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A Review of the State Housing Finance and Development Authority's Low-Income Housing Tax Credit Program

Members of the General Assembly requested that we audit the State Housing Finance and Development Authority's low-income housing tax credit program. The requesters were concerned about the authority's efforts to monitor program requirements, its role in reviewing and scoring applications for credits, and whether the agency maximizes the use of tax credits.

The low-income housing tax credit program directs private capital towards the creation of affordable rental housing. The credits provide incentives by offsetting the costs of development acquisition, new construction, or substantial rehabilitation. For example, a developer receiving $200,000 in tax credits may deduct $200,000 from his overall federal tax liability each year for up to ten years.

Developers apply to the authority for proposed tax credit projects. Authority staff score tax credit applications and reserve credits based on the total points scored. A developer who is reserved credits must submit a carryover application and receive an allocation of credits prior to year end. The developer must then expend 10% of estimated development costs within six months of receiving the allocation. After the allocation is received, the developer has two years to place the project in service.

BETWEEN 1997 AND 2000, THE HOUSING AUTHORITY RESERVED APPROXIMATELY $19 MILLION IN LOW-INCOME HOUSING TAX CREDITS FOR 84 DEVELOPMENTS.

TAX CREDIT RESERVATIONS AND APPLICATIONS

TAX YEAR	APPROVED APPLICATIONS	TAX CREDIT RESERVATIONS	DENIED APPLICATIONS
1997	27	$4,671,563	11
1998	20	4,299,736	20
1999	18	4,856,487	38
2000	19	5,485,431	41
TOTAL	**84**	**$19,313,217**	**110**

Source: State Housing Finance and Development Authority.

OVERSIGHT ISSUES

PROJECT PLANS AND SPECIFICATIONS

Authority staff has not provided adequate oversight to ensure that developers who successfully compete for tax credits comply with project plans and specifications. In evaluating proposals, the authority awards points based on the developers' plans to use certain materials and amenities. However, agency staff does not directly verify developer compliance with these requirements.

In Alabama, Georgia, Kentucky, Mississippi, and North Carolina, housing personnel conduct on-site inspections at various phases of construction to ensure developer compliance with plans and specifications. When agency staff does not verify adherence to these proposals, there is less assurance of developer compliance and the fairness and integrity of the tax credit program may be compromised.

EXAMPLES OF POINTS AWARDED FOR CONSTRUCTION MATERIALS AND AMENITIES

MATERIALS	POINTS	AMENITIES	POINTS
Interior doors that are six-paneled colonist, or solid core birch, or solid core lauan.	4	All grass areas must be sodded.	4
All interior cabinets to be solid wood or wood/plastic veneer products with dual slide tracks on drawers.	4	Garbage disposal in all units.	4
Architectural, dimensional anti-fungal shingles or equivalent.	10	Dishwasher in all units.	4

Source: 2001 Qualified Allocation Plan.

PROGRESS

DEVELOPERS HAVE EITHER NOT SUBMITTED PROGRESS REPORTS OR HAVE SUBMITTED INACCURATE REPORTS TO THE HOUSING

The authority requires developers who have been reserved tax credits to submit quarterly progress reports for two years until a project is completed. We concluded that the agency has not taken the initiative to follow up with developers when reports have not been submitted or when minimum progress has been indicated on the reports. However, we identified one case in which the authority terminated a project before it was scheduled for completion. The lack of agency follow-up may result in delays in the construction of affordable housing and/or the loss of credits to developers in the state.

We reviewed progress reports from January 2000 to April 2001 and found the following.

- Eleven (65%) of 17 developers did not submit all 6 of the required reports.
- A developer who did not complete two projects, as required in 2000, did not submit any of the four required reports on either project in 1999.
- In the July 2000 progress report for one of the projects, the same developer stated that foundations were being laid on the project site. However, following this *developer's failure to complete the project* and nine months after the July report was submitted, a housing official confirmed that no foundations had been laid on the property.

Other states follow up with developers when minimum progress has been made on tax credit projects. For example, according to an official of the Alabama Housing Authority, if minimum progress has been made on a development, staff either contacts the developer or conducts an on-site inspection of the property.

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IRS MONITORING REQUIREMENTS

After a tax credit project is completed, the Internal Revenue Service requires the authority to monitor compliance with the United States Department of Housing and Urban Development tenant rents and incomes and housing standards. We found that the authority has adequately monitored compliance with these requirements.

ADMINISTRATIVE ISSUES

RETURNED TAX CREDITS

IN 2000, THE AUTHORITY LOST $475,000
IN TAX CREDITS TO A NATIONAL POOL.

The authority has not maximized the use of tax credits. A developer who fails to meet carryover or to complete a project must return credits to the authority. Between 1998 and 2000, approximately $2.3 million in credits were returned. Of this amount, the authority lost $475,000 in credits to a national pool and these credits are no longer available to developers in the state.

