Susan Montee, CPA

Missouri State Auditor

TAX CREDIT

Analysis of Affordable Housing Tax Credit Program

July 2008

Report No. 2008-47

auditor.mo.gov

Susan Montee, CPA
Missouri State Auditor

YELLOW SHEET

Improvement Needed in Affordable Housing Assistance Tax Credit Program Administration

This audit evaluated the Missouri Housing Development Commission's (MHDC) administration and the cost-effectiveness of the state's Affordable Housing Assistance Tax Credit (AHATC) Program. The credit is designed to induce contributions by business firms of cash, equity, professional services, and real or personal property to not-for-profit organizations involved in the construction or rehabilitation of specific developments that will have affordable housing units. For each fiscal year, $11 million in tax credits ($10 million for projects and $1 million for not-for-profit organization administrative costs unrelated to projects) are available for distribution. The credit is not to exceed 55 percent of the value of the contribution. This means for every $1 of AHATC issued, $1.82 in cash, property, or services goes toward affordable housing. MHDC records show that from fiscal year 1991 to 2007, an estimated $186 million has been donated through the AHATC Program, resulting in $102.3 million in AHATCs being issued. Approximately $72.5 million in tax credits has been redeemed through fiscal year 2007, leaving $29.8 million in credits outstanding. MHDC data shows 7,895 units of affordable housing have been placed in service from fiscal year 1991 through 2007 utilizing the tax credit. State law requires the State Auditor to perform a cost-benefit analysis of all state tax credit programs, and this report is part of ongoing work.

Evaluation of appraisals for donated properties needs improvement

MHDC did not adequately ensure the value of property donated through the AHATC. During 2006 and 2007, a not-for-profit organization received a donation of 20 apartment properties, containing 464 total units, with the donor receiving $5,092,007 in AHATCs (28 percent of tax credits issued for housing production during the period). Our review of appraisals for 3 of the 20 donated properties showed the method of calculating the value of the property was not consistent with other appraisals reviewed. An appraiser, who reviewed the appraisals at our request, told us the method used to appraise the value of these three properties was not consistent with the typical and accepted method used to value properties of this type. MHDC's appraiser also reviewed one of the appraisals at our request and concluded the appraisal was insufficient. He said he would have recommended sending the appraisal back to the appraiser for revision. One company performed all 20 appraisals for the properties donated. MHDC staff said they did not ask the staff appraiser to evaluate the appraisals on these properties at the time of the donation because they considered the donor's submitted appraisals sufficient. (See page 8)

Donated services need more evaluation

MHDC uses insufficient procedures to ensure the value of donated services. Our review of project files showed invoices from donors typically supported documentation of services provided; however, the invoices did not always include details such as the number of hours spent and the hourly rate charged for the services. (See page 9)

Use of AHATCs to fill LIHTC funding gaps provides minimal benefit

The AHATC is commonly used with projects receiving state and federal Low Income Housing Tax Credits (LIHTCs). For fiscal years 2006 and 2007, approximately 45 percent ($8.3 million) of production AHATCs went to projects that also received federal and state LIHTC funding. Of the $8.3 million in AHATCs combined with LIHTC projects, $1.6 million (19 percent) had been applied for and obtained to fill funding gaps or cover cost overruns in projects where LIHTCs had already been awarded with construction already underway. When state LIHTC funding is already being used to build rent restricted housing, the use of AHATCs in this manner provides minimal return to the state due to the limited number of units allocated for AHATC purposes. (See page 10)

Economic benefit overstated

The economic impact being reported to the General Assembly regarding AHATCs is overstated. For the fiscal year 2009 state budget process, the General Assembly received information showing 1,956 and 1,910 units of housing placed in service for 2006 and 2007, respectively. Data provided to us by MHDC shows only 698 and 546 AHATC units, respectively, actually placed in service during those years. MHDC staff said the number of units reported may have been total overall units, which would include LIHTC units as well as AHATC units. (See page 11)

All reports are available on our Web site: www.auditor.mo.gov

Contents

Abbreviations

AHATC	Affordable Housing Assistance Tax Credit
DED	Department of Economic Development
DOR	Department of Revenue
LIHTC	Low Income Housing Tax Credit
MHDC	Missouri Housing Development Commission
RDP	Rural Development Program
RSMo	Missouri Revised Statutes
SAO	State Auditor's Office

SUSAN MONTEE, CPA
Missouri State Auditor

Honorable Matt Blunt, Governor
and
Joint Committee on Tax Policy
and
Missouri Housing Development Commission
and
Pete Ramsel, Executive Director
Missouri Housing Development Commission
and
Gregory A. Steinhoff, Director
Department of Economic Development
Jefferson City, MO

State law mandates the State Auditor's office perform cost-benefit analyses on state tax credit programs. The audit objectives included (1) analyzing the costs and benefits of the Affordable Housing Assistance Tax Credit (AHATC) Program to determine if it is an effective and efficient use of state resources, (2) reviewing other states' AHATC programs for potential changes to Missouri's program, and (3) evaluating Missouri Housing Development Commission (MHDC) controls and procedures over management of the program.

