

Executive Summary

The Asset Management Division (Asset Management) was created in June 2012. Asset Management adds value to the Texas Department of Housing and Community Affairs (Department) by providing oversight of development performance in order to minimize the Department's risk. This oversight includes performing a variety of activities such as processing cost certifications, conducting financial analyses, developing solutions for troubled properties and delinquent borrowers, and conducting quarterly financial reviews. Although Asset Management effectively performs their assigned activities, there are inconsistencies in the way that these activities are performed. Management is using some guidance originally developed for other divisions previously charged with the same responsibilities.

They have developed policies and procedures for some of their activities, but the policies and procedures have not been finalized. This has resulted in some inconsistencies.

Enhancements should be made in the policies, procedures and processes used by Asset Management staff to perform their duties. Improving and finalizing Asset Management's policies and procedures would increase consistency and enable management to better track the performance of these activities.

Asset Management processes cost certifications accurately and completely. However, we were unable to determine if cost certifications are performed in a timely manner due to the limited information tracked by Asset Management staff. Asset Management also performs financial analyses when processing cost certifications and when considering ownership transfer requests. In addition, Asset Management has recently started performing quarterly financial reviews of select properties to assess their condition.

Asset Management includes an asset resolution section developed specifically to deal with troubled properties and delinquent borrowers. We found that the single-family asset resolution activities are performed as expected but are not always performed consistently and in accordance with the guidance used by Asset Management. We were unable to evaluate the multifamily asset resolution process due to limited criteria.

Summary of Recommendations

Asset Management should:

- develop and document more detailed guidance for conducting financial analyses of ownership transfers, including the methodology used and the results expected,
- finalize their policies and procedures and ensure they communicate them to staff to ensure consistency,

Asset Management

Asset Management is a newly created division responsible for the oversight of development performance for all multifamily properties. In addition, Asset Management performs collections and works with single-family owners to develop repayment plans.

Asset Management monitors and processes all post-carryover activities for developments involving Housing Tax Credits, HOME funds, Housing Trust Funds, and Neighborhood Stabilization Program (NSP) funds.

Asset managers work with development owners and the Department's Asset Review Committee to develop workout solutions for troubled or "at-risk" developments.

An Internal Audit of Asset Management

- continue to work with the development owners to ensure timely completion of the cost certification process,
- maintain documentation regarding additional information requested or received if tracking the timeliness of the cost certification process is required or if the information is helpful, and
- perform single-family asset resolution activities consistently and establish processes for multifamily asset resolution activities.

Table of Contents

Chapter 1

Expectations Should be Clearly Defined, Communicated and Consistently Applied4

Chapter 2

Improve the Timeliness and Tracking of Cost Certification Processing7

Chapter 3

Enhance Asset Resolution Activities9

Appendix A

Objectives, Scope and Methodology11

Detailed Results

Chapter 1

Expectations should be Clearly Defined, Communicated and Consistently Applied

Since its inception in June 2012, the Asset Management Division (Asset Management) has added value to the operations of the Texas Department of Housing and Community Affairs (Department) by performing activities that help development owners and homeowners achieve compliance with the terms of the loans or land use restriction agreements (LURAs), and by ensuring that properties are transferred to owners who are financially able to purchase and maintain the development. They also process cost certifications so that development owners can request the final allocation of their tax credits. However, because Asset Management is a relatively new division in the Department, they have not fully developed the processes, policies or procedures that help prevent inconsistencies in how activities are performed. In addition, the existing policies and procedures have not been consistently applied.

Asset Management has not developed specific criteria for performing the financial analysis conducted when processing an ownership transfer request and has not finalized the division's standard operating procedures. Financial analyses are generally performed when processing ownership transfer requests but they are not performed in a consistent manner. For example, the financial information communicated to management was sometimes the prospective owner's net worth or net income and sometimes the prospective owner's cash assets. Some financial information was not communicated to management at all. Consistency in performing the financial analysis and other asset management tasks may be enhanced by clearly defining management's expectations.

Asset Management's standard operating procedures are in draft form and have not been finalized. Policies and procedures are internal controls that help ensure that management's directives are carried out. Without finalizing and formally communicating policies and procedures to staff, the staff may not be performing their duties consistently or in the manner intended by management.

