Tennessee Housing Development Agency

March 2001

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STATE OF TENNESSEE
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John G. Morgan
Comptroller

March 9, 2001

The Honorable John S. Wilder
Speaker of the Senate
The Honorable Jimmy Naifeh
Speaker of the House of Representatives
The Honorable Thelma M. Harper, Chair
Senate Committee on Government Operations
The Honorable Mike Kernell, Chair
House Committee on Government Operations
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the performance audit of the Tennessee Housing Development Agency. This audit was conducted pursuant to the requirements of Section 4-29-111, *Tennessee Code Annotated,* the Tennessee Governmental Entity Review Law.

This report is intended to aid the Joint Government Operations Committee in its review to determine whether the agency should be continued, restructured, or terminated.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/dww
99/104

State of Tennessee

Audit Highlights

Comptroller of the Treasury Division of State Audit

Performance Audit
Tennessee Housing Development Agency
March 2001

AUDIT OBJECTIVES

The objectives of the audit were to review the Tennessee Housing Development Agency's legislative mandate and the extent to which the agency has carried out that mandate efficiently and effectively, and to make recommendations that might result in more efficient and effective operation of the agency.

FINDINGS

Funding for the Single-Family Homeownership Program Using Tax-Exempt Revenue Bonds May Not Be Adequate to Meet the Program's Demands
The Single-Family Homeownership Program provides funds for below-market interest rate mortgage loans to those who qualify. The agency sells tax-exempt revenue bonds to fund the program, but federal law limits the amount of these bonds that can be sold. The agency will have limited resources in the future to provide mortgage funds. Although management made program requirements more restrictive in November 1999 and February 2000, the amount of loan requests from eligible applicants was still at a pace that could not be supported by current resources. Each tightening of program requirements increases the number of households that need the program and cannot qualify for it (page 22).

The Agency Needs a Comprehensive Management Plan
A plan is needed to establish state housing priorities, describe methods to use to accomplish plan objectives, and identify desired program outcomes. Evaluating the effectiveness of housing activities is difficult without a plan with specific goals and objectives against which operations can be compared (page 23).

The Housing Management Division Does Not Follow Its Procedures Requiring Verification of Assets for Section 8 Assistance
The Section 8 program provides rental assistance to those who meet eligibility requirements. Assets valued at $100 or more must be verified. At the field office we visited, bank balances were not being verified. When field office staff do not follow procedures, incorrect eligibility determination and subsidy payments can occur (page 26).

OBSERVATIONS AND COMMENTS

The audit also discusses the following issue that may affect the operations of the Tennessee Housing Development Agency: the percentage of very-low-income beneficiaries of the homeownership program has recently increased (page 20).

"Audit Highlights" is a summary of the audit report. To obtain the complete audit report, which contains all findings, recommendations, and management comments, please contact

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Performance Audit
Tennessee Housing Development Agency

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INTRODUCTION

PURPOSE AND AUTHORITY FOR THE AUDIT

This performance audit of the Tennessee Housing Development Agency was conducted pursuant to the Tennessee Governmental Entity Review Law, *Tennessee Code Annotated*, Title 4, Chapter 29. Under Section 4-29-222, the Tennessee Housing Development Agency is scheduled to terminate June 30, 2001. The Comptroller of the Treasury is authorized under Section 4-29-111 to conduct a limited program review audit of the agency and to report to the Joint Government Operations Committee of the General Assembly. The audit is intended to aid the committee in determining whether the agency should be continued, restructured, or terminated.

OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to determine the authority and responsibility mandated to the agency by the General Assembly;

2. to determine the extent to which the agency has fulfilled its legislative mandate and complied with applicable laws and regulations; and

3. to develop possible alternatives for legislative and administrative actions that could result in more efficient and effective operation of the agency.

SCOPE AND METHODOLOGY OF THE AUDIT

The activities and procedures of the Tennessee Housing Development Agency were reviewed with a focus on procedures in effect during field work (December 1999 to May 2000). The audit was conducted in accordance with generally accepted government auditing standards and included

1. review of applicable statutes and rules and regulations;

2. examination of agency files, documents, and policies and procedures;

3. review of prior performance audit and financial and compliance audit reports and audit reports from other states; and

4. interviews with agency staff and staff of other state housing agencies.

LEGISLATIVE HISTORY

The Tennessee Housing Development Agency was established in 1973 under the provisions of *Tennessee Code Annotated*, Title 13, Chapter 23. The agency was created to

- promote the production of more affordable new housing units for very-low-, low-, and moderate-income individuals and families in the state;

- promote the preservation and rehabilitation of existing housing units for such persons; and

- bring greater stability to the residential construction industry and related industries to assure a steady flow of production of new housing units.

To accomplish this, the agency has authority to issue bonds and notes and to use the funds from them, along with investment income and funds from public and private entities. The agency's mission is "to be the lead state agency promoting sound and affordable housing for people who need help."

BOARD MEMBERSHIP AND ORGANIZATION

A 19-member Board of Directors directs the agency's affairs. Five of these directors serve *ex-officio*: the State Treasurer, the Comptroller of the Treasury, the Commissioner of Finance and Administration, the Secretary of State, and a staff assistant to the Governor. Of the remaining 14 directors, one is appointed by the Speaker of the House of Representatives, one by the Speaker of the Senate, and 12 by the Governor. Nine of the 12 Governor appointees are to be representatives of the housing, home-building, real estate, and mortgage lending professions. The Governor appoints 3 members from the public-at-large who are "knowledgeable about housing conditions in the state." One of these must be from the first, second, or third congressional district; one from the fourth, fifth, or sixth congressional district; and one from the seventh, eighth, or ninth congressional district. The statute states that the Governor "shall strive to appoint one member sixty years of age or older and one member of a racial minority." As of March 2001, board composition met statutory requirements. Members are appointed for four-year terms. The board meets bimonthly.

There are four committees comprised of board members: Audit and Budget, Policy and Programs, Bond Finance, and Grants. Two of the committees' membership and responsibilities are mandated by *Tennessee Code Annotated.* Table 1 indicates the board's committees, authorizing statute, mandated members, and responsibilities.

Table 1
Tennessee Housing Development Agency
Committees of the Board of Directors

Committee Name	Membership Mandated by *Tennessee Code Annotated*	Responsibilities
Audit and Budget *TCA* 13-23-112(h)(1)	Board chair Board vice-chair Comptroller of the Treasury Two board members appointed by chair	• Monitor financial and programmatic controls • Review internal audit reports • Review and submit the annual budget • Monitor conflict-of-interest disclosures for board members and staff
Policy and Programs	N/A	• Review programs for consistency with mission • Monitor and review policy issues for board • Review allocation plan for the federal Low-Income Housing Tax Credit program
Bond Finance *TCA* 13-23-120(e)(3)(A)	Board chair Commissioner of Finance and Administration State Treasurer Comptroller of the Treasury Secretary of State	• Select bond counsel and underwriters • Prepare and submit plan of financing for bond issues • Review and evaluate the agency's trustee
Grants	N/A	• Monitor grant programs • Approve rules governing grants and criteria for awarding grants

EXECUTIVE DIRECTOR

Tennessee Code Annotated, Section 13-23-112(a), gives the board the authority to appoint an executive director to administer the affairs of the agency. The current executive director was appointed in May 2000.

