LOW-INCOME HOUSING TAX CREDIT

Some Agency Practices Raise Concerns and IRS Could Improve Noncompliance Reporting and Data Collection

Accessible Version
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Why GAO Did This Study

LIHTC encourages private-equity investment in low-income housing through tax credits. The program is administered by IRS and allocating agencies, which are typically state or local housing finance agencies established to meet affordable housing needs of their jurisdictions. Allocating agency responsibilities (in Section 42 of the Internal Revenue Code and regulations of the Department of the Treasury) encompass awarding credits, assessing reasonableness of project costs, and monitoring projects. GAO was asked to review allocating agencies’ oversight of LIHTC. This report reviews how allocating agencies administer the LIHTC program and identifies any oversight issues. GAO reviewed regulations and guidance for allocating agencies; analyzed 58 allocation plans (from 50 states, the District of Columbia, U.S. territories, New York City, and Chicago); performed site visits and file reviews at nine selected allocating agencies; and interviewed IRS and HUD officials.

This is a public version of a sensitive report that GAO issued in May 2016 and does not include details that IRS deemed tax law enforcement sensitive

What GAO Found

Allocating agencies that administer the Low-Income Housing Tax Credit (LIHTC) program have certain flexibilities for implementing program requirements and the agencies have done so in various ways. Although GAO found that allocating agencies generally have processes to meet requirements for allocating credits, reviewing costs, and monitoring projects, some of these practices raised concerns:

- More than half of the qualified allocation plans (developed by 58 allocating agencies) that GAO analyzed did not explicitly mention all selection criteria and preferences that Section 42 of the Internal Revenue Code requires.
- Allocating agencies notified local governments about proposed projects as required, but some also required letters of support from local governments. The Department of Housing and Urban Development (HUD) has raised fair housing concerns about this practice, saying that local support requirements (such as letters) could have a discriminatory influence on the location of affordable housing.
- Allocating agencies can increase (boost) the eligible basis used to determine allocation amounts for certain buildings at their discretion. However, they are not required to document the justification for the increases. The criteria used to award boosts varied, with some allocating agencies allowing boosts for specific types of projects and one allowing boosts for all projects in its state.

In a July 2015 report, GAO found that Internal Revenue Service (IRS) oversight of allocating agencies was minimal and recommended joint administration with HUD to more efficiently address oversight challenges. GAO’s work for this review continues to show that IRS oversight remains minimal (particularly in reviewing allocation plans and practices for awarding discretionary basis boosts) and that action is still warranted to address GAO’s prior recommendation. In this report, GAO also identified the following issues related to managing noncompliance information from allocating agencies:

- IRS provides discretion to allocating agencies for reporting noncompliance data, and has not provided feedback about data submissions. Consequently, allocating agencies have been inconsistently reporting these data to IRS.
- IRS has not used the information that it receives from allocating agencies to identify trends in noncompliance. GAO’s analysis shows that IRS had recorded only about 2 percent of the noncompliance information it received since 2009 in its database.
- IRS has not used key information when determining whether to initiate an audit, potentially missing opportunities to initiate LIHTC-related audits.

In contrast, HUD collects and analyzes housing data, and through a Rental Policy Working Group initiative, now adds LIHTC inspection results to its database. The IRS division responsible for LIHTC was unaware of this effort and is not involved with the working group. By participating in the working group, IRS could leverage HUD data to better understand the prevalence of noncompliance in LIHTC properties and determine whether to initiate audits.

What GAO Recommends

GAO recommends that IRS clarify when agencies should report noncompliance and participate in the Rental Policy Working Group to assess the use of HUD’s database to strengthen IRS oversight. IRS agreed it should improve its noncompliance data, but also stated that it had to consider resource constraints. HUD supported using its expertise and experience administering housing programs to improve LIHTC.

View GAO-16-360. For more information, contact Daniel Garcia-Diaz at (202) 512-8678 or garciadiazd@gao.gov.
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Abbreviations

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May 11, 2016

The Honorable Charles E. Grassley
Chairman
Committee on the Judiciary
United States Senate

Dear Mr. Chairman,

The Low-Income Housing Tax Credit (LIHTC) program, established under the Tax Reform Act of 1986, is the largest source of federal assistance for developing affordable rental housing and cost an estimated $8 billion in forgone revenue in 2015. The program encourages private-equity investment in low-income housing through tax credits and is administered by the Internal Revenue Service (IRS) and allocating agencies. The allocating agencies typically are state or local housing finance agencies, which are state-chartered authorities established to meet the affordable housing needs of the residents of their states or local housing agencies established for large cities, such as New York or Chicago. Each state receives an annual allocation of LIHTCs, determined by statutory formula according to its population.¹ Allocating agencies then competitively award the tax credits to owners of qualified rental housing projects that reserve all or a portion of their units for low-income tenants.²

In July 2015, we reported on how the LIHTC program is administered; processes for overseeing the program; and how the administration of

¹We use “annual allocation of LIHTCs” in lieu of the statutory term, “state housing credit ceiling.” The ceiling is the aggregate amount of housing credit allocations that may be made in any calendar year by allocating agencies in the state. The housing credit ceiling for each state for calendar year 2016 is the greater of $2.35 multiplied by the state’s population or $2,690,000. A state’s population for any calendar year is determined by reference to the most recent census estimate (whether final or provisional) released by the Bureau of the Census before the beginning of the calendar year for which the housing credit ceiling is set.

²We use “LIHTC” or “tax credits” rather than the statutory term, “housing credit dollar amount,” which is defined as an allocating agency’s apportionment of the state housing credit ceiling for such year.
other tax credit programs compares with LIHTC.³ We found that IRS oversight of the LIHTC program had been minimal, particularly in monitoring the allocating agencies and assessing their compliance. Moreover, we found that IRS had neither set goals nor assessed the performance of the program and its data were not sufficiently reliable to assess compliance with basic program requirements. We concluded that IRS’s oversight to identify and address compliance issues had been minimal because LIHTC has been viewed as a peripheral program for IRS in terms of mission and priorities for resources. Furthermore, we concluded that joint administration with the Department of Housing and Urban Development (HUD) could better align program responsibilities with each agency’s mission and more efficiently address existing oversight challenges. Under joint administration, IRS would retain responsibilities consistent with its mission to enforce tax laws and HUD’s role could include oversight responsibilities to help address deficiencies we identified. We suggested that Congress consider designating HUD as a joint administrator of the program based on its experience in administering affordable housing programs and working with state and local allocating agencies.

You asked us to review how the allocating agencies administer the program and identify any remaining oversight issues. In this report, we describe how allocating agencies implement federal requirements for (1) awarding LIHTCs, (2) assessing the reasonableness of LIHTC properties’ development costs and financial feasibility, and (3) monitoring LIHTC properties’ compliance with program requirements. Additionally, the report identifies and discusses additional oversight issues relating to these three areas.

This report is a public version of a sensitive report that we provided to you.⁴ IRS deemed some of the information tax law enforcement sensitive, which must be protected from public disclosure. Therefore, this report omits sensitive information about IRS’s process for evaluating certain compliance information submitted by allocating agencies. Otherwise, this


report addresses the same questions and uses the same overall methodology as the sensitive report.

To answer these questions, we reviewed Section 42 of the Internal Revenue Code (Section 42), Department of the Treasury (Treasury) regulations, and guidance that detail federal requirements for allocating agencies in administering the LIHTC program. We also interviewed officials from IRS, Treasury, HUD, and the National Council of State Housing Agencies (NCSHA) to discuss the role of allocating agencies in administering the LIHTC program. We conducted a structured analysis of 58 Qualified Allocation Plans (QAP) from 2013, which outline processes for awarding LIHTCs and compliance monitoring responsibilities. We analyzed plans from all 50 states, the District of Columbia, Puerto Rico, American Samoa, Guam, the Northern Mariana Islands, the U.S. Virgin Islands, and the cities of Chicago and New York. We used a standardized data collection instrument to gather and analyze information from the plans on specific selection criteria, established cost limits, compliance monitoring practices, and other topics. Our QAP analysis did not capture information from the agencies' supplemental LIHTC materials, such as applications and manuals. Appendix I contains additional details about our scope and methodology.

We used information from the QAPs relating to the allocating agencies (such as the type of scoring system used for applications and limits on development costs); other factors such as state population (which affects

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5NCSHA is a nonprofit advocacy organization created by state housing finance agencies. NCSHA’s members include housing finance agencies of every state, the District of Columbia, New York City, Puerto Rico, and the Virgin Islands; the agencies that allocate LIHTCs in the states where a housing finance agency does not; and more than 300 affiliate members in the affordable housing field. NCSHA activities include coordinating advocacy efforts for affordable housing and producing reports and guides for members, including recommended practices.

6The 58 QAPs represent plans used to allocate tax credits from all states and territories, and two suballocating agencies with their own QAPs. We identified three suballocating agencies with their own QAPs (Minneapolis/St. Paul, Chicago, and New York City) and included the two largest (Chicago and New York City) in our review. We did not include the Minneapolis/St. Paul QAP in our review due to the size of its annual allocation amount. The majority of QAPs we analyzed (53 of 58) were plans updated in 2013. For allocating agencies that did not have an updated QAP in 2013, we analyzed the most recently updated QAP available.

7We included New York City and Chicago as part of our review based on their population and the size of LIHTC annual allocation amounts.
the size of the annual LIHTC allocation); and geographic location to select a nonprobability, nongeneralizable sample of nine allocating agencies for site visits. Our selected agencies were in California; Chicago, Illinois; Illinois; Massachusetts; Michigan; Nevada; Rhode Island; Virginia; and Washington, D.C. During our visits, we interviewed agency officials and reviewed files for randomly selected housing developments to determine how each agency addressed federal requirements for awarding LIHTCs, assessing the reasonableness of development costs, and monitoring properties’ compliance with program requirements. While the results of these site visits cannot be generalized to all states, they provided insight into the ways in which agencies implemented these requirements.

We conducted this performance audit from February 2014 to May 2016 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

State and local allocating agencies are responsible for day-to-day administration of the LIHTC program based on Section 42 and Treasury regulations. More specifically, allocating agencies are responsible for (1) awarding their tax credits to qualifying projects that meet their QAP, (2) determining the value of the tax credits awarded to projects, and (3) monitoring project compliance following the award of credits. Figure 1 provides an overview of the key responsibilities of an allocating agency from application to the end of the compliance period for an LIHTC development.
Figure 1: Key Responsibilities of an Allocating Agency in the Low-Income Housing Tax Credit Program
Requirements for Qualified Allocation Plans and Agency Evaluations and Award Processes

Agencies receive allocations of tax credits and award the credits to specific projects that meet requirements of Section 42. An allocating agency develops the QAP and receives approval of the plan by the governmental unit of which the allocating agency is a part. The agency then evaluates the proposed projects against the approved QAP. The QAP also must be developed in accordance with Section 42 requirements for such plans. Section 42 requires that QAPs give preference to certain projects; specifically, those that

- serve the lowest-income tenants,
- are obligated to serve qualified tenants for the longest periods, and
- are located in qualified census tracts and the development of which contributes to a concerted community revitalization plan.

QAPs also must incorporate certain “selection criteria” (but are not limited to these criteria). Specifically, under Section 42, the plans must consider

- project location;
- housing needs characteristics;
- project characteristics (including whether the project uses existing housing as part of a community revitalization plan);
- sponsor characteristics;
- tenant populations with special housing needs;
- public housing waiting lists;
- tenant populations of individuals with children;
- projects intended for eventual tenant ownership;
- energy efficiency of the project; and

\(^5\)26 USC § 42(h)(3),(m).

\(^9\)A qualified census tract is one in which 50 percent or more of the households have an income that is less than 60 percent of area median gross income or which has a poverty rate of at least 25 percent.
Finally, allocating agencies, when awarding tax credits, are responsible for meeting other Section 42 requirements relating to developers, the affordability period of projects, project viability, and written communication with the public. Specifically, allocating agencies must

- allocate at least 10 percent of the state housing credit ceiling to projects involving qualified nonprofit organizations;
- execute an extended low-income housing commitment of at least 30 years (of which the first 15 years is the compliance period) before a building can receive credits;
- require developers to hire an agency-approved third party to conduct a comprehensive market study of the housing needs of low-income individuals in the area to be served by the project before the credit allocation is made;
- provide a written explanation to the general public if the agency makes an allocation that is not in accordance with established priorities and selection criteria; and
- notify the chief executive officer (or the equivalent) of the local jurisdiction where the building is located, and provide the official a reasonable opportunity to comment on the project.

To select projects for tax credits, allocating agencies receive and evaluate detailed proposals that developers submit to develop new housing or acquire and rehabilitate existing housing. The project owners agree to set aside a certain percentage of the units with rents affordable to qualifying low-income households for at least 30 years. In return, tax

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10 The projects can be apartments, single-family housing, single-room occupancy, or permanent and transitional housing for the homeless. The projects may include units for low-income households as well as market-rate units.

11 A project must reserve at least 20 percent of the available units for households earning up to 50 percent of the area’s median gross income (adjusted for family size), or at least 40 percent of the units for households earning up to 60 percent of the area’s median gross income (adjusted for family size). Tax credit investors contribute equity financing in exchange for an ownership interest in the project. This exchange is sometimes brokered by a syndicator that administers tax credit deals and charges a fee for overseeing the investment transaction. Tax credit investors can be individuals, but the vast majority of investments have come from corporations. Syndicators pool several projects into one tax-credit equity fund and recruit investors willing to become limited partners in the fund.
credit investors can earn a tax credit over a 15-year period (the compliance period) if they meet the affordability requirements, but can claim the credit over an accelerated time frame (the 10-year credit period), beginning in the year in which the property is placed in service (ready for occupancy) or, if the investor chooses, the succeeding tax year. IRS can recapture some or all of the credits if requirements during the compliance period have not been met.

Requirements for Determining Award Value

The amount of the tax credits awarded to a project generally is based on the eligible basis (total allowable costs associated with depreciable costs in the project). Additionally, the allocating agency is to provide no more credits than it deems necessary to ensure the project’s financial feasibility through the 10-year credit period. To determine financial feasibility, Section 42 requires that allocating agencies consider the reasonableness of developmental and operational costs, any proceeds or receipts expected to be generated through the tax benefit, and the percentage of credit amounts used for project costs other than the cost of intermediaries.
Allocating agencies must review costs to determine the credit amount at three points in time: application (when the proposal is submitted), allocation (when the agency commits to providing credits to a specific project), and placed-in-service (when the project is ready for occupancy under state and local laws). The allocating agency also must report the allocated amount of tax credits available over a 10-year credit period for each building in a project on IRS Form 8609 (credit allocation and certification form).

Requirements for Monitoring Project Compliance

After credits are awarded, Treasury regulations state that allocating agencies must conduct regular site visits to physically inspect units and review tenant files for eligibility information. As shown in figure 1, initial inspections must be conducted by the end of the second calendar year following the year in which the last building of the development was placed in service. Subsequent inspections must take place at least once every 3 years, starting from the initial inspection. During the inspections, allocating agencies must randomly select the units and records to be inspected and reviewed.

The agencies also have reporting and notification requirements. For example, allocating agencies must notify IRS of any noncompliance found during inspections and ensure that owners of LIHTC properties annually certify that they met certain requirements for the preceding 12-month period. If a property is not in compliance with the provisions of Section 42, allocating agencies must provide written notice to owners and file an IRS Form 8823 (report of noncompliance or building disposition) no later than 45 days after the end of the correction period, whether or not the noncompliance or failure to certify has been corrected. Agencies also must report a summary of compliance monitoring activities annually on IRS Form 8610 (low-income housing credit agencies report).

The design of the LIHTC program (such as the roles of investors and syndicators) can result in other entities providing additional types of monitoring of LIHTC projects. Investors and syndicators may provide project oversight to help ensure that they receive the expected tax credits over the designated period. For instance, investors and syndicators may
maintain a list of properties (based on identified performance measures) to more closely monitor.

**IRS Offices Involved in LIHTC Program Oversight**

IRS administers the LIHTC program primarily within one division, with assistance from other offices and units.

- The Small Business/Self-Employed Division primarily administers the LIHTC program. One full-time program analyst develops internal protocols, provides technical assistance to allocating agencies, and provides community outreach to industry groups and taxpayers (developers/owners and investors).

- The Low-Income Housing Credit Compliance Unit in Philadelphia, Pennsylvania, assists in determining if tax returns may warrant an audit and populates IRS’s Low-Income Housing Credit database. The database has been used to record information from certain IRS forms that allocating agencies or taxpayers submit (such as Form 8823, which we discuss later in this report).

- The Office of Chief Counsel provides technical assistance for the LIHTC program and determines the amount of credit available for the national pool. The pool consists of additional credits that qualified states can use in a calendar year—these are credits that were unused in the prior year and thus “carried over” into a new year.

**Agencies Implemented Requirements for Allocation Plans and Award Credits in Varied Ways; IRS Has Not Reviewed the Plans or Agency Criteria**

**Most Agencies Did Not Explicitly Cite All Required Preferences and Selection Criteria in Qualified Allocation Plans**

Based on our review of 58 QAPs and our site visits, we found the QAPs did not consistently contain, address, or mention preferences and selection criteria required in Section 42, but we found that some allocating agencies incorporated the information into other LIHTC program documents, or implemented the requirements in practice. Specifically, 23
of 58 QAPs we analyzed contained references to all required preferences and selection criteria. Of the 35 QAPs that did not contain references to all required preferences and selection criteria, 5 were from the selected agencies that we visited. All five of these agencies provided us with documentation that demonstrated that these requirements were being implemented. For example, Michigan’s scoring criteria attachment to their LIHTC application included several requirements that were not found in their QAP. As another example, although Nevada’s QAP did not include selection criteria related to public housing waiting lists, officials from the agency illustrated how they met this requirement by including an attachment to their application package that requires the developer to certify that it will notify public housing agencies of the project’s availability for tenants on public housing waiting lists. The remaining 30 agencies (which we did not visit) also may have documented the information elsewhere. For example, for several plans with missing Section 42 requirements, we were able to find evidence that these required items were listed or referenced in other publicly available sources.

Consistent with our previous report, IRS officials stated that they did not regard a regular review of QAPs as part of their responsibilities as outlined in Section 42 and therefore, did not regularly review the plans. IRS officials said that allocating agencies have primary responsibility to ensure that the plans meet Section 42 preferences and selection criteria. According to Section 42, allocating agencies must use a QAP that has been approved by the governmental unit of which the agency is a part but the Code does not specify that the unit must check for all required preferences and selection criteria. IRS officials noted that review of a QAP to determine if the plan incorporated the elements specified in Section 42 could occur if an allocating agency were to be audited. IRS has conducted seven audits of allocating agencies since the inception of the program and found issues related to QAPs, including missing preferences and selection criteria, lack of an updated plan, and incorrect paraphrasing of Section 42 requirements. For these audits, IRS recommended that the agencies update their QAPs to address the identified deficiencies. As a result of IRS’s lack of regular oversight of the allocating agencies, we concluded in July 2015 that IRS is not well positioned to provide this type of oversight because of its tax compliance mission and recommended that Congress consider designating HUD as a

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joint administrator of the program to better align program responsibilities with each agency’s mission and more efficiently address existing oversight challenges, including a lack of regular review of QAPs. However, to date, no action has been taken to address this recommendation.

