



Issue Date April 1, 2011
Audit Report Number 2011-KC-1003

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

//signed//

FROM: Ronald J. Hosking, Regional Inspector General for Audit, 7AGA

SUBJECT: The Missouri Housing Development Commission Did Not Always Disburse Its Tax Credit Assistance Program Funds in Accordance With Recovery Act Requirements

## **HIGHLIGHTS**

### **What We Audited and Why**

We audited the Missouri Housing Development Commission (Commission) because it received and disbursed the largest amount of American Recovery and Reinvestment Act of 2009 (Recovery Act) funds in Region VII. The Commission received nearly \$39 million in Tax Credit Assistance Program (TCAP) funds and had disbursed more than \$23 million of these funds as of July 26, 2010. Our objective was to determine whether the Commission expended Recovery Act grant funds in accordance with Recovery Act requirements and applicable U.S. Department of Housing and Urban Development (HUD) rules.

### **What We Found**

The Commission did not always disburse TCAP funds in accordance with Recovery Act requirements and applicable HUD rules. It disbursed more than \$3.6 million in TCAP funds for ineligible and improperly documented expenditures. It spent over \$137,000 of these funds on ineligible TCAP expenditures. In addition, it spent over \$3.4 million of these funds on expenditures that lacked sufficient documentation of their eligible basis portion.

HUD has no assurance that these funds were used for eligible TCAP purposes, and those that were not could have been made available for other eligible expenditures.

### **What We Recommend**

We recommend that the Director of HUD's Office of Affordable Housing require the Commission to reimburse \$137,062 to its U.S. Treasury line of credit from non-Federal funds for the ineligible expenditures. We also recommend that the Commission provide supporting documentation showing the amount includable in the eligible basis for the over \$3.4 million of unsupported costs and reimburse its U.S. Treasury line of credit from non-Federal funds for the amount it determined was ineligible or it could not support. Further, we recommend that the Director require that HUD verify the implementation of the Commission's new review process for the approval of draw requests to ensure that only eligible TCAP expenditures are paid.

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 the Commission on March 8, 2011. The Commission provided its written comments on March 25, 2011. It generally agreed with our recommendations.

The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

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## BACKGROUND AND OBJECTIVE

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The Missouri Housing Development Commission (Commission) was established by the 75th Missouri General Assembly in 1969 and is the housing finance agency for the State of Missouri. The Commission operates under a board of commissioners including the governor, lieutenant governor, attorney general, state treasurer, and six persons appointed by the governor with the advice and consent of the Senate. The Commission has invested almost \$4 billion to construct, renovate, and preserve affordable housing.

The Commission functions as a bank, providing financing directly to developers of affordable rental properties and funding for home loans to qualified first-time buyers. It also administers the Federal and Missouri low-income housing tax credit (LIHTC) programs and the Federal HOME Investment Partnerships Program (HOME) funds as well as other programs related to its housing finance activities.

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 investing in infrastructure that will provide long-term economic benefits. The Recovery Act appropriated \$2.25 billion under the HOME program heading for a Tax Credit Assistance Program (TCAP) grant to provide funds for capital investments in LIHTC projects. The U.S. Department of Housing and Urban Development (HUD) awarded TCAP grants to the 52 State housing credit agencies. On June 26, 2009, HUD awarded the Commission nearly \$39 million in TCAP funds.

Although these funds were appropriated under the HOME heading, TCAP funds are not subject to HOME requirements other than the environmental review and can only be used in LIHTC projects, which are administered through the U.S. Department of the Treasury. HUD awarded TCAP grants to facilitate development of projects that received LIHTC awards between October 1, 2006, and September 30, 2009.

As of July 26, 2010, the Commission had awarded all of its TCAP funds to 24 LIHTC projects and disbursed more than \$23 million of these funds. The 24 LIHTC projects consist of 12 family and 12 elderly projects, which will create or rehabilitate 1,474 housing units.

Office of Community Planning and Development (CPD) Notice 09-03-REV, Implementation of the Tax Credit Assistance Program, states that TCAP funds must be used for capital investment in eligible LIHTC projects. Capital investment means costs that are included in the eligible basis of a project under Section 42 of the Internal Revenue Code, costs of land acquisition, onsite demolition costs, and hazardous material remediation costs. TCAP funds cannot be used for the administrative costs of TCAP grantees, including the cost of operating the program or monitoring compliance.