AGENCY ORGANIZATION AND RESPONSIBILITIES

The Tennessee Housing Development Agency has 12 divisions, each of which is managed by a division director. The executive; research, planning, and technical services; multi-family and special programs; and Section 8 Multifamily Restructuring Program divisions report to the executive director. The internal audit division reports to the executive director and to the audit and budget committee of the board. The production divisions—community programs, mortgage administration, homeownership, and housing management—report to the deputy executive director. The financial and administrative support divisions—finance, management information systems, and fiscal administration—report to the chief financial officer.

Executive Division – This division is responsible for program development, legal affairs, public relations, and personnel.

Research, Planning, and Technical Services Division – This division provides technical assistance to the agency, firms, and individuals; works with other state agencies to coordinate a consolidated housing plan; and conducts and oversees research on housing issues.

Multifamily and Special Programs Division – This division administers the Low-Income Housing Tax Credit Program for developers of rental properties and allocates multifamily bond authority to local issuers for a specific development.

Multifamily Restructuring Division – This division administers the U.S. Housing and Urban Development's (HUD) Mark-to-Market program to provide rent and mortgage restructuring to multifamily projects that have rental assistance contracts with HUD. In addition to this program, in April 2000, the agency was selected by HUD to be the contract administrator for HUD's project-based Section 8 program in Tennessee.

Community Programs Division – This division is responsible for the federal HOME Investment Partnerships Program (HOME) and the state Housing Opportunities Using State Encouragement (HOUSE) program, which provide funds for locally designed housing efforts. The division also administers the agency's grant program offered in fiscal year 2000 when the General Assembly redirected tax revenue for the HOUSE program for that year.

Internal Audit Division – This division performs internal audits of all agency programs, grants, and servicing institutions, and is responsible for long-term compliance of the HOUSE, HOME, and Tax Credit programs.

Mortgage Administration Division – This division oversees the collection of loans for the agency. The division provides full in-house servicing of multi-family loans. Single-family loans are serviced by approved servicing agents under the direction of the mortgage administration division.

Homeownership Division – This division provides the link between funds available for single-family home loans and the individual prospective homeowners through the development of a statewide network of participating lenders and the underwriting of loans for qualified applicants.

Housing Management Division – This division administers the Section 8 Housing Assistance Program. The division's functions include administering housing assistance payment contracts, and monitoring and auditing housing developments and subcontractors.

Finance Division – This division is responsible for cash management of the agency. This division's major functions are debt management and investment of funds.

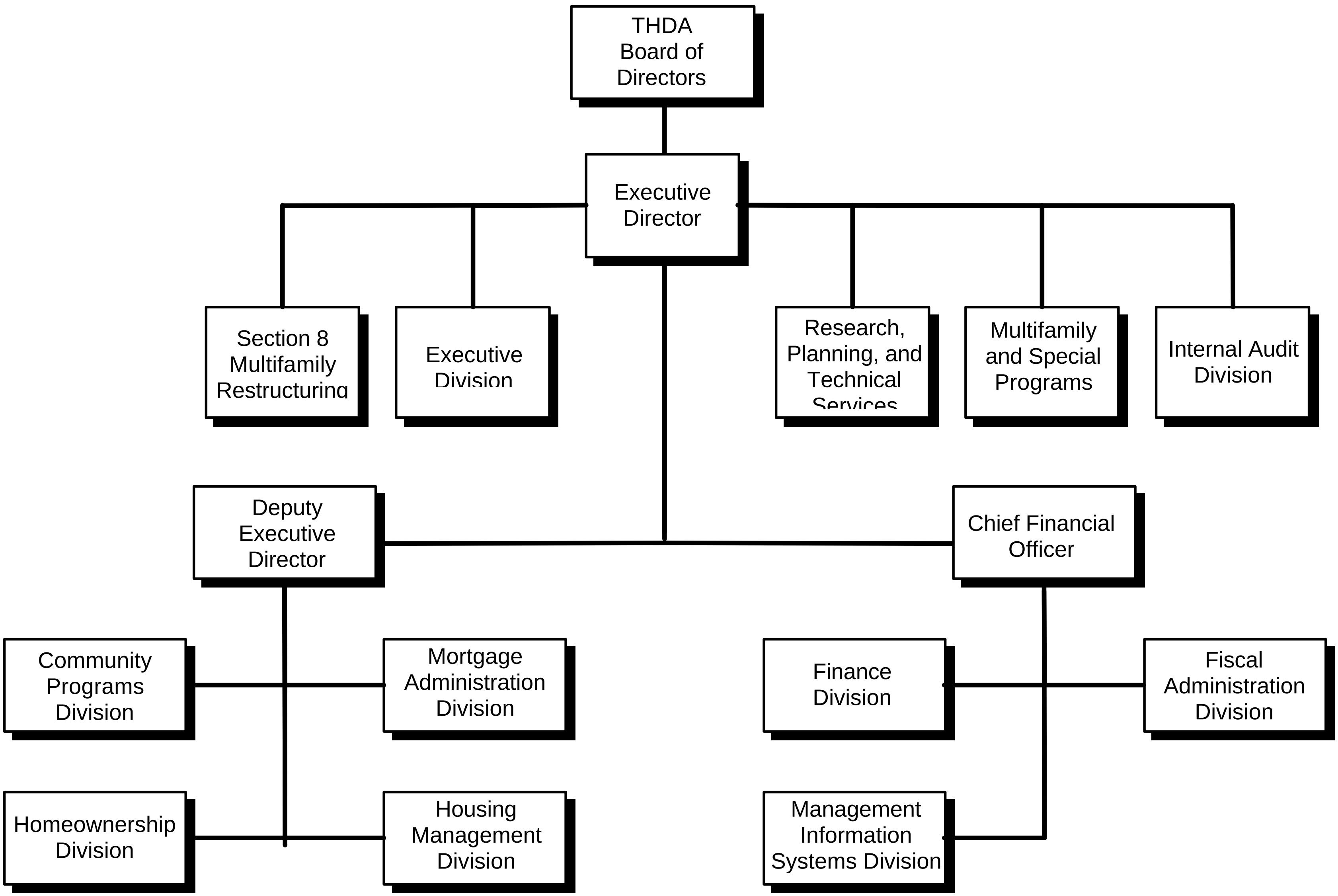
Management Information Systems Division – This division is responsible for developing, implementing, and maintaining the agency's computer systems.

