portions of the Texas Government Code and TDHCA Board resolutions, as well as the program's Standard Operating Procedures (SOP). Based upon our preliminary understanding of the Multifamily Bond Program we identified critical points and risk, to develop audit objectives and an audit program including methodology.

We reviewed the Multifamily Bond Program's goals, processes, and roles and responsibilities. We reviewed the controls related to the Bond Program and tested certain transactions and controls. The Texas Internal Auditing Act, Tex. Gov't Code §2102.005 requires auditing of a state agency's major programs and systems.

Standard Policies and Procedures

An SOP is a procedure specific to the operation of a division that describes the activities necessary to complete tasks in accordance with applicable rules and regulation. It defines expected practices in a process where quality standards exist. SOPs play an important role in any organization and division as they're policies, procedures and standards needed to operate in a successful way. They can create efficiencies, consistency and reliability, fewer errors, and value added to the division.

As of the beginning of this audit the SOP provided by the Multifamily Bond program for audit review was not signed. The Director has acknowledged that the SOP should be signed and dated to establish its reliability.

Observation Number	Status Pertaining to the Recommendations and Action to be Taken	Target Completion Date	Responsible Party
20-001.01	Internal Audit recommends that the Multifamily Bond program establish signed and dated SOPs to create consistency and efficiency for all parties involved in the program.	3/5/2020	MF Bond Program

Management Response

The SOPs that encompass the MF Bond Program have been signed and will be provided to Internal Audit with the final Audit report.

C) Roles and Responsibilities of each party in the Multifamily Bond Program

- **TDHCA Staff**

  The Multifamily Bond program consists of only one operational staff, the director, at this time. The process of application reviews and approval is completed in conjunction with Tax credit applications and through Multifamily Finance division's staff. While the details of the process followed by the Director are documented in Standard Operating Procedures (SOPs), the deep knowledge of both the key relationships and deal structures remain solely with the Director.

  The Multifamily Bond program is supported by the Financial Administration division which has recently been realigned to expand management of the team and encourage cross training as well as to streamline procedures. Until this change was made, Multifamily Bonds were primarily supported by one individual in Financial Administration.

Observation Number	Status Pertaining to the Recommendations and Action to be Taken	Target Completion Date	Responsible Party
20-001.02.a	Internal Audit recommends that a secondary staff be cross trained in the duties and responsibilities of the Director of Multifamily Bond program for the purpose of consistency and continuity of operation of the program.	3/3/2020	MF Bond Program
20-001.02.b	Internal Audit recommends that Financial Administration continue its efforts to cross train others on the key processes such as monthly reconciliation and document the procedures in detailed and approved SOPs.	08/01/2020	Manager of Bond Accounting

Management Responses:

20-001.02.a; A new employee was hired on March 3, 2020 who will be assisting the Multifamily Bond Program Director in carrying out certain responsibilities of the division.

20-001.02.b; Financial Administration acknowledges this observation. Financial Administration continuously evaluates and initiates cross training efforts on essential processes. Even though one senior bond accountant is primarily responsible for the accounting of multifamily bond transactions; the team leader of bond accounting, a senior bond accountant, and an associate bond accountant have been trained and are able to perform the necessary duties to process and monitor multifamily bond transactions if the need arises. Due to an increase in volume and complexity in multifamily bond transactions, the bond accounting team is currently training an additional senior bond accountant to be able to process and monitor multifamily transactions using the established technological processes. We expect for this training to facilitate the documentation of procedures to supplement current procedural checklists and identify any areas that would increase efficiency.

- **Bond Finance Division**
  The Bond Finance Division is primarily responsible for administering the Department's MRB programs post-issue. MRB programs provide below market interest rate funds for multifamily mortgage loans made to qualifying developers of multifamily housing for lower income households. The Bond Finance Division ensures compliance with applicable bond covenants and provides detailed reporting to other regulatory agencies including the BRB and Internal Revenue Service (IRS).

- **Financial Advisor**
  The Financial Advisor assists the Department by working with Bond Counsel and the Department to ensure that the transaction as structured poses no undue risk to the Department from a financial perspective.

- **Trustee**
  The Trustee is the entity responsible for managing the Trust Estate under the indenture. The Trustee administers the funds specified in the indenture in a fiduciary capacity on behalf of the bondholders. Applicants are required to utilize a Department approved Trustee. Currently the Department has several approved Multifamily Bond Trustees, and the list is available on TDHCA's website.

  The process of Request for Qualification (RFQ) for selecting "Approved Trustees" was changed in 2016 with a Board resolution which stated; *"The seven trustees remain on Department's approved list for a period of two years or until their qualifications are required to be renewed"*. Financial Administration requires all trustees to submit an annual System of Organization Control report known as SOC1 report. Currently, this report is received and reviewed only by financial administration division.

Observation Number	Status Pertaining to the Recommendations and Action to be Taken	Target Completion Date	Responsible Party
20-001.03	Internal audit recommends that the Multifamily Bond program establish communication with Financial Administration division to be kept apprised of the results of SOC1 reports	12/01/2020	Manager of Bond Accounting

Management Response:

Financial Administration acknowledges this observation. As part of the financial opinion audit process, the Financial Administration requests a System and Organization Controls Report (SOC1 Report) from each of the multifamily bond trustees. The purpose of this report is to provide users of these entities' processes reasonable assurance that the internal controls are suitably designed and operating effectively. The reports are reviewed and a memorandum is prepared listing key elements of the report and the overall conclusion of the report. The SOC1 reports are also submitted to the

State Auditor's Office for review. All reports received during the fiscal 2019 audit process reflected an opinion by independent auditors noting that internal controls were suitably designed to provide reasonable assurance of their effectiveness. Going forward, reports and memorandums will be made available to multifamily program area for their reference.

- **Lender**
  The transactions have a construction lender and a permanent lender that sometimes can be one in the same entity. In some transactions, a federally chartered organization such as the Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Mortgage Corporation (Freddie Mac) buys the loan from the initial lender and provides Mortgage Backed Securities that guarantee payment to the bond holders.

- **Developer / Borrower**
  The Developer or Borrower manages and executes the project for affordable multifamily housing. Often the Developer will designate 100% of the project for affordable housing based on the IRS's guidelines for the 4% HTC to maximize on the tax credits.

- **Underwriter**
  The Underwriter purchases the MRBs from TDHCA and sells them to investors. The Underwriter can either place the MRBs privately, in which case they would act as placement agent, or sell to the public, usually in $1,000 increments.

- **Outside Bond Counsel**
  Outside counsel is responsible for legal representation of the Department on bond and related matters. Bond counsel provides legal counsel and assistance to the Department's Governing Board, the Executive Director, the General Counsel, and other senior staff in developing and implementing housing assistance bond programs. It includes the drafting of the bond documents that govern the Department's multifamily bond issuances, review and analysis of relevant law and documentation, delivery of oral and written advice and other consultation as needed. Bracewell LLP has been serving as the Department's outside bond counsel for the last several years.

- **Outside Disclosure Counsel**
  The Bond disclosure counsel is responsible for performing necessary legal services in connection with disclosures concerning the Department and its multi-family program in any offering of securities by the Department. These services include review of Official Statement and all other offering disclosure documents to be used in the marketing of the security associated with the Department's multifamily bond program.

<u>Observation</u>

The Outside Bond Counsel and Outside Disclosure Counsel are selected through Request for Qualification (RFQ) process and on biennial basis. Minimum of three bids is required for the procurement process. The completed bids are reviewed by three staff members and scored based on four generally established criteria. Department has been contracting with Bracewell LLP, for Bond Counsel services, and with McCall Parkhurst & Horton for disclosure Counsel Services

In reviewing RFQs and the procurement documents of the last two biennials we've noticed that all of the three evaluators gave perfect scores of 100 to the selected firm, Bracewell LLP, during each biennial's evaluation. Internal audit believes that the process can be improved to provide more transparency and to avoid any appearance of bias in selecting outside counsels.

Observation Number	Status Pertaining to the Recommendations and Action to be Taken	Target Completion Date	Responsible Party
20-001.04	Internal Audit recommends that the evaluation criteria be expanded and additional criteria, such as previous history and relationship of the firm with the Department, be added to the evaluation criteria and scoring.		