The eligible basis is the amount of all depreciable development costs that may be included in the calculation of housing tax credits. Eligible depreciable costs include all "hard" costs, such as

construction costs, and most depreciable “soft” costs, such as architectural and engineering costs, soil tests, and utility connection fees.

This is our second audit report on the Commission’s TCAP program. Our first report disclosed that the Commission did not obtain and review all Davis-Bacon Act reports and lobbying certifications from contractors working on TCAP-funded projects and it did not accurately report job creation data to Recovery.gov (report number 2010-KC-1007, dated September 10, 2010).

Our objective was to determine whether the Commission expended Recovery Act grant funds in accordance with Recovery Act requirements and applicable HUD rules.

## RESULTS OF AUDIT

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### Finding 1: The Commission Disbursed TCAP Funds for Ineligible and Improperly Documented Expenditures

The Commission disbursed TCAP funds for ineligible and improperly documented expenditures. This deficiency occurred because the Commission did not have a reliable process in place to review the eligibility of TCAP expenditures. As a result, HUD has no assurance that more than \$3.6 million in TCAP funds were used for eligible purposes, and those that were not could have otherwise been used for allowable TCAP purposes.

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The Commission drew money from the Recovery Act grant funds for ineligible and improperly documented expenditures. Specifically, it paid TCAP expenses that did not meet the eligibility criteria outlined in the Internal Revenue Code, HUD's TCAP guidance and the Commission's own TCAP guidance. In addition, it paid TCAP expenses that lacked supporting documentation showing that the expenses met the criteria for inclusion in eligible basis under Section 42 of the Internal Revenue Code. See appendix C for the criteria.

#### **Ineligible Expenditures**

##### Market Study Costs

For 12 projects, the Commission paid market study costs, although such costs are ineligible under the Internal Revenue Code. Based on the Internal Revenue Code, Section 42(m)(1)(A)(iii), the comprehensive market study is conducted before the credit allocation is made and at the developer's expense. In addition, the Internal Revenue Service maintains that market studies conducted and used to secure the credit allocation are associated with the credit allocation and are not included in eligible basis.

##### Construction Inspection Fees

For 10 projects, the Commission paid itself construction inspection fees, which were not allowed under HUD's TCAP Guidance on Fees and Asset Management (HUD's TCAP guidance). CPD Notice 09-03-REV (TCAP notice) requires that TCAP grantees perform asset management functions for TCAP projects. HUD's TCAP guidance shows monitoring construction and conducting periodic construction inspections as an eligible asset management fee. However, 24 CFR (Code of Federal Regulations) 85.22(a)(2) prohibits project owners from paying these fees with TCAP funds.

##### Construction Draw Fee

The Commission used TCAP funds to pay construction draw fees for one project contrary to HUD's TCAP guidance. The construction draw fee title companies

charge to projects for paying their creditors is considered a TCAP grantee's administrative cost. The Commission chose to contract with a third party (title companies) to perform this administrative function. Regardless of who performs this function, a grantee may not charge fees to the project owner so no pass-through fees are permitted. Therefore, these fees should not be charged to the TCAP project in an attempt to recoup all or a portion of the TCAP grantee's administrative costs.

#### Application Fee

The Commission improperly paid itself an application fee for two projects. The Commission's application fee would fall under an administrative task as shown in HUD's TCAP guidance. TCAP Questions and Answers: Program Income, Fees, and Asset Management states that fees charged by the tax credit allocating agency to LIHTC projects, such as fees normally charged in conjunction with applications for LIHTC awards, cannot be paid for with TCAP funds. In addition, the Internal Revenue Service's Revenue Ruling 2004-82 states that the application fee is not includable in the eligible basis of the applicant's low-income housing building because the fees are not capitalizable into the adjusted basis of the building.

### **Insufficient Documentation of the Eligibility**

#### Legal Fees

The Commission paid legal expenses for 15 projects without determining which portion of the expenses was included in the eligible basis. Under Section 42 of the Internal Revenue Code, there is no general treatment for legal fees; rather, the purpose of the fee has to be determined. The Internal Revenue Service provided several examples of fees that are excluded from the eligible basis, including forming the partnership and preparing a prospectus to syndicate or sell partnership interests.

Many of the legal invoices were extremely detailed, but the Commission made no determination of whether the line items on the invoices should be included in the eligible basis. Other legal invoices did not provide any detail other than including a generic statement such as payment for legal services. In the latter examples, there was no way to determine whether the legal services provided related to eligible basis items. The Commission did not properly review these legal invoices to determine which portions could be included in eligible basis under Section 42 of the Internal Revenue Code.

