

2015

**Limited Review of the Housing Authority of Travis
County & the Strategic Housing Finance
Corporation**

**Risk Evaluation & Consulting Division
Travis County Auditor's Office
June 1, 2015**

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To: Sherri Fleming
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From: Nicki Riley, CPA
Travis County Auditor

Date: June 1, 2015

Re: Review of the Housing Authority of Travis County and the Strategic Housing Finance Corporation

At the request of the Travis County Health & Human Services Department (HHS), and with the approval of Commissioners' Court, the Risk Evaluation & Consulting Division (REC) of the Travis County Auditor's Office has completed a limited review of the financial records and processes of the Housing Authority of Travis County (HATC) and the Strategic Housing Finance Corporation (SHFC). The overall objective of the review was to provide input to HHS regarding HATC/SHFC's financial situation and to provide actionable recommendations based on our findings to assist both HATC/SHFC personnel and Travis County management.

SCOPE

The following details the scope of our limited review of these entities:

1. Document general accounting and internal control processes for both entities. Review the relevant contracts, statutes and agreements that govern each.
2. Determine what programs are administered by the two entities and at what points those programs have operated at a loss during the last three years. Determine how these losses were recouped or funded.
3. Perform program-specific and entity-wide analytical reviews of revenues and expenditures from the last three years.
4. Determine how costs, particularly shared costs, are allocated between the two entities.
5. Examine receivables and payables created between the two entities over the last four years ("Due to" and "Due from" accounts). Determine why these assets and liabilities are created, their reasonableness, and the timeliness of their payment.

6. Document any other issues noted, including recommendations for changes in internal controls or accounting processes.
7. Formulate an opinion on HATC/SHFC's ability to continue as a going concern (i.e., its ability to fund its programs in the coming years without receiving additional assistance from outside entities.).

FINDINGS

During our review, we noted four chief areas of concern:

1. The financial situation at HATC/SHFC appears to be decaying rapidly, principally due to the significant losses incurred by the Housing Choice Voucher program in recent years. Because of this, we question HATC/SHFC's ability to fund its operations beyond the next 9 to 15 months without receiving outside funding.
2. Financial and accounting management is not sufficient to properly assist management, particularly in the areas of cost analysis, analytical review, internal controls, budgeting, and strategic planning.
3. The SHFC has not received sufficient resources and attention from management in recent years.
4. Program costs, especially administrative costs, are high. For federal programs, these costs often exceed the amount allowed for cost recoupment from HUD.

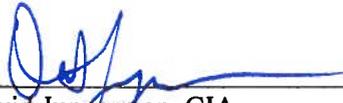
Our detailed findings can be found on pages 5 through 8. Our recommendations for correcting these issues can be found on pages 9 and 10.

ENGAGEMENT TEAM

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CLOSING

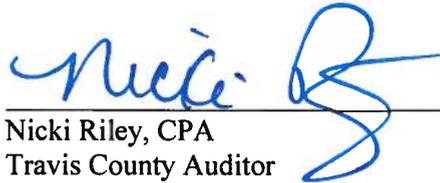
This report is intended solely for the information and use of HHS, the Commissioners' Court, HATC/SHFC, and the Auditor's Office. We greatly appreciate the cooperation and assistance received from management and staff during this review. Please contact our office if you have any concerns or questions regarding this report.



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BACKGROUND

HOUSING AUTHORITY OF TRAVIS COUNTY (HATC)

Chapter 392 of the Texas Local Government Code was adopted to address the shortage of safe and/or sanitary housing for low-income residents through the creation of county, municipal, and regional housing authority entities. Section 392.012(e) of this chapter requires the Commissioners' Court of Texas counties to determine if there is a need for a housing authority. On September 10, 1975, Travis County Commissioners' Court passed a resolution declaring the need for and the creation of the Housing Authority of Travis County.

The HATC procures grants and other subsidies from the U.S. Department of Housing and Urban Development (HUD) to fund the housing programs they have implemented to assist low-income and other eligible residents in Travis County. The programs currently provided by the HATC are summarized below:

Public Housing

HUD administers federal aid to local housing authorities to enable them to develop, manage, and maintain housing for eligible residents at rents they can afford. Through the use of HUD funds, HATC was able to build three public housing developments in the early 1980s. They are able to continue funding the operation and maintenance of these properties with tenant rents and annual HUD capital and operating subsidies. Capital funds are to be used for major repairs and/or remodeling; whereas, operating funds are provided to help maintain services and provide minimum operating reserves. The HATC is currently able to provide 105 units of public housing.

