Issue Date April 28, 2011	
Audit Report Number 2011-SE-1005	

TO: Virginia Sardone, Acting Director, Office of Affordable Housing, DGH

//**signed**//

FROM: Ronald J. Hosking, Regional Inspector General for Audit, 0AGA

SUBJECT: Oregon Housing and Community Services, Salem, OR, Did Not Always Disburse Its Tax Credit Assistance Program Funds in Accordance With Program Requirements

HIGHLIGHTS

What We Audited and Why

We audited Oregon Housing and Community Services (Oregon Housing) because it received the only Tax Credit Assistance Program (TCAP) grant in Oregon and the second largest grant in the U.S. Department of Housing and Urban Development's (HUD) Region 10, which includes Alaska, Idaho, Oregon, and Washington. Oregon Housing received more than $27 million in TCAP funds under the American Recovery and Reinvestment Act of 2009 (Recovery Act). We also suspected that TCAP information entered into FederalReporting.gov was incorrect because the reported grant amount was greater than the actual grant awarded. Our objectives were to determine whether Oregon Housing selected eligible TCAP projects in accordance with the applicable HUD notice, entered TCAP information into FederalReporting.gov correctly, and paid only eligible TCAP expenditures in accordance with the HUD notice.

What We Found

Oregon Housing complied with the applicable Recovery Act and HUD rules and regulations in selecting eligible grant projects and in the entering of TCAP information into FederalReporting.gov. However, it did not always disburse TCAP funds in accordance with program requirements. Oregon Housing disbursed TCAP funds to two project owners for unsupported legal fees and ineligible appraisal, market study, project compliance, and legal fees. It paid these fees because it did not have adequate procedures in its application review process.

What We Recommend

We recommend that the Director of HUD's Office of Affordable Housing require Oregon Housing to provide supporting documentation for the $80,098 in unsupported costs or reimburse its U.S. Treasury line of credit from non-Federal funds for any costs that remain unsupported. We also recommend that the Director require Oregon Housing to reimburse $20,334 to its U.S. Treasury line of credit from non-Federal funds for the ineligible expenditures. As a result of our audit, on March 17, 2011, Oregon Housing reimbursed its U.S. Treasury line of credit for the unsupported and ineligible costs. Further, we recommend that the Director require Oregon Housing review the other TCAP projects to ensure that there are no ineligible costs.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We provided the discussion draft of the audit report to Oregon Housing on April 15, 2011, and requested its comments by April 22, 2011. Oregon Housing provided its written comments on April 22, 2011. It generally agreed with the finding and recommendations.

The complete text of Oregon Housing's response can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

On February 17, 2009, President Obama signed the American Recovery and Reinvestment Act of 2009 (Recovery Act) into law. The purpose of the Recovery Act was to jump-start the Nation's economy, with a primary focus on creating and saving jobs in the near term, and to invest in infrastructure that would provide long-term economic benefits. The Recovery Act appropriated $2.25 billion under the HOME Investment Partnerships Program (HOME) heading for a Tax Credit Assistance Program (TCAP) grant to provide funds for capital investments in low-income housing tax credit projects. The U.S. Department of Housing and Urban Development (HUD) awarded TCAP grants to the 52 State housing credit agencies. On June 24, 2009, HUD awarded Oregon Housing and Community Services (Oregon Housing) more than $27 million in TCAP funds to be used on qualified low-income buildings that were awarded low-income housing tax credits under section 42 of the Internal Revenue Code (IRC).

Although these funds were appropriated under the HOME heading, TCAP funds are not subject to any HOME requirements other than the environmental review and can only be used in low-income housing tax credit projects, which are administered through the U.S. Department of the Treasury. HUD awarded TCAP grants to facilitate development of projects that received low-income housing tax credit awards between October 1, 2006, and September 30, 2009. Since a major purpose of these funds was to immediately create new jobs or save jobs at risk of being lost due to the current economic crisis, the Recovery Act established deadlines for the commitment and expenditure of grant funds and required State housing credit agencies to give preference to projects that would be completed by February 16, 2012. The grantee was required to distribute the TCAP funds competitively under the requirements of the Recovery Act and pursuant to its existing qualified allocation plan.