#### Furniture, Fixtures, and Equipment

The Commission paid furniture, fixture, and equipment expenses for two projects without determining which expenses would be maintained for 15 years. According to the Internal Revenue Service, furniture, fixtures, and equipment can

be included in the eligible basis, but usually only rugs, curtains, and appliances are included. The Internal Revenue Service noted that usually only those items are included because the project owner is obligated to maintain the items for the entire 15-year period and most of these items have a much shorter life. Those items also must be depreciated.

The Commission paid TCAP funds for many items that would not be included in the Internal Revenue Service definition of eligible basis including pencils, pens, binders, legal pads, and bathroom and facial tissue. The Commission also made no determination in the file as to whether any of the furniture, fixture, and equipment items were being depreciated, which would trigger inclusion in the eligible basis and qualify for TCAP reimbursement.

#### Accounting and Auditing Fees

The Commission paid accounting and auditing expenses for seven projects without evaluating the purpose of the expenses and calculating the eligible basis portion. According to the Internal Revenue Service, the services provided for accounting and auditing need to be evaluated to determine whether the fees meet the criteria for inclusion in eligible basis under Section 42 of the Internal Revenue Code. If the accounting was for the purpose of a loan, the cost should be included in the cost of financing and amortized over the life of the loan, and if the loan period overlaps the construction period, a portion would be includable in the eligible basis. In general, amortized costs are not includable in eligible basis.

The Internal Revenue Service noted that accounting fees incurred to prepare the cost certification required to get the LIHTC allocation are not includable in the eligible basis. The invoices in the Commission's draw files did not always indicate the purpose of the accounting and auditing fees and did not show whether any of the fees were amortized over the life of the loan. Several of the accounting and auditing invoices reimbursed with TCAP funds showed a fee for cost certifications relating to the LIHTC, which is not includable in the eligible basis.

#### Closing Costs and Financing Fees

The Commission paid closing and/or financing costs for 12 projects without evaluating the purpose of the costs and calculating the eligible basis portion. According to the Internal Revenue Service, all costs, including the closing costs and financing costs incurred to secure a permanent loan, are capitalized and amortized over the life of the loan. Amortized costs are not includable in eligible basis. Costs associated with permanent financing are generally not includable in eligible basis.

On the other hand, construction period costs may indirectly qualify for inclusion in eligible basis, as calculated based on the construction period and the life of the loan. Many of the closing and financing invoices failed to document whether the costs related to construction or permanent financing. In addition, the Commission made no determination in the file of whether the line items on the invoices should

be included in the eligible basis, nor did it calculate what portion of the line item warranted inclusion.

#### Developer Fee

The Commission paid developer fees with TCAP funds for four projects without determining the eligible basis portion. The Internal Revenue Service states that the developer fee should be allocated based on associating the services provided with an asset includable in eligible basis. Not all developer costs are included in the eligible basis of a project.

#### Construction Interest

The Commission paid construction interest for one project with TCAP funds. The Novogradac Handbook, which provides guidance in applying eligible basis costs for LIHTC under Section 42 of the Internal Revenue Code, states that interest expense must be capitalized to the extent that it is incurred during the production period. Interest expense must be capitalized if it is traceable directly or indirectly to the production costs. To the extent that the loan proceeds are used to pay for costs associated with the production of depreciable assets, the portion of the amortized fees during the production of depreciable assets can be included in the project's eligible basis. The Commission made no determination in the file of whether interest expense was capitalized, nor did it calculate what portion of the line item warranted inclusion in the eligible basis.

#### Environmental Fees

The Commission used TCAP funds to pay the environmental fee for 14 projects without evaluating the eligible basis portion. The TCAP Questions and Answers: National Environmental Policy Act (NEPA) & Related Laws states that the costs incurred by the grantee for conducting and completing environmental reviews are administrative costs of the TCAP program and therefore cannot be charged to the TCAP grant. The project owner's costs for providing information to the TCAP grantee are eligible to the extent that the costs may be included in the eligible basis of the project under Section 42 of the Internal Revenue Code of 1986, as amended. In addition, the Internal Revenue Service stated that costs associated with receiving an LIHTC credit or anything to do with securing the TCAP funds would not be includable in eligible basis.

