

Executive Summary

The Texas Department of Housing and Community Affairs' (Department) Tax Credit Assistance Program (TCAP) correctly awarded \$148.4 million in funds to eligible tax credit projects as required by the U. S. Department of Housing and Urban Development (HUD) rules for TCAP. The Department provided 60 low-income housing tax credit projects with TCAP funds but one of these projects was later terminated. We reviewed the application process used to award TCAP funds and compared it to the HUD requirements as well as to the Department's TCAP rules. We found that all of the projects that received funding met HUD's and the Department's requirements for a TCAP award. The Department competitively awarded TCAP funds using four different application rounds, with each having its own unique eligibility rules. In addition, the Department developed a scoring system for applications and used a checklist to ensure that each application met the eligibility requirements. We tested the contracts and amendments for all of the TCAP projects and found no errors.

The Department paid draws (a draw is a request for payment) for expenses associated with TCAP projects in accordance with the program's requirements, the Department's procedures, and applicable laws and regulations. We tested a sample of 30 draws and found that all of them were processed correctly and that payments were only made for eligible expenses. The Department has a process in place to provide two levels of review for draws, as well as checklists to ensure that the correct documentation is obtained to support the payment of the draw.

The Department met all of the TCAP reporting requirements and is providing HUD with accurate, complete, and timely data. HUD's annual reporting requirements for TCAP were designed to ensure that the program is completed within the required three years. The Department met HUD's requirement to award at least 75% of the \$148.4 million it received in TCAP funds and to commit at least 75% of these funds by the end of the first year. HUD also required the Department to spend at least 75% of the TCAP funds it received by February 16, 2011. The Department expended \$121.7 Million (82%) of the funds by this deadline. The Department also successfully committed all of the TCAP grant funds (100%) by the end of the second year. The Department is on track to spend all of the TCAP funds by the end of the third year (February 16, 2012) as required by HUD.

The Tax Credit Assistance Program (TCAP)

TCAP is a three-year program under HUD's HOME Investment Partnerships Program (HOME). Its purpose is to provide funds for capital investments in multi-family projects that received low-income housing tax credit awards between October 1, 2006 and September 30, 2009. TCAP is funded by the American Recovery and Reinvestment Act (ARRA.)

(See Appendix B for additional TCAP eligibility requirements.)

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Chapter 1

The Department Awarded All Tax Credit Assistance Program Funds to Eligible Properties

The Texas Department of Housing and Community Affairs (Department) correctly awarded all Tax Credit Assistance Program (TCAP) funds to eligible low-income housing tax credit projects, as required by the Department and the U.S. Department of Housing and Urban Development (HUD.) The Department received an allocation of \$148.4 million in TCAP funds in July 2009. The Department committed funds to 60 projects, but one of these was subsequently terminated for cause. The American Recovery and Reinvestment Act of 2009 (ARRA) which funds TCAP, limits TCAP awards to those projects that received an award of tax credits between October 1st, 2006 and September 30th, 2009 . All TCAP contracts and amendments also complied with the requirements established by the Department and by HUD. We tested the applications for all projects that received commitments and reviewed the contracts and amendments associated with these projects and did not find any errors.

The application process used by the Department ensured that all TCAP applicants were eligible to receive funding and that all applications met the Department's and HUD's requirements. We reviewed the application process for TCAP and verified that all of the necessary requirements of the Department and of HUD were included in the application. The application review process was thorough and was consistently applied to each applicant.

The Department conducted four application rounds to competitively award TCAP funds, each with unique eligibility rules. (See Appendix C) In addition, the Department established a scoring system for applications and used a checklist to ensure that each application met the eligibility requirements. The applications were reviewed and independently scored by two staff in order to identify any deficiencies, such as missing documents. Applicants were notified of deficiencies in their application and were allowed to correct them. In addition, the application review process included an updated feasibility analysis from the Department's underwriting section. The results from each application round were then forwarded to the Department's governing board for final approval.

We tested each of the applications to determine if all eligibility requirements were met prior to the applicant receiving TCAP funds. Our testing included:

- verifying a tax credit award between October 1st, 2006 and September 30th, 2009,
- confirming that the property had an environmental clearance on file,
- determining that the project developer was not in material non-compliance for any other Department programs,
- verifying that a new underwriting report was completed and that the amount recommended in the underwriting report matched the amount of the TCAP award, and
- confirming that each checklist was completed and signed by the reviewers.