Oregon Housing acts as Oregon's housing finance agency and works to create and preserve opportunities for quality, affordable housing for low- and moderate-income families. It promotes affordable housing through grants and tax credits, the construction or rehabilitation of multifamily developments, and the financing of single-family homes. Additionally, Oregon Housing manages Federal and State funds for antipoverty, homelessness, energy assistance, and community service programs. It also assists in the financing of single-family homes and the new construction or rehabilitation of multifamily affordable housing developments, as well as providing grants and tax credits to promote affordable housing.

Oregon Housing finances a spectrum of affordable multifamily housing statewide by means of allocating Federal low-income housing tax credits and issuing tax-exempt bonds. As of February 4, 2011, it had awarded all of its TCAP funds to 15 low-income housing tax credit projects and had disbursed more than $21.5 million in TCAP funds. The 15 projects are multifamily projects which will create or rehabilitate 611 low-income housing units for large families, the elderly, disabled individuals, and homeless individuals.

The use of TCAP funds had resulted in the creation of more than 115 full-time-equivalent jobs as of December 31, 2010.

Our objectives were to determine whether OHCS

1. Selected eligible TCAP projects in accordance with the applicable HUD notice,
2. Entered TCAP information into FederalReporting.gov correctly, and
3. Paid only eligible TCAP expenditures in accordance with the HUD notice.

RESULTS OF AUDIT

Finding 1: Oregon Housing Reimbursed Unsupported and Ineligible Costs

Oregon Housing disbursed TCAP funds to two project owners for unsupported legal fees and ineligible appraisal, market study, project compliance, and legal fees. The payment of unsupported and ineligible costs occurred because Oregon Housing did not have adequate procedures in its application review process. Consequently, it spent more than $80,000 on unsupported costs and more than $20,000 on ineligible fees (see appendix D). Since reimbursed, these funds will be available for other eligible TCAP expenses.

Oregon Housing Used TCAP Funds To Pay for Unsupported Legal Fees

Most of the unsupported legal fees were identified as "land use" on the invoices with no explanation as to what specific services were provided by the attorney. As a result, we could not determine whether these costs were for services relating to partnership formation, organizational costs, the syndication or selling of partnership interests, permanent financing, or eligible costs.

According to the Low-Income Housing Tax Credit Handbook published by Novogradac & Company, which the industry refers to for best practices, the services mentioned above are ineligible basis costs.

Oregon Housing Paid an Ineligible Appraisal Fee

The appraisal was commissioned to obtain permanent financing. According to the Internal Revenue Service (IRS), an appraisal performed to determine the value of the building for purchase is includable in the eligible basis. However, an appraisal to secure financing is treated in accordance with the type of financing obtained. For permanent financing, the fee would be amortized under IRC 263A and not depreciated. Consequently, the cost would not be includable in the eligible basis.

Oregon Housing Paid an Ineligible Market Study Fee

The market study was conducted for the tax credit application. According to IRC 42(m)(1)(A)(iii), a comprehensive market study is conducted before credit allocation is made and is at the developer's expense. The IRS determined that market study fees are not includable in eligible basis because the market study is associated with receiving the allocation of tax credits and is, therefore, an intangible asset, not depreciable residential property.

Oregon Housing Paid Ineligible Project Compliance Fees

The project compliance fees were for a third party retained by the owner to review compliance with Davis-Bacon Wages and Recovery Act-related requirements. HUD's TCAP Guidance on Fees and Asset Management states that while the costs to carry out compliance monitoring fall solely on Oregon Housing, the project owner is solely responsible for the costs of making the project compliant with all applicable TCAP program requirements during the development of the project as well as during the TCAP grant period. The project owner is responsible for the costs of providing the information or documentation to the grantee about such compliance. Therefore, project compliance fees incurred by the project owner are ineligible for TCAP funding.