### **Lack of a Reliable Review Process**

The Commission did not have a reliable process in place for reviewing the eligibility of TCAP expenditures. The review process at the Commission was developed by the former director of the TCAP program and the program administrator. The reviewer used a list of eligible and ineligible TCAP items. However, the list showed items that we determined to be ineligible TCAP expenditures as eligible, such as market study fees and Commission inspection

fees. In addition, the list did not recognize items that need to be prorated to show the eligible basis portion of the expenditure. The reviewer did not follow the list consistently when reviewing soft costs. While the Commission had an LIHTC expert on staff, he was not involved in developing the TCAP eligibility review process or performing the review.

After we started this audit, the Commission stated that it had developed a new review process. The LIHTC expert reviewed the existing process and determined that only hard construction costs would be paid with TCAP funds going forward. The Commission had decided not to pay soft costs such as legal and accounting costs.

### 3.6 Million Disbursed for Ineligible and Improperly Documented Expenditures

The Commission disbursed more than \$3.6 million in TCAP funds for ineligible and improperly documented expenditures. It spent over \$137,000 of these funds on ineligible TCAP expenditures. In addition, it spent over \$3.4 million of these funds on expenditures that lacked sufficient documentation of their eligible basis portion. HUD has no assurance that these funds were used for eligible TCAP purposes, and those that were not could have been made available for other eligible expenditures.

<u>Expenditure category</u>	<u>Ineligible</u>	<u>Unsupported</u>
Market study	\$ 59,762	
Commission inspection fee	\$ 75,000	
Construction draw fee	\$ 800	
Application fee	\$ 1,500	
Legal fees		\$ 439,545
Furniture, fixtures, and equipment		\$ 33,064
Accounting		\$ 96,948
Closing costs		\$ 149,708
Financing fees		\$ 426,878
Developer fees		\$ 2,145,585
Construction interest		\$ 2,636
Environmental		\$ 178,583
<b>Totals</b>	<b>\$ 137,062</b>	<b>\$ 3,472,947</b>
<b>Grand total</b>		<b>\$ 3,610,009</b>

An accounting firm audited the Commission's TCAP expenditures for three projects. During its review, it identified legal fees and financing and closing costs that did not meet the criteria for inclusion in the eligible basis. The Commission

reimbursed the U.S. Treasury line of credit for these ineligible costs. Therefore, these amounts are not included in the questioned costs in this report.

## Conclusion

The Commission did not have a reliable review process in place to determine the eligibility of TCAP expenditures and, therefore, may not have properly spent more than \$3.6 million in TCAP funds. The TCAP notice states that the grantee must repay TCAP funds that were used for ineligible costs. During the grant period, the repayment must be made to the grantee's TCAP line of credit in accordance with procedures established by HUD. Therefore, the Commission needs to reimburse its U.S. Treasury line of credit for the ineligible expenditures and also provide supporting documentation or reimburse for the improperly documented expenditures or provide supporting documentation. Additionally, we recommend that HUD verify the implementation of the new review process to ensure that only eligible TCAP expenditures are paid.

## Recommendations

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

- 1A. Require the Commission to reimburse its U.S. Treasury line of credit \$137,062 from non-Federal funds for the ineligible TCAP expenditures paid.
- 1B. Require the Commission to provide supporting documentation showing the amount includable in the eligible basis for the \$3,472,947 of unsupported costs and reimburse its U.S. Treasury line of credit from non-Federal funds for the amount it determined was ineligible or it could not support.
- 1C. Verify the implementation of the new review process for the approval of draw requests to ensure that only eligible TCAP expenditures are paid.

## SCOPE AND METHODOLOGY

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We reviewed the Commission's TCAP expenditures to ensure that it paid eligible TCAP expenditures in accordance with the applicable Recovery Act and HUD rules and regulations. To accomplish our objective, we reviewed applicable HUD requirements; Commission requirements; Internal Revenue Code, Section 42, eligible basis costs requirements; and the Recovery Act and applicable implementing regulations. We interviewed HUD, Commission, and Internal Revenue Service staff to obtain further guidance on specific program requirements.

On June 26, 2009, HUD awarded the Commission nearly \$39 million in TCAP funds. Based on HUD's Integrated Disbursement and Information System report, as of July 26, 2010, the Commission had awarded all of its TCAP funds to 24 LIHTC projects and disbursed more than \$23 million of these funds. We used these automated data for background purposes only and did not rely on the data to support our conclusion. All conclusions were based on our review of the Commission's draw files and other supporting documentation for the LIHTC projects.

For our review of expenditures, we reviewed all 24 of the Commission's LIHTC projects. We reviewed all draw requests from August 2009 through July 2010 to ensure that the expenditures were for TCAP-eligible activities. We expanded this period as necessary to address issues identified during our review.