Fiscal Administration Division – This division is responsible for bond, state, and federal accounting; financial reporting; and general administrative areas such as purchasing and budgeting.

An organization chart for the Tennessee Housing Development Agency is on the following page.

Tennessee Housing Development Agency

June 2000



HOUSING COST INDEX

Tennessee Code Annotated, Section 13-23-114, requires the agency to calculate a housing cost index. The index determines the average Tennessee household's percentage of gross monthly income required to pay for primary fixed housing costs and establishes a threshold at which the financial assistance programs of the agency become effective. Statute specifies the programs become operative when the index is 25% or more and upon board approval. Even if the calculation produces a lower index, the programs can be approved with the affirmative vote of nine board members.

Tennessee Code Annotated, Section 13-23-103(7), defines the method used to calculate the index. The median gross monthly household income is divided into a monthly average mortgage payment including property taxes and insurance. The mortgage payment is based on a 30-year mortgage at the prevailing interest rate on a house that meets minimum property standards of the Federal Housing Administration.

Tennessee Code Annotated, Section 13-23-114, specifies that the agency compute the housing cost index "monthly or at such time or times as the agency in its discretion may require." The agency's Division of Research, Planning, and Technical Services calculates the index annually in January, based on prior calendar year information. The index is reported to the board at the January meeting. According to division management, the same methodology for calculating the index has been used for several years. The index is calculated annually because some factors used in the calculation are published annually. For instance, the median purchase price of a home and the weighted average residential property taxes are reported annually by the Office of the Comptroller of the Treasury.

Table 2 indicates the housing cost index calculated by the agency and reported to the board in January 1996 through 2001.

Table 2
Housing Cost Index
Years 1996 to 2001

As of January	Housing Cost Index
1996	26.59%
1997	26.22%
1998	25.25%
1999	23.40%
2000	24.84%
2001	24.24%

Source: THDA Division of Research, Planning, and Technical Services

Minutes of January board meetings for the years 1996 through 2000 reflect that the board voted to accept the index when it met the 25% or more criteria and approved the programs. In the years when the index was lower than the 25% threshold, the minutes reflect that the board voted unanimously to continue the agency's programs. According to division management, one reason for the decline in the index is that median incomes have increased at a higher percentage than the median purchase price of a home.

AREA MEDIAN INCOME

Each year the U.S. Department of Housing and Urban Development (HUD) establishes the median income of given geographic areas. These are used to determine the limits for the very-low- and low-income households. HUD defines very-low-income households as those earning no more than 50 percent of the area median income adjusted for family size. It defines lower-income households as those earning no more than 80 percent of the area median income adjusted for family size. (Neither HUD nor *Tennessee Code Annotated* defines moderate income. The agency's definition of moderate income varies by program.)

Table 3 indicates the median income for Tennessee for the years 1996 through 2000. It is based on a weighted average of all household sizes.

Table 3
Median Household Income

Year	Amount
1996	$30,058
1997	$32,913
1998	$34,424
1999	$37,111
2000	$39,094

Source: THDA Division of Research, Planning, and Technical Services

PROGRAMS

The Tennessee Housing Development Agency carries out its mission through several programs: Single-Family Homeownership, Section 8 Rental Assistance, HOME and HOUSE Grants, Tax-Exempt Multifamily Bond Authority, Low-Income Housing Tax Credit, and Multifamily Restructuring.

Single-Family Homeownership Program

Sale of Bonds

The Tennessee Housing Development Agency is authorized to sell bonds to provide funds for making mortgage loans. A majority of the bonds sold have been federally tax-exempt bonds. That allows the agency to lend money at below-market interest rates because the interest it pays its bondholders is exempt from taxation under the provisions of the Internal Revenue Service Code. This also imposes federal constraints on the homeownership program. *Tennessee Code Annotated*, Section 13-23-124, states that any bonds issued by the agency are not the obligations of the state. As of June 30, 2000, the agency had bonds outstanding of $1.878 billion. As of June 30, 2000, the agency was servicing 31,754 mortgage loans totaling approximately $1.5 billion.

The agency repays the bonds with the revenue it receives as borrowers make mortgage loan payments. The mortgage loans are originated by approved mortgage lenders in the private sector, subject to approval of the agency. Applicants qualify for the mortgages by meeting income limits. The purchase price of the home is also limited by the program. After a loan is made, it is serviced by private-sector financial institutions approved by the agency. Those servicers include the payments collected from the borrowers in monthly remittances to the agency.

Federal Allocation of Tax-Exempt Bond Authority to the State

Each year Tennessee receives federal authorization (based on the Internal Revenue Service Code) to issue tax-exempt bonds, subject to a federally imposed cap. This cap was imposed in 1986 and is referred to as the private activity volume cap. Since that time the cap was $50 per capita. However, in 2000, Congress passed legislation that increased the amount. In 2001, the cap is $62.50 per capita or $187,500,000 per state. In 2002, the private activity volume cap will be $75 per capita or $225,000,000 per state. Beginning in 2002, the cap will be adjusted annually for inflation.

In January of each year, the Tennessee Housing Development Agency (THDA), pursuant to an adopted plan, receives an allocation of Tennessee's volume cap from the Department of Economic and Community Development (ECD). Table 4 indicates the total federal allocation to the state and the amount allocated to the agency for years 1996 through 1999. *Tennessee Code Annotated*, Section 9-20-104, requires ECD to have an allocation plan for the tax-exempt bond allocation. In the most current plans, ECD has specified the following plan priorities:

- state projects,
- housing bonds,
- student loan bonds, and
- small issue and exempt facility bonds.

At the end of the calendar year, ECD can allocate any residual volume cap, and some of that has been allocated to the agency in the past few years.

Table 4
State Allocation of the Volume Cap and Allocation to THDA
1996 Through 1999

Calendar Year	State Allocation From Federal Government	Initial Amount Allocated to THDA by ECD	End of Year Additional Amount Allocated to THDA by ECD	Total Allocated to THDA by ECD
1996	$258,800,000	$75,000,000	$22,535,792	$97,535,792
1997	$265,983,000	$75,000,000	$0	$75,000,000
1998	$268,400,000	$75,000,000	$5,000,000	$80,000,000
1999	$274,176,750	$75,000,000	$13,906,000	$88,906,000

Sources: The 1996, 1997, and 1998 amounts were obtained from Factbooks published by the National Council of State Housing Agencies (THDA provides those numbers). The 1999 amounts were obtained from the Tennessee Department of Economic and Community Development (ECD). End of year allocations were obtained from THDA.