Management Response:
Management acknowledges this recommendation but respectfully disagrees. The prior RFQ responses were evaluated and scored based on the identified scoring criteria and responses provided. While it was inferred that the scores given to the Bracewell LLP firm took into account their previous relationship with the Department, their score should also be viewed in the context of the submissions provided by other firms.

D) Processes and Flow of Transactions

Bonds are debt instruments requiring repayment to the investor of the principal amount borrowed plus interest over some specified period of time. Bonds may be issued as short-term bonds or long-term bonds, depending on the structure of the transaction. The Multifamily Bond Program is coupled with the non-competitive (4%) Housing Tax Credit Program when the bonds finance at least 50% of the cost of the land and buildings in the development.

In November of each year, the IRS announces the per capita and small state minimum levels Private Activity Bonds on a per capita basis for the following calendar year. Based on the BRB's Governing Statute, TDHCA has a set-aside of 20%, 10% goes to Texas State Affordable Housing Corporation (TSAHC) with the majority of 70% volume cap set-aside for local Housing Finance Corporations.

Based on expected activity, if there are requests for bond or note issues that exceed the volume cap set-aside, TDHCA will participate in the BRB lottery to select the recipients. In recent years, there has been no need to participate in the lottery as the volume cap has been sufficient to meet the demand for TDHCA bond issuances. Per review of the latest Multifamily Bond Pipeline report dated February 15th 2020, the current issue requests is equal to $196M and the TDHCA volume cap for Multifamily bonds is $229M (including 2019 carryover amounts).

Each transaction is unique in the way it is structured and financed. Each Developer / Borrower engages their own team (comprised of their legal counsel, lenders, equity providers, general partner selection (if not the developer) to help figure out how best to structure the deal. TDHCA has key relationships with its Bond Counsel, Disclosure Counsel, and financial advisor to ensure that the deal is valid and financially sound from TDHCA's perspective in adhering to rules, regulations and standing as a conduit issuer. In addition, State regulations require both the Texas BRB and TDHCA's Board approve the transactions before closing can occur.

The many parties to the deal include, but are not limited to, the following:

Developer / Borrower – receives a loan to build or rehabilitate properties for affordable housing that provides funds at a low borrowing cost; is paid a developer fee for its efforts; receives tax credits that can be sold to a third party to obtain additional financing for the project.
Lender - collects fees from the transaction and may assist in compliance with the Community Reinvestment Act of 1977 (CRA) for banks to lend funds to build affordable housing.
Investor Partner – large corporations (such as financial institutions, communication companies, or insurance companies) access tax credits.
Trustee – administers the trust estate on the Department's behalf.
External legal counsel, financial advisors – collect fees for their work on the transaction, noting total fees for the Bond issue are capped by the IRS at 2% of total PAR value.
TDHCA – furthers the goal of increasing multifamily affordable housing options in the State without taking on liability for the repayment to the bondholders.
Low income Texans – have a safe, secure place to live at affordable rent pricing.

Because the Bonds and Notes are issued as conduit debt, there are multiple legal documents required in order to document all the relationships and assignments of rights, duties and liability to all the appropriate parties. Therefore, there are many knowledgeable and experienced people involved with each deal who are considered to be experts in the field. Through the years, the transactions have evolved and parties to the deals are finding creative ways to reduce risk and costs while maintaining funding opportunities for the projects. A more common approach at this time is to utilize Mortgage Backed Securities (MBS) in place of the outstanding loan to the Borrower so that these securities can guarantee payments to the bondholder should the Borrower default. Again, this reduces the pass through interest rate paid by the Borrower by enhancing credit in the overall deal as well as providing further assurance that bondholders will be repaid.

The process of TDHCA's issue of Bonds or Notes begins with an inducement questionnaire filled out by the Developer. TDHCA MF Bond Division reviews the questionnaire to gain an understanding of how the deal may be structured. Once that has occurred, the Developer submits a pre-application requesting a reservation of bond volume cap that includes fees for TDHCA, Bond Counsel and the BRB.

The pre-app is processed in accordance with MF Bond Division rules regarding threshold requirements and scoring; the pre-app will be ranked at that time if there is an over-subscription of volume cap. TDHCA sends out a notification letter to local elected officials and organizations as well as an email to the affected zip code email list. Bond Counsel utilizes the pre-app posted on TDHCA's website to draft the TDHCA Board Inducement Resolution for presentation at the next Board meeting. The pre-app process takes about 30 days to complete if everything goes smoothly and all information is provided as requested on a timely basis.

Once the TDHCA Board approves the Inducement, Bond Counsel prepares the BRB application for volume cap and submits to the BRB. Once approved, the BRB sends a reservation notice to the applicant and other relevant parties confirming the reservation of TDHCA's volume cap for the transaction. In the meantime, the Developer will submit the full application for the HTC in accordance with MF Division guidelines. Within 14 days of submission, TDHCA sends out another round of notifications as noted above for the pre-app. TDHCA staff will also coordinate and hold the IRS-required TEFRA hearing as bond issuer.

The MF Bond Division coordinates the assembly of the project team with a kick-off call and subsequent follow-up conference calls. Once the deal structure is reviewed, Bond Counsel files the BRB required 35-day notice on behalf of the Developer and Issuer and drafts the required legal documents and distributes them for review and comments from all participants in the working group. Due to the complex nature of these transactions and the number of people involved with review, the process of finalizing the documents can take 4-6 weeks, or even longer. Bond Counsel will alert the MF Bond Director if there is any language that may need to be clarified based on TDHCA policy and rules.

The deadline to have these legal documents substantially final is within 10 days before the targeted TDHCA Board meeting. The MF Bond Director presents the transaction to the Executive Award Review Advisory Committee (EARAC) for a recommendation to the Board to approve. Both a Previous Participation Review and Real Estate Analysis report are included for review. A recommendation from EARAC is required prior to Board consideration. Once received and legal documents substantially final, the Board Action Request is routed for inclusion in the TDHCA Board materials. At the Board meeting, the MF Bond Director will present the transaction for Board action. Once approved, the transaction details and associated BRB required documents are compiled for BRB review and approval.

Once approved by the BRB, the MF Bond Director circulates the approval to the working group. The Director prepares the TDHCA closing fees memo which includes origination fee, one year of bond compliance fees and two years of administrative fees (first year prorated based on closing date). At this time the TDHCA General Counsel will add its opinion letter to the legal documents. The closing memorandum is routed to the working group and each party verifies pertinent information (for the Department this includes accurate wiring instructions and Department fees due at closing).

Once all parties have confirmed that they are in a position to close, the funds are received by the bond Trustee, wires to pay cost of issuance are initiated and the Bonds are closed. A final report for each transaction is filed with the BRB as required.

Each year on August 15th, the remaining amount of volume cap is collapsed from the original set-asides of the Program and requests are considered on a first come, first serve basis. At this time, TDHCA may request additional private activity bond allocation from the BRB for any individual projects it may have in its pipeline.

The Bond Accounting group processes the transactions related to all Revenue Bonds, with the balance outstanding at FY2019 year-end of $1.7B of which $938M relates to Multifamily Revenue Bonds. All revenue bonds are backed by the pledged revenue sources and restricted funds of the trust estate. Each series is designed to be self-supporting with no repayment nor obligation from the State's General Revenue. The Department issues MF bonds to assist in financing the construction or acquisition and rehabilitation of rental housing for families or seniors with very low to moderate incomes.

These bonds are considered to be conduit debt whereby the conduit issuer (TDHCA) is not responsible for making payments to bondholders; rather, the borrower, through the revenue produced by the property, is responsible for repaying the bondholder. Therefore the investors in the bonds are investing in the construction project as well as the credit standing of the bond issuer. As a result of the higher risk that this arrangement poses, the yield on conduit bonds tends to be higher than that of traditional municipal bonds. In addition, these arrangements are held and administered via a trust relationship where the trustee is an authorized bank that takes on the role of handling all the funds and accounting for underlying transactions within the trust funds.