Agencies Have Flexibility on Methods for Evaluating Applications, and Nearly All Use Points or a Threshold System

While Section 42 specifies some selection criteria (such as project location, tenant populations with special housing needs, and the energy efficiency of the project), it also more broadly states that a QAP set forth selection criteria “which are appropriate to local conditions.” As a result, allocating agencies have the flexibility to create their own methods and rating systems for evaluating applicants.

Fifty-four of the 58 QAPs we reviewed cited the use of points or thresholds (minimum requirements) to weight, evaluate, and score applications against certain criteria and factors (see table 1). Nearly all the QAPs we reviewed referenced scoring criteria for the qualifications of the development team. For example, allocating agencies can award points based on the team’s demonstrated successful experience in developing tax credit projects, as well as the physical and financial condition of other properties they developed. Agencies also commonly used energy efficiency as a criterion. This category encompassed green building practices, including the design of buildings in accordance with green standards, as well as use of energy- and water-efficient fixtures. Additionally, over one-third of the QAPs reviewed cited letters of support from local governments. (We discuss letters of support in more detail in the next section.)

| Table 1: Selected Point or Threshold Scoring Criteria Categories in Qualified Allocation Plans GAO Reviewed |
|--------------------------------------------------|--------------------------------------------------|--------------------------------------------------|
| Category                                          | Qualified allocation plans that use points or thresholds as scoring criteria (number) | Qualified allocation plans that use points or thresholds as scoring criteria (percentage) |

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<th>Category</th>
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Source: GAO analysis of qualified allocation plans. | GAO-16-360

Note: Fifty-four of 58 qualified allocation plans we reviewed had references to points or thresholds. The remaining allocating agencies either did not specify a scoring system in their plan or used a system of rankings and recommendations.

Allocating agencies typically ranked applications and reserved credits based on the needs of the state after scoring applications. Several allocating agencies with which we met said they have established allocation pools based on the geographic area of the project or development characteristics to help ensure that affordable housing needs are met in those areas. If applications receive the same score, these allocating agencies have established different kinds of tiebreakers to decide which applicant would receive the tax credits. For example, one of California’s tiebreakers is a ratio that compares funds from federal or local government subsidies a developer expects to finance the project with total development costs.

Allocating agencies also can implement a qualitative evaluation system that uses rankings and recommendations to evaluate applications. For example, the allocating agency from Chicago reviews submitted applications using internal guidelines based on the agency’s underwriting standards and project feasibility criteria, and chooses which developments to recommend for LIHTC awards. Two of the nine agencies we visited that used a qualitative ranking or recommendation-based system in 2013 noted that they were considering (Chicago) or had already switched (Rhode Island) to a point-based scoring system.
Some allocating agencies we visited evaluate applications with the goal of selecting projects for which to reserve future years’ credits, a practice termed “forward reserving.” While Section 42 and Treasury regulations allow such reserving, credits only can be allocated to projects in the calendar year in which the projects are placed in service.\(^{16}\) Officials from California noted that forward reserving helped ensure the agency would be eligible for the national pool of tax credits.\(^{17}\) Other agencies noted that they reserved credits for planning purposes. For example, Chicago’s allocating agency has decided to reserve 5 years’ worth of credits to build a pipeline of projects with which to work. Chicago officials stated that a multiple-year queue allows them to better plan their allocations based on affordable housing needs in their jurisdiction. Because of this practice, Chicago does not hold competitive funding rounds every year.

### In Addition to Notifying Affected Officials of Planned Projects, Some Agencies Required Local Letters of Support Raising Fair Housing Concerns That Are Being Litigated

According to Section 42, allocating agencies must notify the chief executive officer (or the equivalent) of the local jurisdiction in which the project is to be located, and provide the official with a reasonable opportunity to comment on the proposed project. Some agencies also imposed an additional requirement of local letters of support that have raised fair housing and other concerns. For example, some allocating agencies give points to developers that have letters of local government support as part of their application. These agencies require a signed letter of support (from a chief elected or administrative official of the community in which the project would be sited) that specifically endorses the proposed project.

\(^{16}\)LIHTC reservations are, generally, binding agreements made by allocating agencies to allocate credit to the taxpayer at a future date. The binding agreement may include a reservation of credit or a binding commitment to allocate credit in a future taxable year. A reservation or a binding commitment to allocate credit in a future year has no effect on the state housing credit ceiling until the year the allocating agency actually makes an allocation.

\(^{17}\)Agencies that fail to allocate their entire annual tax credit allocation within 2 years have to return the unused portion to the national pool. Agencies are eligible to receive a portion of the national pool proceeds only if they did not return credits during the previous year.
Based on our review of 58 QAPs, we found that 12 agencies noted that their review or approval of applications was contingent on letters of support from local officials.\textsuperscript{18} Another 10 agencies awarded points for letters of local support.\textsuperscript{19} Six of the nine agencies we visited had selection criteria in their 2013 QAPs that stated that letters of local support would affect the agency’s review of the application or result in point awards or deductions.\textsuperscript{20} According to officials from these six agencies, there are various advantages to using this criterion. For example, officials from Massachusetts told us the letters indicate a project will move more quickly through the development process, which includes local zoning and permitting, than a project without local support. However, the officials also said that an applicant could be awarded credits without a letter if all other threshold and scoring requirements were met. Furthermore, officials from Chicago’s allocating agency noted that the letters were evidence of support for the proposed development from the surrounding community and they continued to use the letters as a threshold item upon which tax credit awards were based.

Four of the allocating agencies we visited that used letters of support as scoring criteria in 2013 (Nevada, Rhode Island, Virginia, and Washington, D.C.) had concerns with this additional requirement and took steps or were planning to change how the letters were used for LIHTC projects. For example, officials from Virginia’s allocating agency noted that they stopped awarding points for the letters after being notified that local officials were choosing developments they wanted to support based on personal preferences. As of 2014, Virginia stopped awarding points for local letters of support but began deducting up to 25 points for negative letters if, after further analysis, the state determined the claims of negative effect were valid. Additionally, officials from Nevada said that they changed their requirements because they became aware of the difficulties developers in rural areas faced in receiving letters of support

\textsuperscript{18}The 12 agencies are Alaska; Arkansas; Chicago; Georgia; Illinois; Kansas; Montana; Nevada; New Mexico; North Dakota; Oklahoma; and South Dakota. Chicago’s allocating agency does not use a points or threshold system for selecting projects, but requires that a letter of support from an alderman be submitted with an application.

\textsuperscript{19}The 10 agencies are Guam; Indiana; Kentucky; Massachusetts; Ohio; Texas; Virginia; Washington, D.C.; West Virginia; and Wisconsin.

\textsuperscript{20}The six agencies are Chicago; Illinois; Massachusetts; Nevada; Virginia; and Washington, D.C.
(due to local officials’ fear of losing elections if affordable housing were built in their districts). As of 2015, Nevada no longer required letters of local support; instead the agency notifies local jurisdictions and provides them with an opportunity for comment.

In Texas, concerns also have been raised about the requirement, but its allocating agency continues to require letters of support. Specifically, in 2013, the state’s Sunset Advisory Commission recommended eliminating letters of support from state senators and representatives because the commission believed the letters gave too much power to officials far removed from the process.21 In 2010, a Texas developer was convicted on corruption charges, which included supplying a below market-rate apartment to a state representative in exchange for the representative’s support for the developer’s projects.

There is also ongoing litigation about the requirement for letters of local support that alleges that Treasury did not issue any regulations to prevent state actions that contribute to perpetuating racial segregation of LIHTC units and that this is a violation of its obligation to affirmatively further fair housing under the Fair Housing Act.22 The litigation specifically alleges that in 2013 the Texas legislature enacted two statutes that give substantial control over the location of LIHTC projects to local municipal and county government, one of which requires the allocating agency to provide a high number of points to developers that receive the explicit approval of the relevant municipal or local government. According to the lawsuit, Section 42 gives Treasury the authority to regulate such local government restrictions, but the agency has not issued regulations or otherwise prevented states from enacting such policies.23 Officials from

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21 The Sunset Advisory Commission is charged with monitoring state agency performance. During its review of state agencies, the commission typically makes recommendations to improve agency operations. The commission reviewed the Texas Department of Housing and Community Affairs (which administers LIHTC) in 2010 and 2013.


Treasury’s Office of Tax Policy said they could not comment on ongoing litigation.24

Moreover, research conducted by HUD and others has analyzed how scoring criteria (like letters of local support) can influence project location and HUD officials have expressed fair housing concerns about these letters. Specifically, officials from HUD’s Office of Fair Housing and Equal Opportunity and Office of General Counsel have cited fair housing concerns in relation to any preferences or requirements for local approval or support because of the discriminatory influence these factors could have on where affordable housing is built.25 In 2013, HUD and other participants in the Rental Policy Working Group—which was established by the White House to better align the operation of federal rental policies across the administration—shared these concerns with Treasury.26 These HUD officials suggested that eliminating local approval or support requirements or preferences from QAPs should be top priorities for Treasury and IRS, based on fair housing concerns. As of January 2016, neither Treasury nor IRS had issued any guidance about letters of local support, and Treasury’s Priority Guidance Plan does not include any plans to address HUD’s recommendation.27 Treasury officials said they could not comment or take action on matters related to the ongoing litigation. In addition, research from HUD’s Office of Policy Development and Research has explored the relationship between tax credit allocation priorities as outlined in QAPs (such as local letters of support or approval)

24 Consistent with GAO’s policy, GAO does not comment on or evaluate specific issues that are pending before administrative or judicial forums, such as this ongoing litigation.

25 The mission of the Office of Fair Housing and Equal Opportunity includes eliminating housing discrimination. Its activities include the enforcement, administration, development, and public understanding of federal fair housing policies and laws (the Fair Housing Act and other civil rights laws). The office also works with other government agencies on fair housing issues.

26 The Rental Policy Working Group comprises representatives from the White House Domestic Policy Council, National Economic Council, Office of Management and Budget, HUD, Treasury, the Department of Agriculture, and the Department of Justice.

27 Treasury’s Office of Tax Policy and IRS use the Priority Guidance Plan each year to identify and prioritize the tax issues that should be addressed through regulations, revenue rulings, revenue procedures, notices, and other published administrative guidance. The plan can be found at: https://www.irs.gov/uac/Priority-Guidance-Plan.
and the location of LIHTC units. For example, one HUD report found that certain state QAP prioritization of local approval exhibited increases in the overall exposure to poverty of LIHTC units. Furthermore, a report by the Poverty and Race Research Action Council found that local approval requirements beyond the required Section 42 notification provide municipalities with an opportunity to “opt out” of developing LIHTC projects.

Selected Agencies Implemented Other LIHTC Requirements in Varying Ways

Allocating agencies we visited had processes in place to meet other Section 42 requirements relating to awarding credits, long-term affordability of projects, project viability (market studies), and written explanation to the public.

Nonprofit Set-Aside

Allocating agencies must allocate at least 10 percent of the state housing credit ceiling to projects involving qualified nonprofit organizations. All nine allocating agencies we visited had a set-aside of at least 10 percent of credits to be awarded to projects involving nonprofits. Some agencies choose to reserve more than 10 percent. For example, the allocating agencies from Virginia and Chicago reserve 15 percent and 30 percent of their tax credits for qualified nonprofits, respectively. Officials from Illinois’s allocating agency mentioned that almost every application has a 


Poverty and Race Research Action Council, Building Opportunity: Civil Rights Best Practices in the Low Income Housing Tax Credit Program (Washington, D.C.: December 2008). The report examined QAPs from the 50 states to determine, among other things, what approaches states had taken in relation to priorities or scoring for project location and local support.
nonprofit partner and therefore the minimum set-asides are fairly easy to meet.

**Extended Use Agreement**

Allocating agencies must execute an extended low-income housing commitment of at least 30 years (the first 15 years of which are the compliance period) before a building can receive credits. Allocating agencies with which we met also used various tools when awarding credits to maintain the affordability of LIHTC projects beyond the 30-year extended-use period. One allocating agency we visited requires developers to sign agreements for longer extended-use periods, while some agencies award points to applications whose developers elect longer periods. For example, California’s allocating agency has a minimum affordability period of 55 years, 25 years longer than the 30-year requirement. Other allocating agencies, including those from Massachusetts, Virginia, Nevada, and California, award extra points to developers that elect affordability periods beyond the 30-year minimum.

Nevada’s allocating agency noted that it was challenging to preserve the affordability of LIHTC units due to the qualified contract process outlined in Section 42. Under the process, owners of properties subject to an extended-use restriction may seek to remove the restriction for maintaining affordability after the first 15 years (compliance period) by requesting that the allocating agency find an eligible buyer for the property. The agency has 1 year to find a potential buyer that will maintain the property’s affordability and present an offer in accord with qualified contract provisions. If the allocating agency cannot find a buyer that will offer a qualified contract, then the current owner is entitled to be relieved of LIHTC affordability restrictions (which phase out over 3 years after the 15-year compliance period ends). Officials from Nevada mentioned that their larger projects (more than 200 units) were at risk of losing affordability because of the qualified contract process. Specifically, when the qualified contract price exceeds a development’s market value, it is difficult for the agency to find a buyer for the above-market price. The qualified contract must name a price that will acquire any non-low-income portion of the property for “fair market value” and the low-income portion for the sum of “outstanding indebtedness secured by or with respect to the building,” plus the “adjusted investor equity in the building,” plus “other capital contributions,” minus “cash distributions from (or available for distribution from) the project.”

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31The qualified contract must name a price that will acquire any non-low-income portion of the property for “fair market value” and the low-income portion for the sum of “outstanding indebtedness secured by or with respect to the building,” plus the “adjusted investor equity in the building,” plus “other capital contributions,” minus “cash distributions from (or available for distribution from) the project.”
officials suggested that in such cases, the development should be priced according to the market or fair value price to attract more buyers willing to preserve the affordability of the properties. One way we observed that allocating agencies can maintain LIHTC properties’ affordability is to restrict owners from using the qualified contract process.\textsuperscript{32} For example, in Michigan, the allocating agency has restricted owners from using the qualified contract process by limiting their ability to remove affordability restrictions.

**Market Study**

Before a credit allocation is made, allocating agencies must receive from the developer a comprehensive market study of the housing needs of low-income individuals in the area to be served by the project. An agency-approved third party must perform the study and the developer must pay for it.\textsuperscript{33}

Eight of the nine allocating agencies we visited require the market study to be submitted with a developer’s application to ensure the agency can review the study during its evaluation to award and reserve credits. One agency (Rhode Island) requires the study to be submitted after credits are reserved, but evaluates it before allocation. Officials noted that their agency is familiar with state housing needs because the market is small and a market study is not necessarily needed to make a decision about reserving credits (versus allocation).

Two of the nine allocating agencies we visited had agency-specific requirements for procurement of market studies. For example, Michigan chooses a firm on behalf of the applicant and has the developer pay for the study. Agency officials noted that this process increases the independence of the market analysis and lessens any potential conflicts of interest. Rhode Island also commissions the market study (by itself or in partnership with the investor).

\textsuperscript{32} The extended use period deadline shall not apply to the extent more stringent requirements are provided in the agreement or in state law. 26 U.S.C § 42(h)(6)(E)(i).

\textsuperscript{33} This requirement, part of the Community Renewal Tax Relief Act of 2000, was based on the findings from GAO, *Tax Credits: Opportunities to Improve Oversight of the Low-Income Housing Program*, GGD/RCED-97-55 (Washington, D.C.: Mar. 28, 1997).
Written Explanation to the General Public

According to Section 42, allocating agencies must provide a written explanation to the general public if they make an allocation not in accordance with established priorities and selection criteria. The allocating agencies we visited met this requirement in varying ways. For example, two agencies, including Michigan, chose to release a memorandum to the public describing the specific circumstances of an allocation. The other agency, California, provided us with an example of a public memorandum detailing how the agency used forward reserving—that year’s credits already were allocated for the area in which the proposed development would be located—because the agency saw merit in the proposed development. Virginia made publicly available meeting minutes that discussed decisions not made in accordance with established priorities. The remaining six agencies we visited (Chicago; Illinois; Massachusetts; Nevada; Rhode Island; and Washington, D.C.) had not issued a public notification because officials said their agencies had never allocated credits not in accordance with established priorities and selection criteria.
Selected Agencies Have Procedures to Assess Reasonableness of Development Costs, but IRS Is Not Well Positioned to Examine How Agencies Award Credit Boosts

Selected Agencies Determine Award Amounts for Projects Differently and Use Various Cost Limits and Benchmarks to Determine Reasonableness of Costs

Section 42 states that allocating agencies must consider the reasonableness of costs and their uses for proposed LIHTC projects, allows for agency discretion in making this determination, and also states that credits allocated to a project may not exceed the amount necessary to assure its feasibility and its viability as a low-income housing project. Section 42 does not provide a definition or offer guidance on determining how to calculate these amounts.

All nine allocating agencies we visited require applicants to submit detailed cost and funding estimates, an explanation of sources and uses, and expected revenues as part of their applications. These costs are then evaluated to determine a project’s eligible basis (total allowable costs associated with depreciable costs in the project), which in turn determines the qualified basis and ultimately the amount of tax credits to be awarded.\(^{34}\)

\(^{34}\)The amount of credit the taxpayer can claim each year is determined by the following calculations: (1) eligible basis x applicable fraction = qualified basis; and (2) qualified basis x applicable percentage = annual credit amount. Qualified basis is the portion of a project’s total costs—excluding the costs of land, obtaining permanent financing, rent reserves, syndication, and marketing—allocable to units that meet Section 42 requirements for rent, tenant income, and habitability. The applicable fraction is the lesser of the portion of rental units that are qualified low-income units in relation to total rental units or the portion of total floor space dedicated to low-income units in relation to the total floor space of residential rental units. The applicable percentage is the discount factor needed to limit the present value of the credit available over a 10-year period to either 70 percent or 30 percent of the qualified basis, depending on the characteristics of the housing. The credit percentages are adjusted monthly by the IRS based on current interest rates. Under a special rule first enacted in 2008, the minimum percentage is 9 percent for the buildings eligible for the 70 percent credit. Legislation enacted in 2015 permanently extended the 9 percent floor.
More specifically, the agencies we visited used different methods for determining the amount of LIHTCs to award.

- Six agencies (California, Illinois, Michigan, Nevada, Virginia, and Washington, D.C.) determined credit amounts explicitly in their application reviews by comparing the award amount calculated from the qualified basis with the amount calculated based on the project’s existing equity gap and awarding the lesser of the two. In other words, agencies reviewed cost information to determine the annual amount of tax credits needed to fill the gap in financing. These six agencies documented their calculations and award amounts in the project application and review files.

- The other three agencies (Chicago, Massachusetts, and Rhode Island) determined credit amounts similarly by reviewing financial information from developers, but did not explicitly compare the equity gap and qualified basis to determine award credit amounts. Instead, officials told us that underwriters reviewed this information and assessed if the amounts were reasonable based on their internal underwriting criteria to make award decisions.