The agency uses this authority to issue federally tax-exempt bonds to provide mortgage funds for the Single-Family Homeownership Program and reallocates some of this authority to local issuers for multifamily developments. *Tennessee Code Annotated,* Section 13-23-120(e)(1), requires the agency to submit an annual schedule of financing to the State Funding Board prior to the beginning of the state's fiscal year. The State Funding Board reviews and approves the schedule of financing. Prior to the sale of a bond issue, the agency works with the Division of Bond Finance in the Office of the Comptroller of the Treasury to prepare the Plan of Financing and the Official Statement for the issue. The agency also has a bond counsel and a financial advisor that advise about the structure for each bond issue.

Program Demand

In November 1999, agency management expressed concern that the level of demand for its mortgage programs could not continue to be funded with the volume cap allocations. Demand for the Single-Family Homeownership Program increased significantly in 1999 (see Table 5).

Table 5
Single Family Homeownership Program
1996 Through 1999

Year	Total Number of Loans	Total Amount of Loans	Average Loan Amount
1996	2,570	$133,459,760	$51,930
1997	1,843	$103,407,278	$56,108
1998	1,928	$123,454,735	$64,033
1999	5,787	$424,462,372	$73,348

In addition to the volume cap, the "Ten Year Rule" also limits funds for lower interest mortgages made from tax-exempt bonds. This Internal Revenue Service (IRS) Code rule requires prepayments of mortgages received more than ten years after the loan was made to be used to pay outstanding bonds, rather than finance new mortgages.

In June 2000, the agency issued bonds that are taxable in order to continue to provide funds to meet program demand. The agency's current financial advisor, CSG, Inc., advised the agency in November 1999 to consider the option of blending taxable bonds with the tax-exempt bonds for new issues in 2000. The agency last issued taxable bonds in 1990, when according to management, volume cap restrictions on tax-exempt bonds and limited resources did not provide for sufficient funds to meet program demand. (The agency issued taxable bonds in 1994 for a refunding.)

Based on a review of board meeting minutes and other information, it appears that management did not anticipate for the increase in program demand during 1999. Minutes reflect that in 1996 and 1997, mortgage production at the agency was "slow." The information in Table 5 supports this. During the September 1999 board meeting, the executive director expressed concern that the level of mortgages funded during 1999 could not be sustained because the agency had used a substantial amount of available volume cap. Program income limits were reduced in November 1999. However, board minutes show that those limits had been raised from previous limits and set as recently as January 1999.

Income limits for the program were reduced in February 2000 in order to try to reduce demand (see Table 6). However, management expressed concern after the reduction that demand had not been reduced sufficiently by those changes. In April 2000, agency management expected to fund approximately $300 million in mortgages during calendar year 2000. Purchase price limits were reduced in June 2000 (see Table 7). In January 2001, the agency reported that changes in program eligibility requirements resulted in a decrease in demand—the agency made commitments totaling $199,543,250 in the calendar year 2000.

Table 6
Homeownership Program Annual Income Limits
1994 Through February 2000

		1-2 Person Household Income Limits				**3+ Person Household Income Limits**			
		1994 through 1998	**January 1, 1999**	**November 15, 1999**	**February 15, 2000**	**1994 through 1998**	**January 1, 1999**	**November 15, 1999**	**February 15, 2000**
MSAs*	**Memphis** **Nashville** **Knoxville** **Chattanooga**	$36,500	$44,000	$40,000	$36,500	$41,500	$51,000	$47,000	$41,500
MSAs*	**Jackson** **Tri-Cities** **Clarksville**	$33,500	$44,000	$40,000	$36,500	$38,500	$51,000	$47,000	$41,500
All Other Counties		$41,000	$41,000	$37,000	$33,500	$38,500	$47,000	$43,000	$38,500

* Metropolitan Statistical Areas

Source: Tennessee Housing Development Agency

Table 7
Homeownership Program Purchase Price Limits
1997 Through June 2000

		New Homes				Existing Homes			
		January 1, 1997	**January 1, 1998**	**January 1, 1999**	**June 1, 2000**	**January 1, 1997**	**January 1, 1998**	**January 1, 1999**	**June 1, 2000**
MSA	**Nashville**	$90,000	$99,000	$135,000	$99,000	$75,000	$85,000	$105,000	$85,000
MSA	**Knoxville**	$90,000	$99,000	$120,000	$99,000	$75,000	$85,000	$90,000	$85,000
MSA	**Memphis**	$90,000	$99,000	$120,000	$99,000	$75,000	$85,000	$85,000	$85,000
MSA	**Chattanooga**	$90,000	$90,000	$115,000	$90,000	$70,000	$75,000	$80,000	$75,000
MSA	**Jackson**	$80,000	$90,000	$110,000	$90,000	$65,000	$75,000	$80,000	$75,000
MSA	**Tri-Cities**	$75,000	$90,000	$90,000	$100,000	$65,000	$75,000	$75,000	$75,000
MSA	**Clarksville**	$75,000	$80,000	$90,000	$80,000	$65,000	$70,000	$70,000	$70,000
Maury County		$80,000	$90,000	$110,000	$90,000	$65,000	$80,000	$90,000	$80,000
Lincoln County		$70,000	$80,000	$110,000	$80,000	$55,000	$55,000	$69,900	$55,000
Carroll County		$70,000	$80,000	$95,000	$80,000	$55,000	$55,000	$69,900	$55,000
Gibson County		$70,000	$80,000	$95,000	$80,000	$55,000	$55,000	$69,900	$55,000
Henderson County		$70,000	$80,000	$95,000	$80,000	$55,000	$55,000	$69,900	$55,000
Weakley County		$70,000	$80,000	$95,000	$80,000	$55,000	$55,000	$57,000	$55,000
Jefferson County		$70,000	$80,000	$90,000	$80,000	$55,000	$70,000	$80,000	$70,000
Bradley County		$70,000	$80,000	$90,000	$80,000	$55,000	$65,000	$75,000	$65,000
Franklin County		$70,000	$80,000	$90,000	$80,000	$55,000	$65,000	$75,000	$65,000
Meigs County		$70,000	$80,000	$90,000	$80,000	$55,000	$55,000	$75,000	$55,000
Putnam County		$75,000	$80,000	$90,000	$80,000	$65,000	$75,000	$75,000	$75,000
Cumberland County		$70,000	$80,000	$90,000	$80,000	$55,000	$65,000	$70,000	$65,000
Hamblen County		$80,000	$85,000	$90,000	$85,000	$65,000	$70,000	$70,000	$70,000
Roane County		$75,000	$85,000	$90,000	$85,000	$65,000	$65,000	$75,000	$65,000
Coffee County		$80,000	$85,000	$90,000	$85,000	$63,000	$60,000	$60,000	$60,000
Rhea County		$70,000	$80,000	$90,000	$80,000	$70,000	$60,000	$69,900	$55,000
Marshall County		$70,000	$80,000	$90,000	$80,000	$55,000	$60,000	$60,000	$60,000
All Other Counties – Targeted*		$70,000	$80,000	$90,000	$80,000	$55,000	$55,000	$69.900	$55,000
All other Counties – Not Targeted*		$70,000	$80,000	$90,000	$80,000	$55,000	$55,000	$57,000	$55,000

* Targeted areas are those with qualified census tracts according to Internal Revenue Service Code. In a census tract, 70 percent or more of the families have income that is 80 percent or less of the statewide median family income.