Recent transactions issued by the Department have utilized a cash collateralized structure:

1. TDHCA issued bonds are sold to either a private investor or to the public.
2. Bond proceeds are deposited to the trust funds and used for project costs.
3. A lender (bank chosen by the Borrower) loans the Borrower funds to cash collateralize the bonds during construction. This loan is collateralized by the project itself.
4. As amounts are requested from the trust funds to pay project costs, additional portions of the loan are provided by the lender to fund the project costs.
5. In some arrangements, the lender sells its loan to a federally chartered organization such as Fannie Mae or Freddie Mac in exchange for Mortgage-backed securities which are used to guarantee payments on the outstanding bonds.

From an accounting perspective, the funds are held in trust and are not owned by TDHCA nor is the liability owed by TDHCA, In highly simplified form, the Financial Administration division currently books the following entries for each piece of the process:

1. Bonds are issued and sold:

DR Cash	$10,000	
CR Bond payable		$10,000

*keeping in mind that the cash is actually deposited in trust, so it doesn't truly belong to TDHCA. Because of all the legal documents in place, the liability is not owned by TDHCA either.

2. TDHCA makes a "loan" to the Borrower:

DR Loan receivable	$10,000	
CR Cash		$10,000

3. IF there is an MBS component:

DR MBS	$10,000	
CR Loan receivable		$10,000

4. Trustee reports current assets in trust:

DR Cash and cash equivalents	$10,000	
CR Due to Developer		$10,000

*the "Due to Developer" amount is recorded in "Other Long-term Liabilities" and is offset by the amount of cash and cash equivalents held in trust.

In this scenario, the assets and liabilities are equal to the amounts reported in the trustee statements. The Bond module in MITAS is updated as changes are made, and interest is recorded for these transactions, which is offset as well.

Observation

The accounting and reporting for these transactions uses an offsetting account such as "Due to Developer" to equal the cash and cash equivalents held in trust, which keeps the balance sheet in balance. The booking of Bonds Payable and an offsetting Loan Receivable or MBS balance are included the asset and liability balances.

This problem is wide-spread across governmental agencies that have been issuing conduit debt. There has been inconsistent reporting of these assets and liabilities. Recognizing this problem, the Governmental Accounting Standards Board issued *GASB No. 91, Conduit Debt Obligations* which will require that these assets and liabilities are no longer reported directly on the financial statements; rather they will be reported as footnotes. The GASB statement is effective for reporting periods starting after 12/15/2020. This will represent a major change to the TDHCA Bond Revenue Fund financial statements, and per discussion with Financial Administration the latest implementation date would be FY2022, however the State Comptroller may direct early implementation.

Observation Number	Status Pertaining to the Recommendations and Action to be Taken	Target Completion Date	Responsible Party
20-001.05	When implementing the new GASB standard, the Financial Administration team should review the entire process that it completes to determine how best to comply with the standard along with any regulatory requirement in the most efficient manner.	08/01/2022	Director of Financial Administration

Management Response:

Financial Administration acknowledges this observation. Financial Administration keeps abreast of changes in accounting guidance by attending conferences, training classes, and referring to published resource materials. As part of any implementation of Governmental Accounting Standards Board (GASB) pronouncement, Financial Administration evaluates its current reporting processes, Texas Comptroller of Public Accounts reporting requirements, and discussions with the State Auditor's Office to ensure that it is compliant with the new reporting guidelines. When implementing GASB 91, Financial Administration will be following this process to ensure that its implementation is accurate, effective and efficient.

E) Testing and Review

As part of our audit we reviewed two transactions involving the issuance of Multifamily Bonds or Notes and four transactions that occurred post-issue (such as a defeasement or ownership change). Reviewing the transactions included the origination of the transaction, tracking it within the processes noted above and through to the accounting systems and processes. See Transaction Flow Review documents included at the end of this report for the major processes evaluated in the audit scope (See Appendix B). In addition, we reviewed IRS rules, Texas Administrative Code, BRB rules, TDHCA rules and qualified allocation plan, and Division level policy, procedures and SOPs to ensure consistency. Based on our reviews the function of the Multifamily Bond Program is effective and shows no instance of non-compliance to the rules under which it operates.

F) Other audit work

Internal Audit has conducted an audit of Bond Finance division, with focus on Single Family bonds. This is the first comprehensive internal audit of the Multifamily Bond Program's processes and controls. TDHCA contracts with the Texas State Auditor's Office ("SAO") to conduct annual financial statement audits of the Revenue Bond Program. The latest audit was issued in December 2019, and stated that the financial statements were presented in accordance with Generally Accepted Accounting Principles ("GAAP").

OIA extends our sincere appreciation to the director of Multifamily Bond Program and management of Financial Administration division for their cooperation and assistance during the course of this audit.

Sincerely,

Mark Scott

Mark Scott, CPA, CIA, CISA, CFE, MBA
Internal Audit Director

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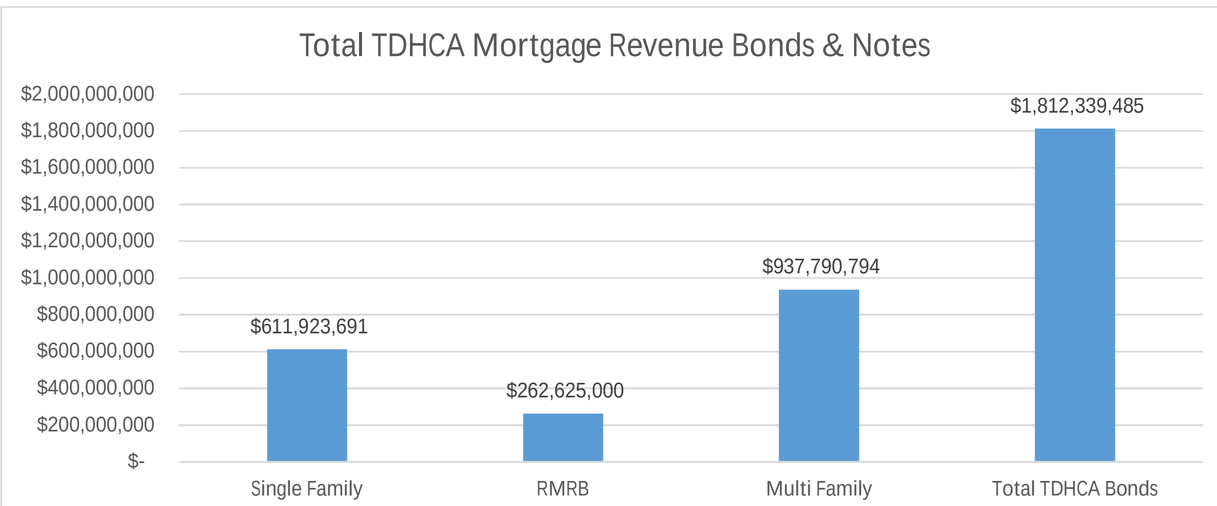
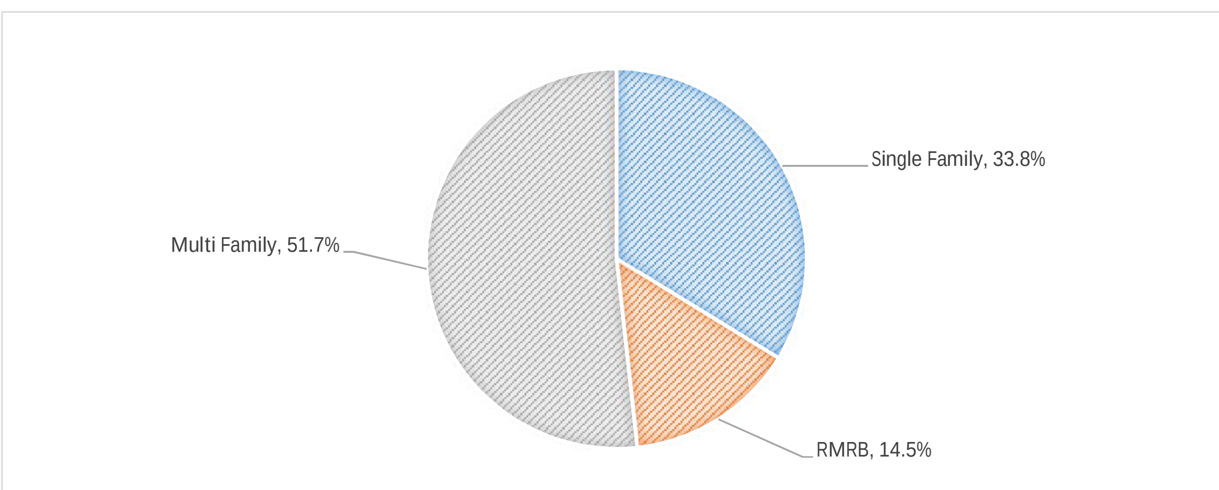
Appendix
A