We determined the AHATC has resulted in $186 million in cash, property, and services being donated toward affordable housing from 1991 through 2007. As a result, a total of $102 million in AHATCs have been issued over that timeframe. The audit found AHATCs are frequently used on projects also receiving Low Income Housing Tax Credit (LIHTC) funding. Management of the program needs improvement because current procedures (1) have not ensured proper valuation of donated property and services, (2) allow credits to be used to fill funding gaps on projects resulting in limited additional public benefit, (3) have not always ensured reasonable program costs, (4) allowed issuance of tax credits for projects not completed, and (5) have resulted in reporting of overstated program benefits to the General Assembly. Also, state law changes could benefit the program.

We conducted our audit in accordance with the standards applicable to performance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States with the exception of the external impairment of access to tax credit redemption data from income tax returns which limited our ability to conduct our work. Those standards require that we plan and perform our 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 such a basis. This report was prepared under the direction of John Blattel and John Luetkemeyer. Key contributors to this report included Jon Halwes, Robert Showers, and Travis Owens.

Susan Montee

Susan Montee, CPA
State Auditor

Introduction

The Affordable Housing Assistance Tax Credit (AHATC) Program started in 1990 and is established under Section 32.105 and Sections 32.111 to 32.115, RSMo. The tax credit has no expiration. The Missouri Housing Development Commission (MHDC)[1] manages the program which is designed to induce contributions by business firms[2] of cash, equity, professional services, and real or personal property to not-for-profit organizations involved in the construction or rehabilitation of specific developments that will have affordable housing units.

Tax credits can generally be broken into three categories. Some are established to create certain economic benefits, some are established to induce certain social benefits and others are created for both economic and social benefits. The AHATC is designed to create both economic and social benefits with more emphasis on social impact. The social impact of more and/or better housing can induce economic benefits in a community and the construction phase of projects produces at least short term economic impact.

To be eligible for an AHATC the contribution must be used in the acquisition, rehabilitation, or new construction of a site-specific development or to fund rental assistance for residents of a development. In some cases, the donation may provide assistance for administrative costs of the organization. The not-for-profit organization may be involved directly as part of the development team or it may assist a specific development through a grant or loan. Proposed housing must (1) meet a demonstrated affordable housing need, (2) provide housing for low income persons and families, (3) target housing for persons at or below 50 percent of area median income or provide market rate housing in "rebuilding communities" as defined by state law, and (4) meet economic feasibility guidelines.

Application and approval process

The tax credit approval process begins with the submission of an application from a not-for-profit organization for a specific housing development.

[1] The MHDC includes the Governor, Lieutenant Governor, Attorney General, State Treasurer and six persons appointed by the governor with the advice and consent of the Senate. An Executive Director manages MHDC operations. MHDC is part of the Department of Economic Development.

[2] Section 32.105, RSMo, defines business firm as a person, firm, a partner in a firm, corporation or a shareholder in an S corporation doing business in the state of Missouri and subject to the state income tax imposed by the provisions of chapter 143, RSMo, or a corporation subject to the annual corporation franchise tax imposed by the provisions of chapter 147, RSMo, or an insurance company paying an annual tax on its gross premium receipts in this state, or other financial institution paying taxes to the state of Missouri or any political subdivision of this state pursuant to the provisions of chapter 148, RSMo, or an express company which pays an annual tax on its gross receipts in this state.

MHDC will accept applications from July 1 through April 30 of each fiscal year. The application generally will describe the physical and financial characteristics of the development, the housing need being addressed, and the anticipated donations or contributions by business firms.

According to MHDC documents, after notifying the State Senator, State Representative and the Mayor of the district or community where the development will be located, allowing a 30 day comment period, and holding a public hearing, the MHDC will notify the sponsor regarding the approval or non-approval of the application for tax credits. If approved, the tax credit reservation letter will inform the sponsor of the tax credit amount reserved and that the donation can be made and accepted. The actual tax credit certification will be issued to the donor after (1) the donor submits evidence that the donation has been made and any required supporting documentation of the value of the donation, (2) the sponsor has submitted any other items or fees requested by the MHDC concerning the development,[3] and (3) the restrictive covenants are filed.

Tax credit limits and uses

The credit is not to exceed 55 percent of the value of the contribution. This means for every $1 of AHATC issued, $1.82 in cash, property, or services goes toward affordable housing. The AHATC may be sold or transferred, and may be used in the first year or carried forward for 10 years to offset future tax liability.[4] For each fiscal year beginning July 1, the amount of available AHATC is $11 million.[5] Generally, no single entity will be approved for tax credits in excess of $1 million for a particular project. The tax credits may be redeemed against state income tax, corporate franchise tax, financial institution tax, gross premiums receipt tax, and gross receipts of express companies tax.