Also, in recent years there has been a steady increase in returned credits from $0 in 1997 to $1.4 million in 2000. In addition, the number of developers returning credits increased from 0 in 1997 to 4 in 2000.

We concluded that both the increase in the dollar amount and the number of returned credits may be due to the authority's lack of penalties against developers who have failed to meet program requirements. Developers have been allowed to reapply for tax credits for the same and other tax credit projects *immediately* after they have failed to meet carryover or to complete a project. For example, in 2001, a developer who failed to meet carryover on two projects in 2000 reapplied for tax credits for one of the failed projects and six other projects. As of May 2000, authority staff had eliminated two of the six new applications. The application for the failed project was still being considered.

TAX CREDITS RETURNED FROM 1997 TO 2000

YEAR RETURNED	AMOUNT RETURNED	NUMBER OF PROJECTS
1997	$0	0
1998	$265,400	1
1999	$640,989	2
2000	$1,380,723	4

Source: Housing Authority tax credit records.

PROGRAM DISQUALIFICATION

In 2000, authority staff attempted to disqualify two developers from participating in the tax credit program after they did not meet carryover on two projects. However, because staff did not include these penalties in the agency's 2000 qualified allocation plan, the penalties would have been difficult to enforce.

MARKET STUDIES

Market studies address the needs of the market area and the ability of the community to support a tax credit project. The authority began requiring independent studies in 1999. However, the agency did not clearly define standards for these studies, such as the circumstances that would constitute an unacceptable relationship between a market analyst and a developer. When independent studies are not conducted, there is an increased risk of project failure.

COMPLETED PROJECTS

Our review indicated that 46 of the 48 tax credit projects that were allocated credits in 1997 and 1998 were completed. Two projects amounting to $710,336 in credits were returned to the authority. We concluded that the authority did not adequately monitor these projects.

RETENTION OF TAX CREDIT RECORDS

Since the authority does not retain denied applications, we were unable to compare criteria used in the scoring of denied and successful applications. This practice makes the agency vulnerable if tax credit decisions are legally challenged and does not allow the audit of records to ensure compliance with tax credit selection criteria. Eight states that we contacted retain denied applications from two years to permanently as compared to three months retention in South Carolina. We recommend that the authority work with South Carolina Department of Archives and History officials to arrange for storage and to develop a retention schedule for tax credit records.

Project Locations

28 (33%) OF THE 84 TAX CREDIT PROJECTS AWARDED ARE LOCATED IN 4 COUNTIES.

Tax credit projects tend to be located in areas of the state with high median incomes. We found that 28 (33%) of the 84 tax credit projects awarded between 1997 and 2000 are located in 4 counties of the state — Charleston, Greenville, Horry, and Spartanburg. Three of these counties have relatively high median incomes. According to an authority official, rents that can be achieved in poorer areas are often below allowable rents making tax credit developments infeasible in these areas. To allow the construction of projects in poorer areas, the authority should evaluate and seek funding to reduce rental rates for the tax credit program.

Number of Tax Credit Projects By County 1997 – 2000

County	2000 Median Income	Projects	County	2000 Median Income	Projects
York	$57,100	1	Chester	$42,200	2
Beaufort	$53,400	5	**Horry**	**$42,100**	**6**
Lexington	$51,100	1	Newberry	$42,000	2
Richland	$51,100	2	Saluda	$41,300	0
Anderson	$48,700	2	Darlington	$40,000	1
Cherokee	$48,700	2	Union	$39,800	1
Greenville	**$48,700**	**6**	Calhoun	$38,200	0
Pickens	$48,700	2	Chesterfield	$37,800	0
Spartanburg	**$48,700**	**6**	Sumter	$37,800	4
Barnwell	$48,400	3	Orangeburg	$37,700	1
Aiken	$46,600	1	Colleton	$37,500	2
Edgefield	$46,600	3	Marlboro	$37,500	1
Lancaster	$45,400	3	Georgetown	$36,500	1
Greenwood	$45,000	1	Hampton	$34,700	0
Oconee	$44,900	0	Jasper	$34,500	0
Berkeley	$44,600	0	McCormick	$34,100	0
Charleston	**$44,600**	**10**	Marion	$33,300	1
Dorchester	$44,600	1	Williamsburg	$32,500	2
Kershaw	$44,000	1	Dillon	$31,200	1
Fairfield	$43,300	0	Bamberg	$31,000	0
Florence	$43,100	3	Clarendon	$30,800	2
Laurens	$43,000	1	Allendale	$29,800	1
Abbeville	$43,000	1	Lee	$29,100	1

Sources: United States Department of Housing and Urban Development (HUD) and Housing Authority data.

26 Years of Service

This document summarizes our full report, ***A Review of the State Housing Finance Development Authority's Low-Income Housing Tax Credit Program.*** Responses from state agencies are included in the full report. All LAC audits are available free of charge. Audit reports and information about the LAC are also published on the Internet at www.state.sc.us/sclac. If you have questions, contact George L. Schroeder, Director.