We also reviewed all 24 projects' draws to ensure that the TCAP funds were expended within 3 days of being drawn from the project's U.S. Treasury account. We compared the Commission's bank statements showing the date of the TCAP draw deposit to the disbursement summaries showing the date of payment. During our review, we noted several instances of noncompliance with the rule, which states that once funds are drawn from the grantee's U.S. Treasury account, they must be expended for an eligible TCAP cost within 3 days. These instances were noted in a minor deficiencies letter to the Commission.

In addition, we reviewed the draw files for each TCAP project to determine whether proper supporting documentation was present to support the draws. We identified the contractor's application for payment, invoices, and issued checks as proper support for the draws. During our review, we noted several missing supporting documents. These documents were identified in a minor deficiencies letter to the Commission.

Our audit period generally covered August 2009 through July 2010. We performed audit work from August 2010 through January 2011 at the Commission's office at 3435 Broadway, Kansas City, MO.

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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

# INTERNAL CONTROLS

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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.

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## Relevant Internal Controls

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

- Controls to ensure that the Commission paid only for eligible costs under TCAP requirements.

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:

- The Commission did not have adequate controls in place to ensure that reimbursements were only for eligible expenditures for TCAP.

## Separate Communication of Minor Deficiencies

Minor internal control and compliance issues were reported to the auditee in a separate letter, dated April 1, 2011.

## APPENDIXES

### Appendix A

#### SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

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Recommendation number	Ineligible 1/	Unsupported 2/
1A	\$137,062	
1B		\$3,472,947

- 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 AND OIG'S EVALUATION

### Ref to OIG Evaluation

### Auditee Comments

 <p><b>Jeremiah W. (Jay) Nixon</b> Governor</p> <p><b>Peter Kinder</b> Lieutenant Governor</p> <p><b>Clint Zweifel</b> State Treasurer</p> <p><b>Chris Koster</b> Attorney General</p> <p><b>Jeffrey S. Bay</b> Chairman</p> <p><b>Cale Bradford</b> Vice Chairman</p> <p><b>Troy L. Nash</b> Secretary-Treasurer</p> <p><b>Timothy Joyce</b> Commissioner</p> <p><b>John Stanfield</b> Commissioner</p> <hr/> <p><b>Margaret D. Llineberry</b> Executive Director</p> <p><b>Kansas City</b> 3435 Broadway Kansas City, MO 64111 816-759-6600 Fax 816-759-6828 TTY 816-759-6839</p> <p><b>St. Louis</b> 4625 Lindell, Suite 300 St. Louis, MO 63108 314-877-1350 Fax 314-877-1360 TTY 314-877-1303</p>	<p style="text-align: right;">March 25, 2011</p> <p>Mr. Ronald J. Hosking Regional Inspector General for Audit U.S. Department of Housing and Urban Development Office of Inspector General Region VII Office of Audit Gateway Tower II – 5<sup>th</sup> Floor 400 State Avenue Kansas City, KS 66101-2406</p> <p>Re: Discussion Draft of HUD OIG Audit of Missouri Housing Development Commission's Tax Credit Assistance Program</p> <p>Dear Mr. Hosking:</p> <p>Thank you for providing to the Missouri Housing Development Commission (the "Commission") the opportunity to respond to the Discussion Draft Audit Report issued on March 10, 2011 (the "Audit Report") prepared by the Office of Inspector General (the "OIG") of the U.S. Department of Housing and Urban Development ("HUD") with respect to the Commission's administration of funding provided pursuant to the Tax Credit Assistance Program ("TCAP").</p> <p>Among its other functions, the Commission administers the Federal and the Missouri Low Income Housing Tax Credit (LIHTC) programs for the State of Missouri. The American Recovery and Reinvestment Act of 2009 (the "Recovery Act") included an appropriation in the amount of \$2.25 billion to provide funds for capital investments in LIHTC projects. The Commission received nearly \$39 million in TCAP funds and had disbursed more than \$23 million of this amount by July 26, 2010. The Commission awarded its allocation of TCAP funds to 24 LIHTC developments, consisting of 12 family and 12 elderly projects, which involved the creation or rehabilitation of 1,474 housing units in the State of Missouri.</p> <p>A major 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 while also investing in infrastructure that will provide long-term economic benefits. Thus, the purpose of the OIG audit was to review the Commission's transactions to ensure that proper disbursements were made for eligible expenditures in connection with the 24 LIHTC projects mentioned above. On Friday, March 18, 2011, staff members of the Commission participated in a conference with OIG representatives to discuss the Audit Report. The Audit Report contains several findings, together with recommendations for appropriate corrective actions. It is the intent of the Commission to comply with the recommendations as indicated herein.</p>
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**Ref to OIG Evaluation**