Chapter 1-A

Develop and Communicate Criteria for Performing Financial Analyses

Asset Managers perform a financial analysis when processing ownership transfer requests. Ownership transfer requests are submitted to the Department by the development owners in order to seek approval for transferring an ownership interest in a property from one entity or individual to another. The analysis is a high-level overview of the borrower's financial statements. The financial analysis performed as part of the ownership transfer request determines whether the new owner has the sufficient funds available to purchase and maintain the development. These financial analyses are usually performed and communicated to management but are not always performed in a consistent manner.

We tested a judgmental sample of thirteen transactions to determine if Asset Management is performing a financial analysis when processing ownership transfer requests and if the results of the analysis are

An Internal Audit of Asset Management

communicated to management. Two of thirteen (15.4%) transactions we tested did not have evidence of a financial analysis although one was required. Financial analyses for three of thirteen (23.1%) of the transactions were not communicated to management. In addition, the methodology used to perform a financial analysis varies. Some of the analyses focus on cash assets and others focus on net worth or net income.

The criteria for performing financial analyses as part of the ownership transfer process are not specific. Asset Management's draft standard operating procedures emphasize the need for the Department to determine the "economic viability of purchasers" and the "availability of funds to purchase and maintain the development." The draft procedure states that the asset manager will consider the financial review in their overall analysis when making a recommendation for ownership transfer, and provide the results of the financial analysis with the ownership transfer documents routed to management for approval. However, the draft procedure does not provide guidance on how to conduct a financial analysis, it only states that the financial records and reports will be reviewed. Also, the draft procedure does not indicate what type of financial information to provide (cash assets, net worth or both.)

Without more specific criteria, the financial analyses may not provide management with the information it needs to properly evaluate a prospective owner's financial ability to purchase and maintain a development. This could result in the transfer of an ownership interest in a property to a non-qualified owner or partner.

Recommendation

Asset Management should develop and document more detailed guidance for conducting financial analyses of ownership transfers, including the methodology used and the results expected.

Management's Response

Management agrees that the SOP for Ownership Transfers should be revised to include more in-depth guidance on how to complete and document the financial analysis review. Division Director Cari Garcia is responsible for completing this SOP and it should be in final form by July 31, 2013.

Chapter 1-B

Finalize and Approve the Policies and Procedures for Asset Management

Asset Management drafted standard operating procedures that address many of the various activities they perform. However, these policies and procedures have not been approved and finalized. The Department's standard operating procedures development system (SOP 1100.01) requires that each manager or team lead develop procedures that are applicable to their program or areas of responsibility and ensure they are current. Without finalizing and formally communicating policies and procedures to Asset Management staff, there is a risk that staff may not be performing their job duties as intended and inconsistencies may occur.

Recommendation

Asset Management should finalize their policies and procedures and ensure they communicate them to staff to ensure consistency.

Management's Response

Management agrees that these need to be finalized and communicated to staff to ensure consistency. Division Director Cari Garcia is responsible for ensuring that all SOPs are updated and finalized by August 30, 2013.

Chapter 2

Improve the Timeliness and Tracking of Cost Certification Processing

Asset Management is processing cost certifications accurately and completely, however complete information necessary to fully evaluate the timeliness of the cost certification process was not readily available. Development owners are required to submit a cost certification in order to request the final allocation of tax credits. After review of the cost certification, the Department issues Internal Revenue Service (IRS) Form 8609 to owners of residential low-income developments awarded tax credits. Asset Management estimates that more time is spent processing cost certifications than any of the other activities they perform.

We tested twenty cost certifications completed by Asset Management and found that they were processed completely and accurately. For all twenty (100%) of the cost certifications tested, each had:

- all of the required documentation necessary to process the cost certification and issue IRS Form 8609,
- a completed IRS Form 8609, and
- a financial analysis which was communicated to management prior to the issuance of IRS Form 8609.

We also tested the same twenty cost certifications for timeliness. However, the information necessary to evaluate the timeliness of the cost certification process was not readily available because Asset Management does not consistently document when they request and receive additional information needed to process a cost certification.