Section 42 also does not provide a definition of reasonableness of costs, giving allocating agencies discretion on how best to determine what costs are appropriate for their respective localities. In addition, Section 42 does not require criteria for assessing costs to be documented in QAPs. To update its best practices in light of the Housing and Economic Recovery Act (HERA) of 2008 and the American Recovery and Reinvestment Act of 2009, NCSHA provided allocating agencies with recommended practices, including recommendations on cost limits, credit award amounts, and on fees associated with construction in allocating housing credit and underwriting projects in 2010. However, allocating agencies have different ways for determining the reasonableness of project costs. More specifically, based on our analysis of 58 QAPs and our site visits, agencies have established various limits against which to evaluate the reasonableness of submitted costs, such as applying limits on

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development costs, total credit awards, developer fees, and builder's fees.\textsuperscript{36}

- **Limits to development costs.** NCSHA recommends that each allocating agency develop a per-unit cost limit standard based on total development costs.\textsuperscript{37} Fourteen of the 58 QAPs we reviewed stated that total development costs, development costs per unit, or development costs per square foot were assessed against limits the agencies established for these cost categories. Of the nine agencies we visited, four noted that their limits for development costs were benchmarks determined by costs of similar projects, historical pricing, and other factors. For instance, the Massachusetts QAP contains recommended per unit costs using cost information from the agency’s portfolio. The Illinois QAP contains per square foot and per unit cost limits, set on the basis of historical data and adjusted for inflation annually.

- **Limits to total credit award.** Similarly, agencies placed limits on the tax credit award amounts that taxpayers can claim per project.\textsuperscript{38} While NCSHA recommends that credit awards be limited to the amount needed to fill any financing gap for the project, several agencies had specific limits in their QAPs. According to our QAP analysis, 39 of the 58 noted such limits either as a specific dollar amount or as a percentage of the total amount of credits available for a given year. Officials from one agency told us they do not mention the award limit in the QAP because they did not want to encourage applicants to seek the maximum award amount. However, agency officials stated that they evaluate applications against a general maximum award amount that they do not publicize. At the nine agencies we visited, the

\textsuperscript{36}Our QAP analysis comprised of reviewing plans from 2013. A small number of allocating agencies did not update their plans in 2013; instead, we reviewed the most recent QAP available. Agencies may have practices in place to evaluate the reasonableness of costs as part of their application or underwriting process. We observed that this was the case during our site visits, and confirmed the use of limits in discussions with officials and stakeholders. Therefore, allocating agencies that we observed that do not describe cost limits in their QAPs still may use cost limits or other factors as a measure of reasonableness in their actual application reviews and these may be documented elsewhere, but not in the QAP.

\textsuperscript{37}Report of the National Council of State Housing Agencies’ Housing Credit Task Force on Recommended Practices in Housing Credit Allocation and Underwriting.

\textsuperscript{38}According to our analysis, 13 agencies had limits on both total development cost per unit and credit award amounts.
maximum amount taxpayers can claim over the 10-year credit period ranged from $1 million to $2.5 million per project.\textsuperscript{39}

- **Limits to fees for developers.** The developer fee—payment made to the developer for its services—is included in the eligible basis. Because the developer fee is included in the eligible basis from which the credit award is ultimately calculated, limits on the fee can help maintain reasonable costs. NCSHA guidance states that the fee should not exceed 15 percent of total development costs, except for developments meeting specified criteria (for size, characteristics, or location) that could cause fees to be higher. Based on our analysis of 2013 QAPs, 40 of 58 agencies specified limits on the value and calculation of developer fees. Some allocating agencies cited limits as the lesser of a specific dollar value or a percentage based on the number of units in a development. For example, the Michigan QAP notes that developer fees can be no higher than the lesser of 15 percent of total development costs or $2.5 million for buildings with 50 or more units; higher limits (20 percent) may be used for buildings with 49 units or fewer to create incentives for developers. Other agencies calculate the fee limit differently, using a percentage of total development cost minus costs such as acquisition, reserves, or syndication. Three of the agencies we visited had no developer fee limits in their QAPs, but two had limits in supplemental documentation that is publicly available.

- **Limits to fees for builders.** Agencies also may elect to place limits on builder’s fees. A builder’s fee is a payment made to the builder and is included in eligible basis from which the credit award is ultimately calculated. Similar to the limits on the developer fees, limits on builder’s fees can help maintain costs. Builder’s profit, builder’s overhead, or general requirements are common components of builder’s fees. NCSHA recommends that builder’s profit not exceed 6 percent of construction costs, builder’s overhead not exceed 2 percent of construction costs, and general requirements not exceed 6 percent of construction costs. NCSHA notes that the limits should not be exceeded except for developments with characteristics that may

\textsuperscript{39}As an example, consider a new affordable housing apartment complex with a qualified basis of $1 million. Since the project involves new construction, it will qualify for the 9 percent credit and generate a stream of tax credits equal to $90,000 (9% × $1 million) per year for 10 years, or $900,000 in total. Total LIHTCs are allocated to the states according to their population: $2.30 per person. In 2015, the minimum a state could be allocated is $2,680,000.
justify higher fees (such as small size or location in difficult development areas). Based on our QAP analysis, we found that 34 of 58 noted limits on builder’s fees, but the value and calculations varied. Some agencies elected to aggregate the fee components into one fee limit and others set limits for each component of the fees.

We also found that few QAPs (4 of 58) cited specific circumstances under which developments could exceed cost or credit award limits, such as the developer demonstrating need. However, we found that eight of the nine allocating agencies we visited had policies where applicants could exceed limits that were specified in their QAPs or internal documents.

Selected Agencies Have Different Processes to Meet Regulatory Requirements for Reviewing Costs at Application, Allocation, and Placed-in-Service

Section 42 requires allocating agencies to review cost information and determine the credit amount at three different points of time: application, allocation, and placed-in-service and agencies we visited had different practices for meeting Treasury requirements at each stage.

With regard to reviewing costs at the time of application, as we previously discussed, all nine agencies we visited require applicants to submit detailed cost and funding estimates, an explanation of sources and uses, and expected revenues as part of their applications. The allocating agencies then evaluate the submitted cost estimates based on their established limits and benchmarks for reasonableness, and the total tax credit award amount is calculated.

“Allocation” occurs when a project is selected for a tax credit award and credits are set aside for that specific developer as work on the project begins. Based on our site visits and project file reviews, the nine agencies we visited told us that they would respond in different ways if costs previously reported in a developer’s application increased.
Five agencies explicitly stated that award amounts would not increase beyond the amount determined at application, although awards could decrease if costs were lower than initially estimated. Four others stated that award amounts could rise after application due to cost increases.

The “placed-in-service” date is when the first unit of the building is ready and available for occupancy under state and local laws. Section 42 states that a project must be placed-in-service by the end of the calendar year in which the tax credits were allocated. A few allocating agencies require in their QAP that developers submit periodic progress reports to better ensure that the development will be placed-in-service on time. According to our QAP analysis, 7 of 58 plans required developers or owners to submit reports at regular intervals during construction to monitor progress. Five agencies we visited stated that they monitored construction progress, and one explicitly described requirements in its QAP. In addition to progress reports, the others cited practices such as scheduled meetings with construction staff and visits to project sites as ways to monitor construction progress to ensure that the placed-in-service deadlines would be met.

If the project cannot be placed-in-service by that deadline, developers can apply for a “carryover allocation” which, if approved, extends the deadline to be placed in service. Specifically, the project will have to be placed in service no later than the end of the second calendar year after the agency approves the carryover request. Section 42 requires proof that at least 10 percent of reasonably expected basis in the project was spent in the 12 months after the execution of a carryover allocation. Treasury regulations state that allocating agencies may verify this in several ways, including having a requirement that projects requesting a carryover allocation, and one explicitly described requirements in its QAP. In addition to progress reports, the others cited practices such as scheduled meetings with construction staff and visits to project sites as ways to monitor construction progress to ensure that the placed-in-service deadlines would be met.

If the project cannot be placed-in-service by that deadline, developers can apply for a “carryover allocation” which, if approved, extends the deadline to be placed in service. Specifically, the project will have to be placed in service no later than the end of the second calendar year after the agency approves the carryover request. Section 42 requires proof that at least 10 percent of reasonably expected basis in the project was spent in the 12 months after the execution of a carryover allocation. Treasury regulations state that allocating agencies may verify this in several ways, including having a requirement that projects requesting a carryover allocation.

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40 One of these five agencies stated that developers would receive a penalty on future applications if the current project’s award amount increased after application.

41 The placed-in-service date is recorded on the Form 8609 (housing credit allocation and certification) and is the date that taxpayers can begin claiming the tax credits.

42 As mentioned previously, allocating agencies may have these requirements recorded in other documents aside from the QAP.

43 Reasonably expected basis is defined as the adjusted costs in land or depreciable property reasonably expected to be part of the project as of the close of the second calendar year.
allocation must submit an independent report on the progress of construction spending to the allocating agency. The procedures we observed at all nine agencies we visited were consistent with the requirements and all required a report to document the expenditures. However, we observed that three agencies required report submission in fewer than 12 months following allocation, a more stringent time frame than currently in Section 42. Two of these agencies said their deadlines were more stringent in order to give them enough time to review costs and provide developers an incentive to start construction earlier.

**IRS Does Not Review Agencies’ Criteria for Awarding Discretionary Increases, Which Could Result in Oversubsidizing Projects**

Section 42 notes that an increase or “boost” of up to 130 percent in the eligible basis can be awarded by an allocating agency to a housing development in a qualified census tract or difficult development area.\(^{44}\)

Although the boost is applied to the total eligible basis (as opposed to the total credit amount), the credit amount awarded increases.\(^{45}\) In addition, HERA amended Section 42 in 2008 and gave allocating agencies the discretion to designate any building, regardless of location, as eligible for a boost of up to 130 percent of the eligible basis.\(^{46}\) Section 42 requires allocating agencies to find that “discretionary basis boosts” were necessary for buildings to be financially feasible before granting them to developers.\(^{47}\) Section 42 does not require allocating agencies to document their analysis for financial feasibility (with or without the basis boost). However, HERA’s legislative history included expectations that allocating agencies would set standards in their QAPs for which projects

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\(^{44}\)A difficult development area is “any area designated by the Secretary of Housing and Urban Development as an area which has high construction, land, and utility costs relative to area median gross income.” 26 U.S.C § 42(d)(5)(B)(iii)(I). HUD updates the list of such areas annually.

\(^{45}\)The actual increase to the credit award is less than 30 percent because the credit award is determined by multiplying the applicable fraction by the total eligible basis, which is increased by the boost.

\(^{46}\)Per Section 42, any building which is designated by the state housing credit agency as requiring the increase in credit in order for such building to be financially feasible shall have an eligible basis of 130 percent of the basis determined.

\(^{47}\)We use “discretionary basis boosts” to describe boosts awarded to developments outside of qualified census tracts or difficult development areas.
would be allocated additional credits, communicate the reasons for designating such criteria, and publicly express the basis for allocating additional credits to a project.\textsuperscript{48} In addition, NCSHA recommends that allocating agencies set standards in their QAPs to determine eligibility requirements for discretionary basis boosts (those outside of qualified census tracts and difficult development areas) and make the determinations available to the public.\textsuperscript{49}

According to our QAP analysis, 44 of 58 plans we reviewed included criteria for awarding discretionary basis boosts, with 16 plans explicitly specifying the use of basis boosts for projects that need them for financial or economic feasibility. Additionally, of the 53 project files we reviewed for cost information during our site visits, 7 received a discretionary basis boost.\textsuperscript{50} The discretionary boosts were applied to different types of projects (for example, historic preservation projects, projects in high-foreclosure areas, or projects with enhanced environmental standards) and on different scales (for example, statewide or citywide).

In some cases, discretionary boosts were applied more broadly. For example, during our file review in Virginia, we found one development that received a boost to the eligible basis for having received certain green building certifications, although the applicant did not demonstrate financial need or request the boost. The allocating agency told us that all projects that earned the specified green building certifications received the boost automatically, as laid out in its QAP. As mentioned previously, Virginia compares (1) the award amount calculated from the qualified basis with (2) the amount calculated based on the project’s existing equity gap, and subsequently awards the lesser of the two. In this case, because the application showed that the project’s equity gap was still less than the credit amount with the basis boost, the allocating agency


\textsuperscript{49}Report of the National Council of State Housing Agencies’ Housing Credit Task Force on Recommended Practices in Housing Credit Allocation and Underwriting.

\textsuperscript{50}One of the project files is in California. The California allocating agency’s QAP outlines criteria for discretionary boosts that increase the limits on eligible basis. While the QAP does not expressly apply a 30 percent boost to eligible basis, the limit increases that are applied in effect allow for a potential 30 percent boost.
awarded a credit amount equal to the equity gap.\textsuperscript{51} In response to our findings during the file review, officials from Virginia’s allocating agency said that the agency has since changed its practices to prevent automatic basis boosts from being applied and now requires additional checks for financial need for boosts.

Furthermore, one 2013 QAP we reviewed (Arizona) described an automatic 130 percent statewide boost for all LIHTC developments. Agency officials told us they first applied the boost in 2009, when credit pricing was low.\textsuperscript{52} According to the officials, the automatic statewide basis boost remains in effect because officials have made the determination that nearly all projects will need it for financial feasibility due to limited gap financing resources. More specifically, resources decreased when the state legislature decided to use part of the housing trust fund for other uses. The agency’s 2015 QAP outlines goals for providing low-income housing in areas with high market demand where the land is frequently more expensive. All the projects in the most recent competitive funding round (2015) are expected to receive the 130 percent boost.

Consistent with our previous report, IRS does not review the criteria allocating agencies use to award the boosts (most of which are found in their QAPs).\textsuperscript{53} IRS also has not provided guidance to agencies on how to determine the need for the additional basis to make the project financially feasible. IRS officials stated that Section 42 gives allocating agencies the discretion to determine if projects receive a basis boost and does not require documentation of financial feasibility. Additionally, IRS officials explained that because the overall amount of subsidies allocated to a state is limited, the inherent structure of the program discourages states

\textsuperscript{51}Virginia’s allocating agency officials noted that the award of the boost does not always yield a higher credit award, as in examples like this. Because the agency takes the lesser of the two calculations, an increase in credit amount would depend on the amounts calculated using the qualified basis (with the basis boost taken into account) and the project’s existing equity gap.

\textsuperscript{52}For more information about credit prices following the tax credit market collapse in 2008 and 2009, see GAO, Recovery Act: Housing Programs Met Spending Milestones, but Asset Management Information Needs Evaluation, GAO-12-634 (Washington, D.C.: June 18, 2012).

\textsuperscript{53}GAO-15-330. We reported that IRS does not regularly review QAPs due to resource constraints and their view that regular reviews of QAPs are outside the scope of the agency’s compliance responsibilities.
from oversubsidizing projects, since doing so would reduce the amount of the remaining allocable subsidies and yield fewer LIHTC projects overall within a state. However, we observed a range of practices for awarding discretionary basis boosts, including a blanket basis boost that could result in fewer projects being subsidized and provide more credits than are necessary for financial feasibility. In addition, because IRS does not regularly review QAPs, many of which list criteria for discretionary basis boosts, IRS is unable to determine the extent to which agency policies could result in oversubsidizing of projects. In our previous report, we concluded that IRS’s oversight of allocating agencies and the program was minimal and recommended that Congress consider designating HUD as joint administrator of the program based partly on its experience in administering other affordable housing programs. We continue to believe that if the program were jointly administered, HUD would be in a better position (given its housing mission) to provide guidance on discretionary basis boosts and regularly review allocating agencies’ criteria for awarding them.

### Selected Agencies Had Processes to Monitor Compliance but IRS Collects Inconsistent Information and Uses Little of It to Assess Extent of Noncompliance in the Program

Allocating agencies are responsible for monitoring the compliance of LIHTC properties and agencies we visited had processes consistent with Section 42 and Treasury regulation requirements. However, agencies we visited had varying practices for submitting noncompliance information to IRS using the Form 8823 (report of noncompliance or building disposition). Furthermore, when IRS receives forms, it records little of this information into its database. IRS also does not review forms with certain noncompliance issues for audit potential. HUD, through the Rental Policy Working Group, has started to collect physical inspection results of LIHTC properties electronically, but the division within IRS responsible for the LIHTC program was unaware of this effort.
Selected Agencies Had Processes to Monitor Properties’ Compliance with Program Requirements

Allocating agencies we visited had processes for and conducted compliance monitoring of projects consistent with Section 42 and Treasury regulation requirements.

Treasury regulations require allocating agencies to conduct on-site physical inspections for at least 20 percent of the project’s low-income units and file reviews for the tenants in these units at least once every 3 years. In addition, allocating agencies must annually review owner certifications that affirm that properties continue to meet LIHTC program requirements.

Allocating agencies we visited followed regulatory requirements on when to conduct physical inspections and tenant file reviews. Based on our site visits, five of the nine agencies conducted inspections and file reviews once every 3 years. The remaining four agencies (Chicago, Michigan, Nevada, and Rhode Island) conducted inspections and file reviews more frequently than required. Officials from Nevada noted that inspecting properties annually helped to detect possible issues in properties earlier. In addition, officials from Chicago, Michigan, and Rhode Island said they inspect properties more frequently due to monitoring requirements associated with other public subsidies that funded the development. For example, projects funded by HUD’s HOME Investment Partnerships Program (HOME) can require inspections every 1, 2, or 3 years, depending on the size of the project. Because HOME is often used as another financing source within an LIHTC development, these agencies said they chose to inspect projects every year to satisfy both HOME and LIHTC requirements.

Treasury regulations also allow agencies to delegate compliance monitoring functions to a private contractor as long as the allocating agency retains the responsibility for notifying IRS about noncompliance. Two agencies, Michigan and Massachusetts, contracted monitoring to third-party firms due to agency preference to use contractors and

54 HOME provides block grants to states and localities that can be used to fund a wide range of activities including building, buying, and rehabilitating affordable housing for rent or homeownership or providing direct rental assistance to low-income families.
resource constraints. In addition, Treasury regulations require that the allocating agency ensure that its authorized delegate (third-party contractor) properly performs the delegated functions. Both agencies’ contracts with the third parties outlined responsibilities, time frames, and performance reports to the allocating agency. For instance, Massachusetts receives quarterly and annual performance reports for all inspections and Michigan has contractors upload inspection findings to an electronic database for review.

Agencies we visited generally used electronic databases to track the frequency of inspections, file reviews, and certifications, although most agencies documented these reviews (such as inspection checklists and file review worksheets) on paper. Based on our review, we found that seven of the nine agencies maintained databases that compliance staff used to record inspections and file reviews, follow up on findings, and track deadlines for owners to correct noncompliance issues. The remaining two agencies kept and updated spreadsheets that included similar information. In addition, agencies we visited generally had processes to help ensure and improve the reliability, accuracy, and completeness of database information. For example, officials from Virginia noted that they have started combining databases that contain information on compliance with databases that contain application information to make their datasets more complete.

All agencies we visited had inspection and review processes in place to monitor projects following the 15-year compliance period, as required under Section 42. As we previously mentioned, allocating agencies must execute an extended low-income housing commitment to remain affordable for a minimum of 30 years before a tax credit project can receive credits. After the compliance period is over, the obligation for allocating agencies to report to IRS on compliance issues ends and investors are no longer at risk for tax credit recapture. Four agencies (California; Michigan; Nevada; and Washington, D.C.) also chose to reduce various requirements for compliance monitoring in this time frame, such as the percentage of units sampled or the frequency of review. For example, during the extended-use period, Michigan officials stated that they will conduct physical inspections once every 5 years rather than once every 3 years.