Texas Department of Housing and Community Affairs
Bond Finance Division
As of August 31, 2019

TDHCA Bond Indentures	Total $ Bonds/Notes	%
Single Family	$ 611,923,691	33.8%
RMRB	$ 262,625,000	14.5%
Multi Family	$ 937,790,794	51.7%
Total TDHCA Bonds	$ 1,812,339,485	100.0%



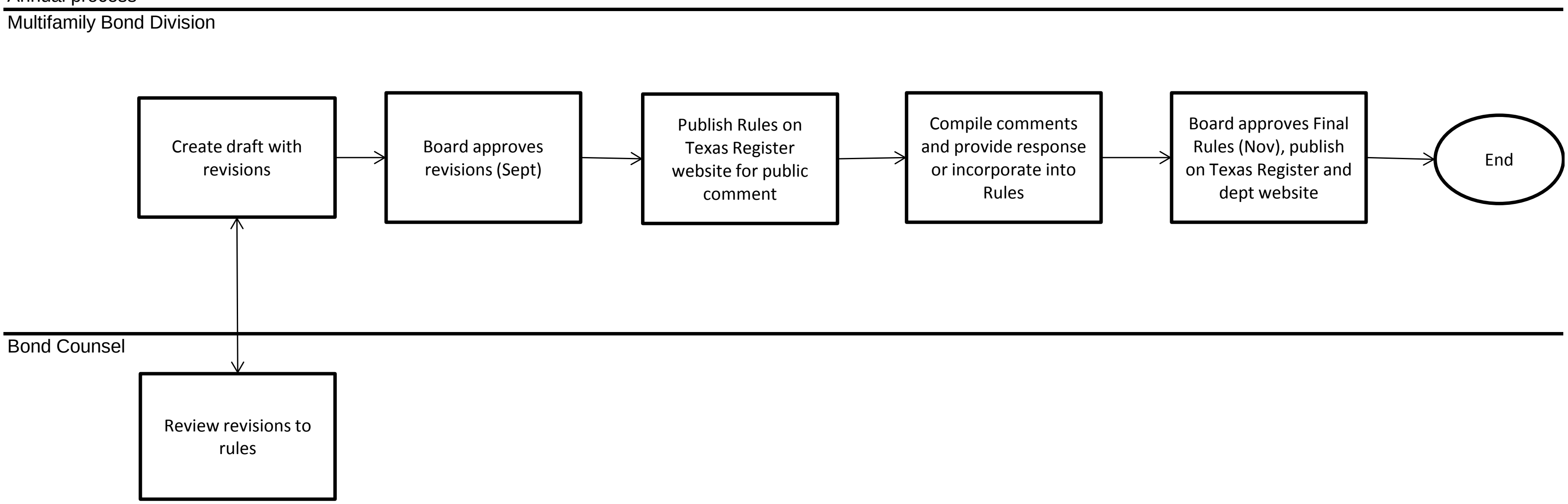


Appendix

B

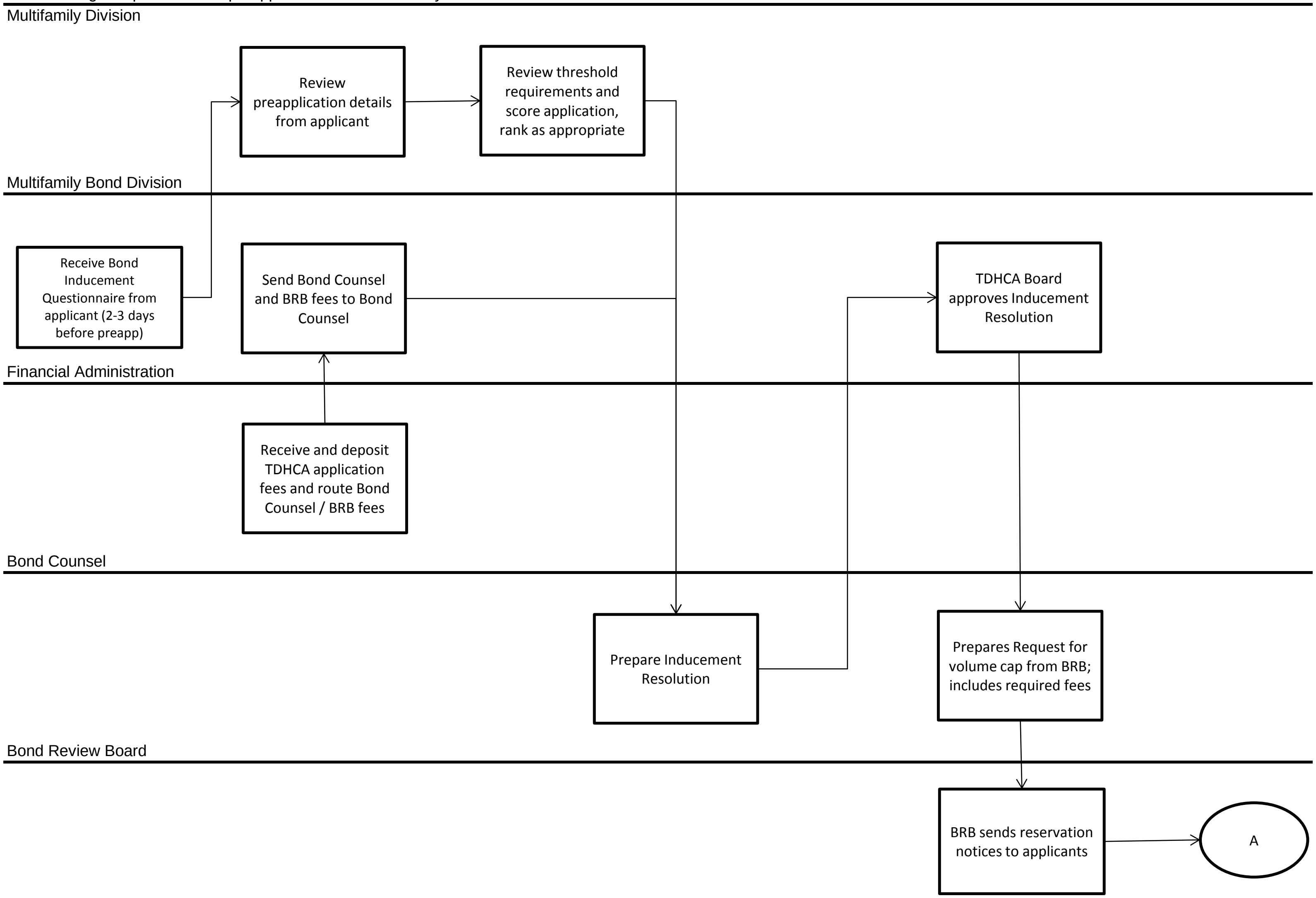
TDHCA Internal Audit
Multifamily Bond Audit - 20-001
Transaction Flow - Rule Making