Homeownership Programs

The agency has outstanding mortgage loans in the following programs (see Table 8), although only one program is currently open.

Table 8
Single Family Homeownership Loan Programs

Program Name	Great Rate Homeownership	Homeownership Plus	Great Start	START	START Plus
Interest Rate	Fluctuates *	Fluctuates *	Fluctuates *	5.5% Fixed	5.5% Fixed
Description	Offers lower than market interest rate loan for first-time homebuyer	Provided downpayment assistance for Homeownership	Provided 4% of the loan amount for downpayment and closing costs	Targeted very-low-income households	Downpayment assistance for Start program
Program Start Date	September 1998	December 1993	August 1998	September 1993	September 1993
Program End Date	Still in effect	December 1998	February 2000	December 1998	December 1998

* Interest Rate for these programs varies based on THDA's cost.

Table 9 indicates the number of loans by program for the years 1996 through 1999.

Table 9
Number of Loans by Homeownership Program

Year	START	START Plus	Great Start	Great Rate Homeownership	Homeownership Plus	Total Number of Loans
1996	374	93	0	1,973	130	2,570
1997	197	37	0	1,551	58	1,843
1998	113	25	0	1,741	49	1,928
1999	1	0	2,599	3,187	0	5,767

Households Benefiting from the Single-Family Homeownership Program

According to *Tennessee Code Annotated*, Section 13-23-102, a purpose of the agency is to promote the production of affordable new housing units for very-low-, low-, and moderate-income individuals. Table 10 indicates the percent of mortgage loans to households by income.

Table 10
Percent of Mortgage Loans by Household Income by Year

Year	<50% Median Income	50-60% Median Income	60-80% Median Income	80-100% Median Income	>100% Median Income
1996	32.6	19.3	32.3	15.8	0.0
1997	28.0	19.6	39.2	13.0	0.2
1998	28.3	21.4	40.6	9.7	0.0
1999	19.6	19.7	39.1	19.5	2.0
2000	33.8	28.6	34.1	3.5	0.0

Sources: The 1996, 1997, and 1998 figures were obtained from Factbooks published by the National Council of State Housing Agencies (THDA provides those numbers). Figures for 1999 and 2000 were obtained from the Tennessee Housing Development Agency.

According to the table, participation by very-low-income households (less than 50% of the area median income) declined from 28.3% in 1998 to 19.6% in 1999. Agency management said this was a result of the START program's discontinuance in December 1998. The program was discontinued because management believed that there were few quality homes available for purchase under the program and that the market for the program was covered. Also, the START program had a high payment delinquency rate. However, the percentage of very-low-income households rose to 33.8% in 2000.

Homeownership Program Delinquencies

The agency's Division of Research, Planning, and Technical Services completed an analysis in 1998 concerning delinquent mortgage loans made from 1994 through 1997. The research showed that delinquencies peaked in the seventh quarter of a mortgage loan. The division has not performed any delinquency research since that analysis. However, the Division of Mortgage Administration calculates delinquency rates each month and produces a report that it uses internally to supervise servicer loan collections. Based on those reports, the Single-Family Homeownership Program had the following percentage of delinquent loans:

Table 11
Single-Family Homeownership Delinquencies
1996 Through 1999

Year Ending December 30	Percent of Loans 60 Days or More Delinquent
1996	8.24%
1997	8.10%
1998	7.76%
1999	6.67%

Section 8 Rental Assistance

Through the U.S. Department of Housing and Urban Development's (HUD) Section 8 Program, the agency provides rental assistance to low-income families. The agency's tenant-based assistance is administered through nine field offices throughout the state. Staff at the field offices process applications, verify eligibility, inspect units, and perform annual recertifications.

The agency also administers project-based assistance for 38 multifamily projects with rental assistance contracts for the units. The agency holds the mortgage on 37 of the housing developments. The developments are privately owned and operated, and a resident manager hired by the owner handles the daily affairs.

In March 2000, HUD reviewed the agency's administration of the project-based assistance. A letter regarding that review indicates that the agency did not have any major findings and that "the number of deficiencies and discrepancies are relatively low." Table 12 indicates the amounts of Section 8 assistance for the years 1997 through 1999 (the agency could not provide amounts for 1996).

Table 12
Section 8 Tenant-Based Assistance
Calendar Years 1997-1999

Year	Amount
1997	$26,425,640
1998	$15,825,322
1999	$15,000,000

Sources: The 1997 and 1998 amounts were obtained from Factbooks published by the National Council of State Housing Agencies. The 1999 amount was obtained from the Tennessee Housing Development Agency.

HOME and HOUSE Grants

The agency administers two grant programs—HOME Investment Partnerships Program (HOME) and Housing Opportunities Using State Encouragement (HOUSE)—to assist very-low- and low-income households with housing needs. Grants are awarded to qualifying local housing programs to help the local housing providers in implementing affordable housing plans. Federal dollars fund the HOME program through the U.S. Department of Housing and Urban Development. HOME funds are used to assist families with incomes less than 80 percent of the area median income. The HOME allocation must be committed within two years and spent within five years. The amounts of HOME and HOUSE funds allocated for fiscal years 1996 through 1999 are in Table 13.

Table 13
Total HOME and HOUSE Awards
Years 1996 Through 1999

Calendar Year	Total HOME Grants Awarded	Total HOUSE Funds Awarded
1996	$ 9,871,797	$10,121,750
1997	$14,411,722	$11,105,000
1998	$13,287,769	$10,228,211
1999	$13,859,788	$ 9,880,000

HOUSE is funded through the state of Tennessee's Real Estate Transfer Tax and the Mortgage Recording Fee. However, those tax revenues were reallocated to the state's general fund in fiscal year 2000 and again in fiscal year 2001. The agency made available funds for its own grant program, called Great Place, for fiscal year 2000.

Tables 14 and 15 indicate the percent of households by income that benefited from HOME and HOUSE grants.

Table 14
Percent of HOME Beneficiaries by Household Income by Year
Completed Projects

	<30% Median Income	30-50% Median Income	50-60% Median Income	60-80% Median Income
1996	22	46	13	15
1997*	22	45	14	20
1998	34	30	18	18
1999		100**		

*   The median income for 5% of the households was unknown in 1997.
** Only one project was funded and completed in 1999.