Housing Choice Vouchers

The Section 8 Housing Choice Voucher Program was created to assist low-income and other eligible residents obtain affordable housing in the private marketplace. Participants are free to choose any housing that meets program requirements, including their current residence, as long as the property owner agrees to participate in the program. HUD provides housing authorities with housing subsidies and administrative funding to operate the program. The housing authority makes housing assistance payments (HAPs) directly to the landlords on behalf of the participants, who are responsible for paying the difference between the actual rent charged by the landlord and the HAP. The HATC currently operates this program with 568 HUD-approved units.

Shelter Plus Care

The Shelter Plus Care Program (SPC) was designed to provide permanent housing and support services to homeless people, primarily those with serious mental illnesses and chronic problems with alcohol and/or drugs. HUD provides rental assistance grants which must be matched in value with supportive services. HATC administers the voucher rental assistance program and partners with Austin Travis County Integral Care to meet the matching requirement. Participants can choose their own housing and keep their rental assistance if they move, although limits can be placed on where they may live if it is deemed necessary for the provision of the support services. The HATC currently runs a homeless program with approximately 155 units.

Non-HUD Funded Housing

The HATC owns and operates the following housing developments, which they purchased without federal assistance: Carson Creek (duplexes) and Manor Town Apartments (for seniors). These developments provide 49 units of affordable housing to low-income Travis County residents.

STRATEGIC HOUSING FINANCE CORPORATION (SHFC)

Chapter 394 of the Texas Local Government Code (or Texas Housing Finance Corporations Act) was adopted to “provide a means to finance the cost of residential ownership and development that will provide decent, safe, and sanitary housing at affordable prices for residents of local governments.” Housing finance corporations created under this chapter are public, nonprofit corporations that are authorized to issue limited obligation bonds to fund their public purpose. Travis County’s SHFC was created by the Commissioners’ Court on June 11, 2004.

TAG Associates, Inc., a company that specializes in providing specialized investment and advisory services to public and subsidized housing providers, was hired by HATC to prepare a business plan for SHFC. They provided the following purpose statement for the SHFC in their report dated November 5, 2013:

“The purpose of the organization is the promotion and advancement of neighborhood economic development, related employment opportunities and housing revitalization and urban renewal through the provision of decent, safe and affordable housing to low and moderate income families within the Travis County community. Specific areas of focus for SHFC can be expected to include housing development, including the entering of partnerships in tax credit and other affordable housing deals, site acquisition for future development activities and property management.”

SHFC’s involvement in development, site acquisition, and property management activities not only results in the increase of HATC’s stock of affordable housing, it also brings in funding in the form of ownership interests and fees that can be used to further increase the available inventory of affordable housing and provide financial assistance to HATC.

As of June 30, 2014, SHFC had issued three series of limited obligation bonds. They were also involved in six development projects and four ground-lease projects through their investment in seven non-government wholly-owned single-member Texas Limited Liability Companies (LLCs).

RELATIONSHIP BETWEEN HATC AND SHFC

On May 7, 2013, HATC and SHFC entered into an interlocal agreement, the terms of which require HATC to provide certain governmental functions and services to SHFC. In return for providing these services, SHFC is required to pay HATC an annual fee of \$174,000 and reimburse HATC for all costs and expenses incurred on SHFC’s behalf.

In addition, SHFC regularly provides funding to HATC when HATC does not have sufficient funds to meet their obligations. HATC typically treats this funding as a short term loan, and timely reimburses SHFC when they receive HUD funds. However, there have been occasions when SHFC forgave the debts and treated them as contributions because HATC did not have adequate funds with which to reimburse them. During FY12 through FY14, SHFC forgave loans to HATC totaling \$617,369.

After members of SHFC’s Board of Commissioners expressed concerns regarding the funding relationship between SHFC and HATC, SHFC engaged Naman, Howell, Smith & Lee (attorneys) to determine whether HATC and SHFC were separate and distinct legal entities. The attorneys opined that they were in fact separate and distinct. However, they also acknowledged that SHFC was formed with the intention that it would “be an entity that aided and assisted HATC with multifamily residential activities, as well as provide an additional source of operating funds to HATC.” For more detailed information about the legal relationship between HATC and SHFC, see the attorneys’ letter dated February 3, 2015.