Compliance requirements

Developments involving rental units which utilize AHATC funding will be subject to an affordability period of 10 years. During this affordability period, AHATC units must be rent restricted for families with a household income less than 50 percent of area median income. For any year during the affordability period, the owner of the affordable housing rental units shall certify to the MHDC that all tenants renting qualified units are income

[3] Such as evidence of ownership of the development site and completed tax credit certifications for each business or individual firm making a donation.

[4] Section 32.115, RSMo.

[5] Section 32.115, RSMo, limits annual tax credit issuances to $10 million for projects and $1 million to help cover administrative costs of not-for-profit organizations engaged in housing related activities. The tax credit issuance limit for projects started at $2 million and increased $2 million per year in subsequent fiscal years until reaching the current $10 million limit. The $1 million in credits for administrative costs began in 1997.

eligible. The MHDC is authorized, at its discretion, to audit the records and accounts of the owner to verify the certification. The MHDC compliance unit handles this function.

For owner occupied units, all single family home ownership developments approved by the MHDC are also subject to an affordability period of 10 years. For single family home ownership developments, any subsequent owner, except a lender with a security interest in the property, must also be income qualified under the guidelines established for this program. The acquisition price to any subsequent owner shall not exceed the acquisition price to the original owner at the time tax credits are first claimed by more than 5 percent annual appreciation.

Donation-based Housing Programs in Other States

Based on our review of other state programs, Missouri is one of six states which has a donation-based (charitable) housing tax credit and is one of three states which has implemented a charitable credit as well as a state Low Income Housing Tax Credit (LIHTC) Program. Of the states with a charitable housing tax credit, only Missouri and Connecticut limit donations from individuals. Connecticut does not allow any donations from individuals while Missouri limits participation to only individuals with farm or rental income. Missouri is also one of two states which allow services to be donated. Table 1.1 compares Missouri's AHATC to the other state charitable tax credit programs,[6] including the level of funding involved, the percentage of the donation awarded in credits, the types of donations allowed, and allowable donors.

Table 1.1: Donation-based Housing Tax Credit Programs

				Donations Allowed				Allowable Donors	
State	2007 Awards	2007 Per Capita	Credit Percent	Cash	Real Property	Personal Property	Services	Individual	Business
Connecticut	$10,000,000	$2.85	100	X					X
Missouri	10,461,228[2]	1.79	55	X	X	X	X	[1]	X
Illinois	16,591,660	1.29	50	X	X	X		X	X
Arkansas	750,000	0.27	30	X	X	X		X	X
New Mexico	490,250	0.25	50	X	X	X	X	X	X

[1] Missouri law allows contributions by business firms which are defined as a person, firm, a partner in a firm, corporation or a shareholder in an S corporation doing business in the state. Based on the law, MHDC requires individuals to have farm or rental income to be an eligible donor.

[2] Includes an award of $810,150 in tax credits not issued. The credits may still be issued if the not-for-profit organization completes the award process.

Source: Housing agency documentation and interviews with housing agency officials

[6] Vermont is not included in the Table 1.1. Vermont utilizes a program which awards tax credits to individuals or entities who invest in loan funds which provide low-interest rate loans to affordable housing developments.

Tax Credits Issued and Redeemed, Units Developed

MHDC records show that from fiscal year 1991 to 2007, an estimated $186 million has been donated through the AHATC Program, resulting in $102.3 million in AHATCs being issued. Approximately $72.5 million in tax credits has been redeemed through fiscal year 2007, leaving $29.8 million in outstanding tax credits.[7] For fiscal years 2004 through 2007 an average of $10.2 million has been issued annually, with an average of $7.5 million being redeemed each year. See Appendix I for detailed data on credits issued and redeemed.

According to MHDC data, 7,895 units of affordable housing have been placed in service from fiscal year 1991 through 2007 utilizing the AHATC. For fiscal years 2004 through 2007, an average of 606 AHATC units per year have been placed in service. Table 2.1 provides detail of the distribution of AHATCs by project type and funding for fiscal years 2006 and 2007.

Table 1.2: Distribution of AHATCs by Project Type and Funding - 2006 and 2007

Project Type	Number of Units	Percent of Total	Tax Credits[2]	Percent of Total
New	428	34.4	$7,845,443	42.5
Rehabilitation	522	42.0	3,972,103	21.5
Existing Units[1]	281	22.6	6,301,126	34.1
Other	13	1.0	340,450	1.9
Totals	1,244	100.0	$18,459,122	100.0

[1] Existing units refers to United States Department of Agriculture Rural Development Program properties donated to a not-for- profit organization. See page 8 for additional information.

[2] Includes only production credits. Amounts in Appendix I include both production and administrative credits.

Source: MHDC data and project applications

Scope and Methodology

Section 620.1300, RSMo, requires the State Auditor's office to analyze the cost-benefit impact to evaluate the effectiveness of all state tax credit programs.