**Auditee Comments**

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**Comment 1**

**Ineligible Expenditures**

The Audit Report found that the Commission had expended \$137,062 of the \$39 million in TCAP funds on certain expenses (market study costs, construction inspection fees, construction draw fee, and application fee) that the OIG considered to be ineligible under the TCAP program. The OIG recommended that the Commission reimburse this amount to its U.S. Treasury line of credit from non-Federal funds. The Commission agrees with this finding and recommendation and is in the process of providing the recommended reimbursement.

**Insufficient Documentation of Ineligibility**

The Audit Report found that the Commission disbursed \$3.4 million of the \$39 million in TCAP funds for legal fees; furniture, fixtures, and equipment; accounting and auditing fees; closing costs and financing fees; developer fee; construction interest; and environmental fees without obtaining sufficient documentation of their eligible basis portion. The OIG recommended that the Commission provide supporting documentation showing the amount includable in eligible basis (and reimburse its U.S. Treasury line of credit from non-Federal funds to the extent the eligible basis of any such expenditure cannot be documented).

**Comment 2**

The Commission believes that the amounts it disbursed for these expenditures are eligible expenditures, and it is currently working to provide the appropriate supporting documentation. This supporting documentation will include detailed invoices from project owners as well as independent support from third parties in the form of cost certifications or letters from Certified Public Accountants (if the cost certification has yet not been completed), confirming the items and amounts includable in eligible basis. The Commission will work with HUD to provide this documentation on a timely basis and on a schedule agreeable to HUD. To the extent the eligible basis cannot be documented to HUD's satisfaction, the Commission will reimburse its line of credit as recommended.

**Lack of Reliable Review Process**

**Comment 3**

The Audit Report found that, prior to the audit, the Commission did not have a reliable process in place for reviewing the eligibility of TCAP expenditures, and the OIG recommended that HUD verify the Commission's new review process for approving draw requests, which was implemented during the course of the audit. Specifically, the Commission has strengthened its review process by requiring the approval of each draw by the Commission's Tax Credit Administrator before TCAP funds are processed and drawn from HUD's IDIS system. The Tax Credit Administrator's review is facilitated by the detailed documentation provided by the Commission's Construction Disbursement Department personnel. In addition, the Commission will continue to provide additional training for its staff members who are involved in the processing of TCAP funds.

Once again, the Missouri Housing Development Commission would like to thank the U.S. Department of Housing and Urban Development, as well as its Office of Inspector General, for their oversight of the

**Ref to OIG Evaluation**

**Auditee Comments**

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Commission's administration of TCAP funds to ensure their proper disbursement in support of our Nation's recovery from the current economic crisis.

Very truly yours,

  
Margaret D. Lineberry  
Executive Director

### **OIG Evaluation of Auditee Comments**

- Comment 1** Once the Commission completes the reimbursement, it will fulfill our first recommendation. HUD will review the reimbursement prior to closing the finding.
- Comment 2** If the Commission implements the planned actions, it will fulfill our second recommendation as long as the review includes a line by line analysis of the costs on the detailed invoices with a breakdown of which costs are includable in the eligible basis. An overall review of each eligibility category is not acceptable to fulfill this recommendation; rather, each line item on the invoices must be reviewed to determine the eligible basis portion of the costs. HUD will review the documentation prior to closing the finding.
- Comment 3** The Commission has taken positive steps to implement the final recommendation, including the approval of each draw by the TCAP administrator before the funds are processed as well as providing additional future training for its staff. We were told during the audit that the Commission was only going to use TCAP funds going forward on hard construction costs. HUD needs to verify the implementation of this process as well as the administrator's review of the draws and the additional training. With the implementation of this process, the Commission will have better oversight of the TCAP expenditures.

## Appendix C

### CRITERIA

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#### Internal Revenue Code

The Internal Revenue Code, Section 42(m)(1)(A)(iii), states that a comprehensive market study of the housing needs of low-income individuals in the area to be served by the project is conducted before the credit allocation is made and at the developer's expense by a disinterested party who is approved by such agency.

The Internal Revenue Code, Section 42(d)(1), provides that the eligible basis of a new building is its adjusted basis as of the close of the first taxable year of the credit period.