Although investors are not at risk for tax credit recapture after the 15-year compliance period, agencies we visited have implemented policies to encourage compliance during the extended-use period. Specifically, all nine agencies established criteria that deduct points from or affect a
developer’s future application if prior LIHTC developments had noncompliance issues during and beyond the 15-year compliance period. The agencies noted that this practice was a useful tool for promoting compliance as long as developers were interested in future projects.

Lack of Clear Guidelines on When to Send IRS Noncompliance Information Results in Inconsistent Reporting across Allocating Agencies

Treasury regulations require allocating agencies to use IRS Form 8823 (report of noncompliance or building disposition) to notify IRS of noncompliance with LIHTC provisions or any building disposition. Treasury regulations also state that agencies must report any noncompliance issues of which they become aware, including through physical inspections and tenant file reviews. The regulations also require that an allocating agency submit a form regardless of whether the owner remedied the noncompliance. That is, allocating agencies must send IRS forms with information on both uncorrected and corrected noncompliance issues. As of April 2016, IRS had received approximately 214,000 Form 8823s since calendar year 2009 (an average of nearly 27,000 forms a year).

As shown in figure 2, the form includes information on the number of LIHTC units in the building, dates of noncompliance, and a list of categories to describe the type of noncompliance. The form also includes checkboxes to indicate if the noncompliance was corrected by the end of the correction period (the time given to the owner to correct the noncompliance issue) or remained uncorrected.
IRS developed guidelines for allocating agencies to use when completing the Form 8823, the “fundamental purpose” of which was identified as providing standardized operational definitions for the noncompliance
categories listed on the form. The IRS guide adds that it is important that noncompliance be consistently identified, categorized, and reported. The guide notes that the benefits of consistency included enhanced program administration by IRS. In addition, according to Standards for Internal Control in the Federal Government, information should be recorded and communicated to management and others who need it in a form that enables them to carry out internal control and other responsibilities. Management also should ensure there are adequate means of communicating with, and obtaining information from, external stakeholders that may have a significant impact on the agency achieving its goals.

However, agencies we visited had various practices for submitting Form 8823 to IRS, including different timing of submissions and amounts of additional detail provided. For example, California, Virginia, and Rhode Island will not send a Form 8823 for minor violations of the Uniform Physical Conditions Standards (UPCS)—such as peeling paint or missing lightbulbs—if the violations were corrected during the inspection. Officials from these agencies stated they chose not to send forms for such minor findings because of the administrative burden this creates for the agency, developers, and IRS. In contrast, Michigan, Nevada, and Washington, D.C., will send a form (following notification to the owner) for all instances of reportable noncompliance, whether or not the issue was resolved during the inspection or the correction period. Partly because of these different practices, the number of forms the nine agencies told us they sent to IRS in 2013 varied from 1 to more than 1,700 (see table 2).

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57 For physical inspections, the agency must review whether the buildings and units satisfy HUD’s Uniform Physical Conditions Standards for public housing or local health, safety, and building codes. The ratings in the standards (Level 1, 2, and 3) differentiate the severity of deficiencies found, with Level 1 being the least severe and 3 the most severe. The standards also define health and safety hazards that pose immediate threats to the well-being of residents.

58 Other factors for the variation in volume of forms include the different numbers of projects in each state as well as the number of buildings associated with each project (forms must be filed for each building within a project).
## Table 2: Varying Practices of Nine Selected Agencies for Submitting Form 8823 to IRS

<table>
<thead>
<tr>
<th>Allocating agency</th>
<th>Practice for submitting Form 8823 to Internal Revenue Service (IRS)</th>
<th>Number of Form 8823s filed with IRS in 2013&lt;sup&gt;a&lt;/sup&gt;</th>
<th>Number of properties inspected in 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>California</td>
<td>Form is sent for Level 2 and 3 findings, health and safety findings, and rent and income issues, whether or not the issue was corrected. Form is also sent for all income and rent eligibility issues, whether or not they were corrected.</td>
<td>59</td>
<td>785</td>
</tr>
<tr>
<td>Chicago</td>
<td>Form is sent only if noncompliance remains uncorrected within the 90-day correction period.</td>
<td>1</td>
<td>125</td>
</tr>
<tr>
<td>Illinois</td>
<td>Prior to 2015, form was sent only for health and safety findings. Currently form is sent for all instances of noncompliance reportable on the form, whether or not the issue was corrected.</td>
<td>1</td>
<td>232</td>
</tr>
<tr>
<td>Massachusetts</td>
<td>Form is sent for all instances of noncompliance reportable on the form whether or not the issue was corrected.</td>
<td>96</td>
<td>212</td>
</tr>
<tr>
<td>Michigan</td>
<td>Form is sent for all instances of noncompliance reportable on the form, whether or not the issue was corrected.</td>
<td>1,728</td>
<td>929</td>
</tr>
<tr>
<td>Nevada</td>
<td>Form is sent for all instances of noncompliance reportable on the form, whether or not the issue was corrected.</td>
<td>511</td>
<td>196</td>
</tr>
<tr>
<td>Rhode Island</td>
<td>Form is sent for patterns of physical inspection noncompliance where findings are minor as well as uncorrected health and safety violations. Form is also sent for income and rent eligibility issues.</td>
<td>1</td>
<td>125</td>
</tr>
<tr>
<td>Virginia</td>
<td>Form is sent for uncorrected and corrected Level 3 Uniform Physical Conditions Standards findings, health and safety findings, and patterns of noncompliance. Form is also sent for other eligible noncompliance issues, including income and rent eligibility issues.</td>
<td>368</td>
<td>183</td>
</tr>
<tr>
<td>Washington, D.C.</td>
<td>Form is sent for all instances of noncompliance reportable on the form, whether or not the issue was corrected.</td>
<td>28</td>
<td>10</td>
</tr>
</tbody>
</table>

Source: GAO analysis of information provided by nine selected allocating agencies. | GAO-16-360

<sup>a</sup>Multiple forms can be completed for each property. For example, a property can consist of several buildings and a Form 8823 must be filed for each building.

Agencies we visited also submitted different amounts of information to accompany the Form 8823s. According to the IRS guide, agencies do not have to describe the noncompliance, but if they submit information with the form, IRS suggests that it is helpful to identify the unit number, the date out of compliance and the date corrected, and summarize the problems with a brief description. A majority of the agencies we visited send attachments when submitting Form 8823. For instance, Virginia submits the form with an attachment that includes inspection dates, types
of credits, units reviewed, annual amount of allocation, and explanation of noncompliance. In contrast, Michigan sends its forms with an attachment that specifies the unit number but not the specific noncompliance issue, and Washington, D.C. does not send attachments.

The timing of actual submission of forms to IRS also varied among agencies we visited. Treasury regulations require agencies to file a form no later than 45 days after the end of the correction period. Six agencies (Virginia, Illinois, Michigan, Massachusetts, Rhode Island, and Nevada) followed this time frame and sent forms to IRS on a rolling basis. The remainder waited until certain points in time to submit the forms. For example, California, Chicago, and Washington, D.C., sent forms on a monthly, annual, and biannual basis, respectively. For one of our selected agencies (Illinois), the timing of submissions to IRS was affected by staff turnover and the implementation of a new software program. Because of these changes, officials from this agency noted they had a backlog of tenant file reviews from 2013 and 2014 to assess for noncompliance and estimated that they would send Form 8823s to IRS for any previously identified issues by June 2016.

Once the allocating agencies submit noncompliance information on Form 8823 to IRS, this federal tax information is protected by law. IRS cannot share the outcomes of the reported issues with the allocating agencies or any federal agency without taxpayer consent. All allocating agencies with which we met confirmed that IRS does not provide them with information about recapture or resolution of issues after a Form 8823 has been submitted.

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59 The correction period is not to exceed 90 days from the date of the notice to the owner about noncompliance. An allocating agency may extend the correction period for up to 6 months, but only if the agency determines there is good cause for granting the extension.

60 Federal tax information is kept confidential under Section 6103 of the Internal Revenue Code, except as specifically authorized by law.

61 An allocating agency can require project developers to complete Form 8821 (tax information authorization) as part of the LIHTC application process. IRS officials noted that a properly completed and submitted Form 8821 by the appropriate representative of the taxpayer authorizes IRS to release noncompliance information about the applicant’s LIHTC compliance, including audit results and Form 8823 filings from other allocating agencies.
Factors that contributed to the variety of agency submission practices include conflicting guidance, different interpretations of the guidance, and lack of IRS feedback about agency submissions. For example, although Treasury regulations require allocating agencies to submit a form for any violation and regardless of whether the owner remedied the noncompliance, the IRS Guide for Completing Form 8823 notes that professional judgment should be used by allocating agency officials to identify “significant noncompliance issues.” IRS officials told us they are not communicating with agencies regarding form submission practices or the application of the IRS guide. Moreover, IRS officials were aware that agencies might interpret the guidance differently, but were not aware of the varying interpretations and submission rates among agencies because, as we describe in more detail in the following section, IRS uses and analyzes little of the information collected on the Form 8823. Without IRS clarification of when to send in the Form 8823, allocating agencies will continue to submit inconsistent noncompliance data to IRS, which will make it difficult for IRS to efficiently distinguish between minor violations and severe noncompliance, such as properties with health and safety issues. Furthermore, collaboration with the allocating agencies and Treasury would help IRS to obtain stakeholder perspectives about noncompliance reporting and ensure that any new guidance is consistent with Treasury regulations.

IRS Continues to Do Little with the Information It Collects

IRS has assessed little of the noncompliance information collected on the Form 8823 or routinely used it to determine trends in noncompliance. Once the allocating agency decides to submit a Form 8823, it must be mailed to the IRS Low-Income Housing Credit Compliance Unit in Philadelphia, where tax examiners determine if the form should be recorded in IRS’s database as well as forwarded for audit potential review (which we discuss in the following section). IRS’s Compliance Unit captures little information from the Form 8823 submissions in its database.

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62 Guide for Completing Form 8823.

63 Tax examiners in the Compliance Unit assist other IRS units and do not necessarily spend all their time on LIHTC tasks. As of January 2016, there were nine tax examiners in the compliance unit who are assigned to various states and review Form 8823 submissions from those allocating agencies. In accordance with IRS retention policy, submitted forms are kept at the Compliance Unit for 3 years and moved to the Federal Records Center and kept for another 15 years before being destroyed.
and has not tracked the resolution of noncompliance issues or analyzed
trends in noncompliance. Consistent with our previous report, during our
visit to the Compliance Unit, we observed that the tax examiners focused
on forms indicating a change in building disposition, such as the
foreclosure of the project, and only entered information from these forms
into the Low-Income Housing Credit database.64 As of April 2016, the
database included information from about 4,200 of the nearly 214,000
Form 8823s IRS received since 2009 (less than 2 percent of forms
received). Because little information is captured in the Low-Income
Housing Credit database, IRS was unable to provide us with program-
wide information on the most common types of noncompliance.

Of the sample of files we reviewed from the agencies we visited, a
majority of project files with Form 8823s filed in 2013 were submitted
because of violations of the UPCS or local standards, a noncompliance
category that tax examiners do not record in IRS’s database.65 All nine
agencies we visited confirmed that physical inspection findings were the
most common noncompliance issues found during their compliance
reviews and recorded on the Form 8823.

Furthermore, IRS tax examiners noted that there is no system to track the
number and status of “uncorrected” forms (noncompliance not resolved in
a specified correction period) that they receive. That is, IRS has no
method to determine if issues reported as uncorrected have been
resolved or if properties have recurring noncompliance issues.

In addition, tax examiners noted that the different timing of submissions
among agencies further affect their review of these forms. For instance,
agencies that submit forms on a rolling basis require examiners to
reconcile the “uncorrected” forms with the “corrected” forms
(noncompliance was resolved in the correction period and the
“noncompliance corrected” box was checked). Tax examiners noted that
they may receive an uncorrected form for review in the morning mail and

64 GAO-15-330. IRS officials told us the decision was made in 2008–2009 to input
information only from forms indicating a change because of the serious nature of these
occurrences for the program, the impacts on taxpayers’ ability to receive credit, and
greater prevalence of these occurrences as a result of the economic downturn.

65 At each of the agencies we visited, we conducted a file review of six developments that
were inspected in 2013 and reviewed any noncompliance findings and Form 8823s that
were filed, among other things.
the corrected form for the same building in the afternoon mail; in the interim, a warning letter would have been mailed to the tax credit investor, although the issue was ultimately resolved. Tax examiners with whom we spoke noted that they have observed inconsistencies with submissions from the allocating agencies. However, consistent with their role in processing Form 8823s, the tax examiners said that their primary responsibility was data entry and initial review of the forms rather than influencing policies or guidance to allocating agencies regarding form submission.

In our July 2015 report, we found that IRS had not comprehensively captured information on credit allocation and certification in its Low-Income Housing Credit database and recommended that IRS address weaknesses identified in data entry and programming controls to ensure reliable data are collected. In response to our recommendation, IRS officials cited that they are exploring possibilities to improve the database, which not only houses allocation and certification information, but also data from submitted Form 8823s. Specifically, IRS has been considering moving the database to a new and updated server, which will provide program managers the ability to more easily review noncompliance issues. However, this recommendation remains open. Because forms are not completely entered into the database or submitted electronically, IRS still cannot analyze noncompliance information over time, by state, by property, or by developer.

**IRS Bases Its Review for Audit Potential on Incomplete Information**

IRS tax examiners are responsible for forwarding forms to be considered for audit. If IRS tax examiner staff determine that the identified noncompliance on the Form 8823 may warrant consideration of an audit of the taxpayer (that is, the project owner claiming the tax credit), they send the form and supplemental information—known as a “classification package”—to the one full-time analyst in the Small Business/Self-Employed Division for further review. The analyst then determines the audit potential. If an audit were needed, the analyst would forward the package to the relevant IRS audit examination division.

*GAO-16-360.*
However, some information from the submitted forms is not being forwarded to the analyst and such information could help identify serious noncompliance issues in the program. Since 2006, the Philadelphia Compliance Unit has reviewed Form 8823s and certain issues are to receive a “mandatory consideration of audit potential.” Tax examiners told us that they forward forms with noncompliance findings subject to mandatory consideration to the analyst in the Small Business/Self-Employed Division for review. Two noncompliance categories that are among the most directly related to the LIHTC program’s principal purpose of providing affordable housing to low-income tenants are not forwarded to the Small Business/Self-Employed Division to be considered for audit potential. Furthermore, if these types of noncompliance findings on the Form 8823 were forwarded to the analyst, it could lead to the recapture of credits. Although the Form 8823 is not the only way IRS can identify and initiate audits of taxpayers who claim LIHTCs, according to IRS officials, the majority of LIHTC-related audits of taxpayers that IRS conducted stemmed from these forms.

Standards for Internal Control in the Federal Government state that information should be recorded and communicated to management and others within the entity who need it and in a form and within a time frame that enables them to carry out their responsibilities. While IRS officials were aware that they were not reviewing forms with certain noncompliance issues for audit potential, they noted that IRS lacks the resources for the one Small Business/Self-Employed Division analyst to review each form it receives and therefore, decisions were made about which noncompliance issues should be focused on when determining

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67 As previously mentioned, IRS deemed some of this information tax law enforcement sensitive, which must be protected from public disclosure. Thus, this section omits sensitive information about IRS’s process for evaluating certain compliance information submitted by allocating agencies.

68 According to Section 42, if, at the close of any taxable year in the compliance period, the amount of qualified basis of any building is less than the amount of such basis as of the close of the preceding taxable year, then the taxpayer’s tax shall be increased by the credit recapture amount.

69 IRS can identify taxpayers who claim LIHTCs and select them for audit for a number of reasons, including being identified by the Small Business/Self-Employed Division for another tax-related reason or if the taxpayer was identified as a partner in an LIHTC partnership that was under audit.

70 GAO/AIMD-00-21.3.1.
audit potential and forwarded to the analyst. IRS does not plan on updating the categories of noncompliance that have to be forwarded to the analyst in the Small Business/Self-Employed Division, but officials stated that IRS continuously evaluates how to most effectively apply its resources and staff to evaluating forms. However, due to inconsistencies in form submission by allocating agencies, as previously discussed, IRS practices for forwarding certain forms, and a lack of database entries for certain categories of findings, the reviews to determine audit potential are based on incomplete information. Without a better process to gather consistent noncompliance information from agencies and regularly review compliance trends, there is a significant risk that ongoing noncompliance issues in LIHTC properties may not be detected and that appropriate actions, including recapture of tax credits, will not be taken.

HUD Expects to Augment Its Databases with LIHTC Information through the Inspection Alignment Initiative, but IRS Was Not Involved in This Effort

While IRS is limited in its ability to identify continuing noncompliance issues and potential recapture events because it captures and analyzes little information it collects, HUD is building data on affordable housing that includes information about LIHTC projects. HUD’s Real Estate Assessment Center (REAC) already maintains a series of databases with information about the condition of its affordable housing portfolio, including a database of physical inspection results and a system to verify tenant incomes to accurately calculate rents. REAC collects standardized sets of information from state and local housing agencies responsible for administering HUD programs and evaluates the data collected to develop objective performance scores.71 HUD also analyzes the information for various purposes. Because the information is collected electronically, HUD can sort the data by state, inspection score, and property to conduct trend analyses. HUD can also disseminate information to HUD program staff and others involved in preserving affordable housing. HUD officials noted that they use these analyses to provide feedback to states about

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71 REAC inspections are conducted for rental housing that is owned, insured, or subsidized by HUD. Because some HUD properties are also subsidized LIHTCs, REAC’s database of inspections includes LIHTC properties. HUD does not conduct REAC inspections for Section 8 voucher housing or properties that solely have HOME funds. For this report, we did not assess the reliability of REAC’s databases.
the condition of their properties. In addition, HUD officials noted that they use REAC database information when estimating future funding needs for affordable housing programs. REAC scores are published quarterly online, increasing the transparency of information about the condition of HUD’s housing portfolio. HUD officials noted that inspection findings such as health and safety deficiencies also are made available through REAC’s online portal, which state and local agencies and property owners can access.

In addition to physical inspection information, HUD has experience maintaining databases to address tenant income and rent issues. Specifically, REAC maintains other databases that contain information on tenant income information and the financial condition of multifamily housing projects. In addition, HUD officials noted that REAC regularly shares data with HUD’s Office of Policy Development and Research, which conducts research on housing needs, market conditions, and outcomes of current HUD programs. According to HUD, intended results from using REAC databases include increasing the efficiency and accuracy of income and rent determinations, removing barriers to verifying tenant-reported information, and reducing the number of incidents of underreported and unreported household income.

HUD Collection of LIHTC Data Likely Will Increase Due to Inspection Alignment Initiative

HUD’s involvement in collecting LIHTC program information likely will increase due to the use of the REAC physical inspection database in the

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72Through the Enterprise Income Verification system, housing agencies provide the tenant’s Social Security number and HUD searches for data associated with that number in its database of income information. HUD then communicates any information back to the agencies so they can verify the tenant’s income. The Financial Assessment Subsystem for Multifamily Housing is used to collect annual electronic financial statement data.