To gain an understanding of the AHATC, we interviewed MHDC officials involved in the application and approval process as well as staff involved in monitoring the compliance of AHATC projects. We also discussed tax

[7] The amount of outstanding credits will be slightly overstated due to tax credit redemption data from early in the program being incomplete. DED and DOR staff could only provide tax credit redemption data back to fiscal year 1994. Also, the amount may include some credits which are no longer eligible for redemption due to time expiration. Current law does not require DOR to maintain this information.

credit redemptions with officials at the Department of Revenue (DOR) and the Department of Economic Development (DED).

We analyzed data on all 87 AHATC production projects for 2005 to 2007. In addition, we reviewed project files for five AHATC projects. As part of this review, we interviewed staff of the United States Department of Agriculture, Rural Development Program (RDP) and officials with the not-for–profit organization that received the donated RDP properties discussed in the report. We also interviewed the MHDC staff appraiser and an appraiser in the Kansas City area regarding appraisals on these properties. We reviewed appraisal documents for an additional four properties as a result of issues identified during that review.

To assess total AHATCs reserved, issued, redeemed, and outstanding, we obtained data from MHDC, DOR, and DED.

To determine how Missouri's AHATC compared to similar tax credits in other states, we reviewed housing agency documents and had discussions with housing agency officials in Arkansas, Connecticut, Illinois, New Mexico, and Vermont.

To understand how the economic impact of the AHATC is calculated, we met with a representative of the DED responsible for completing the economic impact budgetary documents for the tax credit. We also discussed with MHDC staff the assumptions provided to DED staff to calculate the economic impact of the AHATC.

We obtained aggregate totals of annual tax credit redemptions from the DOR. We were not provided detailed redemption information. The Director of the DOR denied us access due to the department's interpretation of the Missouri Supreme Court decision in the case of Director of Revenue v. State Auditor 511 S.W.2d 779 (Mo. 1974). This external impairment limited our ability to conduct work and therefore, we could not verify the completeness and accuracy of annual redemption totals.

Affordable Housing Assistance Program Could Be Improved

Management of the program needs improvement because current procedures (1) have not ensured proper valuation of donated property and services, (2) allow credits to be used to fill funding gaps on projects resulting in limited additional public benefit, (3) have not always ensured reasonable program costs, (4) allowed issuance of tax credits for projects not completed, and (5) have resulted in reporting of overstated program benefits to the General Assembly. Also, state law changes could benefit the program.

Value of Donations Not Always Ensured

MHDC did not adequately ensure the value of property and services donated through the AHATC. Donated properties are awarded AHATCs based on an appraisal of the property supplied by the donor. According to MHDC staff, no independent appraisal is performed, despite having an appraiser on staff.

During 2006 and 2007, a not-for-profit organization received a donation of 20 apartment properties, containing 464 total units, with the donor receiving $5,092,007 in AHATCs (28 percent of tax credits issued for housing production during the period). As part of the transaction, the not-for-profit organization took over the properties and assumed any existing federal program debt associated with the properties. The donor received tax credits equaling 55 percent of the appraised value of the properties, less any debt assumed by the not-for-profit organization. Appraisals obtained by the donor valued the properties at a total of $19,740,825,[8] or an average of $987,041 per property. According to officials of the not-for-profit organization, six of the properties have been renovated during 2006 and 2007 using LIHTC funding, and three have been approved to receive LIHTC funding in 2008. The official said none of the properties had central air or heat and all need complete renovation. MHDC officials said they approved the transactions to preserve the low income status of the properties that had been part of the United States Department of Agriculture RDP. That agency planned to foreclose on the properties if the transfer did not take place.

No independent appraisal of properties performed

Our review of appraisals for 3 of the 20 donated RDP properties showed the method of calculating the value of the property was not consistent with other appraisals reviewed. According to an interview with an experienced appraiser, the method used to appraise the value of these three properties was not consistent with the typical and accepted method used to value properties of this type. Using the typical appraisal method, a 137 unit, completely renovated, apartment complex in Kansas City, appraised for $1.26 million. In comparison, the method used to appraise the RDP

[8] The total appraised value was calculated from application documents, and includes donated operating reserves in addition to the value of the property in some cases.

properties concluded the value of a 13 year-old, 24 unit (not-renovated) rural apartment building, with no central air or heat, appraised for $1.18 million. MHDC's appraiser reviewed one of the RDP property appraisals at our request and concluded the appraisal was insufficient. He said he would have recommended sending the appraisal back to the appraiser for revision. One company performed all 20 appraisals for the RDP properties donated.

MHDC staff said they did not ask the staff appraiser to evaluate the appraisals on these properties at the time of the donation because they considered the donor's submitted appraisals sufficient. RDP staff estimated that in addition to the 20 properties donated by this donor, about 14 other rural properties had been contributed by other donors in prior years with the donors receiving AHATCs. The staff also said similar donations would likely take place in the future.