SIGNIFICANT DEVELOPMENTS

Sale of Building

Between 2009 and 2012, a number of outside audits reported significant findings regarding how HATC handled their HUD funds. The findings included, but were not limited to, the inappropriate transfer of funds between federal and nonfederal programs, a failure to accurately record transfers between programs, and allowing program payable/receivable balances to remain unpaid for extensive periods of time.

In order to settle the inter-program balances and address other pressing financial issues, the HATC sold their building to Travis County for \$2.5 million during May 2012. They used \$1,745,525 of the proceeds to settle the inter-program balances, and posted the remainder to their Administration Fund.

Management Changes

The HATC and SHFC have undergone substantial change in their management during the past year. The previous Executive Director tendered his resignation which was effective July 31, 2014. An interim Executive Director has been in place since then, providing oversight to both HATC and SHFC without receiving compensation. There has been a significant loss of institutional knowledge because the previous Executive Director was the person who was primarily responsible for handling some of the more complex tasks such as working on the development deals and procuring HUD funding. In addition to the Executive Director's departure, three member of SHFC's Board of Commissioners and one member of HATC's Board have resigned their positions in the last 12 months.

Financial Concerns

In recent audit reports, there has been a great deal of concern about HATC being able to survive going forward due to the rate at which they are using their reserves. Although HATC has improved their standing with HUD, largely as the result of selling their building, HUD continues to closely monitor them due to their past financial issues and current use of program reserves. The Auditor's Office was asked to perform a limited review to determine their ability to continue as a going concern and address other issues.

New Hires

The SHFC hired a Portfolio Manager who will also act as the HATC Executive Director for one year. His employment begins on June 15, 2015. They also hired an Asset Manager to oversee existing projects and those underway. He will begin his employment with SHFC on June 1, 2015. The Chief Financial Officer position is still open.

FINDINGS

During the course of our limited review of HATC and SHFC, we noted the following areas of concern:

1. ABILITY OF HATC/SHFC TO CONTINUE AS A GOING CONCERN

The first priority of our review of HATC/SHFC was to determine their ability to continue to fund their operations going forward without outside assistance - their ability to continue as a going concern. One important measure of an entity's ability to continue as a going concern is the condition of its reserve balance. From the beginning of FY12 to the end of FY14, total, consolidated reserves for HATC/SHFC fell by \$1,928,352. The following details this change:

FY12 Beginning Equity/Reserve Balance	\$5,766,108
Consolidated net loss in FY12	(482,855)
Consolidated net loss in FY13	(927,529)
Consolidated net loss in FY14	(634,858)
FY14 Ending Equity/Reserve Balance	\$3,720,866

Based on this, total reserves fell by \$2,045,242 in three years, or 35% - a significant reduction. In addition, of the ending FY14 reserve balance, only \$1,435,636 relates to relatively unrestricted reserves that can be transferred to multiple programs under certain circumstances. Given the trend of annual consolidated losses from the three years under review, these relatively unrestricted reserves could be exhausted before the end of FY16 (June 30, 2016). The large annual losses incurred by HATC/SHFC and its dwindling reserve balance cause us to question HATC/SHFC's ability to fund all of its programs without outside assistance for more than the next 9 to 15 months, a worst-case scenario.

While a number of HATC programs incur annual losses, at least periodically, our analysis found that the Housing Choice Voucher (HCV) program is the most significant source of the losses and dwindling reserves noted above. The following schedule details the annual losses incurred by this program from FY12 thru FY14 and the overall reduction in program fund balance in the period:

Housing Choice Vouchers Operating Gain/(Loss) Pro Forma Schedule:

Beginning FY12 HCV Equity/Reserve Balance	\$1,317,935
FY12 Operating Loss	(288,450)
FY13 Operating Loss	(529,268)
FY14 Operating Loss	(874,056)
Total Operating Loss FY12 - FY14	(1,691,774)
Ending FY14 Equity/Reserve Balance - Operating Only	(373,839)
Transfers in/Recoupments from other funds FY12 - FY14	930,775
Ending FY14 HCV Equity/Reserve Balance - Final	\$556,936

Based on the above, any HCV loss in FY15 that exceeds \$556,936 will completely consume the program’s reserves, resulting in negative equity and requiring funds to be transferred to HCV from another fund or outside source. The HUD Snapshot Review of January 13, 2015 estimates that HCV will require a \$738,641 transfer from HCV reserves to cover its FY15 operating losses, an amount \$181,705 in excess of the ending FY14 HCV reserve balance.