73The Office of Policy Development and Research also maintains a database containing LIHTC project-level data and tenant characteristics (http://lihtc.huduser.org). It is the largest federal source of information on the LIHTC program.
Rental Policy Working Group’s inspection alignment initiative. Although the Rental Policy Working Group is working to address 10 areas for improving collaboration and aligning federal rental policy, the physical inspection alignment initiative has been one of the most active efforts. Because properties that have multiple federal funding sources may be subject to several physical inspections with different standards, the working group has an initiative to align inspection standards, reporting of results, frequency, and sample size of units to reduce the number of duplicative federal physical inspections for these properties. In particular, the initiative focuses on reducing the number of duplicative inspections for HUD, the Department of Agriculture (USDA), and the LIHTC program. In 2011, the working group launched a pilot program for aligning inspections of such properties, including those subsidized with LIHTCs. As of April 2016, HUD noted that 31 states were participating in the physical inspection pilot and that the REAC physical inspection database has been used to capture the inspection information from these states. Further, HUD officials expect participation in the pilot to eventually include all states.

To bolster its data collection effort, HUD officials also said they plan to collect physical inspection data from the pilot states for properties solely subsidized by LIHTC. HUD officials noted several advantages of adding LIHTC inspection data to the REAC database, including the ability for HUD to determine regional trends in new construction or rehabilitated projects, analyze information about the types of tenants being served by the program, assess the location of LIHTC properties, and track physical inspection noncompliance trends within the program. HUD officials said this initiative will be completed in phases to address technology and data quality concerns. HUD officials noted that most allocating agencies do not have electronically generated inspection reports and HUD has been working to determine the best method for incorporating this information in the REAC database. HUD completed testing of the electronic collection of inspection reports of properties solely subsidized by LIHTC in March 2016 and plans to expand the collection of LIHTC inspection information.

The Rental Policy Working Group’s guiding principles center on changes that could help respond to the concerns of external stakeholders (rental housing owners, developers, and managers, and state and local housing agency officials); require minimal statutory action; are realizable at little or no cost or through education, outreach, or the issuance of new guidance or rules; and help create cost and time savings for all parties.
throughout 2016. HUD officials told us that if asked, they would provide IRS with access to the database.

**IRS Division Responsible for LIHTC Not Involved in Alignment Initiative and Unaware of Data Collection Initiatives for Rental Housing**

IRS is responsible for administering the LIHTC program, but its primary division overseeing the program currently is not involved in interagency efforts to modernize, standardize, and improve compliance monitoring of properties. IRS officials from the Small Business/Self-Employed Division told us that they were not aware of HUD REAC’s databases, capabilities, or ongoing efforts to collect LIHTC inspection information through the Rental Policy Working Group. While they stated that the previous analyst was involved in the group’s early planning efforts, the Small Business/Self-Employed Division has not participated since that analyst retired and has no plans to participate in any new working group initiatives because statutory restrictions prevent them from sharing data collected on the LIHTC program with other federal agencies.

Furthermore, although Treasury has been involved with the inspection alignment, officials noted that IRS’s primary role has been for the Chief Counsel to provide legal authority for LIHTC property inspections to be done using REAC inspection standards.75

*Standards for Internal Control in the Federal Government* state that management should ensure there are adequate means of communicating with, and obtaining information from, external stakeholders that may have

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75 Until recently, Treasury regulations required allocating agencies to inspect at least 20 percent of a property’s low-income units and review information for the tenants in those same units. In comparison, REAC requires a statistically valid random sample from all units in a property. Previous IRS notices allowed states in the physical inspection pilot to use REAC’s sampling methodology and allowed the inspection of units that are different from those for which tenant files are reviewed. Recently, Treasury has issued temporary regulations (effective late February 2016) that authorize IRS to specify in guidance the ways states may satisfy physical inspection and tenant file review requirements. IRS has issued such guidance through Revenue Procedure 2016-15. The revenue procedure provides that the lesser of 20 percent of the low-income units in the project or the number of low income units set forth in the Minimum Unit Sample Size Reference Chart (provided in Section 4 of the revenue procedure) must undergo physical inspection and tenant file review. It also permits physical inspections performed under REAC protocols to be used to satisfy Treasury regulation requirements. Finally, under the temporary regulations, a state is no longer required to conduct physical inspections and review tenant files on the same units.
a significant effect on the agency achieving its goals and that effective information technology management is critical to achieving useful, reliable, and continuous recording and communication of information.\textsuperscript{76} The Rental Policy Working Group aims to provide a forum for agencies to collaborate and achieve alignment of federal inspections of rental properties, but lack of participation by the Small Business/Self-Employed Division has resulted in IRS not being able to leverage the progress made by the working group. As we previously mentioned, IRS cannot easily discern noncompliance in the LIHTC program due to the small amount of information inputted into its database, and officials cited that IRS is considering moving the database that houses Form 8823s, among other information, to a new and updated server. However, in conjunction with the working group, HUD, USDA, and the participating allocating agencies have been working to produce and compile consistent, electronic LIHTC inspection information. Having the Small Business/Self-Employed Division participate in the working group provides IRS with opportunities to use compliance data from HUD’s database. This information and further collaboration with HUD would help IRS better understand the prevalence of noncompliance in LIHTC properties and reevaluate how the Form 8823 can be modified to better capture the most significant information from allocating agencies as well as how IRS determines which types of noncompliance issues should be considered for audit potential.

Conclusions

Although allocating agencies play a key role in allocating tax credits, determining the reasonableness of development costs, and monitoring project compliance, IRS is the federal entity responsible for monitoring the agencies and enforcing taxpayer compliance. IRS oversight of allocating agencies continues to be minimal, particularly in reviewing QAPs and allocating agencies’ practices for awarding discretionary basis boosts. As we concluded in our July 2015 report, although LIHTC is the largest federal program for increasing the supply of affordable rental housing, it is a peripheral program for IRS in terms of resources and mission. Without regular monitoring of allocating agencies, IRS cannot determine the extent to which agencies comply with program requirements. As a result,

\textsuperscript{76}GAO/AIMD-00-21.3.1.
we continue to believe, as we suggested in 2015, that Congress should consider designating HUD as a joint administrator of the program responsible for oversight due to its experience and expertise as an agency with a housing mission. For example, applying HUD’s experience in administering affordable housing programs to address areas such as QAP review, federal fair housing goals, and tenant income and rent issues would provide information, analysis, and potentially guidance on issues that apply across all allocating agencies.

Our work for this review highlights the need for clarification to guidelines on submitting noncompliance information as well as further collaboration with HUD and other federal agencies to help IRS improve functions related to tax enforcement. The reasons for inconsistent reporting of noncompliance on Form 8823 include conflicting guidance, different interpretations of the guidance, and lack of IRS feedback about agency submissions. Clarifying what to submit and when—in collaboration with the allocating agencies and Treasury—could help IRS improve the quality of the noncompliance information it receives and help ensure that any new guidance is consistent with Treasury regulations. In addition, IRS has not taken advantage of the important progress HUD has made through the Rental Policy Working Group to augment its databases with LIHTC property inspection data. This data collection effort has created opportunities for HUD to share inspection data with IRS that could improve the effectiveness of reviews for LIHTC noncompliance. However, the IRS division managing the LIHTC program is not involved in the Rental Policy Working Group. Such involvement would allow IRS to leverage existing resources, augment its information on noncompliance, and better understand the prevalence of noncompliance. Specifically, IRS is missing an opportunity to identify pertinent information on LIHTC properties in REAC databases that could help IRS reevaluate how the Form 8823 can be revised to better capture the most significant information from allocating agencies. The information also could help IRS reevaluate which categories of noncompliance should be further reviewed for audit potential.

Recommendations for Executive Action

GAO is making the following three recommendations:

To receive more consistent information on LIHTC noncompliance, the IRS Commissioner should collaborate with the allocating agencies to clarify when allocating agencies should report such information on the Form
8823 (report of noncompliance or building disposition). The IRS Commissioner should collaborate with the Department of the Treasury in drafting such clarifications to help ensure that any new guidance is consistent with Treasury regulations.

To improve IRS’s understanding of the prevalence of noncompliance in the program and to leverage existing resources, the IRS Commissioner should ensure that staff from the Small Business/Self-Employed Division participate in the physical inspection alignment initiative of the Rental Policy Working Group.

To improve IRS’s processes for identifying the most significant noncompliance issues, the IRS Commissioner should evaluate how IRS could use HUD’s REAC databases, including how the information might be used to reassess reporting categories on the Form 8823 and to reassess which categories of noncompliance information have to be reviewed for audit potential.

Agency and Third-Party Comments and Our Evaluation

We provided a draft of this report to IRS, HUD, and Treasury for their review and comment. IRS and HUD provided written comments that are reprinted in appendixes II and III. Treasury did not provide any comments on the findings or recommendations. All three agencies provided technical comments that were incorporated, as appropriate. We also provided a draft to the National Council of State Housing Agencies (NCSHA), a nonprofit organization that represents the allocating agencies, for its review and comment. NCSHA provided written comments that are reprinted in appendix IV.

IRS agreed that it should improve noncompliance reporting and data collection, but added that it would have to consider whether it has the resources to implement the recommendations. For example, IRS wrote that it would commit staff time to attend a few of the Rental Policy Working Group meetings to ascertain whether participation would be cost-effective. IRS noted that the working group was established to address fair housing concerns and cannot address tax matters. The Rental Policy Working Group is addressing 10 areas of concern, including fair housing compliance, for improving collaboration and aligning federal rental policy. However, the pilot to reduce the costs and increase the
efficiency of physical inspections has been one of the most active efforts undertaken by the Rental Policy Working Group to date. Moreover, as noted in this report, the physical condition of projects is a component of program compliance, which affects taxpayers’ eligibility to claim the tax credit. IRS also stated that the REAC information is limited because not all the states are involved with the data collection effort and the REAC database contains properties that are not LIHTC properties. Although not all states are involved in the pilot to align physical inspections, the number of participating states has grown from 6 in 2011 to 31 in 2016. HUD officials expect participation in the physical inspection pilot to further expand and eventually include all states. HUD also plans to expand the electronic collection of inspection reports of properties solely subsidized by LIHTC. As we state in the report, IRS could have a better understanding of the prevalence of noncompliance by using REAC’s computerized data on and analysis of the physical condition of properties—a capability that IRS does not currently have. It could also help IRS evaluate how the Form 8823 can be revised to better capture noncompliance information from allocating agencies and help IRS determine which categories of noncompliance should be further reviewed for audit potential.

While we understand that IRS has limited resources, leveraging HUD’s work with the Rental Policy Working Group pilot and accessing REAC’s computerized system could result in cost savings. IRS noted that it provides extensive information to allocating agencies through its audit technique guide, but, as we noted in the report, allocating agencies have been interpreting the guide differently, which results in the agencies inconsistently reporting the data to IRS. Additionally, allocating agencies send thousands of Form 8823s to IRS’s Low-Income Housing Credit Compliance Unit in Philadelphia that are not entered into a database or considered for audit each year. Instead, as we note in our report, many of these files are held for 3 years at the Compliance Unit and then moved to the Federal Records Center for another 15 years before being destroyed. Using REAC’s database with assistance from HUD could allow IRS to analyze noncompliance information over time, by state, by property, or by developer, which are capabilities currently unavailable to IRS.

In HUD’s comments, it stated that with regard to our July 2015 recommendation calling for enhanced interagency coordination, it remains supportive of mechanisms to use its expertise and experience administering housing programs to enhance the effectiveness of LIHTC. HUD stated that it will continue its work in areas such as fair housing and physical inspection protocols in order to help the LIHTC program perform
more effectively. As our report noted, applying HUD’s experience in administering affordable housing programs to address areas such as QAP review, federal fair housing goals, and tenant income and rent issues could provide information, analysis, and potentially guidance on issues that apply across all allocating agencies.

In its comments, NCSHA reiterated its disagreement with our previous recommendation to Congress, noting that introducing HUD as a co-administrator would reduce program effectiveness or potentially result in HUD micromanaging allocating agency decisions. We disagree because the findings from this report highlight specific areas in which HUD would enhance the administrative support and oversight of the program from a federal level. For example, this report shows that HUD could apply its experience in administering affordable housing programs—including collecting physical inspection data, analyzing noncompliance trends, and reviewing fair housing issues—that could result in guidance to support the work done at the allocating agencies. IRS would still retain all responsibilities related to tax law enforcement. Further, while we did not make recommendations directly to the allocating agencies, our recommendations to IRS reflect concerns about some state practices that we observed, including the missing QAP items and the use of an automatic basis boost.

NCSHA also noted that it encourages GAO and others to view the QAPs broadly as a collection of documents that also include other related publicly available documents and allocation practices by the agencies. We recognize that the details of each required preference and selection criterion may be described in more detail in other documents. However, the QAP is the sole document required by Section 42, and we maintain that the plans should be consistent in meeting federal requirements and transparent about an allocating agency’s practices for awarding credits to projects. Additionally, we note in our report that IRS does not regularly review QAPs, but in the few audits it has conducted of allocating agencies, IRS has identified findings related to the QAPs, such as missing preferences and selection criteria. For those audits, IRS recommended that the QAP document—not auxiliary documents—should be updated to address the identified deficiencies. Leveraging HUD in the oversight process could help ensure that QAPs are reviewed regularly and meet minimal federal requirements.

Finally, NCSHA states that GAO seems to confuse the financial feasibility analysis with standards states may set for eligibility for the discretionary basis boost. We acknowledge in our report that allocating agencies
conduct financial feasibility and other analyses to determine the appropriate amount of LIHTCs to award and describe the different methods we observed in the nine selected agencies. However, as noted in the report, we observed a range of practices for awarding discretionary basis boosts, including an automatic basis boost that is applicable to all LIHTC projects and could lead to fewer projects being subsidized. Further, because IRS does not regularly review QAPs that list criteria for discretionary basis boosts, IRS is unable to determine the prevalence of these types of policies among allocating agencies that could result in oversubsidizing projects. Furthermore, continuance of such policies could establish a precedent for other states to adopt. NCSHA wrote that nothing in Section 42 directs IRS to provide guidance about discretionary basis boosts. Although not explicit in Section 42, we maintain that federal agencies and state allocating agencies—acting as stewards of federal resources—have the responsibility to efficiently use such resources to the best of their ability, particularly in what NCSHA has accurately noted as a resource-constrained environment.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies of this report to the Secretaries of Housing and Urban Development, and Treasury; the Commissioner of Internal Revenue; the appropriate congressional committees; and other interested parties. In addition, the report is available at no charge on the GAO website at http://www.gao.gov.

If you or your staff members have any questions about this report, please contact me at (202) 512-8678 or garciadiazd@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix V.

Sincerely yours,

Daniel Garcia-Diaz
Director, Financial Markets and Community Investment
Appendix I: Objectives, Scope, and Methodology

This report discusses how state and local allocating agencies administer the Low-Income Housing Tax Credit (LIHTC) program and any oversight issues the allocating agencies or the Internal Revenue Service (IRS) face in implementing the program. More specifically, this report describes how allocating agencies (1) award LIHTCs, (2) assess the reasonableness of development costs and financial feasibility of LIHTC properties, and (3) monitor LIHTC properties’ compliance with program requirements.

For all three objectives, we conducted a structured analysis of 2013 Qualified Allocation Plans (QAP) to gather information about the practices of allocating agencies for awarding credits, assessing costs, and monitoring.\(^1\) The QAPs we reviewed were from all 50 states, the District of Columbia, Puerto Rico, American Samoa, Guam, the Northern Mariana Islands, the U.S. Virgin Islands, and the cities of Chicago and New York City, for a total of 58 QAPs.\(^2\) For our analysis, which primarily focused on information in the QAPs themselves, we developed a Data Collection Instrument (DCI). To help determine what questions to include, we reviewed a small sample of plans to ascertain what types of information were available in QAPs and interviewed housing groups, academics, the National Council of State Housing Agencies (NCSHA), and officials from IRS and the Department of Housing and Urban Development (HUD). The

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\(^1\) We chose to review plans from 2013 (1) because it was the most recent year of QAPs available when we started our review; (2) to help avoid accounting for the effects of Housing and Economic Recovery Act programs related to LIHTCs that were created in 2008–2010; and (3) because the National Council of Housing State Agencies issued best practices related to development costs in 2011 and these practices were likely to be reflected in the 2013 QAPs. A small number of allocating agencies (American Samoa, Chicago, Florida, Vermont, and Washington, D.C.) did not update their QAPs in 2013; instead, we reviewed the most recent QAP available.

\(^2\) The 58 QAPs represent the vast majority of plans used to allocate tax credits from all states, territories, and the two largest suballocating agencies with their own QAPs (Chicago and New York City). We are aware that there could be a number of suballocating agencies with their own QAPs, but we did not include them in our review. For example, we identified one state (Minnesota) with a suballocating agency with its own QAP, but did not include this plan in our review due to the size of its annual allocation amount.
Appendix I: Objectives, Scope, and Methodology

DCI did not capture information from the agencies’ supplemental LIHTC materials, such as applications, manuals, and other documents. However, in an effort to present the most recent information available on certain practices, we also reviewed 2015 QAPs and other LIHTC documents at nine allocating agencies we visited (we discuss agency selection and the site visits below). The results of the DCI analysis provide insights into what information these plans include in relation to awarding credits, assessing costs, and monitoring compliance.

In addition, we visited nine allocating agencies to observe the processes used to award tax credits, assess the reasonableness of development costs, and monitor compliance of properties. The nine agencies were in California; Chicago, Illinois; Illinois; Massachusetts; Michigan; Nevada; Rhode Island; Virginia; and Washington, D.C. We primarily considered the following four factors to select this nonprobability nongeneralizable sample:

- 2014 state population, which is used to determine the amount of LIHTCs available to each state annually;
- findings from HUD’s Office of the Inspector General and state auditors on LIHTC-related audits;
- selected information from our analysis of 2013 QAPs, such as types of scoring criteria used, limits to total development costs, and references to separate compliance monitoring guidelines; and
- selected information from NCSHA’s 2012 Factbook, such as the amount of credits requested and allocated in 2012 and whether the allocating agency contracted out compliance monitoring activities.³

We also considered variation in geographic location, information about program administration in press releases or media articles, perspectives from interviews with industry experts, and the presence of suballocating agencies within a state. While the results of the site visits cannot be generalized to all allocating agencies, they provided insight into the ways in which agencies implemented various LIHTC requirements.

³National Council of State Housing Agencies, State HFA Factbook: 2012 NCSHA Annual Survey Results (Washington, D.C.: 2014). We chose this group because it represents allocating agencies and advocates affordable housing.
During our visits, we conducted a file review of a nongeneralizable set of projects at each allocating agency to collect information about agency practices as well as compliance with program requirements. We used a random sample method to select files based on the full list of applicants that were awarded tax credits in 2013, the full list of projects placed-in-service in 2013, and the full list of projects that were inspected in 2013 and any noncompliance issues found. We assessed the reliability of the databases that contained the information at each allocating agency by reviewing documentation (such as data dictionaries and database manuals) and interviewing the relevant officials responsible for administering and overseeing the databases. We determined the data were reliable for the purpose of selecting files for our review. For the file review, we also used a checklist to help ensure that we were capturing consistent and pertinent information from each file. For example, in developing the checklist, we reviewed Section 42 of the Internal Revenue Code (Code) as well as Department of the Treasury (Treasury) regulations to help ensure we could document relevant information that evidenced agency compliance with federal requirements.