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Chapter 2

The Department Processed and Paid Draws in Compliance with TCAP Requirements

The Department paid draws for eligible TCAP expenses in accordance with the program requirements, the Department's procedures, and applicable laws and regulations. We tested 30 TCAP draws and found no errors. The process in place to review and approve draw requests is thorough and multiple reviews ensure that expenses are eligible for payment using TCAP funds. For example, TCAP funds can only be used for capital investment in low-income housing tax credit properties. Funds can be used for new construction or to rehabilitate a property. TCAP funds may also be used for land purchase, demolition, and hazardous materials remediation. However, TCAP funds may not be used for administrative costs or for asset management of TCAP properties. (See Appendix B for additional requirements.)

The TCAP draw process ensures that TCAP projects are only paid for eligible expenses. A draw is a request for payment. The project developer requests payment by providing supporting documentation for the amount requested. The documentation is reviewed by program staff and, if sufficient, is approved for payment. A second review is provided by a member of the quality assurance team. Both reviewers sign off on review checklists and approve the draw in the Housing Contract System. TCAP personnel are knowledgeable about processing TCAP draws. In addition, there is effective communication between TCAP personnel and consistency in the processing of TCAP transactions.

To verify that draws were processed properly and expenditures were made only for TCAP eligible expenses, we judgmentally selected the final draws for five completed projects and a random sample of 25 other draws. The random sample included draws for 25%, 50%, 75% and 100% of the award amounts. We reviewed the documentation and the completed checklists for each of the draws. For draws of 50% and greater, we verified that the project construction was 50% complete within 12 months of the loan closing date. We verified that expenditures were TCAP eligible and were properly documented. We confirmed that the checklists were completed and signed. All 30 of the draws we reviewed were processed correctly.

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Chapter 3

The Department Met HUD’s Timelines for Awarding and Spending TCAP Funds and Provides HUD with Accurate, Complete and Timely TCAP Data

The Department met all of the TCAP reporting requirements we reviewed and is providing HUD with accurate, complete, and timely data. HUD’s annual reporting requirements for TCAP were designed to ensure that the program is completed within the required three years. TCAP was created on February 17, 2009. In the first year, the Department met HUD’s requirement to award at least 75% of the \$148.4 million it received in TCAP funds and to commit at least 75% of these funds. In the second year, HUD required the Department to spend at least 75% of the TCAP funds it received by February 16, 2011. The Department expended \$121.7 Million (82%) of the funds by the 75% deadline. Furthermore, the Department successfully committed all of the TCAP grant funds (100%) by the end of the second year. The Department is on track to spend all of the TCAP funds by the end of the third year (February 16, 2012) as required by HUD. (See Table 1)

To ensure that TCAP reporting was accurate, we compared the annual TCAP reports that the Department submitted to HUD via HUD’s Integrated Disbursement and Information System (IDIS) with data in the Department’s Housing Contract System as of February 16, 2011, which was the last day of the second year of TCAP. We found that the information provided to HUD was accurate and complete and that it matched the data in the Housing Contract System. The Department regularly reconciles the TCAP data reported to HUD in IDIS with the data in the Housing Contract System in order to ensure the accuracy and completeness of the information. A formal reconciliation is prepared at the end of each calendar quarter and forwarded to management for review. We also observed an informal review, which occurs after each TCAP transaction is recorded. HUD relies on the information in IDIS to determine the progress of the TCAP program, so it is essential that the data entered into IDIS is accurate and complete.

TCAP Program Year	Milestone	Department Performance
Year 1	Award 75% of TCAP Funds	Awarded over 75%
Year 1	Commit 75% of TCAP Funds	Committed 78.5%
Year 2	Commit 100% of TCAP Funds	Committed 100%
Year 2	Spend 75% of TCAP Funds	Spent 82%
Source: HUD CPD Notice 09-03 “Implementation of the Tax Credit Assistance Program” (milestones) and IDIS reports on 2-16-10 and 2-16-11 (performance)		

Table 1

To verify that at least 75% of TCAP funds were awarded and committed through contracts by the end of the first year, we reviewed documentation from HUD acknowledging the Department’s success in meeting these goals. We also requested a report from IDIS at the end of the second year to confirm that all TCAP funds were awarded. In addition, we compared the activity in the Department’s Housing Contract System with the HUD IDIS reports and confirmed the contract

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awards reported to HUD for both years were complete and accurate. We also found that the Department submitted all required TCAP reports on a timely basis.

The Department successfully paid draws for eligible expenses that totaled 82% of TCAP funds before the end of the second year. We compared the TCAP draws recorded in the Housing Contract System with the amount reported in IDIS as of February 16, 2011 to confirm the total amount of these draws. We also reviewed a sample of these draws for accuracy and completeness and found no errors. (See Chapter 2)

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Appendix A

Objectives, Scope and Methodology

Objectives

To determine if:

- the Department awarded TCAP contracts and amendments in accordance with HUD's and the Department's TCAP requirements,
- draws are processed in compliance with key program requirements, relevant procedures, laws, and regulations, and
- TCAP data reported to HUD is accurate, complete and timely.