The Internal Revenue Code, Section 42(d)(2)(A), states that the eligible basis of an existing building is "(i) in the case of a building which meets the requirements of subparagraph (B), its adjusted basis as of the close of the 1st taxable year of the credit period, and (ii) zero in any other case."

The Internal Revenue Code, Section 42(d)(2)(B), states that a building meets the requirements of this subparagraph if "(i) the building is acquired by purchase (as defined in section 179(d)(2)), (ii) there is a period of at least 10 years between the date of its acquisition by the taxpayer and the date the building was last placed in service, (iii) the building was not previously placed in service by the taxpayer or by any person who was a related person with respect to the taxpayer as of the time previously placed in service, and (iv) except as provided in subsection (f)(5), a credit is allowable under subsection (a) by reason of subsection (e) with respect to the building."

Internal Revenue Code, Section 42(d)(2)(C), states that for purposes of subparagraph (A), "the adjusted basis of any building shall not include so much of the basis of such building as is determined by reference to the basis of other property held at any time by the person acquiring the building."

#### **Low-Income Housing Credit Newsletter (Issued by the Internal Revenue Service, #39, issued April 2010)**

The developer fee should also be allocated based on associating the services provided with an asset includable in eligible basis. Examples of services likely to be performed by the developer, which are not includable in eligible basis include (*but are not limited to*):

- Securing undeveloped land,
- Forming the partnership or syndicating the partnership to investors, and
- Securing the credit allocation.

## IRS Technical Memorandum 200043017

### PARTNERSHIP SYNDICATION AND FORMATION

[3] If Developer 2 engaged in organizational or syndication activities relating to and on behalf of the Taxpayer, then the corresponding percentage of the developer fees paid by the Taxpayer should be treated as nondeductible expenses incurred in either the organization or syndication of the partnership under *section 709(a)*, and would not be includable in eligible basis under *section 42(d)(1)*.

### TCAP Guidance on Fees and Asset Management

#### Section II - Grantee Administrative Costs

The Recovery Act did not authorize the use of TCAP funds for administration of the TCAP Program. Therefore, TCAP grantees must pay for the cost of administration of their TCAP program. Furthermore, a TCAP grantee cannot reimburse its administrative costs by charging fees to TCAP projects. 24 CFR 85.22(a)(2), which applies to many federal programs, including TCAP, prohibits the use of TCAP funds awarded to a project for payment of fees to TCAP grantees. In addition, fees charged to TCAP projects, paid for by other sources of funds, are considered “program income.” Program income can only be used to pay for TCAP eligible costs and cannot be used to pay for a grantee’s administrative costs

If a TCAP grantee does not have the appropriate staff to perform required administrative tasks, it may choose to contract with a third party to perform certain administrative functions. However, regardless of whether a TCAP grantee performs these administrative functions itself or hires a contractor to do so, a TCAP grantee may not charge any fees to the TCAP project owner in an attempt to recoup all or a portion of the TCAP grantee’s administrative costs. For example, some TCAP grantees have proposed to charge “pass-through fees” that they plan to charge projects to pay third-party contractors to perform (NEPA [National Environmental Policy Act]) environmental reviews. This is not permitted because the grantee’s costs for performing required functions, such as environmental reviews, are not reimbursable from any outside source of funds (i.e., TCAP funds, other project funds).

The following are examples of required TCAP grantee administrative functions:

- *General management, oversight and coordination.* Reasonable costs of overall program management, coordination, monitoring, and evaluation.
- *Preparing reports and other documents* related to the program for submission to HUD.
- *Travel costs* incurred for official business in carrying out the program.
- *Administrative services.* Services such as general legal services, accounting services, and audit services.
- *Staff and overhead.* Staff and overhead costs directly related to carrying out the project, such as work specifications preparation, loan processing, inspections, and other services related to assisting potential tenants.

- *Compliance Monitoring, such as*
  - *NEPA*: Conducting “environmental reviews” of proposed projects to meet the requirements of the National Environmental Policy Act (NEPA) of 1969 (and related laws) before committing TCAP funds to projects.
  - *Federal Labor Standards*: Monitoring to assure compliance with federal labor standards during construction, such as the Davis Bacon Act.
  - *Lead-based Paint*: Monitoring projects during construction to ensure compliance with the Residential Lead-Based Paint Hazard Reduction Act of 1992 (where applicable).

#### IV. Asset Management

The Recovery Act requires that TCAP grantees perform asset management functions for TCAP projects “to ensure compliance with section 42 of the IRC [Internal Revenue Code] of 1986, and the long term viability of buildings funded” by TCAP.