Table 15
Percent of HOUSE Beneficiaries by Household Income by Year
Completed Projects

	<30% Median Income	30-50% Median Income	50-60% Median Income	60-80% Median Income
1996	41	37	12	10
1997	46	36	11	7
1998	41	38	9	12
1999	50	9	27	14

The Knoxville office of the U.S. Department of Housing and Urban Development conducted a review of the agency's HOME program in July 1999. A letter issued in September 1999 says that the review team found the overall management of the program to be "substantially in compliance with the governing regulations" and that "no findings that need corrective actions" were taken.

Tax-Exempt Multifamily Bond Authority Program

The agency reallocates a portion of its private activity volume cap to local issuers for multifamily developments. A local board or other issuing entity in the area of the proposed development issues the bonds. Some of the development's units must be rented to persons of low income as follows:

- 20% of the units must be rented to persons at or below 50% of the area median income; or
- 40% of the units must be rented to persons at or below 60% of area median income; and
- 75% of the units in the development must be occupied by individuals or families having incomes at or below 115% of the area median income.

The private activity volume cap can be used only to provide permanent financing for new construction of affordable rental housing units, conversion of existing properties through adaptive reuse, or acquisition and rehabilitation of rental units.

Table 16 indicates the authority amounts allocated by the agency for the Tax-Exempt Multifamily Bond Authority Program. Beneficiary data is not available on this program. The local issuing authority, not the agency, performs monitoring. Any amounts not issued by the end of the calendar year revert to the Single-Family Homeownership Program.

Table 16
Authority Allocated to Tax-Exempt Multifamily Bond Authority Program
1996 Through 1999

Calendar Year	Total Allocated to THDA by ECD	Amount of Tax-Exempt Authority Reallocated by THDA for Multifamily
1996	$97,535,792	$12,790,000
1997	$0	$15,000,000
1998	$80,000,000	$25,300,000
1999	$88,906,000	$18,500,000

Sources: The 1996, 1997, and 1998 amounts were obtained from Factbooks published by the National Council of State Housing Agencies (THDA provides those numbers). The 1999 amounts were obtained from the Tennessee Housing Development Agency.

Low-Income Housing Tax Credit

The program is administered by the agency and supports acquisition, rehabilitation, and new construction of rental units for low-income tenants. The credit provides a ten-year reduction in federal tax liability for owners or developers of low-income rental housing. The units must be rented to families earning no more than 60% of the area median income at restricted rents for 30 years or more. The amount of tax credits is based on the cost of development and the number of qualified low-income units.

State agencies allocate these federal tax credits based on a qualified allocation plan. The Tennessee Housing Development Agency prepares the plan for the State of Tennessee based on IRS rules, and the Governor approves it. Tennessee's plan gives priority to new construction and serving a higher percentage of low-income households. The agency monitors properties for compliance with income, rent, and other program requirements.

Until 2001, a state's annual authority to allocate credits was $1.25 times the state's population. In 2000, Congress increased the cap to $1.50 effective 2001 and to $1.75 effective 2002. Starting in 2003, the cap will be increased annually for inflation.

Table 17 indicates the allocation of low-income credits and number of units receiving allocations by year. The agency does not compile information on the beneficiaries of this program, but awards are based on units rented to households with 60% or less of area median income.

Table 17
Allocations of Low Income Housing Tax Credits
Years 1996 Through 1999

Calendar Year	Amount	Number of Units
1996	$8,177,662	1,904
1997	$7,509,079	1,353
1998	$6,780,276	1,407
1999	$6,824,423	1,312

Sources: The 1996, 1997, and 1998 amounts were obtained from Factbooks published by the National Council of State Housing Agencies. The 1999 amount was obtained from the Tennessee Housing Development Agency.

Multifamily Restructuring Program

The agency has a contract with the U.S. Department of Housing and Urban Development (HUD) to administer HUD's Mark-to-Market program. The program provides restructuring of rents and/or mortgages for Section 8 multifamily housing projects by resetting rents to market levels and restructuring mortgage debt. The multifamily projects being restructured are public housing projects built in the 1970s. The owners of the projects have rent subsidy contracts with HUD. In the early 1990s, as those contracts began expiring, HUD determined that the rents subsidized were often more than the market rents. However, if subsidized rents were lowered, owners could be at risk for defaulting on mortgage payments.

The agency makes recommendations to HUD about the restructuring of the projects assigned to it under the contract. Those may be a rent restructuring or a full restructuring—rent and mortgage. In a rent restructuring, the agency provides a market rent comparison by area, number of rooms, etc., and evaluates the physical state of the building. In a full restructuring, the agency determines methods to restructure debt, adjust rents, and provide for the owner to continue to afford the debt payment. As of May 2000, the agency had been assigned 32 projects and had contracted with qualified appraisers and inspectors to assist with the restructuring recommendations. The agency had completed work on four projects as of May 2000.

OBSERVATIONS AND COMMENTS

The issue discussed below did not warrant a finding but is included in this report because of its potential effect on the operations of the agency and on the citizens of Tennessee.

THE PERCENTAGE OF VERY-LOW-INCOME BENEFICIARIES OF THE HOMEOWNERSHIP PROGRAM HAS RECENTLY INCREASED

The Single-Family Homeownership Program is the Tennessee Housing Development Agency's largest program in terms of total dollars financed. In 1999, the program funded $424 million in mortgage loans. In 1999, the percentage of very-low-income family mortgages decreased while the percentage of mortgages to moderate-income households increased. (See Table 10.) The participation percentage by very-low-income households declined from 28.3% in 1998 to 19.6% in 1999, while at the same time households with incomes of 80% of the area median income or greater (moderate income) increased from 9.7% in 1998 to 19.5% in 1999. However, in 2000, because of changes in income and purchase price limits in February and June 2000, the percentage of very-low-income households served increased to 33.8%. Management indicated that the agency is within the national average for mortgage loans by household income for 1996 through 1999.

According to management, the decline in participation by very-low-income households in 1999 was a result of the START program's discontinuance in December 1998. The program was discontinued because management felt that the available quality homes were few and that the market was saturated. It also had a high payment delinquency rate, although management did not cite this as a reason for suspending the program.

Other agency programs benefit very-low-income households, but they do not help these households buy homes. They consist of rental assistance or multifamily unit development, although HOME and HOUSE funds have been used by homeowners for rehabilitation. Funds for those programs totaled approximately $64 million in 1999.

According to the agency, 97% percent of households in the Section 8 Rental Assistance program have incomes of 50% or less of area median income. In 1999, the total rental assistance provided in the program was $15 million.