Scope

- The scope of the audit was from February 17, 2009 (the date of the enactment of the American Recovery and Reinvestment Act of 2009) to February 16, 2011, a period of two years.
- We did not perform audit work on the Integrated Disbursement and Information System, which is HUD's automated system and is used to track projects, including TCAP.
- We did not perform audit work on the Department's Housing Contract System because it was evaluated by KPMG in 2009 as part of the annual Statewide Audit and no issues were identified.

Methodology

The methodology consisted of gaining an understanding of the application, award, and draw processes for administering TCAP by reviewing background materials, policies and procedures, TCAP documents, federal laws, regulations, financial data, application review tools and checklists, and interviews with staff and division management. Understanding of the reporting process was gained through interviews with HOME and TCAP staff, and Financial Administration staff having direct involvement in the TCAP program, and analysis of the reported TCAP activity.

We reviewed the following documents:

- HOME Standard Operating Procedures (SOPs):
 - SOP for Multi-family Set-up Requests
 - SOP for Multi-family Draw Requests
 - SOP for Application Intake and Awards
 - Draft SOP for TCAP Electronic Application Intake and Awards
 - SOP for Multifamily Project Completion Reports IDIS Closeout
 - SOP for Contract Generation
- Checklists and Review Sheets:
 - TCAP Activity Set-up Checklist

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- TCAP Draw Disbursement Checklist
- TCAP Loan Closing Due Diligence Checklist
- 2009 TCAP Application Threshold & Selection Review Sheet
- 2009 TCAP Application Threshold Review Sheet Round 2
- 2009 TCAP Application Threshold Review Sheet Round 3
- 2009 TCAP Application Threshold Review Sheet Round 4
- Previous Participation Review of TCAP Applications Memo
- 2010 Enterprise Risk Management self-assessment for HOME
- Expenditure Revenue and Budget Information:
 - TCAP Population of Grantees by Contract Number and Amount
 - IDIS status report of TCAP as of 1-11-2011
 - HUD table of grantee states' expenditures as of 1-30-2011
 - HUD IDIS Contract Commitment Report 2-16-2010
 - Financial Administration IDIS report reconciliation
 - Housing Contract System - TCAP Program Fund Summary

We used the following documents as criteria:

- American Recovery and Reinvestment Act of 2009
- Internal Revenue Code of 1986, 26 USC 42
- HUD Community Planning and Development Notice 09-03
- HUD Community Planning and Development TCAP Grant Agreement Guidance
- HUD Community Planning and Development TCAP Written Agreement Guidance
- HUD Community Planning and Development TCAP IDIS Guidance
- The Department's Legal Determination on TCAP by General Counsel
- Tax Credit Assistance Program Submission Packet (as revised 7-16-09)
- Multifamily and HOME Divisions, American Recovery and Reinvestment Act of 2009 Tax Credit Assistance Program (TCAP) Policy through Board Resolution No. 09-043
- Supplemental Information to the Board Policy on American Recovery and Reinvestment Act of 2009, Tax Credit Assistance Program
- Funding Approval and Tax Credit Assistance Program (TCAP) Agreement dated 7/23/2009
- TCAP Round Three Policy (March 2010)
- TCAP Round Four Policy (July 2010)
- 2007 Housing Tax Credit Program, Qualified Allocation Plan and Rules
- 2008 Housing Tax Credit Program, Qualified Allocation Plan and Rules
- 2009 Housing Tax Credit Program, Qualified Allocation Plan and Rules

To answer the detailed objectives of our audit, we performed the following audit work:

- We compared overall contract amounts in HUD's IDIS with the contracts recorded in the Housing Contract System to ensure that the total Department grant award was distributed to TCAP projects.
- We tested the application and award process to ensure that applications were processed correctly, in a timely manner, with supporting documentation, in compliance with HUD

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and the Department's program requirements, and awards were made to eligible applicants.

- We tested a combined judgmental and random sample of TCAP draws to ensure that the draws were for eligible expenditures and were completed in accordance with key program requirements, relevant procedures, and laws and regulations.
- We reviewed and reconciled TCAP data in the Department's Housing Contract System with HUD's IDIS milestone reports to determine the accuracy and timeliness of reporting contract commitments and expenditures.

Type of Audit

This audit was a performance audit of the Tax Credit Assistance Program.