Oregon Housing Paid Ineligible Legal Fees

These legal fees were for review of fair housing laws and TCAP documents, organizational costs, and permanent financing. Fair housing laws and TCAP document reviews are related to program compliance, which must be borne by the project owner. These costs are ineligible in accordance with HUD's TCAP Guidance on Fees and Asset Management. Organizational costs consisted of filing strategy, entity formation and structuring, and researching to trademark the project name. Organizational costs are ineligible basis costs in accordance with the Novogradac Low-Income Tax Credit Handbook, 2010 Edition, section 3:59, because they are amortizable costs. Legal fees related to permanent financing are not includable in eligible basis. According to the IRC, all costs incurred to secure permanent financing are ineligible because they are capitalized and amortized over the life of the loan. Only depreciable costs are includable in eligible basis.

Oregon Housing Did Not Have Adequate Procedures in Its Review Process

Oregon Housing's application review procedures did not include a process for determining whether costs on the uses of funding schedule were eligible basis costs. The loan officers used the uses of funding schedules, which were approved by the former low-income housing tax credit program manger during the application process, as a guideline to reimburse project owners for eligible program costs. However, the uses of funding schedule identified ineligible basis costs as eligible. As a result, neither the loan officers nor the supervisor questioned the ineligible costs. Therefore, Oregon Housing spent more than $80,000 on unsupported legal fees and more than $20,000 on an ineligible appraisal fee, market study fee, project compliance review, and legal fees. These funds could have been made available for other eligible TCAP expenses.

Oregon Housing decided to reimburse its U.S. Treasury line of credit for the unsupported expenses instead of obtaining additional information to support eligibility of the costs. It believed that this process would be more efficient since there were plenty of construction costs left to offset future draws of TCAP funds.

Conclusion

On March 17, 2011, Oregon Housing reimbursed its U.S. Treasury line of credit for the unsupported and ineligible costs cited in this finding. In addition, Oregon Housing has initiated processes to improve its control weakness by reorganizing the work unit and amending its application review process to ensure that it does not allow ineligible costs.

Recommendations

We recommend that the Director of HUD's Office of Affordable Housing require Oregon Housing to

1A. Provide supporting documentation for the $80,098 in unsupported costs or reimburse its U.S. Treasury line of credit from non-Federal funds for any costs that remain unsupported.

1B. Reimburse its U.S. Treasury line of credit $20,334 from non-Federal funds for the ineligible fees.

1C. Review the other TCAP projects to ensure that there are no ineligible costs.

SCOPE AND METHODOLOGY

Oregon Housing was awarded more than $27 million in TCAP funds and had expended more than $21 million at the time of our review. We reviewed its project selection process, reported TCAP information, and TCAP expenditures to ensure that it selected eligible grant projects, entered TCAP information into FederalReporting.gov accurately and in a timely manner, and paid eligible TCAP expenditures in accordance with the applicable Recovery Act and HUD rules and regulations.

To accomplish our objectives, we

- Reviewed applicable laws; regulations; HUD requirements; Oregon Housing requirements, including its policies and procedures; IRC section 42 eligible basis cost requirements; and the Low-Income Housing Tax Credit Handbook published by Novogradac & Company.

- Interviewed HUD and Oregon Housing staff and communicated with IRS staff to obtain further knowledge of program requirements.

For the eligible grant project selection objective, we reviewed all 15 of the projects that were awarded TCAP funding to determine whether the projects had been awarded low-income housing tax credits between October 1, 2006, and September 30, 2009, under section 42(h) of the IRC of 1986 and that those projects were expected to be completed by February 16, 2012.

For the reporting objective, we selected 3 of the 15 projects to review for the full-time equivalency reported. We selected one project with the highest full-time equivalency reported in FederalReporting.gov for the quarter ending June 30, 2010, and two projects with the highest full-time equivalency reported in FederalReporting.gov for the quarter ending December 31, 2010. We also reviewed the expenditures reported in FederalReporting.gov for the seven projects selected for the TCAP-eligible activities review (as described below) because we had already reviewed the source documentation for accuracy.