To describe how allocating agencies award LIHTCs, we reviewed the Code, Treasury regulations, and guidance. During our site visits, we interviewed agency officials for information on how the agencies develop and apply selection criteria in reviewing applications and awarding tax credits to developers. We also conducted file reviews at each of the selected agencies—for a total of six approved applications (or all approved applications, if less than six were selected in the 2013 allocation round)—to determine what information and documentation developers submitted with their applications, and how allocating agencies reviewed and scored the applications. Using the checklist, we reviewed how agencies met Code requirements for market studies, extended use agreements, and local government notifications. To identify any issues the IRS faces in overseeing allocating agencies awarding LIHTCs, we interviewed officials from IRS and Treasury to discuss agencies’ practices and any guidance issued. We also reviewed federal internal control standards to identify key activities that help ensure that compliance with applicable laws and regulations is achieved.4 We also interviewed officials from HUD’s Office of Fair Housing and Equal Opportunity to gain their

Appendix I: Objectives, Scope, and Methodology

To describe how allocating agencies assess the reasonableness of development costs and financial feasibility of LIHTC properties, we reviewed the Code, Treasury regulations and guidance, and best practices from NCSHA.\(^5\) We conducted interviews at the nine agencies to obtain perspectives on how the agencies assess the reasonableness of development costs and financial feasibility, including the types of cost limits that were established, how required cost certifications were documented, and how cost overruns were handled. We also conducted a file review at each of the agencies for three approved applications from 2013 and three developments that were placed-in-service in that year to determine how allocating agencies analyzed project feasibility and viability. Using the checklist, we reviewed the agencies’ determinations of credit amounts as well as how agencies met the Code requirement to determine credit amounts at three points in time (at application, allocation, and placed-in-service). To identify any issues the IRS faces in overseeing allocating agencies assessing the reasonableness of costs, we interviewed officials from IRS and Treasury about agencies’ practices for assessing the reasonableness of development costs and financial feasibility of LIHTC properties. We also reviewed federal internal control standards to identify key activities that help program managers achieve desired results through effective stewardship of public resources.\(^6\) We also interviewed HUD officials from the Office of Fair Housing and Equal Opportunity and from the Office of Multifamily Housing Programs to gain perspectives on development cost limits and the use of basis boosts in the LIHTC program.

To evaluate how allocating agencies monitor LIHTC properties’ compliance with program requirements, we reviewed the Code, Treasury regulations, and IRS guidance that describe federal requirements for such monitoring. We also reviewed IRS documentation on its roles and responsibilities in overseeing allocating agencies and taxpayers. We conducted interviews at the nine agencies to obtain perspectives on how


\(^6\)GAO/AIMD-00-21.3.1.
the agencies met Code requirements for physical inspections and file reviews, communicated inspection findings to property owners, and transmitted noncompliance findings to IRS using Form 8823. We conducted a file review at each of the agencies for six developments that were inspected in 2013 and reviewed any prior inspections and annual certifications the developments had on file. Using the checklist, we identified and reviewed the frequency of inspections, any noncompliance findings, and how they were resolved, as detailed in the files. To identify any issues the IRS faces in overseeing allocating agencies’ compliance monitoring of LIHTC properties, we reviewed IRS’s processes for identifying and conducting audits on taxpayers claiming LIHTCs and conducted a site visit to the IRS Low-Income Housing Credit Compliance Unit in Philadelphia, Pennsylvania, to observe how submitted forms were processed. We interviewed officials from IRS and Treasury about agencies’ practices for submitting Form 8823 and how IRS records information in its Low-Income Housing Credit database. We also reviewed federal internal control standards to identify key activities that help ensure that compliance with applicable laws and regulations is achieved.7 We interviewed HUD officials from the Real Estate Assessment Center (REAC) to discuss the databases they manage and their efforts to collect information on LIHTC properties, as well as officials from the Office of Policy Development and Research about how HUD uses the data it collects. Lastly, we interviewed HUD officials involved in the Rental Policy Working Group to obtain updates on the interagency effort to consolidate required physical inspections of subsidized rental housing.

We conducted this performance audit from February 2014 to May 2016 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

7GAO/AIMD-00-21.3.1.
Appendix II: Comments from the Internal Revenue Service
Appendix II: Comments from the Internal Revenue Service

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

April 12, 2016

Daniel Garcia-Diaz
Director, Financial Markets and Community Investment
United States Government Accountability Office
Washington, DC 20548

Dear Mr. Garcia-Diaz:

Thank you for the opportunity to review your draft report entitled, "Low-Income Housing Tax Credit: Some Agency Practices Raise Concerns and IRS Could Improve Noncompliance Reporting and Data Collection (GAO-16-360 and GAO-16-421SU)." Your report examined how state allocating agencies administer the Low Income Housing Tax Credit (LIHTC) and, as part of this review, you identified oversight issues related to these areas.

As your report notes, the LIHTC is the largest source of federal assistance for developing affordable rental housing. The Internal Revenue Service administers the program in conjunction with the state Housing Finance Agencies (HFAs) or "allocating agencies". Each state receives an annual amount of LIHTCs computed using a statutory formula based on the state's population. The allocating agencies are state-chartered authorities that competitively award portions of the state credit to owners of qualified rental housing projects that reserve all or a portion of their units for low income tenants. As you note, under the relevant statute and regulations, the state allocating agencies are responsible for the day-to-day administration of the LIHTC program. Specifically, the allocating agencies award LIHTC, determine whether development costs are reasonable and development plans are feasible; and monitor LIHTC property compliance with program requirements. As part of these responsibilities, state allocating agencies are required to inspect properties. When properties are not in compliance, the state agencies are required to notify the IRS using Form 8223. State agencies also are required to annually report a summary of compliance monitoring activities to IRS on Form 8610.

As acknowledged by GAO in its prior report titled "Low-Income Housing Tax Credit: Joint IRS-HUD Administration Could Help Address Weaknesses in Oversight" (GAO-15-330), we provide extensive information to the state allocating agencies through our Audit Technique Guide (ATG) for Completing Form 8823, including information about when desk audits, site visits and file reviews should be performed and how to determine noncompliance in health and safety standards, rent ceilings, income limits and tenant qualifications. Our compliance unit reviews the Forms 8823 and 8610 submitted to the Service. The Office of Chief Counsel also reviews all Forms 8610. All cases that reflect
potential taxpayer non-compliance are further reviewed by our technical specialist, and cases that require additional compliance efforts are assigned to our compliance personnel.

We agree that we should improve noncompliance reporting and data collection; however, as noted in response to your prior audit, significant resource constraints have affected the IRS’s ability to implement a wide range of improvement in procedures and controls, including improving our database. Despite this impediment, we are currently working to obtain an updated server and programs that will allow us to better collect and analyze the data. We agree that it may be helpful to receive more consistent information on LIHTC noncompliance, and will explore options to clarify when allocating agencies should report noncompliance, building disposition or other information on the Form 8823.

Your report recommends that the Service participate in the Department of Housing and Urban Development (HUD)’s Rental Policy Working Group, physical inspection alignment initiative. However, we note that this group was established by the White House to address fair housing concerns and cannot address tax matters. Currently, our staff is very limited, and before participating in such a working group, we must ensure that the benefits of participation in such a group outweigh the resources required. Likewise, significant resource constraints impact our ability both to evaluate the use of the HUD Real Estate Assessment Center (REAC) information and further implementing changes based on that evaluation. Moreover, we note that the REAC information has limitations. Specifically, not all states are involved in the REAC database and the REAC data contains properties that are not LIHTC properties. We will, however, evaluate whether the IRS could use HUD REAC databases to improve our administration of the LIHTC program, including the REAC information might be used to reassess reporting categories on the Form 8823.

We appreciate the valuable feedback you have provided. Responses to your specific recommendations are enclosed. If you have questions, please contact me, or a member of your staff may contact Shenita Hicks, Director, Examination, Small Business/Self-Employed Division at (240) 613-2849.

Sincerely,

[Signature]

John M. Dailymple
Deputy Commissioner for Services and Enforcement

Enclosure
Appendix II: Comments from the Internal Revenue Service

Enclosure

GAO Recommendations and IRS Responses to GAO Draft Report
Low-income Housing Tax Credit: Some Agency Practices Raise Concerns and IRS Could Improve Noncompliance Reporting and Data Collection (GAO-16-360 and GAO-16-421(SU))

Recommendation:
To receive more consistent information on LIHTC noncompliance, the IRS Commissioner should collaborate with the allocating agencies to clarify when allocating agencies should report such information on the Form 8823 (report of noncompliance or building disposition). Following the drafting of such clarification, the IRS Commissioner should collaborate with the Department of Treasury to help ensure that any new guidance is consistent with Treasury regulations.

Comment:
The IRS will explore options to clarify when allocating agencies should report noncompliance, building disposition or other information on the Form 8823. If published legal guidance is required, the Service would need to prioritize a proposal for such guidance compared to other guidance projects and thereafter would require approval by the Department of Treasury.

Recommendation:
To improve IRS’s understanding of the prevalence of noncompliance in the program and to leverage existing resources, the IRS Commissioner should ensure that staff from the Small Business/Self-Employed Division participate in physical inspection alignment initiative of the Rental Policy Working Group.

Comment:
Our staff is currently very limited. However, we will commit staff time to attend a few of the Working Group meetings to ascertain whether participation in the Working Group will provide IRS with potential benefits to our administration of the LIHTC program and whether participation is a cost effective use of our limited staff resources.

Recommendation:
To improve IRS’ processes for identifying the most significant noncompliance issues, the IRS Commissioner should evaluate how the IRS could use HUD’s REAC databases, including how the information might be used to reassess reporting categories on the Form 8823 and to reassess which categories of noncompliance information have to be reviewed for audit potential.
2

Comment:
We will evaluate how the IRS could use HUD REAC databases to improve our administration of the LIHTC program, including how the REAC information might be used to reassess reporting categories on the Form 8823. However, the extent of the evaluation is constrained by our limited staff. Moreover, the extent of the potential use of any information is not only limited by our staff but also is predicated on our current efforts to obtain a new server and database with expanded functionality.
April 12, 2016

Mr. Daniel Garcia-Diaz
U.S. Government Accountability Office
441 G Street NW
Washington, DC 20548-0001

Dear Mr. Garcia-Diaz,

On behalf of the U.S. Department of Housing and Urban Development (HUD), I would like to thank you for the opportunity to review the report, "Low-Income Housing Tax Credit: Some Agency Practices Raise Concerns and IRS Could Improve Noncompliance Reporting and Data Collection." The report is an important follow-up to the July 2015 GAO report, "Low-Income Housing Tax Credit: Joint IRS-HUD Administration Could Help Address Weaknesses in Oversight (GAO-15-330)."

The Low-Income Housing Tax Credit (LIHTC) is one of the federal government’s most important affordable housing delivery mechanisms. It is authorized and codified in the U.S. tax code and administered by the Internal Revenue Service (IRS) within the Department of Treasury (Treasury). As this report notes, HUD also has statutorily established responsibility related to LIHTC, which is discussed below.

HUD has oversight, enforcement and rulemaking authority under the Fair Housing Act, which applies to private market as well as government subsidized and insured housing, and includes LIHTC. HUD has as a Memorandum of Understanding with the Treasury and the Department of Justice "in a cooperative effort to promote enhanced compliance with the Fair Housing Act for the benefit of residents of low-income housing tax credit properties and the general public." HUD continues to work with the IRS in an effort to improve oversight and compliance with fair housing and civil rights requirements in LIHTC.

The specific concerns referenced in the report have previously been communicated to IRS and Treasury, including through the interagency Rental Policy Working Group (RPWG). The RPWG was established in 2010 at the direction of the White House Domestic Policy Council and includes staff from the Office of Management and Budget and the U.S. Departments of Housing and Urban Development, Agriculture (USDA), and the Treasury. The goal of the RPWG is to better


align rental housing policy, including fair housing, among federal agencies that operate housing programs and to reduce administrative burden for state and local housing agency partners and private housing providers. The physical inspection pilot is just one example of the RPWG’s ongoing efforts to align requirements among the critical affordable housing programs administered by different federal agencies. As this report notes, through the RPWG, HUD has shared fair housing concerns with the use of local support requirements in Housing Finance Agency’s (HFAs) Qualified Allocation Plans (QAPs).

HUD also has program and oversight responsibilities for a significant number of individual housing developments that have both LIHTC units and units assisted with HUD programs. HUD programs that are often used together in conjunction with LIHTC include the Section 8 Housing Choice Voucher program, the HOME Investment Partnerships program, Community Development Block Grants, and FHA Insurance. LIHTC is also often used as a critical affordable housing preservation and rehabilitation tool for both public housing and the Project-based Section 8 program.

In addition, HUD’s Real Estate Assessment Center (REAC) operates a comprehensive, systematic physical inspection protocol for many of HUD’s largest housing subsidy programs, many of which often overlap with LIHTC. As the report notes, HUD is currently engaged in both expanding and streamlining physical inspections of LIHTC subsidized development through the auspices of the Rental Policy Working Group’s inspection pilot. The goal of the inspection pilot is to reduce administrative burden of potential duplication of regulatory compliance with multiple federal programs. By reducing administrative costs for state and local HFAs and housing providers themselves, greater efficiencies can be achieved to improve delivery of affordable housing for the families who rely on it. HUD will continue to work with the IRS and the Treasury, and notes that the IRS has been instrumental in helping ensure the success of this pilot, including through the issuance of guidance to the State Housing Finance Agencies involved in the pilot.

Finally, HUD’s Office of Policy Development and Research provides a number of important interagency support functions related to LIHTC. These support functions include designating “Qualified Census Tracts” and “Difficult Development Areas” pursuant to the LIHTC statute, collecting and disseminating information and data on LIHTC assisted households and developments, and conducting research.

With regard to the broader recommendations from GAO’s July 2015 report, particularly with respect to enhanced interagency coordination, HUD remains supportive of mechanisms to use

3 For more information on the RPWG, see https://www.huduser.gov/portal/aff_rental/home.html
5 For information on the characteristics of LIHTC assisted tenants, see PD&R “Understanding Whom the LIHTC Program Serves: Tenants in LIHTC Units as of December 31, 2012” available online at: https://www.huduser.gov/portal/publications/hsgfin/understanding_LIHTC.html
6 For information on project characteristics (e.g. locations, units, placed in service dates, etc.), see the LIHTC database online at https://www.huduser.gov/portal/datasets/lihtc.html
7 See, for example, Effect of QAP Incentives on the Location of LIHTC Properties (http://www.huduser.org/portal/publications/pdf/QAP_incentive_mdrt.pdf)
the Department’s significant expertise and experience administering housing programs for enhanced effectiveness of LIHTC. Enhanced interagency coordination could better ensure compliance with fair housing requirements and improve alignment of LIHTC with national housing priorities.

Please do not hesitate to contact me if I can be of further assistance.

Sincerely,

Katherine M. O’Regan
Assistant Secretary
Office of Policy Development & Research
Appendix IV: Comments from the National Council of State Housing Agencies
April 6, 2016

Mr. Daniel Garcia-Diaz
Director
Financial Markets and Community Investment
United States Government Accountability Office
441 G Street, N.W.
Washington, DC 20001

Dear Mr. Garcia-Diaz:

Thank you for giving the National Council of State Housing Agencies (NCSHA) the opportunity to comment on the U.S. Government Accountability Office’s (GAO) draft of its report on state agency administration of the Low Income Housing Tax Credit (Housing Credit). As you know, NCSHA represents the Housing Finance Agencies (HFA) of every state and the agencies that administer the Housing Credit in the few states where the HFA does not. We appreciate GAO’s willingness to consult with NCSHA as it continues to study the Housing Credit program.

While the report’s title indicates that certain agency practices raise concerns, we are pleased that the body of the report suggests that, as we anticipated, states are administering the Housing Credit program in a manner largely consistent with federal laws and regulations, and in many cases, going above and beyond those requirements. GAO points out that states fulfill program requirements in different ways. These variations in approach are in keeping with Congress’s intent upon establishing the program to devolve much program design and decision-making to the states instead of adopting a Washington-driven, one-size-fits-all approach to its administration.

Although the report focuses mostly on state administration of the Housing Credit, we note that GAO’s recommendations for executive action focus exclusively on Internal Revenue Service (IRS) oversight of the program—specifically encouraging IRS to work more closely with states to clarify when they should report noncompliance, participate more directly in the physical inspection alignment initiative of the Administration’s Rental Policy Working Group, and make better use of HUD’s Real Estate Assessment Center (REAC) databases. We believe that it is indicative of strong state performance and the success of the state administration model that, after such extensive review of state administration, including studying all agencies’
Qualified Allocation Plans (QAP) and conducting more in depth analysis of the practices of nine agencies, GAO did not find it necessary to direct any recommendations to the states for improving their practices.

**NCSHA and Its HFA Members**

NCSHA represents the HFAs of the 50 states, the District of Columbia, New York City, Puerto Rico, and the U.S. Virgin Islands. HFAs are governmental and quasi-governmental, nonprofit agencies created by their jurisdictions to address the full spectrum of housing need, from homelessness to homeownership. HFAs are dedicated to their common affordable housing mission, reinvest their earnings in the furtherance of that mission, and are publicly accountable.

HFAs have established over many decades a track record of outstanding performance in affordable housing finance. Recognizing HFAs’ strong practices and results, Congress and the Administration have entrusted to states the administration of many federal housing programs, including the Housing Credit, tax-exempt private activity Housing Bonds, Section 8, the HOME Investment Partnerships (HOME) program, and the Housing Trust Fund.

**The Housing Credit’s Decentralized Program Structure and the Role of NCSHA’s Recommended Practices**

Congress wisely and with great foresight designed the Housing Credit to achieve a limited but important and appropriate set of federally established, public-purpose goals and imperatives, including income targeting and long-term affordability. It left to the states how to utilize this resource within these broad parameters to respond most effectively to their low-income housing needs and priorities, recognizing that locally driven housing solutions are far more effective than top-down, nationwide policies.

This delegation of authority to the states to administer a major federal tax program is unique and unprecedented. In making it, Congress recognized the value of decentralized decision-making concerning each state’s low-income housing needs, but also appropriately imposed guidelines states must follow in selecting the developments to which they allocate Housing Credits, evaluating the financial needs and feasibility of those properties, and monitoring them for compliance. The states take these responsibilities very seriously.

To further strengthen Housing Credit administration without undermining state decision-making, state allocating agencies have come together through NCSHA to develop recommended practices in Housing Credit allocation, underwriting, and compliance monitoring. GAO references NCSHA’s recommended practices and their implementation by states multiple times throughout this report.
Appendix IV: Comments from the National Council of State Housing Agencies

NCSHA’s recommended practices are voluntary standards that states may either adopt or adapt to best meet their own needs and circumstances. They are not meant to intrude on the discretion Congress wisely left to each state to administer the program in a manner that is most responsive to its housing needs.

We include this information in our comments because we believe it is imperative that GAO, Congress, and the public at large consider GAO’s findings in this report in the context of the program’s intended design as a decentralized model of administration. This model has been key to the Credit’s success over the last three decades. Moreover, it is important that readers of the report understand that NCSHA’s recommended practices, which the states and we developed without a congressional mandate to do so, support this model.

Preferences and Selection Criteria in QAPs

Based on its review of QAPs, GAO finds that states did not consistently include all statutorily established preferences and selection criteria in their QAPs as required by law. However, as GAO acknowledges, allocating agencies often incorporate this information into other Housing Credit program documents—including competitive scoring criteria, underwriting guidelines, design and construction standards, or other state regulations—or implement the requirements in practice. Moreover, GAO notes that while five of the nine states it visited for this study were among those that did not explicitly include all preferences and selection criteria in their QAP, all five were able to provide GAO documentation demonstrating how they met these requirements in practice.