The majority of completed HOME and HOUSE grants have benefited households with incomes of 50% or less of area median income (see Tables 14 and 15). In 1999, the HOME and HOUSE grants were approximately $14 million and $10 million, respectively (see Table 13).

The agency does not track beneficiaries of the Tax-Exempt Multifamily Bond Authority program, but that program was allocated $18 million in 1999 (see Table 16). The Low-Income Housing Tax Credit program benefits households with 60% or less of area median income. The tax credits issued in 1999 were approximately $7 million (see Table 17).

The agency does not analyze mortgage applications received to determine whether there is a need for another program for very-low-income households, nor does it verify whether households with larger incomes would qualify for a private market loan with reasonably equivalent terms.

A downpayment assistance program (START) was suspended because funds were limited. Other states interviewed continue to have downpayment assistance programs. Arkansas and Michigan use some HOME funds to help with downpayment assistance. South Carolina has programs that target single-parent families and families in subsidized rental housing to help them become homeowners.

A report by the federal Department of Housing and Urban Development in March 1999 indicated that the time on waiting lists for Section 8 applicants was increasing, market rents were rising faster than the incomes of poor people, and the number of affordable housing units was falling. These same problems of lower-income families were identified in the 1999 “State of the Nation’s Housing” study by the Harvard Joint Center for Housing Studies.

The agency should assess its programs to determine how it can best meet its statutory mandate to assist very-low-, low-, and moderate-income households. If research supports such an effort and the agency is in a financial position to support such programs, the agency should develop more loan products targeted specifically to very-low-income households.

FINDINGS AND RECOMMENDATIONS

1. Funding for the Single-Family Homeownership Program using tax-exempt revenue bonds may not be adequate to meet the program's demands

Finding

The current method of funding for the Single Family Homeownership Program using tax-exempt revenue bonds may not be adequate to meet the program's demands. (See "Program Demand" on page 10.) According to *Tennessee Code Annotated*, Section 13-23-102, one of the purposes of the agency is to provide stability to the residential construction industry and assure a steady flow of new housing units. The Single Family Homeownership Program provides funds for below-market interest rate mortgage loans to those who qualify for the program. The agency sells tax-exempt revenue bonds to provide those funds.

The amount of tax-exempt revenue bonds is limited by the federally imposed cap of $50 per capita (the volume cap). The amount of volume cap used in a year is affected by the amount of funds needed for mortgages. The number of households applying for agency mortgage programs is affected by several economic factors, including the economy and the level of conventional rates.

Historically, the agency has tried to preserve volume cap by a current refunding of older debt, using short-term notes for existing obligations, etc. More recently, in June 2000, the agency issued bonds that are taxable in order to continue to provide funds to meet program demand. According to analyses prepared by the agency staff, the agency will have limited resources in the future to provide mortgage funds. In November 1999, management forecasts of mortgage demand, volume cap, program eligibility requirements, and other factors that affect the Single-Family Homeownership Program predicted that by 2002 and after, fewer resources would be available for mortgages, even though purchase prices of homes would continue to increase. The result, according to management, would be frequent reductions in income or price limits to keep the program within available resources.

Since November 1999, several options have been proposed by management to reduce demand within program resources. One is suspending the program that allocates some tax-exempt authority to local issuers for multifamily projects. This has the potential to affect households with incomes of 50% to 60% of the area median income. The agency has already suspended a downpayment assistance program (START) due to a lack of resources. Another option, if demand does not slow to an acceptable level given current resources, is to cease making loans altogether. In January 2001, the agency reported that changes in program eligibility requirements during 2000 resulted in a decrease in demand—the agency made commitments totaling $199,543,250 in calendar year 2000.

Although management made program requirements more restrictive in November 1999 and in February 2000, the amount of loan requests from eligible applicants was still at a pace that could not be supported by current resources. Each tightening of program requirements increases the number of households that need the program and cannot qualify for it.

Recommendation

Management needs to develop plans to continue funding of the Single-Family Homeownership Program. The program should balance the needs for all households and incomes needing assistance with mortgage loans as fewer resources become available to fund the program. Management has forecasted available resources and their use, but these forecasts should be enhanced to include loan demand under different eligibility requirements (based on various economic conditions). The plan should consider the statutory mandate of the agency to provide stability to the residential construction industry and assure a steady flow of new housing units.

Management's Comment

We concur. THDA recognizes that the private entity activity volume cap available to the agency is not sufficient to allow issuance of the amount of tax-exempt bonds necessary to provide mortgages for all moderate and lower-income families as permitted by THDA's enabling legislation and the federal guidelines for the Mortgage Revenue Bond Program. However, the agency strategically manages debt issuance, refundings, and redemptions to maximize the amount of mortgage proceeds available and to generate subsidies for special programs. On occasion, taxable debt has been used to increase the amount of mortgage proceeds available.

Mortgage loan programs are designed with specific income limits and acquisition limits to serve specific groups or to meet specific needs. The agency continually monitors the amount of resources available and the use of the proceeds to determine if changes should be made to ensure a continuous flow of funds for mortgage loans for both new construction and existing homes. In considering new programs and changes to existing programs, the agency considers the overall economy, the robustness of the mortgage industry, the mortgage rate for the conventional market, THDA's interest rate, and the mortgage program characteristics and limits to serve a specific need or underserved area.

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2. The agency needs a comprehensive management plan

Finding

The Tennessee Housing Development Agency needs a comprehensive management plan that establishes state housing priorities, describes methods to use to accomplish plan objectives, and identifies desired program outcomes. Evaluating the effectiveness of housing activities is difficult without a plan with specific goals and objectives against which operations can be compared. The lack of a plan increases the possibility that resources for housing-related activities may not be utilized in an effective and equitable manner.

Adequate knowledge of housing conditions is crucial for identifying problems and developing plans to address and correct them. The agency's Division of Research, Planning, and Technical Services provides housing information for use by the board and agency staff. This division coordinates the preparation of the state Consolidated Housing and Community Development Plan pursuant to the Code of Federal Regulations, Title 24, for the federal Department of Housing and Urban Development (HUD). It has also prepared an Affordable Housing Study pursuant to the 1998 House Joint Resolution 505.

Although the state consolidated plan may meet HUD requirements, the action steps in the plan are not specific in stating how the agency will meet housing goals. For example, one funding priority is to "increase the amount of affordable housing and preserve the affordable housing stock." One of the action steps for that priority is to "encourage the production of multifamily housing to serve low-income individuals in the state." The action step does not include a statement of the number of multifamily units presently available or a prediction of those needed in future years and the resources needed to meet the needs. If one multifamily unit were built, the plan could be determined to be successful because it would be assumed production had been encouraged. However, encouragement is not defined in terms of dollars of loans, tax credits, or amount needed. Also, the information in the affordable housing study is thorough, but that study does not have measurable steps.