For the eligible TCAP expenditures objective, we selected the six projects that were awarded more than $2 million each and had drawn at least 90 percent of their available TCAP funds. We also selected one project awarded less than $2 million because construction had been completed and its final certification was provided to us by Oregon Housing as an example of eligible costs. We reviewed all the draws of each of the seven projects selected to determine whether TCAP funds were spent on eligible activities, whether those funds were expended within 3 days of being drawn from HUD’s account, and that no advances were made to the project owners.

We did not rely on automated data for our analysis because Oregon Housing did not have an automated database system for TCAP reimbursements.

The audit generally covered the period February 2009 through January 31, 2011. We performed our audit at Oregon Housing, 725 Summer Street, NE., Suite B, Salem, OR, from January 24 to March 11, 2011.

We conducted the 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.

INTERNAL CONTROLS

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objectives:

- Controls to ensure that Oregon Housing followed applicable laws and regulations with respect to the eligibility of TCAP projects.
- Controls to ensure that Oregon Housing followed applicable laws and regulations with respect to the reporting of TCAP information in FederalReporting.gov.
- Controls to ensure that Oregon Housing paid only for eligible costs under TCAP.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- Oregon Housing did not have adequate controls in place to ensure that reimbursements were only for eligible expenditures for TCAP (finding 1).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/	Unsupported 2/
1A	$20,334	
1B		80,098

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.

2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.

Appendix B

AUDITEE COMMENTS

Auditee Comments

Oregon

John A. Kitzhaber, MD, Governor

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April 22, 2011

Ronald J. Hosking
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Regional Office of Inspector General for Audit
909 1st Ave, Suite 126
Seattle, Washington 98104

Re: HUD TCAP Audit

Dear Mr. Hosking:

Oregon Housing and Community Services (OHCS) received the OIG Audit draft report issued on April 15, 2011. The report stated there were occasions where TCAP funds were disbursed not within program requirements.

Specifically, the report cited three areas of concern with recommendations:

- 1(a) Provide additional documentation for $80,098 in unsupported costs or reimburse its U.S. Treasury line of credit from non-Federal funds for any costs that remain unsupported.

- 1(b) Reimburse $20,334 to its U.S. Treasury line of credit from non-Federal funds for ineligible expenditures.

To expedite the process, funds from 1(a) and 1(b) above have been reimbursed as recommended.

- 1(c) Provide internal review of the remaining TCAP projects to assure no additional ineligible cost expenditures.

To correct issue 1(c) we shall conduct the following activities.

- Within 120-days of the issuance date of the report, re-evaluate the process for expenditure oversight and make improvements as deemed necessary. OHCS will utilize the improved process to review the remaining TCAP projects to ensure that all expenditures charged to TCAP are eligible.

If you have any questions, please contact Dave Summers at (503) 986-2073, or dave.summers@hcs.state.or.us.

Sincerely,

Rick Crager

Rick Crager
Acting Director

c: Lana Monfort, Auditor in Charge

Appendix C

CRITERIA

HUD allows costs for TCAP that are eligible basis costs under section 42 of the IRC. The IRS does not have specific eligible and ineligible basis costs outlined in the IRC. The industry uses section 42(d)(3) of the IRC, which states that eligible basis items are a project's depreciable costs. Specifically it states that eligible basis is the project's adjustable basis as of the close of the first taxable year of the credit period. Oregon Housing refers to the best practices provided by the National Council of State Housing Agencies, the Low-Income Housing Tax Credit Handbook published by Novogradac & Company, and specific guidance and letter rulings from the IRS. From these resources, Oregon Housing derived a uses of funding schedule that identified eligible and ineligible basis costs under section 42 of the IRC for low-income housing tax credit.

Appendix D

TABLE OF DEFICIENCIES FOR FINDING 1

Ineligible/unsupported cost	Project A	Project B	Total
Ineligible costs:			
Appraisal fee	$ 5,250		$5,250
Market study fee	6,750		6,750
Project compliance review fee	657		657
Legal fee	6,717	960	7,677
Subtotal ineligible fees	**19,374**	**960**	**20,334**
Unsupported legal fees	80,098		80,098
Total ineligible fees and unsupported costs	**$ 99,472**	**$960**	**$100,432**