TCAP grantees may charge fees to TCAP project owners for the asset management activities described below. Because asset management for TCAP projects is statutorily required, asset management fees are the only fees charged to TCAP projects that are not considered program income. 24 CFR 85.22(a)(2) prohibits project owners from paying eligible asset management fees with TCAP funds, therefore project owners must identify other funding sources to pay these fees.

Asset management activities for a project may begin when TCAP funds are first committed to a TCAP project. The following is the list of activities eligible to be paid for with fees charged for asset management, organized by project stage. Note: not every activity on this list must be performed for every project, as some activities will not be applicable or necessary to every project.

#### Development/Construction Activities

- Conduct periodic construction inspections and quality reviews, if needed. Confirm construction completion guarantees.
- Monitor construction to ensure the development is progressing as scheduled (e.g. actual construction start date compared to original projections, projected construction end date compared to original projections).

### **Implementation of the Tax Credit Assistance Program (TCAP) - Notice: CPD-09-03-REV**

#### A. Eligible Grantees, Projects and Uses of Funds

TCAP funds must be used for capital investment in eligible LIHTC projects. Capital investment means costs that are included in the ‘eligible basis’ of a project under Section 42 of the IRC, costs of land acquisition, on-site demolition costs, and hazardous material remediation costs. Section 1604 of the Recovery Act specifically prohibits the use of grant funds for swimming pools. TCAP funds cannot be used for the administrative costs of TCAP grantees, including the cost of operating the program or monitoring compliance.

The TCAP assistance provided to a project must be made in the same manner and subject to the same limitations (including rent, income, use restrictions and compliance monitoring) as required by the state housing credit agency with respect to an award of LIHTC to a project (i.e., as required under Section 42 of the IRC and its implementing regulations), and all other requirements of the Act. The TCAP grantee must enforce these LIHTC requirements by seeking specific performance.

The grantee must repay TCAP funds that were used for ineligible costs, or for a project that is never completed or for a project that failed to meet the requirements under Section 42 (i.e. so that the project is considered a LIHTC project). During the grant period, the repayment must be made to the grantee's TCAP Line of Credit, in accordance with procedures established by HUD. After the grant period, HUD may take action in accordance with 24 CFR Part 85, Subpart D. If a project fails to maintain compliance with TCAP requirements, the grantee must seek specific performance to obtain compliance in accordance with the required TCAP written agreement. The grantee has no repayment obligation in the event of foreclosure of a project if the grantee was performing asset management and took reasonable actions to ensure compliance and the long-term viability of the project.

#### G. Asset Management

The Recovery Act requires state housing credit agencies to perform asset management functions, or contract for performance of these services, at the owner's expense, to ensure compliance with Section 42 of the IRC and the long term viability of projects funded by TCAP. However, costs associated with this required asset management are not eligible to be paid with TCAP funds.

### **TCAP Questions and Answers: Program Income, Fees, and Asset Management**

#### Question 2:

Can TCAP grantee charge fees to LIHTC projects receiving TCAP funds? Are these fees considered program income?

#### Answer:

Yes, TCAP grantees can charge fees to LIHTC projects which will also receive TCAP funds. However, fees charged by the tax credit allocating agency to LIHTC project, such as fees normally charged in conjunction with applications for LIHTC awards, cannot be paid for with TCAP funds. Fees associated with LIHTCs are not considered TCAP program income, as these fees are not generated by the use of TCAP funds in a project. If a TCAP grantee charges additional or incremental fees related to TCAP such fees cannot be paid for with TCAP funds. Furthermore, fees charged in connection with TCAP, other than asset management fees, are program income, because they are attributable to TCAP funds. (See Question 5 regarding asset management fees). However, unlike LIHTC's fees, TCAP program income cannot be used for administrative costs incurred by the TCAP grantee. (See Question 3 for more information about eligible uses of program income).

### **TCAP Questions and Answers: National Environmental Policy Act (NEPA) & Related Laws**

Question 12:

Can the cost of conducting and completing federal environmental reviews be charged to the TCAP grant?

Answer:

The costs incurred by the grantee or subgrantee for conducting and completing environmental reviews are administrative costs of the TCAP program and therefore cannot be charged to the TCAP grant. The project owner's costs for providing information to the TCAP grantee or subgrantee are eligible to the extent that the costs may be included in the "eligible basis" of the project under Section 42 of the Internal Revenue Code of 1986, as amended.