With the information that was available, we were able to determine the total number of days to complete the cost certification process for two (10.0%) of the twenty cost certifications we tested. One of the cost certifications took 163 days to complete and the other took 251 days to complete. This includes the time which Asset Management spent on the cost certification process, but excludes any time spent waiting for required documentation from the development owner.

We were able to determine the total number of days it takes Asset Management to issue IRS Form 8609 after the receipt of all required documentation for six (30.0%) of the twenty cost certifications we tested. Two were completed in 45 days or less, two were completed in 90 days or less, and two were completed in 200 days or less. The cost certification manuals developed by the Department's Real Estate Analysis Division and used by Asset Management to perform cost certifications state that IRS Form 8609 will be issued within 90 days of receipt of all required documentation.

Recommendation

Asset Management should:

- continue to work with the development owners to ensure timely completion of the cost certification process, and
- maintain documentation regarding additional information requested or received if tracking the timeliness of the cost certification process is required or if the information is helpful.

Management's Response

Management will continue to work with development owners to ensure timely completion of the cost certification process and agrees that the tracking mechanism for assessing the timeliness of processing cost certifications should be improved. This will be completed through our newly functional Asset Management Database (Access) that was put into operation on 3/1/13. Additional guidance on the expectations for including comments and updating this system will be provided to staff by 5/30/13. Division Director Cari Garcia is responsible for ensuring that the implementation of the new system is complete and provides a better tracking of the timeliness of the issuance of 8609s and will assess and report on its effectiveness by September 30, 2013.

Chapter 3

Enhance Asset Resolution Activities

The asset resolution section of Asset Management oversees troubled properties and works with delinquent borrowers in order to get them back in good standing with the Department. Asset resolution activities add value by working with development owners to find solutions for the challenges the owner may be encountering in repaying a loan or complying with other program requirements. Asset resolution handles both single-family and multifamily properties. Guidance is available for single-family asset resolution activities, but this guidance is not consistently followed. Single-family asset resolution staff follow procedures that were originally developed for the Department's loan servicing function. There is limited guidance in place for multifamily asset resolution activities. As a result, we were unable to assess multifamily asset resolution activities.

Asset resolution activities have been successful in bringing troubled properties back into compliance and collecting from delinquent borrowers. Recently, Asset Management, working with the Department's HOME Division, proposed a plan to the Department of Housing and Urban Development (HUD) to resolve a 2009 monitoring finding related to several HOME properties that were out of compliance. Because of Asset Management's efforts, two of eight properties identified as non-compliant during the 2009 HUD monitoring visit were removed from HUD's list of noncompliant properties and the Department was not required to reimburse HUD for these properties.

Asset resolution activities include overseeing property performance, developing action plans, making recommendations to the Asset Review Committee, and working with property owners and other external parties to resolve challenges associated with the troubled properties. In addition, asset resolution markets and sells properties to buyers in order to maintain the period of affordability required by the original loan or the LURA. Asset resolution activities are complex because each deal is unique and a solution designed to resolve the issues associated with one property may not be appropriate for another property.

Because guidance is available for the single-family asset resolution activities, we were able to test asset resolution activities for a judgmentally-selected sample of twenty delinquent single-family loan accounts. We found that the loan servicing procedures used by asset resolution staff are not followed consistently.

For example:

- Delinquent borrowers that are on repayment plans are not sent reminder notices.
- Nine of twenty accounts (45.0%) were not sent delinquency letters and five of eleven letters (45.5%) that were sent were not signed.

Asset Review Committee

The Asset Review Committee (Committee) oversees the development of asset-specific strategies to address the risk of defaults or properties falling into non-compliance. The Committee may choose to implement debt forgiveness, charge-off, forbearance, loan modification, pre-foreclosure sale, deed-in-lieu of foreclosure, foreclosure, or other legal or equitable remedies available to the Committee. It also makes decisions regarding the transfer, acquisition and disposition of all real, personal, or mixed property, or an interest in property owned by the Department.

The Committee is comprised of six Department employees designated by the executive director and advised by the Legal Services Division.