As GAO understands from its review, states structure their QAPs differently. While some agencies incorporate all Housing Credit requirements into the QAP, others have multiple documents that govern Credit allocations. These variations result from a number of factors, including for example, the agency’s relationship to state government and state requirements for public approval.

NCSHA encourages GAO and others to view QAPs broadly as a collection of documents that include not just the state’s official QAP, but also other related publicly available documents that outline the state’s priorities, policies, and allocation practices. However, should Congress feel that the preferences and selection criteria must be addressed in the QAP itself, even if they are also included in other documentation, NCSHA will work with states to ensure that they adopt this practice.

Local Letters of Support

As the report points out, a minority of allocating agencies require a letter of support from a local official as a threshold requirement for receiving Credits or award points in the scoring process for such letters. This practice goes beyond the statutory requirement to notify
and provide a comment opportunity to the leadership of the local jurisdiction in which a proposed property would be located.

Some agencies maintain that local support can make it more likely that a property will be placed in service within the time period required by law because it is likely to move more quickly through the development process without delays associated with zoning and permitting requirements. However, over the years, many agencies have done away with local support requirements due to concerns that they may have the unintended effect of giving localities veto authority over projects, raising fair housing concerns. In fact, the report notes that four of the six agencies that GAO visited that had such criteria in their QAPs had concerns about these practices and were taking steps to change how they use local letters of support in their Housing Credit awards processes.

In July 2015, the Poverty & Race Research Action Council (PRRAC) issued a report on civil rights best practices in Housing Credit administration, in which it analyzed the most recent QAPs for each state, and compared QAP practices with a similar analysis PRRAC conducted in 2008. PRRAC found that local support continues to factor into some QAPs, but that overall, states are placing less emphasis on local support by, for example, shifting from threshold requirements to providing only a small number of points for local support letters.

At this time, NCSHA’s recommended practices do not address the practice of requiring or providing points for local letters of support. As we consider updates to those recommended practices, NCSHA will consult with our members to determine whether it would be helpful to address this issue.

Development Cost Containment Efforts

One of the most critical responsibilities of state allocating agencies is to ensure that the Housing Credit dollar amount each property receives does not exceed the amount the agency deems necessary for financial feasibility and that property development and operating costs are reasonable. As such, agencies have adopted numerous cost containment procedures and limits, which they balance against other policy objectives that might result in higher costs—for example, serving the lowest income households, using durable materials to reduce long-term upkeep needs, locating projects in higher opportunity areas, and instituting energy efficiency measures.

GAO’s report explains how each of the nine agencies it visited determine the amount of Credits to allocate to properties in order to avoid over-subsidization. The report also describes how NCSHA’s recommended practices in Housing Credit allocation and underwriting address various cost containment strategies, including per unit cost limits, Credit award restrictions, and developer and builder fee limits.
Appendix IV: Comments from the National Council of State Housing Agencies

As discussed earlier, NCSHA’s recommended practices are voluntary standards that agencies may adapt to achieve the same objectives. For example, NCSHA’s recommended practices suggest that agencies should adopt per-unit cost limit standards based on total development costs. While some agencies use a per-unit standard, others base cost limits on square footage or number of bedrooms per unit. Other agencies may not have specific cost limits, but provide scoring incentives for lower cost projects or limit eligible basis as cost control measures.

GAO’s statement that, “Fourteen of the 58 QAPs we reviewed stated that total development costs, development costs per unit, or development costs per square foot were assessed against limits the agencies established for these cost categories” could mislead readers, causing them to assume that most agencies have not established development cost controls. While GAO goes on to describe other avenues for cost containment (limits to total Credit awards, limits to fees for developers, and limits to fees for builders), it does not note that in some instances states have determined reductions in basis or scoring incentives to be the best way for them to control costs. Moreover, GAO only reviewed cost containment requirements contained in state QAPs, and cost limitations are often located in other related documents instead of the QAP.

In 2013, NCSHA informally surveyed its members to learn more about their cost containment practices. We found that the vast majority of states have incorporated cost limits into their QAPs or related documents. Others have adopted internal cost limits but do not publish them to prevent developers from factoring them into their cost projections—thereby possibly pricing projects at the utmost limit of what a given state allows. States continue to refine cost policies in response to construction cost trends and other market forces.

**State-Determined Basis Boost**

In establishing the Housing Credit, Congress recognized that in some instances properties might need additional equity to achieve financial feasibility, and thus allowed a 30 percent basis boost for projects located in certain areas identified as Qualified Census Tracts (QCTs) or Difficult Development Areas (DDAs). Congress later amended the Code as part of the Housing and Economic Recovery Act (HERA) of 2008 to authorize allocating agencies to award a basis boost to Housing Credit properties located outside of QCTs and DDAs if the state determines the property needs the boost for financial feasibility. This provision offers important and necessary discretion to state agencies. Their prudent use of the basis boost has made feasible some of the most difficult to finance properties, including properties with units set aside for extremely low-income or formerly homeless households.

The state-determined basis boost is especially critical in the current resource-constrained environment when many funding sources traditionally used to fill financing gaps in Housing Credit developments have incurred significant cuts. Probably the most egregious example of this is the HOME program, which has suffered a 50 percent decline in funding since 2010.
Many HFAs have also seen reductions to state-level resources that in past years they could rely on to help finance Housing Credit projects. The state-determined basis boost has allowed allocating agencies to provide more Credit equity to these properties so that the lack of other resources does not prevent them from moving forward.

GAO’s report states, “Section 42 does not require allocating agencies to document their analysis for financial feasibility (with or without the basis boost). However, HERA’s legislative history included expectations that allocating agencies would set standards in their QAPs for which projects would be allocated additional credits, communicate the reasons for designating such criteria, and publicly express the basis for allocating additional credits to a project.” In making these two consecutive statements, GAO seems to confuse the financial feasibility analysis with standards states may set for eligibility for the discretionary basis boost, which are two distinct concepts.

Regardless of whether or not a state provides a basis boost to a particular project, it is required to ensure that it allocates no more Credits than are necessary for that project’s financial feasibility. The flexibility to provide properties with a basis boost does not alter states’ responsibilities in this regard, and the criteria a state may set for awarding the basis boost is irrelevant to that responsibility. States apply the same rigor and discipline to analyzing the financial feasibility of projects eligible to receive the discretionary basis boost as they do to all other projects.

With regard to the basis boost eligibility, nothing in law or regulation requires states to publish their criteria for award. As GAO points out, House report language expresses an expectation that states establish in their QAPs criteria and the reasoning behind that criteria for allowing the basis boost. However, House report language does not carry the force of law.

NCSHA has addressed this issue with a recommended practice that generally follows the House report suggestion to states to include criteria for awarding the basis boost in their QAPs. However, as noted previously, NCSHA’s recommended practices are voluntary, and we caution GAO or others against holding states to any standard that is higher than that required by law.

GAO criticizes IRS for not providing guidance to agencies on how to determine the need for the additional basis to make the project financially feasible and for not reviewing the criteria allocating agencies use to determine eligibility for the discretionary basis boost. However, nothing in the law directs IRS to undertake either of these actions. IRS is correct in its observation (as noted in the GAO report) that Congress gave this discretion to allocating agencies, not to IRS; consistent with the decentralized design of the program.

GAO goes on to suggest that if Congress were to provide HUD with joint authority over the program, it would be appropriate for HUD to provide guidance on discretionary basis boosts and regularly review allocating agencies’ criteria for awarding them. We strongly
disagree with this suggestion. Congress did not intend to give IRS, HUD, or any other federal agency control over either the criteria states use in permitting the basis boost or the analysis states undertake to determine if any basis boost is necessary for financial feasibility. In fact, this flies in the face of the decentralized nature of the Housing Credit program. If Congress were to empower HUD in this regard, we believe HUD would micromanage state agency decisions and impose its will and priorities on those agencies in a way that would severely undermine states’ ability to meet their housing needs.

Compliance Monitoring

The GAO report shows how states are not only fulfilling the compliance monitoring requirements of the Housing Credit statute, but in many cases are going above and beyond those requirements. For example, states conduct inspections and file reviews more frequently than the law requires and implement policies to encourage compliance during the extended use period when investors are no longer at risk of Credit recapture.

GAO’s report raises no concerns about state compliance monitoring practices. This demonstrates how seriously states have taken the responsibilities bestowed on them by Congress, even exceeding congressional expectations without the need for additional federal bureaucratic oversight.

The report criticizes IRS for not providing clear guidelines to states on when to send IRS reports of noncompliance (Form 8823) identified during state compliance monitoring visits or desk reviews. Specifically, IRS guidance requires agencies to report any noncompliance issues found during a physical inspection or tenant file review, but also states that agencies should use professional judgement to identify “significant noncompliance issues.” As GAO points out, this has led to states adopting differing practices for submitting Form 8823 to IRS, with some agencies submitting far more reports of noncompliance than others depending on their interpretation of IRS guidance.

GAO’s report notes that the nine agencies it visited for this study not only have different policies in place determining when they file Form 8823 with the IRS, but also have adopted different practices regarding the timing of submissions and amounts of detail provided to IRS. GAO recommends that IRS collaborate with the allocating agencies to clarify when and how they should report such information on Form 8823. NCSHA and our HFA members would be pleased to work with IRS to do so in a manner that ensures compliance but also minimizes unnecessary reporting and paperwork.

Joint IRS-HUD Administration

In this report, GAO reiterates criticism of IRS that it made in its July 2015 report on IRS oversight of the Housing Credit program when it recommended that Congress consider designating HUD as a joint administrator of the program. At that time, NCSHA provided GAO
with comments respectfully disagreeing with that recommendation and explaining why joint IRS-HUD administration is not only unnecessary, but also would be counterproductive and could undermine the program’s effectiveness. Since GAO published that report, we have heard from others in the industry who believe that HUD oversight of the program would be disastrous, including investors who have said they would be less likely to invest in the Credit if HUD had significant involvement in its administration.

NCSHA continues to believe that introducing HUD as a co-administrator of the Housing Credit would substantially reduce program effectiveness and unnecessarily create a new level of bureaucratic red tape, slowing down the production process and causing uncertainty for private sector investors and developers who are so integral to the Credit’s success. We do not believe that HUD would bring value to the program that could not be achieved otherwise by providing additional resources to Treasury/IRS for program oversight. We also think it is unlikely that Congress would provide new resources to HUD for Housing Credit oversight, as GAO itself said would be necessary, if Congress were to involve HUD more significantly in this program.

GAO’s suggestion in this report that HUD should be empowered to provide guidance on discretionary basis boosts and regularly review agencies’ criteria for awarding them is especially troubling. This would be a complete departure from Congress’s design of the Housing Credit program and would allow HUD to impose its will on programmatic decisions that should be made at the state level.

As we stated in our comment on GAO’s previous report, if there are problems with Housing Credit administration, let us work together to define and solve them within the existing, successful program framework. GAO’s review of state administration in this current report seems to have found only minor areas of concern, which we and the states are happy to address.

In closing, we stand ready to work with IRS in any way that we can to continue to strengthen this enormously successful program. Thank you again for this opportunity to provide our perspective on GAO’s work.

Sincerely,

Barbara Thompson
Executive Director
Appendix V: GAO Contact and Staff Acknowledgments

GAO Contact

Daniel Garcia-Diaz, (202) 512-8678 or garciadiazd@gao.gov

Staff Acknowledgments

In addition to the individual named above Andy Finkel (Assistant Director), Christine Ramos (Analyst-in-Charge), Jordan Anderson, Jessica Artis, William R. Chatlos, Max Glikman, Anar Jessani, Elizabeth Jimenez, Stuart Kaufmann, John McGrail, Marc Molino, Ruben Montes de Oca, Anna Maria Ortiz, Nadine Garrick Raidbard, Barbara Roesmann, and MaryLynn Sergent made major contributions to this report.
Appendix VI: Accessible Data

Agency Comment Letters

Accessible Text for Appendix II: Comments from the Internal Revenue Service

Page 1

DEPUTY COMMISSIONER

DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

WASHINGTON, D.C. 20224

April 12, 2016

Daniel Garcia-Diaz

Director, Financial Markets and Community Investment

United States Government Accountability Office

Washington, DC 20548

Dear Mr. Garcia-Diaz:

Thank you for the opportunity to review your draft report entitled, “Low-Income Housing Tax Credit: Some Agency Practices Raise Concerns and IRS Could Improve Noncompliance Reporting and Data Collection (GAO-16-360 and GAO-16-421SU). Your report examined how state allocating agencies administer the Low Income Housing Tax Credit (LIHTC) and, as part of this review, you identified oversight issues related to these areas.

As your report notes, the LIHTC is the largest source of federal assistance for developing affordable rental housing. The Internal Revenue Service administers the program in conjunction with the state Housing Finance Agencies (HFAs) or “allocating agencies”. Each state
receives an annual amount of LIHTCs computed using a statutory formula based on the state's population. The allocating agencies are state-chartered authorities that competitively award portions of the state credit to owners of qualified rental housing projects that reserve all or a portion of their units for low income tenants. As you note, under the relevant statute and regulations, the state allocating agencies are responsible for the day-to-day administration of the LIHTC program. Specifically, the allocating agencies award LIHTC, determine whether development costs are reasonable and development plans are feasible; and monitor LIHTC property compliance with program requirements. As part of these responsibilities, state allocating agencies are required to inspect properties. When properties are not in compliance, the state agencies are required to notify the IRS using Form 8223. State agencies also are required to annually report a summary of compliance monitoring activities to IRS on Form 8610.

As acknowledged by GAO in its prior report titled “Low-Income Housing Tax Credit: Joint IRS-HUD Administration Could Help Address Weaknesses in Oversight” (GAO-15-330), we provide extensive information to the state allocating agencies through our Audit Technique Guide (ATG) for Completing Form 8823, including information about when desk audits, site visits and file reviews should be performed and how to determine noncompliance in health and safety standards, rent ceilings, income limits and tenant qualifications. Our compliance unit reviews the Forms 8823 and 8610 submitted to the Service. The Office of Chief Counsel also reviews all Forms 8610. All cases that reflect potential taxpayer non-compliance are further reviewed by our technical specialist, and cases that require additional compliance efforts are assigned to our compliance personnel.

We agree that we should improve noncompliance reporting and data collection; however, as noted in response to your prior audit, significant resource constraints have affected the IRS's ability to implement a wide range of improvement in procedures and controls, including improving our database. Despite this impediment, we are currently working to obtain an updated server and programs that will allow us to better collect and analyze the data. We agree that it may be helpful to receive more consistent information on LIHTC noncompliance, and will explore options to clarify when allocating agencies should report noncompliance, building disposition or other information on the Form 8823.
Your report recommends that the Service participate in the Department of Housing and Urban Development (HUD)'s Rental Policy Working Group, physical inspection alignment initiative. However, we note that this group was established by the White House to address fair housing concerns and cannot address tax matters. Currently, our staff is very limited, and before participating in such a working group, we must ensure that the benefits of participation in such a group outweigh the resources required.

Likewise, significant resource constraints impact our ability both to evaluate the use of the HUD Real Estate Assessment Center (REAC) information and further implementing changes based on that evaluation. Moreover, we note that the REAC information has limitations. Specifically, not all states are involved in the REAC database and the REAC data contains properties that are not LIHTC properties. We will, however, evaluate whether the IRS could use HUD REAC databases to improve our administration of the LIHTC program, including the REAC information might be used to reassess reporting categories on the Form 8823.

We appreciate the valuable feedback you have provided. Responses to your specific recommendations are enclosed. If you have questions, please contact me, or a member of your staff may contact Shenita Hicks, Director, Examination, Small Business/Self-Employed Division at (240) 613-2849.

Sincerely,

John M. Dalrymple
Deputy Commissioner for Services and Enforcement

Enclosure

Page 3

GAO Recommendations and IRS Responses to GAO Draft Report

Low-Income Housing Tax Credit: Some Agency Practices Raise Concerns and IRS Could Improve Noncompliance Reporting and Data Collection (GAO-16-360 and GAO-16-421(SU))

Recommendation:
To receive more consistent information on LIHTC noncompliance, the IRS Commissioner should collaborate with the allocating agencies to clarify when allocating agencies should report such information on the Form 8823 (report of noncompliance or building disposition). Following the drafting of such clarification, the IRS Commissioner should collaborate with the Department of Treasury to help ensure that any new guidance is consistent with Treasury regulations.

Comment:

The IRS will explore options to clarify when allocating agencies should report noncompliance, building disposition or other information on the Form 8823. If published legal guidance is required, the Service would need to prioritize a proposal for such guidance compared to other guidance projects and thereafter would require approval by the Department of Treasury.

Recommendation:

To improve IRS's understanding of the prevalence of noncompliance in the program and to leverage existing resources, the IRS Commissioner should ensure that staff from the Small Business/Self-Employed Division participate in physical inspection alignment initiative of the Rental Policy Working Group.

Comment:

Our staff is currently very limited. However, we will commit staff time to attend a few of the Working Group meetings to ascertain whether participation in the Working Group will provide IRS with potential benefits to our administration of the LIHTC program and whether participation is a cost effective use of our limited staff resources.

Recommendation:

To improve IRS' processes for identifying the most significant noncompliance issues, the IRS Commissioner should evaluate how the IRS could use HUD's REAC databases, including how the information might be used to reassess reporting categories on the Form 8823 and to reassess which categories of noncompliance information have to be reviewed for audit potential.
Comment:

We will evaluate how the IRS could use HUD REAC databases to improve our administration of the LIHTC program, including how the REAC information might be used to reassess reporting categories on the Form 8823. However, the extent of the evaluation is constrained by our limited staff. Moreover, the extent of the potential use of any information is not only limited by our staff but also is predicated on our current efforts to obtain a new server and database with expanded functionality.

Accessible Text for Appendix III: Comments from the Department of Housing and Urban Development

Page 1

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

WASHINGTON, DC 20410-3000

April 12, 2016

Mr. Daniel Garcia-Diaz

U.S. Government Accountability Office

441 G Street NW

Washington, DC 20548-0001

Dear Mr. Garcia-Diaz,

On behalf of the U.S. Department of Housing and Urban Development (HUD), I would like to thank you for the opportunity to review the report, “Low-Income Housing Tax Credit: Some Agency Practices Raise Concerns and IRS Could Improve Noncompliance Reporting and Data Collection.” The report is an important follow-up to the July 2015 GAO report, “Low-Income Housing Tax Credit: Joint IRS-HUD Administration Could Help Address Weaknesses in Oversight (GAO-15-330).”
The Low-Income Housing Tax Credit (LIHTC) is one of the federal government's most important affordable housing delivery mechanisms. It is authorized and codified in the U.S. tax code and administered by the Internal Revenue Service (IRS) within the Department of Treasury (Treasury). As this report notes, HUD also has statutorily established responsibility related to LIHTC, which is discussed below.

HUD has oversight, enforcement and rulemaking authority under the Fair Housing Act, which applies to private market as well as government subsidized and insured housing, and includes LIHTC. HUD has as a Memorandum of Understanding with the Treasury and the Department of Justice "in a cooperative effort to promote enhanced compliance with the Fair Housing Act for the benefit of residents of low-income housing tax credit properties and the general public." HUD continues to work with the IRS in an effort to improve oversight and compliance with fair housing and civil rights requirements in LIHTC.