In terms of the source of these steadily rising annual losses, expenditures for this program are classified in two ways – administrative costs and housing assistance voucher payments. Reimbursements are received from HUD for both types of expenditure; typically, not all funds expended are recouped from HUD. During the FY12 to FY14 period, expenditures for administrative costs exceeded HUD reimbursements as follows:

<u>HCV Administrative Expenditure Recoupment</u>	<u>FY 12</u>	<u>FY 13</u>	<u>FY 14</u>
Total Administrative Expenses	\$585,309	\$543,376	\$548,368
Reimbursements Received from HUD	422,507	369,629	369,307
Total Admin. Expenses not Reimbursed by HUD	\$162,802	\$173,747	\$179,061

In the same three year period, housing assistance voucher payments exceeded HUD voucher reimbursements as follows:

<u>HCV Housing Assistance Payment Recoupment</u>	<u>FY 12</u>	<u>FY 13</u>	<u>FY 14</u>
Total housing assistance voucher payments	\$3,948,451	\$4,141,512	\$4,506,287
Reimbursements Received from HUD	3,781,565	3,774,498	3,812,705
Total HAPs not Recouped from HUD	\$166,886	\$367,014	\$693,582

While the amount that administrative costs exceed reimbursements is relatively flat over the three years, the amount that Housing Assistance Payments (HAPs) exceeded reimbursements has risen significantly in that period. Without further review, we are currently unable to determine why the amount of HAPs being reimbursed by HUD has risen so quickly to such a high level.

There are a number of possible reasons for the shortfall in HAP recoupment: not all issued vouchers are reported to HUD for reimbursement; reimbursement requests are not handled properly/timely, or they are simply not filed; vouchers are issued in excess of the potential reimbursement ceiling due to poor tracking; non-voucher expenditures being posted as HAP, or some combination of these possible scenarios. The HUD Snapshot Review of January 13, 2015 stated that the vouchers posted to the Voucher Management System (VMS) did not reconcile to the HATC financial records, indicating that HATC’s ability to properly track and account for issued vouchers is likely compromised.

2. LACK OF ONSITE UPPER-LEVEL ACCOUNTING PROFESSIONALS

There is no discernable senior management in place over the accounting and financial functions of HATC/SHFC. Accounting and financial duties are instead spread across two accounting staff positions at HATC/SHFC and a part time “fee accountant” employed by a local public accounting firm. The former two positions are primarily responsible for accounts payable, bank transfers, deposits, grants, and payroll functions, while the fee accountant performs bank reconciliations, adjusting and closing entries, and records inter-fund accounts payable and receivable.

The current accounting/finance personnel are capable of recording routine accounting entries, compiling basic financial statements, and providing accounting records for the myriad of audits that are required for HATC/SHFC.

However, the accounting and finance needs that require an analytical, seasoned professional are not being satisfied. These needs include providing HATC/SHFC management with high-level advice on accounting and financial matters; providing useful, detailed budgets; completing analytical and cost reviews of operating costs and revenues; producing strategic and financial plans; maintaining a reliable internal control environment; and implementing audit recommendations.

The lack of financial and accounting management for HATC/SHFC has been noted in a number of audits, which consistently recommended that HATC/SHFC hire a Chief Financial Officer (CFO).

3. SHFC OPPORTUNITIES

The HATC engaged TAG Associates, Inc. to prepare business plans for SHFC, the results of which were provided in their reports dated November 5, 2013 and March 15, 2014. We believe their reports display a comprehensive understanding of the public housing industry, the financial risks they face, as well as opportunities for SHFC's growth, and improvement. Highlights from their reports are provided below:

- The HATC's programs are running either a deficit or near deficit with net unrestricted reserves small and generally shrinking. HATC relies on SHFC to provide funding to support their programs which may experience a further decline in HUD funding. It is therefore important that SHFC continue to find opportunities to increase their revenues.
- For the SHFC to maximize its fees and cash flow potential, it will need to gain the necessary experience and resources to develop without tax credit partners. At present, the SHFC has neither the financial resources nor assets it can pledge to provide LIHTC guarantees. The SHFC must assume greater roles in future projects to enhance its experience level and to maximize ownership.
- At present, HATC staff is shared with the SHFC and is the equivalent of 107% of a full time position. The shared staffing includes the Executive Director, Finance Manager, Accounting Specialist, maintenance, and administrative support. It is important to consider if SHFC will eventually need dedicated staff if it continues to grow.
- Although the HATC has most of the customary financial policies in place, they have not documented the corresponding procedures. The missing procedures include those for accounts payable, bank transfers, deposits, grants, and payroll functions. The system of internal controls is weakened with the absence of written procedures because alternate procedures providing lesser safeguards could be implemented. In addition, the lack of documented procedures could lead to a significant interruption of accounting processes during periods of staff transition.
- The HATC is not maximizing the use of automation for internal financial activities, so opportunities for efficiencies are being missed. During the course of the TAG Associates assessment, the processing of accounts payable transactions had fallen behind due to the use of manual systems.