Annual process



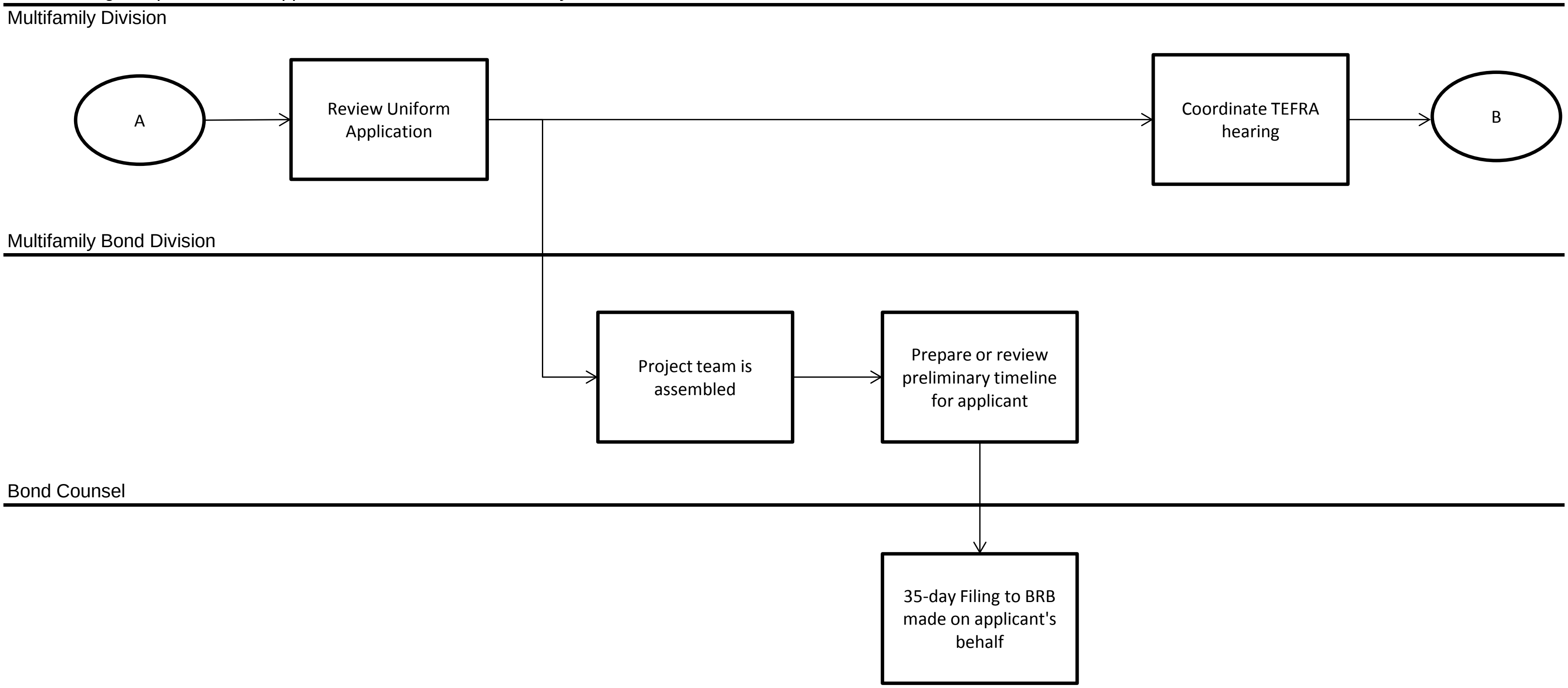
TDHCA Internal Audit
Multifamily Bond Audit - 20-001
Transaction Flow - Preapplication

General length of process from preapp to inducement - 30 days

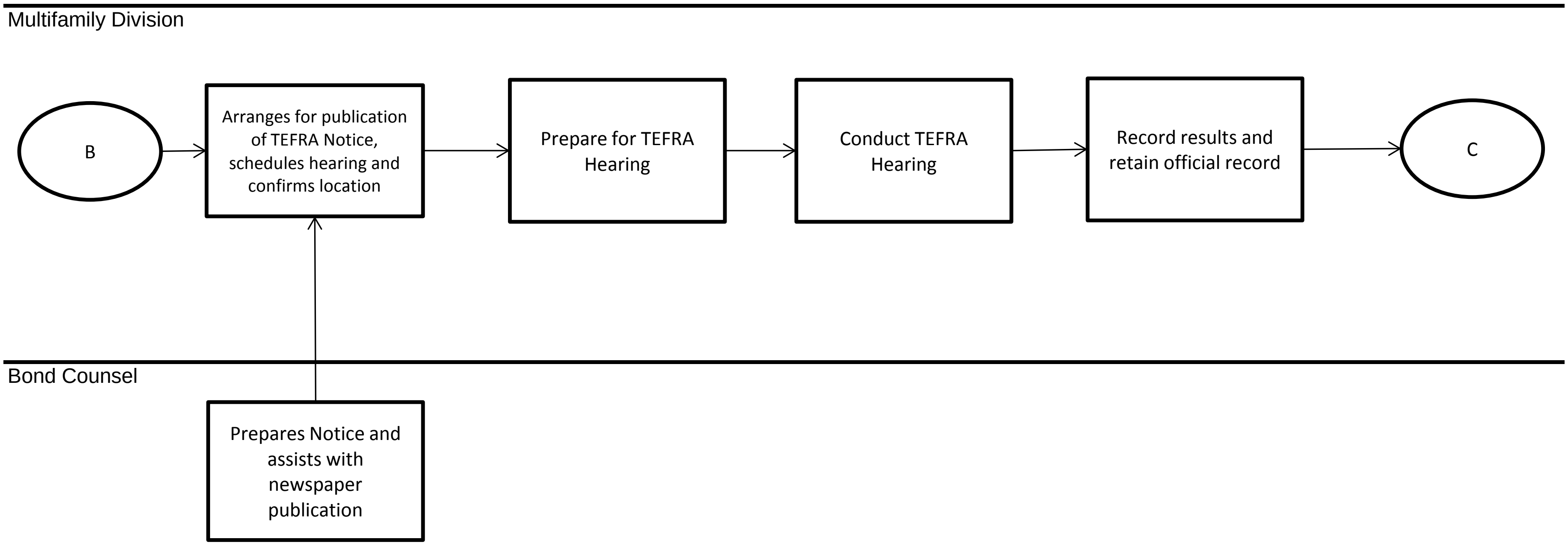


TDHCA Internal Audit
Multifamily Bond Audit - 20-001
Transaction Flow - Application

General length of process from application to Board review - 90 days

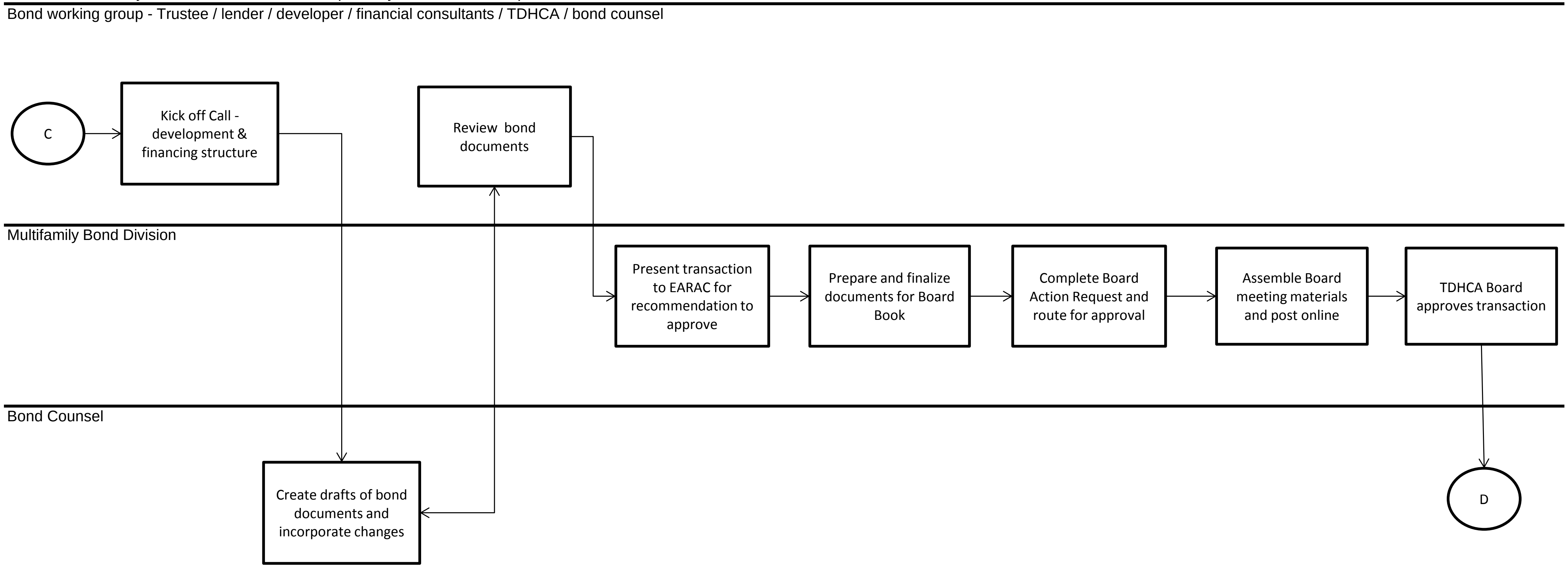


TDHCA Internal Audit
Multifamily Bond Audit - 20-001
Transaction Flow - TEFRA Hearing