Donated services need more evaluation

MHDC uses insufficient procedures to ensure the value of donated services. Our review of project files showed invoices from donors typically supported documentation of services provided; however, the invoices did not always include details such as the number of hours spent and the hourly rate charged for the services. According to MHDC staff, the reasonableness of a service's value is determined based on staff's professional judgment, and is not verified through any other means. For example, in 2006 a not-for-profit organization received donated website design services with a billed value of $10,000, with the donating company receiving $5,500 in administrative tax credits. The invoice and supporting documentation had no detail of hours spent or an hourly rate being charged for the service. MHDC staff said they felt the value of the services was fair and did not ask for any additional detail. We contacted a web design firm who estimated the donated website had a value of about $5,000.

Use of an improved certification could help ensure value of services

New Mexico[9] housing agency staff told us they use an affidavit for donated services to help ensure the service is reasonably valued. The affidavit contains more specific language than the certification document used by MHDC, including a statement where the donor affirms the value of the services donated does not exceed the amount the donor charges for similar services to the general public in the ordinary course of the donor's business. The affidavit also includes a statement notifying the donor that false or misleading statements or other information in the application for the tax credits may result in both civil and criminal actions.

[9] New Mexico is the only other state which allows donations of services for housing credits.

The certification used by MHDC only requires that the donor affirm the value of the donation, although "value" is not defined, and confirms the not-for-profit organization received the donation.

Use of AHATCs to Fill LIHTC Funding Gaps Provides Minimal Benefit

The AHATC is commonly used with projects receiving state and federal LIHTCs. For fiscal years 2006 and 2007, approximately 45 percent ($8.3 million) of production AHATCs went to projects which also received federal and state LIHTC funding. Of the $8.3 million in AHATCs combined with LIHTC projects, $1.6 million (19 percent) had been applied for and obtained to fill funding gaps or cover cost overruns in projects where LIHTCs had already been awarded with construction already underway.

When state LIHTC funding is already being used to build rent restricted housing, the use of AHATCs in this manner provides minimal return to the state. MHDC designates a prorated portion of units as AHATC restricted units, based on the AHATC funding as a percentage of total development costs. This results in a low number of units being restricted at the AHATC level of 50 percent of area median income. For example, a 2007 project which received $250,000 of AHATCs resulted in 3 units (out of 44 total units) being placed under AHATC restrictions. LIHTC project units are already restricted to individuals making less than 60 percent of area median income.

Funding gap donation typically made by a party related to the development

Our review of projects showed donations to fill funding gaps in LIHTC projects were typically made by individuals or parties directly affiliated with a project's development team. We also noted instances where a bank or tax credit syndicator already involved in a LIHTC development provided a separate donation to help fill funding gaps in an ongoing project and received AHATCs for the donation. For example, in order to fill a funding gap in a 2007 project which had been approved to receive state and federal LIHTCs, an individual associated with the development partnership made a $454,545 personal donation and received $250,000 in AHATCs. This donation allowed the development partnership to fill the funding gap in the project without reducing profits or fees earned from the development or cutting costs. The partnership already was committed to complete the project without the additional funding. State law does not restrict such donations.

Project Costs Not Always Reasonable

Costs associated with projects eligible for AHATCs were not always necessary or reasonable or were not consistently handled. MHDC awarded $347,280 in AHATCs for a donation to make $598,368 in repairs to a LIHTC property. Project costs included $25,000 in property management fees associated with the repair, and an $8,051 fee paid to the not-for-profit organization to process the AHATC donation. The donor is a related party to the LIHTC development and to the property management company operating the development. The property management company already receives funding from development revenues to manage the property; therefore, using AHATCs to pay additional management fees should not be necessary. MDHC staff said the project caused increased costs for the management company. In addition, we did not see fees paid to not-for-profit organizations as eligible project expenses on other similar cases. MHDC policy does not specify if such fees are an eligible project expense.

AHATCs Have Been Issued for Projects Not Completed

Our review of project records and discussions with MHDC staff identified on at least two occasions (one in the mid 1990's and the other in 2006/2007) donors received AHATCs for projects not completed. MHDC staff approved the tax credits early in the project process with the donations being used for project planning purposes. Donated architectural services represented the majority of the AHATC contributions for the 2006/2007 project. A representative of the not-for-profit organization involved in the 2006/2007 project told us construction costs increased substantially during planning and the organization could not secure funding from MHDC or through other means to fill the funding gap, resulting in the project's failure. MHDC issued a total of $157,144 ($120,450 for the 2006/2007 project) in AHATCs for these two projects.

MHDC staff said the 2006/2007 failed project resulted from unforeseen circumstances. They said for projects where financing had not been sufficient for projects to continue, the not-for-profit organizations would generally refund donated cash or commodities to avoid the issuance of tax credits. In this case, the services had been rendered and could not be returned. The staff said no procedures had been established to limit not-for-profit organizations from receiving service donations until after project funding had been completed.

Economic Benefit Overstated

The economic impact being reported to the General Assembly regarding AHATCs is overstated. The economic impact of tax credit programs is reported annually to the legislature as part of the state budget process. The fiscal year 2009 analysis for the AHATC shows fiscal year 2007 activity will (1) return $.12 in state revenue for every dollar of credit redeemed, (2) create $162.4 million in new economic output, and (3) create approximately 2,272 new jobs. DED staff prepare the annual cost-benefit analysis for MHDC based on information and assumptions provided by MHDC staff. To calculate the economic benefit of the program, MHDC provides DED data on housing units produced, jobs created and resulting construction demand.