Report Distribution

As required by the Texas Internal Auditing Act (Texas Government Code, Chapter 2102), this report is distributed to the:

- Texas Department of Housing and Community Affairs' Governing Board
- Governor's Office of Budget and Planning
- Legislative Budget Board
- State Auditor's Office
- Sunset Advisory Commission

Project Information

Audit fieldwork was conducted from February 25 through March 18, 2011. The audit was performed in accordance with Generally Accepted Government Auditing Standards and the International Standards for the Professional Practice of Internal Auditing.

The following staff performed this audit:

Harriet Fortson, M.Acy, CGAP, CICA, CCA, (Project Manager)
Derrick Miller
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Appreciation to Staff

We would like to extend our sincere appreciation to management and staff of the HOME division, and especially the staff of the Tax Credit Assistance Program for their cooperation and assistance during the course of this audit.

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Appendix B

Background

The Tax Credit Assistance Program (TCAP) was established by the American Recovery and Reinvestment Act (ARRA) on February 17, 2009. TCAP is funded through the HOME Investment Partnerships Program (HOME) and is administered by the U.S. Department of Housing and Urban Development (HUD). ARRA allocated \$2.25 billion to the states based on the percentage of HOME funds allotted to each state for fiscal year 2008. The state of Texas received \$148.4 million. All of the TCAP funds must be spent by February 16, 2012.

The purpose of TCAP is to provide funding to compensate for the current devaluation of housing tax credits to properties that were awarded low-income housing tax credits in federal fiscal years 2007, 2008 and 2009. (see text box)

Housing developments requesting TCAP awards must meet the following federal eligibility requirements:

- Projects were previously awarded tax credits during the period from October 1, 2006 through September 30, 2009.
- Projects must continue to hold some tax credits. (Some credits may be returned, but a minimal amount must be retained.)
- Projects must meet the housing tax credits' use, income and rent restrictions. Projects are limited to new construction or rehabilitation/reconstruction of rental properties affordable to households earning up to 60% of the Area Median Family Income (AMFI), as determined by HUD.
- States must administer TCAP in accordance with Low Income Housing Tax Credit rules and limitations, with the exception of certain HOME program regulations that apply with respect to compliance with the Davis-Bacon Act (labor standards) and environmental requirements.

The Department must use a competitive selection process to award TCAP funds to tax credits development projects based on the selection criteria in the Qualified Allocation Plan (QAP). ARRA requires that the Department give priority to projects that are expected to be completed by February 16, 2012. The Department developed the following additional eligibility requirements:

The Housing Tax Credit Program

Through the Housing Tax Credit Program, the federal government encourages private investment in affordable rental housing by providing investors a dollar-for-dollar reduction on their federal tax liability for every dollar of eligible construction expenses.

The current economic crisis has decreased demand for tax credits by investors. As a result, the pricing of tax credits has plummeted, and many approved developments now lack the total funding needed for completion.

Source: TDHCA's website

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- Projects receiving funds must continue to meet the threshold and scoring requirements as included in the original application or the most recent amendment approved by the Board.
- The development project may not be in “material noncompliance” with any program within the Department.
- Projects requesting funds must provide evidence of a good faith effort to obtain equity commitments.

Other requirements for the administration of the TCAP program include:

- States are responsible for asset management, either directly or through contracting, of TCAP properties, but they cannot use TCAP funds to fulfill asset management responsibilities.
- TCAP funds may not be used for swimming pools.
- From the date of enactment of ARRA, states must:
 - commit at least 75% of funds within 1 year,
 - demonstrate that property owners expended 75% of allocated funds within two years, and
 - expend 100% of allocated funds within three years.
- The Department set a requirement that projects requesting draws of 50% or more must complete 50% of the construction within 12 months of the loan closing date.

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Appendix C

The Department's Unique TCAP Requirements by Application Round

Application Round	Specific Requirements	TCAP Funds Awarded
Round 1	<ul style="list-style-type: none">• Restricted to low-income housing tax credit recipients for award years 2007 or 2008	\$66,578,847
Round 2	<ul style="list-style-type: none">• Restricted to low-income housing tax credit recipients for award year 2009	\$58,703,353
Round 3	<ul style="list-style-type: none">• Restricted to low-income housing tax credit recipients not awarded TCAP in prior rounds and• Have not submitted a cost certification to the Department	\$14,124,613
Round 4	Open to any project which <ul style="list-style-type: none">• Received TCAP award from any prior round or• Has not received a TCAP award but otherwise program eligible with an environmental clearance, or• Has substantially completed construction but has not submitted IRS Form 8609.	\$ 8,947,956
	Total Awarded	\$148,354,769