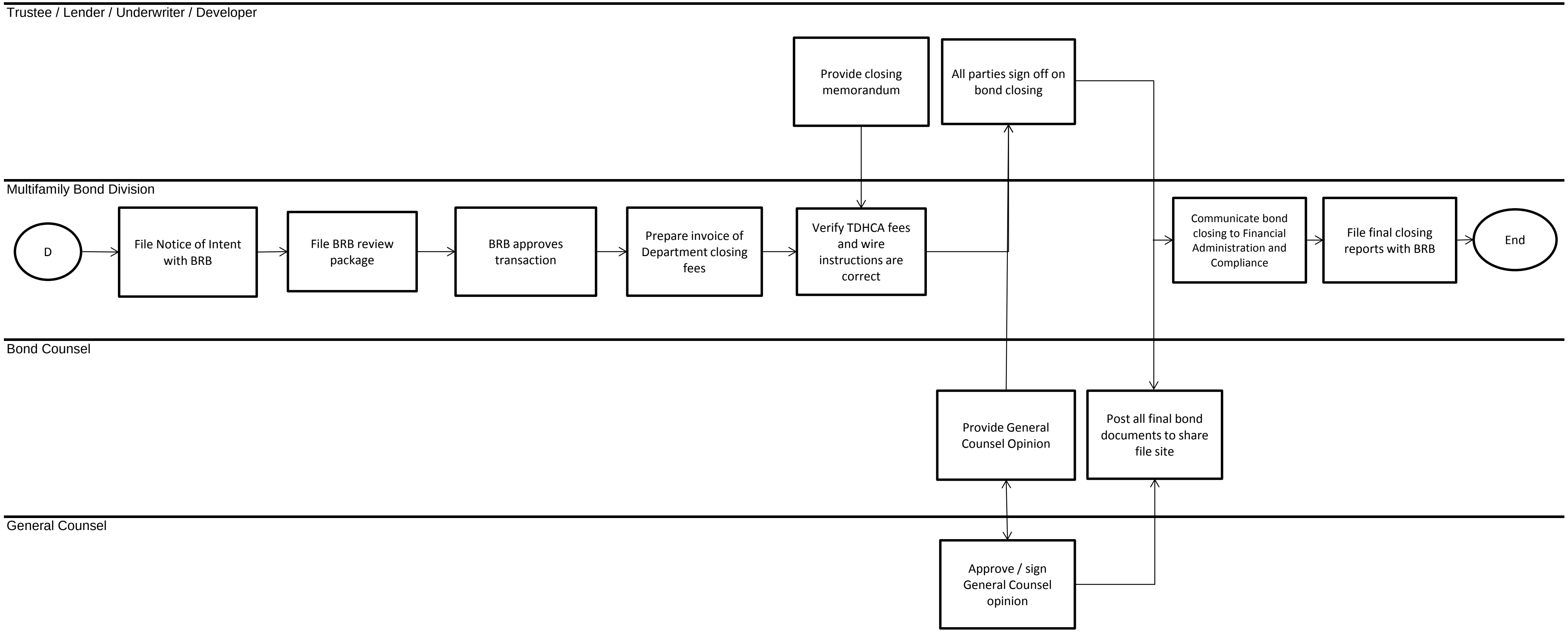


TDHCA Internal Audit
Multifamily Bond Audit - 20-001
Transaction Flow - Bond Documents: New and Restructured Bonds

Deals must close by the Bond Reservation Date (180 days from BRB notice)

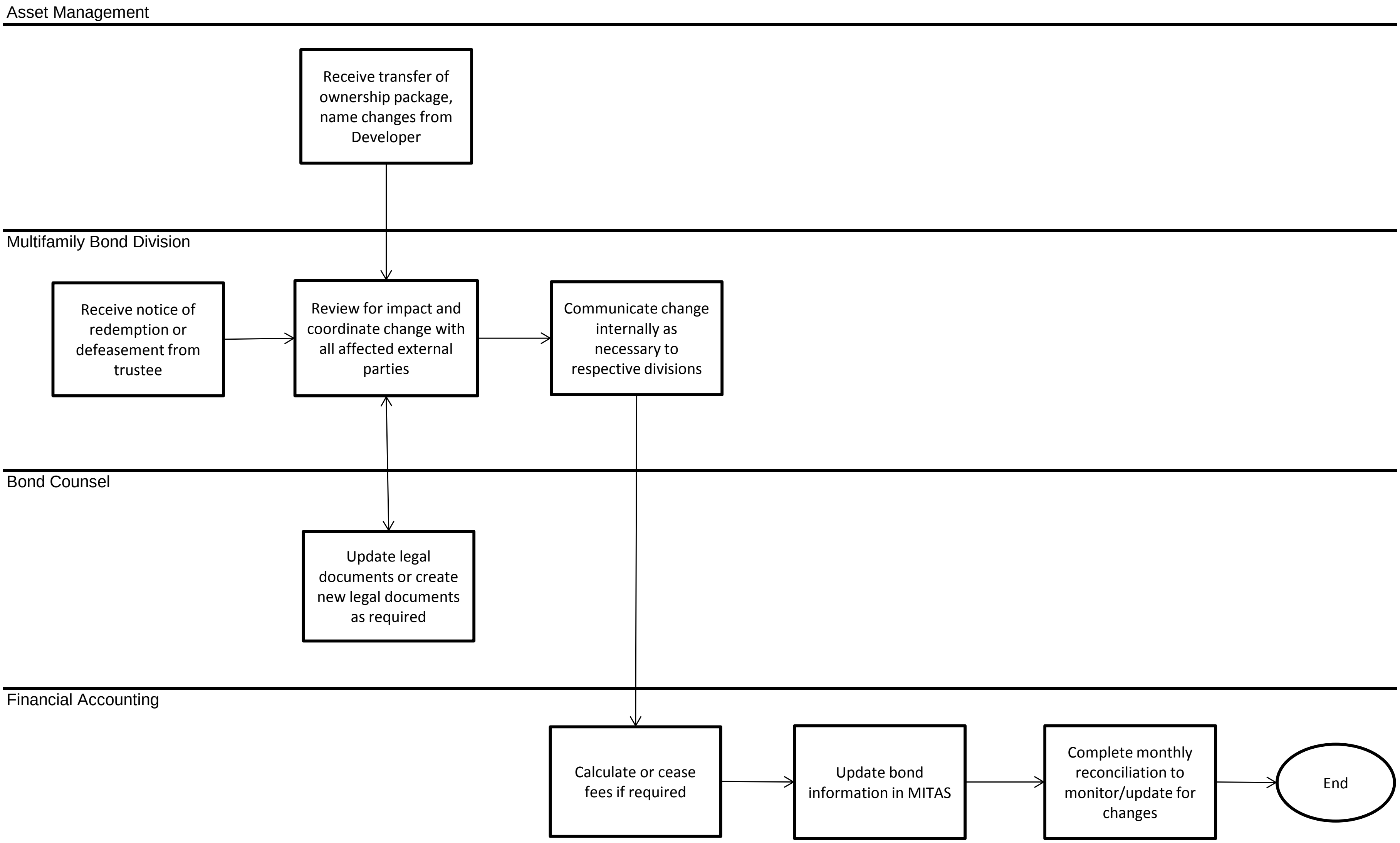


TDHCA Internal Audit
Multifamily Bond Audit - 20-001
Transaction Flow - Bond Review Board Review and Closing