MHDC provided data to DED reporting 1,956 and 1,910 units of housing placed in service (produced) for 2006 and 2007, respectively. Data provided to us by MHDC shows only 698 and 546 AHATC units, respectively, actually produced during those years. MHDC staff said the number of units reported may have been total overall units, which would include LIHTC units as well as AHATC units. In the information provided to DED, MHDC uses the number of units produced to calculate the estimated construction investment and number of jobs created by the AHATC. As a result, the economic impact analyses prepared for the LIHTC and AHATC have duplicated the economic benefit for a significant number of housing units. MHDC staff could not explain why the error occurred. They said the staff person that set up the process to summarize this data was no longer with MHDC.

Even if MHDC staff reported the correct number of AHATC units in the economic benefit analysis, the analysis will likely overstate results. Based on our review of project files, the AHATC is not typically used to actually construct low income housing units without being combined with the LIHTC. When not used in conjunction with other funds, AHATC funds are typically used to rehabilitate existing units and not to construct new units. In addition, during fiscal years 2006 and 2007, 28 percent of AHATCs issued for housing production went towards the purchase of existing affordable housing units, with no actual construction taking place. As previously shown, Table 1.2 provides detail of the distribution of AHATCs.

Tax Credit Not Available to All Taxpayers

State law excludes most individual taxpayers from participation in the AHATC Program. Missouri law allows contributions by business firms which are defined as a person, firm, a partner in a firm, corporation or a shareholder in an S corporation doing business in the state. Based on the law, MHDC officials limit donations to businesses, or individuals with farm or rental income. Four of the five other states with donation related housing tax credits allow any individual along with businesses to make contributions.

Flexibility in Credit Allocation Could Benefit the Program

State law limits annual credit issuances to $10 million for housing production and $1 million to help cover not-for-profit organization administrative costs.[10] MHDC staff said the credits for administrative costs are generally completely issued with requests for funding often being prorated due to demand exceeding the $1 million limit. They also said the allocated production credits may not be issued if not-for-profit organizations cannot raise the necessary donations. MHDC records showed the maximum limit of credits issued for housing production had only occurred in one fiscal

[10] Administrative credits are applied for through a separate application process and are not associated with credits issued for housing production.

year since the inception of the tax credit. MHDC officials said an adjustment in state law allowing them to distribute a portion of the credits restricted to housing production for administrative purposes, when all production credits would not have been issued, could benefit the program and participating not-for-profit organizations.

Conclusions

The value of donated property and services must be verified to ensure credits are not being issued unnecessarily. The value of services can be difficult to determine, and as a result, could be inflated by a donor. MHDC staff needs to ensure procedures are in place to verify the value of donated property and services and ensure the services provided are necessary and reasonable to the project.

AHATCS are frequently used in conjunction with the LIHTC Program. While the AHATC can be used in this manner to help find private funds to supplement LIHTC developments, allowing parties related to an existing LIHTC development to use the credit to fill funding gaps provides little additional benefit to the state. The developer or other related party is already committed to the development's completion for a project already receiving significant state support.

Costs associated with projects eligible for AHATCs need to be necessary or reasonable and consistently handled. Property management fees are not necessary if the manager is already responsible for the property and is being compensated. MHDC does not have a policy stating whether not-for-profit administrative fees are allowable project costs.

Tax credits have been issued on limited occasions for donations related to projects not completed because services have been rendered which cannot be refunded or returned. By ensuring funding is in place for projects prior to not-for-profit organizations accepting donated services, MHDC could limit this situation from occurring.

The economic benefits being attributed to the AHATC are significantly overstated. While the AHATC is primarily designed to create indirect social benefits, without an accurate assessment of the economic benefits and costs of the program, it is difficult for the General Assembly and policymakers to adequately assess the program.

Missouri law does not allow individuals without farm or rental income to participate in the AHATC. Allowing donations from any individual would broaden the pool of potential donors and encourage additional donations for affordable housing projects.

Changing existing law to provide MHDC some flexibility in increasing tax credits distributed for administrative purposes, when production related credits cannot be fully issued (either a dollar limit or percentage of production credits not issued), could enhance the program and benefit participating not-for-profit organizations.

Recommendations

We recommend MHDC:

2.1 Establish procedures requiring the MHDC staff appraiser review appraisals for donated real property and buildings for reasonableness. If considered necessary, second appraisals or revised appraisals should be obtained on properties.

2.2 Establish procedures to ensure donated services are properly valued. Improve the current donation certification by including a statement:

- Where the donor affirms the value of the services donated does not exceed the amount the donor charges for similar services to the general public in the ordinary course of the donor's business.

- Notifying the donor that false or misleading statements or other information provided in claiming tax credits may result in penalties.