4. DISPROPORTIONATE PROGRAM COSTS

As previously mentioned, HUD closely monitors the HATC due to their previous significant audit findings and financially-troubled status. HUD's Enforcement Center was tasked with performing a review of HATC's Low Rent and Housing Choice Voucher programs to identify financial trends and expense management difficulties. According to the HUD Snapshot Review of January 13, 2015, HATC's expenses are excessive in comparison to their peers. Specifically, Low Rent's and HCV's administrative expenses were 81-95% and 91-98% higher than their peer group respectively. In addition, HCV's operating expenses were 70-75% higher than its peers.

In reviewing the programs that were not funded by HUD, we noted no issues with the Carson Creek duplexes which had immaterial losses during the first two fiscal years and net income for the final year of the review period. However, the Manor Town Apartments consistently reported losses for each of the three fiscal years under review.

Excessive costs can be indicative of waste, ineffective internal controls, lack of management oversight, and conflicts of interest. They can also be caused by excessive staffing levels and inefficient purchasing policies and procedures. Excessive costs can also be incurred when fundamental knowledge is not available internally, such as in the accounting and finance area. This condition often leads to expensive outsourcing of duties that should be performed by staff, such as in the case of HATC's fee accountant, who is employed by a local public accounting firm.

In addition, cost savings on administrative costs would allow HATC to assist more County residents with affordable housing. While it is understood that SHFC is a funding source for HATC, SHFC has a number of possible uses for its funds that would also benefit residents needing housing assistance. Therefore, limiting HATC losses through added efficiencies and cost savings is in best interests of both entities.

RECOMMENDATIONS

Based on the issues noted in the preceding pages, we recommend the following:

1. ABILITY OF HATC/SHFC TO CONTINUE AS A GOING CONCERN

We recommend that HATC obtain a detailed audit of its HCV program as soon as possible. We suggest that HATC request assistance from the Travis County Commissioners' Court and the Auditor's Office so that this audit can be performed in the most timely, cost effective manner possible.

The focus of this audit should be to determine why this program is incurring consistent, sizable losses where Housing Assistance Payments exceed HUD reimbursements for these vouchers. Based on the findings of this audit, HATC should take corrective actions as appropriate to reduce/eliminate these losses as quickly as possible.

2. LACK OF ONSITE UPPER-LEVEL ACCOUNTING PROFESSIONALS

We recommend that the new director immediately begin the search process for a CFO to manage HATC/SHFC's accounting and financial functions. The party hired to fill this position must be able to provide the basic, fundamental accounting skills that HATC/SHFC does not have access to internally and is currently obtaining from third parties. Other helpful skills for this position include, but are not limited to the following:

- Experience in the housing field or at least a background in grants/government allocations.
- Experience with budgeting and strategic financial planning.
- Experience with cost accounting and/or performing efficiency reviews.
- Good understanding of internal controls and their implementation.

We also recommend that HATC/SHFC obtain assistance from Travis County during the hiring process as appropriate, including help from the Travis County Auditor's Office, HRMD, and HHS.

3. SHFC OPPORTUNITIES

We recommend a thorough review of the TAG Associates reports, as well as an internal review of SHFC's activities, implementing changes as deemed appropriate. Some of the recommendations provided in the reports are provided below for reference.

- Develop a detailed plan for future activities (strategic planning)
- Develop cash flow projections
- Consider/develop a plan for future staffing
- Develop/expand written financial policies and procedures
- Improve financial/operational automation

4. DISPROPORTIONATE PROGRAM COSTS

We recommend that the new Executive Director work with the new CFO (once hired) to perform detailed cost studies for all HATC program operating costs with a focus on administrative expenses. A complete review of staffing levels and salaries should also be performed.

We also recommend that HATC evaluate its purchasing policies and procedures, particularly its bidding processes, for potential cost savings. HATC may be eligible to participate in Travis County contracts to obtain cost savings or be able to join groups of other nonprofits that have negotiated contract discounts.