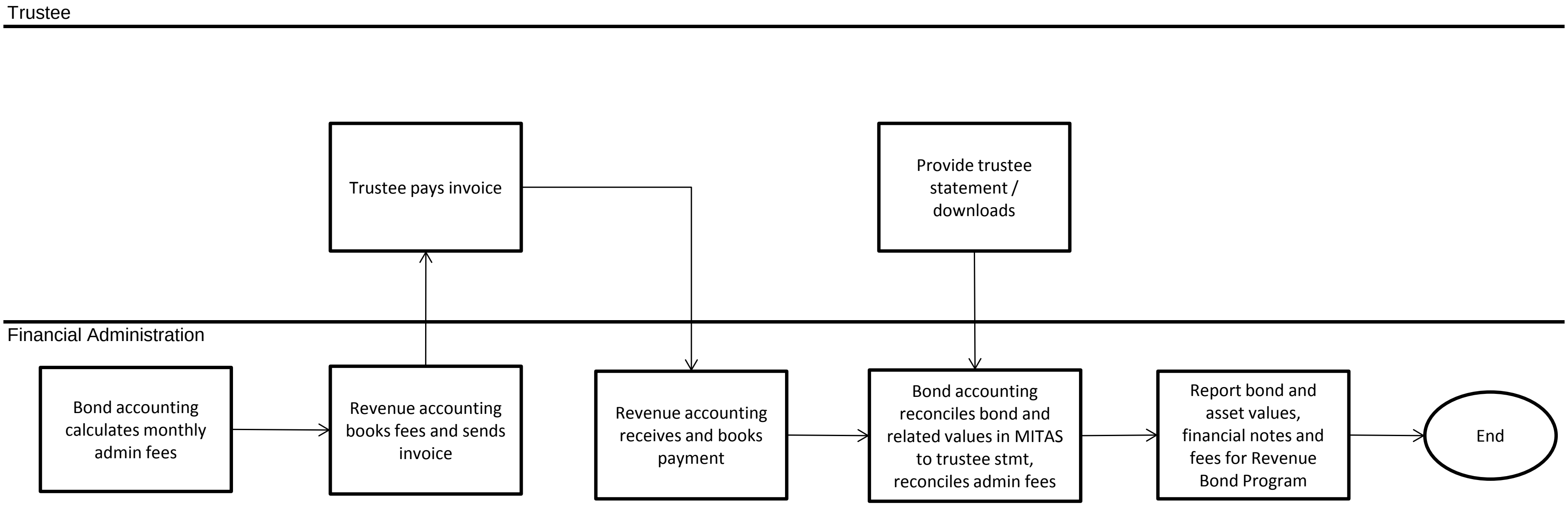


Final - reviewed by MF Bond and Financial Admin divisions 3/3/2020 prepared by Suzi Nelson

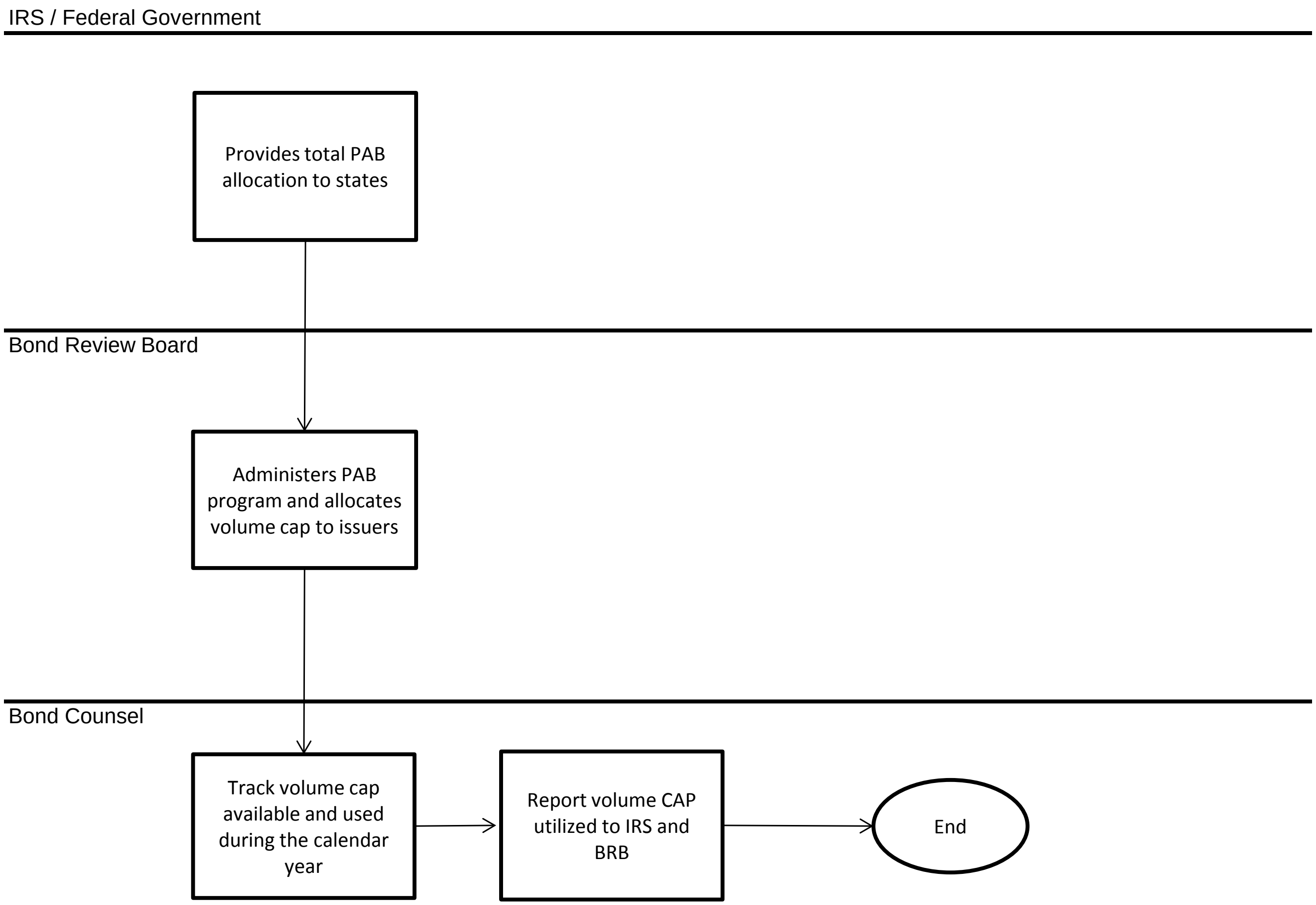
TDHCA Internal Audit
Multifamily Bond Audit - 20-001
Transaction Flow - Post-Issue Changes (ownership changes, defeasement, redemption)