2.3 Establish procedures to ensure costs included in the allowable donation basis are reasonable and necessary to the project.

2.4 Establish policy regarding the inclusion of fees paid to not-for–profit organizations in the allowable donation basis.

2.5 Ensure projects, especially those receiving other state assistance, have sufficient funding to proceed prior to allowing organizations to accept donated services that will be compensated with AHATCs.

2.6 Provide a more accurate cost-benefit analysis to the General Assembly as part of the state budget process.

2.7 Work with the General Assembly, as necessary, on recommendations 2.8 to 2.10.

We recommend the General Assembly:

2.8 Evaluate if the intent of the program is to allow developers and related organizations to fill project funding gaps by donating to their own projects that have received or are receiving assistance from other state programs.

2.9 Change state law to allow issuance of AHATCs for donations from any taxpayer rather than just those with farm or rental income.

2.10 Evaluate modifying state law to give MHDC the ability to increase tax credits distributed for administrative purposes, when production related credits cannot be fully issued. Possible options would include a specific dollar limit or percentage of production credits not issued.

Agency Comments

The following response is provided by the staff members of the Missouri Housing Development Commission and is not the response of the MHDC board of commissioners.

2.1 MHDC staff shall implement the procedure of including the review of appraisals for donated property by our staff appraiser for compliance with professional standards. We shall continue to require that the appraisal be prepared by an independent licensed third-party appraiser unaffiliated with either the seller or the purchaser and dated within six months of the sales transaction. Should an appraisal be suspect in its approach, MHDC reserves the right to order or require the applicant to order a second appraisal.

2.2 MHDC staff shall prepare and implement a form of certification requiring an entity or individual donating services to affirm the value of the services stated in the documentation provided for the allocation of the tax credit does not exceed the amount charged for similar services to the general public in the normal course of business. A notification to the donor that false or misleading information provided in the allocation process will be added to the Tax Credit Certification form to supplement the notification already provided in the Affordable Housing Assistance Program (AHAP) program guide.

2.3 Staff believes its current procedures are adequate to analyze the costs presented in the application budget and cost certification and include the ability to request further information from the agency in order to determine the reasonableness and eligibility of costs being paid by the donation.

2.4 Staff shall establish a policy concerning the use of donated funds to pay fees to the non-profit applicant and publish it in the fiscal year 2009 program guide.

2.5 *Staff believes that having only two developments in seventeen years (0.01%) unable to proceed is a good track record and is not sufficient reason to remove AHAP as a source of seed money for non-profit developers. This type of funding is critical to the predevelopment process and otherwise often out of reach for a non-profit agency with limited resources.*

2.6 *Staff is establishing a methodology for determining cost-benefits and will collaborate with the Missouri Economic Research and Information Center to provide a refined report of investment and jobs generated as well as affordable housing units and beds produced as a result of the allocation of AHAP tax credits. We shall also address the social benefits achieved by the credit in order to give a more complete picture of the credit and its contribution to the state of Missouri and its citizens.*

2.7 *Staff is eager to participate with the legislature in discussion and action concerning potential improvements to the AHAP tax credit program.*

2.8 *Developments with funding gaps are generally complex transactions or are facing unusual costs with limited options available for additional financing. Without AHAP tax credits available to attract donations to cover the shortfall, critical affordable housing projects may not be feasible and therefore face the real danger of failing. A donation by a party related to the transaction is an additional investment by that party which in our experience neither over-subsidizes the property nor enriches the donor.*

2.9 *Increasing the pool of eligible donors will attract more donations and generate further production of affordable housing and related activities.*

2.10 *Staff welcomes the potential flexibility to distribute unreserved production-related credits for donations related to either operating assistance or production as needed.*

Affordable Housing Assistance Tax Credit Activity

Table I.1 lists the AHATC contributions and tax credits issued and redeemed through June 30, 2007.

Table I.1: Contributions, Tax Credits Issued and Redeemed - Fiscal Year 1991 to 2007

Fiscal Year	Contributions	Tax Credits Issued	Tax Credits Redeemed
1991	$557,300	$306,515	-[2]
1992	2,360,885	1,298,487	-[2]
1993	54,849	30,167	-[2]
1994	5,103,322	2,806,827	$238,004
1995	3,996,658	2,198,162	1,549,417
1996	6,383,213	3,510,767	2,195,048
1997	9,757,180	5,366,449	1,950,318
1998	7,352,247	4,043,736	3,621,949
1999	20,000,000	11,000,000	2,049,381
2000	19,954,380	10,974,909	3,588,553
2001	15,210,184	8,365,601	10,949,160
2002[1]	4,643,007	2,553,654	8,912,821
2003	16,528,247	9,090,536	7,601,144
2004	18,055,193	9,930,356	7,554,503
2005	19,060,238	10,483,131	7,702,860
2006	19,384,802	10,661,641	4,080,564
2007	17,547,415	9,651,078	10,497,793
Totals	$185,949,120	$102,272,016	$72,491,515

[1] The state had MHDC limit credit issuances in fiscal year 2002 due to state budget concerns.
[2] No information could be obtained on credits redeemed in fiscal years 1991 to 1993.