The agency should develop its own strategic plan customized by region to be used as a management tool to guide the operations of the agency. Specific steps required to reach a goal should be included and be revised as necessary. The plan should include measurable objectives to ensure that the agency is meeting its statutory mandate to provide affordable housing for very-low-, low-, and moderate-income households. The plan should address all housing needs in the state, including the number of housing units needed by household income types, and include all programs.

The agency can provide historical statistics for some programs regarding persons who have benefited. However, there is a lack of predicting and targeting certain housing needs. For instance, the agency has predicted the number of households by median income category but has not specifically stated how the needs of these households will be met. Based on the current demand on the Single-Family Homeownership Program (see finding 1), the agency's plan should include how the demand for the homeownership program can be managed, the repayment of bond debt under different economic conditions, etc.

By clearly articulating the goals and expectations in a plan, the agency would be able to determine whether its programs and activities are achieving the desired results.

Recommendation

The agency needs to develop a comprehensive management plan that establishes state housing priorities for the programs it oversees, describes the methods to use to accomplish plan objectives, and identifies desired program outcomes. The plan should be customized by region to provide housing solutions targeted to the needs of disparate communities in the state. Specific steps required to reach a goal should be included and revised as necessary.

Management's Comment

We concur in part. All of THDA's programs address the housing needs of lower income Tennesseans. These needs range from homeownership to rehabilitation of owner occupied units to rental assistance to construction and rehabilitation of rental units. THDA has established programs to meet all these needs. Most of these programs are funded and regulated by the federal government. Through competitive scoring matrices, the grant programs, tax credits, and multifamily bond programs are dispersed among rural and urban areas and across regions of the state. Scoring matrices reflect the type of projects and areas identified by the agency as a priority. These priorities may include, but are not limited to, underserved areas, special needs populations, and very-low-income families. The agency monitors the grant and tax credit programs to ensure that the grantees and owners are fulfilling the program purpose.

THDA does not have one comprehensive document that establishes state housing priorities, describes the methods to meet the objectives and identifies the desired program outcomes. THDA does have planning documents in the form of policy statements, guidelines, procedures or implementation plans for the programs.

In lieu of contracting for a statewide needs assessment of housing needs, a process that is expensive, time consuming, and provides data that can be outdated quickly, THDA relies on the information in the Consolidated Plan and allows local governments, non-profits, and developers to suggest the specific projects that are needed in each area and that can be successfully completed during a funding cycle. Often the projects require funding from other sources to be successfully completed. The applicant must have coordinated these efforts prior to submitting an application for THDA funding. Also, the capabilities and capacities of the entities in each area to perform either rehabilitation or new construction are critical in determining if a project will be successful. It is important to note that both rehabilitation and new construction projects are needed to address the housing needs of low income Tennesseans. Because these projects can vary greatly in the amount of subsidy needed to be successful, the number of families helped can vary substantially. Therefore, projecting desired outcomes may not be meaningful.

In recognition that the planning process can always be improved, the agency is currently working with a consultant familiar with low-income housing issues to develop a framework for a strategic plan and a subsequent action plan.

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3. The Housing Management Division does not follow its procedures requiring verification of assets of applicants for Section 8 assistance

Finding

The Housing Management Division of the Tennessee Housing Development Agency administers the federal HUD Section 8 rental assistance program. To qualify for rental assistance, an applicant must meet eligibility requirements defined by HUD. Staff at the agency field offices process applications for assistance and are guided by a procedures manual written by agency staff. Procedures in the manual include methods used to verify family income and other program requirements. The most recent version of that manual is dated February 2000.

Chapter 4 of that manual contains verification procedures. Item D in Chapter 4 lists items to be verified. One of those items is assets valued at $100 or greater. Item B lists methods of verification and says that "in the order presented, the THDA will attempt to effectuate"

- third-party written verification,
- third-party oral verification,
- review of documents, and
- applicant certification/self-declaration(s).

The procedures state that self-declaration is used only when there is no possible third-party verification and no documents.

In April 2000, approximately 4,500 households were receiving assistance through the Section 8 program. Of 22 files we reviewed at one field office, 6 of the households indicated a bank account balance of more than $100 (from $265 to $2,536). However, none of the applicant files contained evidence of third-party verification of those bank balances. During recertification of one of these tenant files, field office staff determined that the person receiving assistance owed money to the Section 8 program. Although the tenant disclosed a bank balance when initially certified, the balance was not verified by field office staff, nor used when determining program eligibility. Staff at two other field offices also appeared to have some misunderstanding of the asset verification procedures.

When field office staff do not follow procedures set by the central office for verifying assets of applicants for rental assistance, incorrect eligibility determination and subsidy payments can occur.

Recommendation

The Housing Management Division should ensure that field office staff follow procedures when verifying the assets of applicants. In addition, the division should ensure that all field offices understand the policies and procedures set by the central office.

Management's Comment

We concur. THDA agrees that the one field office audited, the Tullahoma field office, did not properly follow procedures regarding asset verification. Division management has reviewed the administrative policy regarding assets with this office.

Income and assets are treated separately in the Section 8 program. It is more common for program participants to have a checking account (sometimes interest-bearing) with a low balance, than it is for them to have a savings account or other asset at any given time. Checking accounts typically contain money previously accounted for as income. For example, a family deposits $500 a month when they receive their social security check. The social security income has been verified separately. The only other income from the checking account to be counted is interest income.

The audit recommendation has been addressed. The administrative policy regarding asset verification has been revised. Field staff are now required to verify assets of $2,000 or greater. This should eliminate any potential confusion regarding checking accounts with low balances that contain income previously accounted for, which are maintained to support monthly living expenses, and asset accounts. In addition, asset verification policy was reviewed at the most recent statewide staff meeting for Section 8 field managers.

RECOMMENDATIONS

ADMINISTRATIVE

The Tennessee Housing Development Agency should address the following areas to improve the effectiveness of its operations.

1. The agency needs to develop plans to continue funding of the Single-Family Homeownership Program. The program should balance the needs for all households and incomes needing assistance with mortgage loans as fewer resources become available to fund the program. Management has forecasted available resources and their use, but these forecasts should be enhanced to include loan demand under different eligibility requirements (based on various economic conditions). The plan should consider the statutory mandate of the agency to provide stability to the residential construction industry and assure a steady flow of new housing units.

2. The agency needs to develop a comprehensive management plan that establishes state housing priorities for the programs it oversees, describes the methods to use to accomplish plan objectives, and identifies desired program outcomes. The plan should be customized by region to provide housing solutions targeted to the needs of disparate communities in the state. Specific steps required to reach a goal should be included and revised as necessary.

3. The Housing Management Division should ensure that field office staff follow procedures when verifying the assets of applicants. In addition, the division should ensure that all field offices understand the policies and procedures set by the central office.