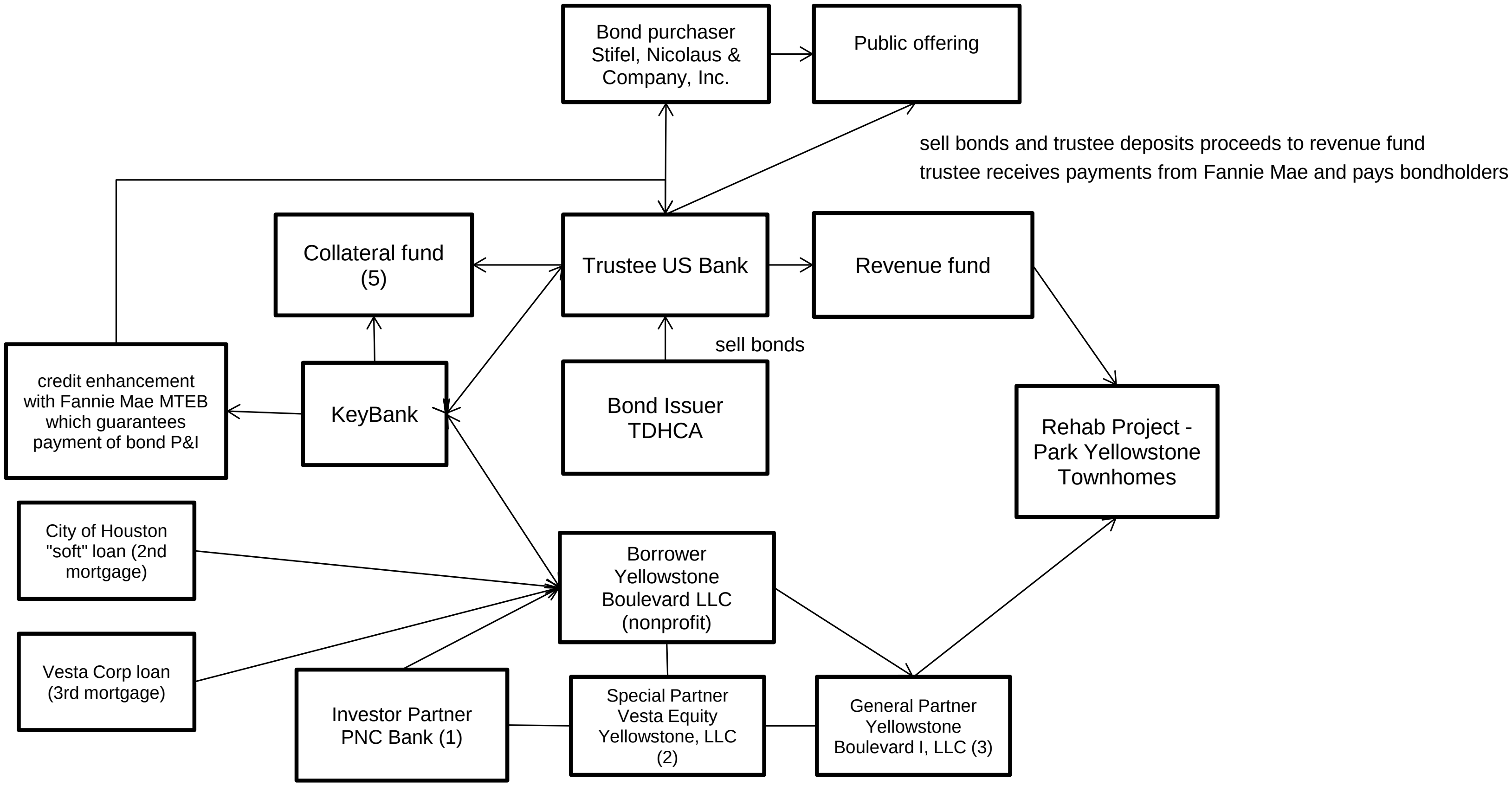
TDHCA Internal Audit
Multifamily Bond Audit - 20-001
Transaction Flow Review - Ongoing Fees, Accounting, Reporting



TDHCA Internal Audit
Multifamily Bond Audit - 20-001
Transaction Flow - CAP Allocation and Tracking

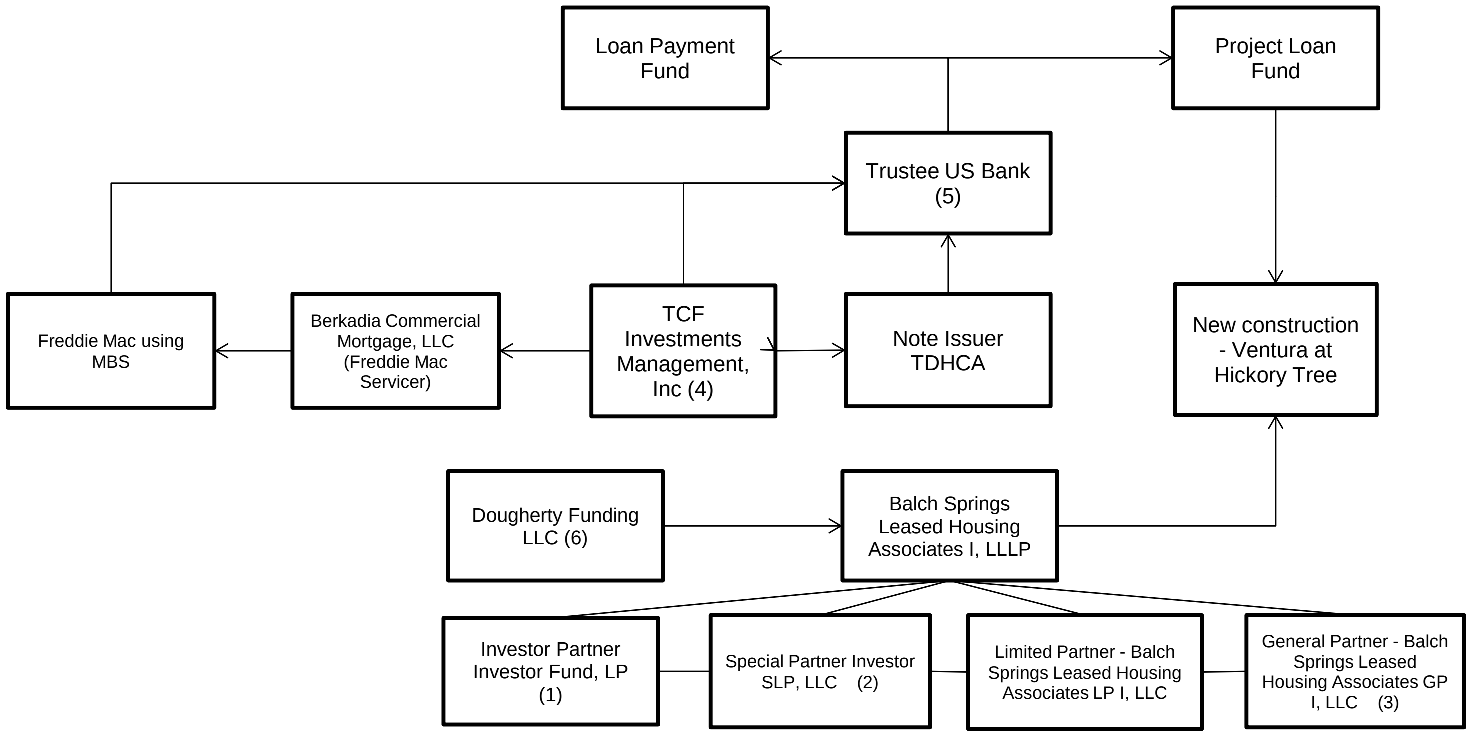


TDHCA Internal Audit
Multifamily Bond Audit - 20-001
Revenue Bonds Issued to Meet 50% Test
Example transaction: Park Yellowstone Townhomes closed 1/31/2020



NOTE: This transaction included both a short and long term bond issue.
MBS - mortgage backed security
MTEB - MBS as Tax-Exempt Bond Collateral
Note (1) - buys tax credits (syndication) and owns the property
Note (2) - assists with development activities
Note (3) - manages day to day operations of property
Note (4) - KeyBank transfers the loan to Fannie Mae which then guarantees payments to the bondholders
Note (5) - this arrangement requires several funds: Revenue (Negative Arbitrage Account), Rebate, Costs of Issuance, Bond Proceeds, Collateral and Rehabilitation (Bond Proceeds and Borrower Equity subaccounts) for sake of simplifying the diagram, will only show Revenue and Collateral funds

TDHCA Internal Audit
Multifamily Bond Audit - 20-001
Revenue Bonds Issued to Meet 50% Test
Example transaction: Ventura at Hickory Tree closed 12/11/2019



NOTE: In this transaction, TDHCA issued a government note.
MBS - mortgage backed security
Note (1) - buys tax credits (syndication) and owns the property
Note (2) - assists with development activities
Note (3) - manages day to day operations of property
Note (4) - as initial lender, TCF purchases the TDHCA Notes and provides funding loan to TDHCA which provides a project loan to Borrower. TDHCA assigns certain rights and obligations to the Trustee.
At conversion, Berkadia purchases the loan from TCF; subsequently, Freddie Mac will purchase the loan and Note from Berkadia.
Note (5) - collateral includes project and future rents with the addition of the Freddie Mac purchase after conversion.
Note (6) - provides tax equity bridge loan to pay for construction costs that are not allowed to be paid by government Note proceeds.