The specific concerns referenced in the report have previously been communicated to IRS and Treasury, including through the interagency Rental Policy Working Group (RPWG). The RPWG was established in 2010 at the direction of the White House Domestic Policy Council and includes staff from the Office of Management and Budget and the U.S. Departments of Housing and Urban Development, Agriculture (USDA), and the Treasury. The goal of the RPWG is to better align rental housing policy, including fair housing, among federal agencies that operate housing programs and to reduce administrative burden for state and local housing agency partners and private housing providers. The physical inspection pilot is just one example of the RPWG’s ongoing efforts to align requirements among the critical affordable housing programs administered by different federal agencies. As this report

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notes, through the RPWG, HUD has shared fair housing concerns with the use of local support requirements in Housing Finance Agency’s (HFAs) Qualified Allocation Plans (QAPs).

HUD also has program and oversight responsibilities for a significant number of individual housing developments that have both LIHTC units and units assisted with HUD programs. HUD programs that are often used together in conjunction with LIHTC include the Section 8 Housing Choice Voucher program, the HOME Investment Partnerships program, Community Development Block Grants, and FHA Insurance. LIHTC is also often used as a critical affordable housing preservation and rehabilitation tool for both public housing and the Project-based Section 8 program.

In addition, HUD’s Real Estate Assessment Center (REAC) operates a comprehensive, systematic physical inspection protocol for many of HUD’s largest housing subsidy programs, many of which often overlap with LIHTC. As the report notes, HUD is currently engaged in both expanding and streamlining physical inspections of LIHTC subsidized development through the auspices of the Rental Policy Working Group’s inspection pilot. The goal of the inspection pilot is to reduce administrative burden of potential duplication of regulatory compliance with multiple federal programs. By reducing administrative costs for state and local HFAs and housing providers themselves, greater efficiencies can be achieved to improve delivery of affordable housing for the families who rely on it. HUD will continue to work with the IRS and the Treasury, and notes that the IRS has been instrumental in helping ensure the success of this pilot, including through the issuance of guidance to the State Housing Finance Agencies involved in the pilot.4

Finally, HUD’s Office of Policy Development and Research provides a number of important interagency support functions related to LIHTC. These functions include designating “Qualified Census Tracts” and “Difficult Development Areas” pursuant to the LIHTC statute,5 collecting and disseminating information and data on LIHTC assisted households and developments, and conducting research.6

With regard to the broader recommendations from GAO’s July 2015 report, particularly with respect to enhanced interagency coordination, HUD remains supportive of mechanisms to use

3 For more information on the RPWG, see https://www.huduser.gov/portal/aff_rental/home.html
Appendix VI: Accessible Data


5 For information on the characteristics of LIHTC assisted tenants, see PD&R “Understanding Whom the LIHTC Program Serves: Tenants in LIHTC Units as of December 31, 2012” available online at: https://www.huduser.gov/pmtal/publications/hsgfin/understanding_LIHTC.html

For information on project characteristics (e.g. locations, units, placed in service dates, etc.), see the LIHTC database online at https://www.huduser.gov/portal/datasets/lihtc.html.

6 See, for example, Effect of QAP Incentives on the Location of LIHTC Properties (http://www.huduser.org/portal/publications/pdf/QAP_incentive_mdrt.pdf)

Page 3

the Department's significant expertise and experience administering housing programs for enhanced effectiveness of LIHTC. Enhanced interagency coordination could better ensure compliance with fair housing requirements and improve alignment of LIHTC with national housing priorities.

Please do not hesitate to contact me if I can be of further assistance.

Sincerely,

Katherine M. O'Regan
Assistant Secretary
Office of Policy Development & Research

Accessible Text for Appendix IV: Comments from the National Council of State Housing Agencies

Page 1

National Council of
State Housing Agencies

April 6, 2016

Mr. Daniel Garcia-Diaz Director

Financial Markets and Community Investment
Dear Mr. Garcia-Diaz:

Thank you for giving the National Council of State Housing Agencies (NCSHA) the opportunity to comment on the U.S. Government Accountability Office’s (GAO) draft of its report on state agency administration of the Low Income Housing Tax Credit (Housing Credit). As you know, NCSHA represents the Housing Finance Agencies (HFA) of every state and the agencies that administer the Housing Credit in the few states where the HFA does not. We appreciate GAO’s willingness to consult with NCSHA as it continues to study the Housing Credit program.

While the report’s title indicates that certain agency practices raise concerns, we are pleased that the body of the report suggests that, as we anticipated, states are administering the Housing Credit program in a manner largely consistent with federal laws and regulations, and in many cases, going above and beyond those requirements. GAO points out that states fulfill program requirements in different ways. These variations in approach are in keeping with Congress’s intent upon establishing the program to devolve much program design and decision-making to the states instead of adopting a Washington-driven, one-size-fits-all approach to its administration.

Although the report focuses mostly on state administration of the Housing Credit, we note that GAO’s recommendations for executive action focus exclusively on Internal Revenue Service (IRS) oversight of the program—specifically encouraging IRS to work more closely with states to clarify when they should report noncompliance, participate more directly in the physical inspection alignment initiative of the Administration’s Rental Policy Working Group, and make better use of HUD’s Real Estate Assessment Center (REAC) databases. We believe that it is indicative of strong state performance and the success of the state administration model that, after such extensive review of state administration, including studying all agencies’
Qualified Allocation Plans (QAP) and conducting more in depth analysis of the practices of nine agencies, GAO did not find it necessary to direct any recommendations to the states for improving their practices.

**NCSHA and Its HFA Members**

NCSHA represents the HFAs of the 50 states, the District of Columbia, New York City, Puerto Rico, and the U.S. Virgin Islands. HFAs are governmental and quasi-governmental, nonprofit agencies created by their jurisdictions to address the full spectrum of housing need, from homelessness to homeownership. HFAs are dedicated to their common affordable housing mission, reinvest their earnings in the furtherance of that mission, and are publicly accountable.

HFAs have established over many decades a track record of outstanding performance in affordable housing finance. Recognizing HFAs’ strong practices and results, Congress and the Administration have entrusted to states the administration of many federal housing programs, including the Housing Credit, tax-exempt private activity Housing Bonds, Section 8, the HOME Investment Partnerships (HOME) program, and the Housing Trust Fund.

**The Housing Credit's Decentralized Program Structure and the Role of NCSHA's Recommended Practices**

Congress wisely and with great foresight designed the Housing Credit to achieve a limited but important and appropriate set of federally established, public-purpose goals and imperatives, including income targeting and long-term affordability. It left to the states how to utilize this resource within these broad parameters to respond most effectively to their low-income housing needs and priorities, recognizing that locally driven housing solutions are far more effective than top-down, nationwide policies.

This delegation of authority to the states to administer a major federal tax program is unique and unprecedented. In making it, Congress recognized the value of decentralized decision-making concerning each state’s low-income housing needs, but also appropriately imposed guidelines states must follow in selecting the developments to which they allocate Housing Credits, evaluating the financial needs and feasibility of those properties,
and monitoring them for compliance. The states take these responsibilities very seriously.

To further strengthen Housing Credit administration without undermining state decision-making, state allocating agencies have come together through NCSHA to develop recommended practices in Housing Credit allocation, underwriting, and compliance monitoring. GAO references NCSHA’s recommended practices and their implementation by states multiple times throughout this report.

Page 3

NCSHA’s recommended practices are voluntary standards that states may either adopt or adapt to best meet their own needs and circumstances. They are not meant to intrude on the discretion Congress wisely left to each state to administer the program in a manner that is most responsive to its housing needs.

We include this information in our comments because we believe it is imperative that GAO, Congress, and the public at large consider GAO’s findings in this report in the context of the program’s intended design as a decentralized model of administration. This model has been key to the Credit’s success over the last three decades. Moreover, it is important that readers of the report understand that NCSHA’s recommended practices, which the states and we developed without a congressional mandate to do so, support this model.

Preferences and Selection Criteria in QAPs

Based on its review of QAPs, GAO finds that states did not consistently include all statutorily established preferences and selection criteria in their QAPs as required by law. However, as GAO acknowledges, allocating agencies often incorporate this information into other Housing Credit program documents—including competitive scoring criteria, underwriting guidelines, design and construction standards, or other state regulations—or implement the requirements in practice. Moreover, GAO notes that while five of the nine states it visited for this study were among those that did not explicitly include all preferences and selection criteria in their QAP, all five were able to provide GAO documentation demonstrating how they met these requirements in practice.

As GAO understands from its review, states structure their QAPs differently. While some agencies incorporate all Housing Credit
requirements into the QAP, others have multiple documents that govern Credit allocations. These variations result from a number of factors, including for example, the agency’s relationship to state government and state requirements for public approval.

NCSHA encourages GAO and others to view QAPs broadly as a collection of documents that include not just the state’s official QAP, but also other related publicly available documents that outline the state’s priorities, policies, and allocation practices. However, should Congress feel that the preferences and selection criteria must be addressed in the QAP itself, even if they are also included in other documentation, NCSHA will work with states to ensure that they adopt this practice.

**Local Letters of Support**

As the report points out, a minority of allocating agencies require a letter of support from a local official as a threshold requirement for receiving Credits or award points in the scoring process for such letters. This practice goes beyond the statutory requirement to notify and provide a comment opportunity to the leadership of the local jurisdiction in which a proposed property would be located.

Some agencies maintain that local support can make it more likely that a property will be placed in service within the time period required by law because it is likely to move more quickly through the development process without delays associated with zoning and permitting requirements. However, over the years, many agencies have done away with local support requirements due to concerns that they may have the unintended effect of giving localities veto authority over projects, raising fair housing concerns. In fact, the report notes that four of the six agencies that GAO visited that had such criteria in their QAPs had concerns about these practices and were taking steps to change how they use local letters of support in their Housing Credit awards processes.

In July 2015, the Poverty & Race Research Action Council (PRRAC) issued a report on civil rights best practices in Housing Credit administration, in which it analyzed the most recent QAPs for each state, and compared QAP practices with a similar analysis PRRAC conducted in 2008. PRRAC found that local support continues to factor into some QAPs, but that overall, states are placing less emphasis on local support
by, for example, shifting from threshold requirements to providing only a small number of points for local support letters.

At this time, NCSHA’s recommended practices do not address the practice of requiring or providing points for local letters of support. As we consider updates to those recommended practices, NCSHA will consult with our members to determine whether it would be helpful to address this issue.

Development Cost Containment Efforts

One of the most critical responsibilities of state allocating agencies is to ensure that the Housing Credit dollar amount each property receives does not exceed the amount the agency deems necessary for financial feasibility and that property development and operating costs are reasonable. As such, agencies have adopted numerous cost containment procedures and limits, which they balance against other policy objectives that might result in higher costs—for example, serving the lowest income households, using durable materials to reduce long-term upkeep needs, locating projects in higher opportunity areas, and instituting energy efficiency measures.

GAO’s report explains how each of the nine agencies it visited determine the amount of Credits to allocate to properties in order to avoid oversubsidization. The report also describes how NCSHA’s recommended practices in Housing Credit allocation and underwriting address various cost containment strategies, including per unit cost limits, Credit award restrictions, and developer and builder fee limits.

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As discussed earlier, NCSHA’s recommended practices are voluntary standards that agencies may adapt to achieve the same objectives. For example, NCSHA’s recommended practices suggest that agencies should adopt per-unit cost limit standards based on total development costs. While some agencies use a per-unit standard, others base cost limits on square footage or number of bedrooms per unit. Other agencies may not have specific cost limits, but provide scoring incentives for lower cost projects or limit eligible basis as cost control measures.
GAO’s statement that, “Fourteen of the 58 QAPs we reviewed stated that total development costs, development costs per unit, or development costs per square foot were assessed against limits the agencies established for these cost categories” could mislead readers, causing them to assume that most agencies have not established development cost controls. While GAO goes on to describe other avenues for cost containment (limits to total Credit awards, limits to fees for developers, and limits to fees for builders), it does not note that in some instances states have determined reductions in basis or scoring incentives to be the best way for them to control costs. Moreover, GAO only reviewed cost containment requirements contained in state QAPs, and cost limitations are often located in other related documents instead of the QAP.

In 2013, NCSHA informally surveyed its members to learn more about their cost containment practices. We found that the vast majority of states have incorporated cost limits into their QAPs or related documents. Others have adopted internal cost limits but do not publish them to prevent developers from factoring them into their cost projections—thereby possibly pricing projects at the upmost limit of what a given state allows. States continue to refine cost policies in response to construction cost trends and other market forces.

**State-Determined Basis Boost**

In establishing the Housing Credit, Congress recognized that in some instances properties might need additional equity to achieve financial feasibility, and thus allowed a 30 percent basis boost for projects located in certain areas identified as Qualified Census Tracts (QCT) or Difficult Development Areas (DDA). Congress later amended the Code as part of the Housing and Economic Recovery Act (HERA) of 2008 to authorize allocating agencies to award a basis boost to Housing Credit properties located outside of QCTs and DDAs if the state determines the property needs the boost for financial feasibility. This provision offers important and necessary discretion to state agencies. Their prudent use of the basis boost has made feasible some of the most difficult to finance properties, including properties with units set aside for extremely low-income or formerly homeless households.

The state-determined basis boost is especially critical in the current resource-constrained environment when many funding sources traditionally used to fill financing gaps in Housing Credit developments have incurred significant cuts. Probably the most egregious example of
this is the HOME program, which has suffered a 50 percent decline in funding since 2010.

Many HFAs have also seen reductions to state-level resources that in past years they could rely on to help finance Housing Credit projects. The state-determined basis boost has allowed allocating agencies to provide more Credit equity to these properties so that the lack of other resources does not prevent them from moving forward.

GAO’s report states, “Section 42 does not require allocating agencies to document their analysis for financial feasibility (with or without the basis boost). However, HERA’s legislative history included expectations that allocating agencies would set standards in their QAPs for which projects would be allocated additional credits, communicate the reasons for designating such criteria, and publicly express the basis for allocating additional credits to a project.” In making these two consecutive statements, GAO seems to confuse the financial feasibility analysis with standards states may set for eligibility for the discretionary basis boost, which are two distinct concepts.

Regardless of whether or not a state provides a basis boost to a particular project, it is required to ensure that it allocates no more Credits than are necessary for that project’s financial feasibility. The flexibility to provide properties with a basis boost does not alter states’ responsibilities in this regard, and the criteria a state may set for awarding the basis boost is irrelevant to that responsibility. States apply the same rigor and discipline to analyzing the financial feasibility of projects eligible to receive the discretionary basis boost as they do to all other projects.

With regard to the basis boost eligibility, nothing in law or regulation requires states to publish their criteria for award. As GAO points out, House report language expresses an expectation that states establish in their QAPs criteria and the reasoning behind that criteria for allowing the basis boost. However, House report language does not carry the force of law.

NCSHA has addressed this issue with a recommended practice that generally follows the House report suggestion to states to include criteria for awarding the basis boost in their QAPs. However, as noted previously, NCSHA’s recommended practices are voluntary, and we caution GAO or
others against holding states to any standard that is higher than that required by law.

GAO criticizes IRS for not providing guidance to agencies on how to determine the need for the additional basis to make the project financially feasible and for not reviewing the criteria allocating agencies use to determine eligibility for the discretionary basis boost. However, nothing in the law directs IRS to undertake either of these actions. IRS is correct in its observation (as noted in the GAO report) that Congress gave this discretion to allocating agencies, not to IRS, consistent with the decentralized design of the program.

GAO goes on to suggest that if Congress were to provide HUD with joint authority over the program, it would be appropriate for HUD to provide guidance on discretionary basis boosts and regularly review allocating agencies’ criteria for awarding them. We strongly disagree with this suggestion. Congress did not intend to give IRS, HUD, or any other federal agency control over either the criteria states use in permitting the basis boost or the analysis states undertake to determine if any basis boost is necessary for financial feasibility. In fact, this flies in the face of the decentralized nature of the Housing Credit program. If Congress were to empower HUD in this regard, we believe HUD would micromanage state agency decisions and impose its will and priorities on those agencies in a way that would severely undermine states’ ability to meet their housing needs.

Compliance Monitoring

The GAO report shows how states are not only fulfilling the compliance monitoring requirements of the Housing Credit statute, but in many cases are going above and beyond those requirements. For example, states conduct inspections and file reviews more frequently than the law requires and implement policies to encourage compliance during the extended use period when investors are no longer at risk of Credit recapture.

GAO’s report raises no concerns about state compliance monitoring practices. This demonstrates how seriously states have taken the responsibilities bestowed on them by Congress, even exceeding
congressional expectations without the need for additional federal bureaucratic oversight.

The report criticizes IRS for not providing clear guidelines to states on when to send IRS reports of noncompliance (Form 8823) identified during state compliance monitoring visits or desk reviews. Specifically, IRS guidance requires agencies to report any noncompliance issues found during a physical inspection or tenant file review, but also states that agencies should use professional judgement to identify “significant noncompliance issues.” As GAO points out, this has led to states adopting differing practices for submitting Form 8823 to IRS, with some agencies submitting far more reports of noncompliance than others depending on their interpretation of IRS guidance.

GAO’s report notes that the nine agencies it visited for this study not only have different policies in place determining when they file Form 8823 with the IRS, but also have adopted different practices regarding the timing of submissions and amounts of detail provided to IRS. GAO recommends that IRS collaborate with the allocating agencies to clarify when and how they should report such information on Form 8823. NCSHA and our HFA members would be pleased to work with IRS to do so in a manner that ensures compliance but also minimizes unnecessary reporting and paperwork.

**Joint IRS-HUD Administration**

In this report, GAO reiterates criticism of IRS that it made in its July 2015 report on IRS oversight of the Housing Credit program when it recommended that Congress consider designating HUD as a joint administrator of the program. At that time, NCSHA provided GAO with comments respectfully disagreeing with that recommendation and explaining why joint IRS-HUD administration is not only unnecessary, but also would be counterproductive and could undermine the program’s effectiveness. Since GAO published that report, we have heard from others in the industry who believe that HUD oversight of the program would be disastrous, including investors who have said they would be less likely to invest in the Credit if HUD had significant involvement in its administration.
NCSHA continues to believe that introducing HUD as a co-administrator of the Housing Credit would substantially reduce program effectiveness and unnecessarily create a new level of bureaucratic red tape, slowing down the production process and causing uncertainty for private sector investors and developers who are so integral to the Credit's success. We do not believe that HUD would bring value to the program that could not be achieved otherwise by providing additional resources to Treasury/IRS for program oversight. We also think it is unlikely that Congress would provide new resources to HUD for Housing Credit oversight, as GAO itself said would be necessary, if Congress were to involve HUD more significantly in this program.

GAO’s suggestion in this report that HUD should be empowered to provide guidance on discretionary basis boosts and regularly review agencies’ criteria for awarding them is especially troubling. This would be a complete departure from Congress’s design of the Housing Credit program and would allow HUD to impose its will on programmatic decisions that should be made at the state level.

As we stated in our comment on GAO’s previous report, if there are problems with Housing Credit administration, let us work together to define and solve them within the existing, successful program framework. GAO’s review of state administration in this current report seems to have found only minor areas of concern, which we and the states are happy to address.

In closing, we stand ready to work with IRS in any way that we can to continue to strengthen this enormously successful program. Thank you again for this opportunity to provide our perspective on GAO’s work.

Sincerely,

Barbara Thompson

Executive Director
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