An Internal Audit of Asset Management

- The “comments” entered into the MITAS Loan Servicing System are detailed and informative. However, two of the twenty accounts (10%) were not updated to reflect why action was not taken on a loan.
- Two significantly delinquent borrowers (2,008 days late and 2,220 days late) had verbal repayment agreements although verbal repayment agreements are not allowed once a borrower is more than 120 days delinquent.

Because single-family asset resolution efforts focus on collecting from the borrowers that are most likely to pay, not all procedures in the currently used guidance may be performed. However, when asset resolution activities are not performed consistently, collection efforts may not be as efficient as possible, loan delinquencies may increase and corrective action on poor performing loans may not be timely.

Recommendation

Single-family asset resolution activities should be performed consistently and processes should be established for multifamily asset resolution activities.

Management’s Response

Management agrees that SOPs need to be revised and/or implemented for both single family and multifamily asset resolution; however, the multifamily strategies will continue to be much more property specific. Division Director Cari Garcia is responsible for ensuring that SOPs for resolution are updated and finalized by September 30, 2013.

Appendix A

Objectives

The objectives of this audit were to determine if:

- a) the Asset Management Division provides sufficient oversight of development performance in order to minimize the Department's risk, and
- b) cost certifications are processed accurately, completely and in a timely manner.

Scope

The scope of this audit was the inception of the Asset Management Division (June 2012) through March 31, 2013.

Methodology

A preliminary understanding of the Asset Management Division was developed in order to determine the project objectives by:

- interviewing Asset Management staff,
- reviewing background information related to asset management,
- observing processes performed by Asset Management staff, and
- performing a project-level risk assessment.

The following tests were conducted to meet the audit objectives:

- We compared the percentage of transactions completed to the number of transactions submitted to the Department for select activities identified during the risk assessment.
- We determined if financial analyses were performed by reviewing supporting documentation including: review sheets, spreadsheets and the related write-ups for thirty-three transactions.
- We determined if the quarterly financial reviews were used to assess properties by reviewing completed review forms and related supporting documentation for a judgmentally-selected sample of twenty-five items.
- We tested a sample of twenty cost certifications:
 - to determine if the cost certifications were processed accurately we evaluated whether they were processed according to criteria set forth in the Texas Administrative Code Subchapter E, Asset Management's Standard Operating Procedure, and Asset Management's review sheet,
 - to determine if cost certifications were completely processed we verified that the IRS Forms 8609 were issued, and
 - to determine if cost certifications were processed in a timely manner we calculated and analyzed the time that elapsed from the time the cost certification was received by the Department to the time the 8609 was issued, however we were unable to determine timeliness in all instances due to a lack of available data.

An Internal Audit of Asset Management

- We evaluated single-family asset resolution by testing accounts for twenty borrowers to determine if collection calls were made or attempted, notices were sent, and required documentation was prepared.

We were unable to assess multifamily asset resolution activities due to limited criteria by which to measure this activity.

Criteria

The following documents were used as criteria:

- Texas Administrative Code Title 10, Part 1, Chapter 10, Subchapters A and E,
- Asset Management Division's draft standard operating procedures,
- 2012 cost certification application spreadsheet,
- Housing Tax Credit Program's Cost Certification Procedures Manual,
- Housing Tax Credit Exchange Program's Cost Certification Procedures Manual,
- cost certification review tool,
- IRS Form 8609,
- instructions for IRS Form 8609,
- 120-Day plus delinquency procedures,
- Asset Management's quarterly financial review form,
- Housing Tax Credit Exchange Program's sub-award contract,
- Tax Credit Assistance Program's written agreement.

Type of Audit

This audit was a performance audit of the Asset Management Division.

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

We conducted audit fieldwork from February 2013 through April 2013. 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 objectives. This audit was conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing*.

An Internal Audit of Asset Management

The following staff performed this audit:

- M. Betsy Schwing, CPA, CGMA, CFE, Project Manager
- Nicole Elizondo, CFE, CICA
- Derrick Miller

Appreciation to Staff

We would like to extend our sincere appreciation to management and staff of the Asset Management Division for their cooperation and assistance during the course of this audit.