Source: MHDC, DED, and DOR data

Affordable Housing Units Produced

Table II.1 lists the AHATC housing units produced from fiscal year 1991 to 2007.

Table II.1: AHATC Units Produced Fiscal Year 1991 to 2007

Fiscal Year	AHATC Units Produced
1991	20
1992	137
1993	124
1994	178
1995	133
1996	478
1997	587
1998	187
1999	1,250
2000	777
2001	620
2002	289
2003	702
2004	512
2005	657
2006	698
2007	546
Total	7,895

Source: MHDC data

Tax Credit Review Status

Table III.1 shows the statewide tax credit programs and the State Auditor's office review status of each program.

Table III.1: Tax Credit Programs and Review Status

Program	Administering Department	Report Number for Review
Affordable Housing Assistance	Economic Development	2008-47
Missouri Low Income Housing	Economic Development	2008-23
Wood Energy	Natural Resources	2007-58
New Generation Cooperative Incentive	Agriculture	2007-06
Agricultural Product Utilization Contributor	Agriculture	2007-05
Community Development Corporation/Bank	Economic Development	2005-55
(Capital) Small Business Investment	Economic Development	2005-54
Certified Capital Companies (CapCo)	Economic Development	2004-56
New Enterprise Creation	Economic Development	2004-56
Adoption (Special Needs)	Revenue	2004-13
Community College New Jobs Training Bonds	Economic Development	2003-32
Brownfield Jobs/Investment	Economic Development	2002-33
Brownfield Remediation	Economic Development	2002-33
Historic Preservation	Economic Development	2002-33
Qualified Research Expense	Economic Development	2002-33
Seed Capital	Economic Development	2002-33
Youth Opportunities and Violence Prevention	Economic Development	2002-33
Film Production	Economic Development	2001-13
Rebuilding Communities	Economic Development	2001-13
Small Business Incubator	Economic Development	2001-13
Winery and Grape Growers	Economic Development	2001-13
Bank Franchise	Revenue	To Be Reviewed
Bank Tax Credit for S Corporation Shareholders	Revenue	To Be Reviewed
Brownfield Demolition	Economic Development	To Be Reviewed
BUILD Missouri Bonds	Economic Development	To Be Reviewed
Business Facility	Economic Development	To Be Reviewed
Cellulose Casings	Revenue	To Be Reviewed
Charcoal Producers	Natural Resources	To Be Reviewed
Children in Crisis	Revenue	To Be Reviewed
Development	Economic Development	To Be Reviewed
Disabled Access	Revenue	To Be Reviewed
Domestic Violence	Social Services	To Be Reviewed
Enhanced Enterprise Zone	Economic Development	To Be Reviewed
Enterprise Zone	Economic Development	To Be Reviewed
Examination Fees and Other Fees	DIFP[3]	To Be Reviewed
Family Development Account	Economic Development	To Be Reviewed
Family Farm[1]	Agriculture	To Be Reviewed
Food Pantry Donation[2]	Revenue	To Be Reviewed

Appendix III
Tax Credit Review Status

Program	Administering Department	Report Number for Review
Guarantee Fee	Economic Development	To Be Reviewed
Homestead Preservation	Revenue	To Be Reviewed
Life and Health Guarantee Association	DIFP[3]	To Be Reviewed
Maternity Home	Social Services	To Be Reviewed
MDFB Development and Reserve	Economic Development	To Be Reviewed
MDFB Export Finance	Economic Development	To Be Reviewed
MDFB Bond Guarantee Credit	Economic Development	To Be Reviewed
MDFB Infrastructure Development	Economic Development	To Be Reviewed
Missouri Health Care Access Fund[2]	Revenue	To Be Reviewed
Missouri Health Insurance Pool	DIFP[3]	To Be Reviewed
Missouri Property and Casualty Guarantee Association	DIFP[3]	To Be Reviewed
Missouri Quality Jobs	Economic Development	To Be Reviewed
Neighborhood Assistance	Economic Development	To Be Reviewed
Neighborhood Preservation	Economic Development	To Be Reviewed
New Enhanced Enterprise Zone	Economic Development	To Be Reviewed
Pharmaceutical	Revenue	To Be Reviewed
Pregnancy Resource Center[1]	Social Services	To Be Reviewed
Property Tax	Revenue	To Be Reviewed
Qualified Equity Investment[2]	Economic Development	To Be Reviewed
Residential Treatment Agency[1]	Social Services	To Be Reviewed
Retain Jobs	Revenue	To Be Reviewed
Self-employed Heath Insurance[2]	Revenue	To Be Reviewed
Shared Care	Health and Senior Services	To Be Reviewed
Sponsorship and Mentoring Program	Elementary and Secondary Education	To Be Reviewed
Transportation Development	Economic Development	To Be Reviewed

[1] New tax credit in fiscal year 2007. No activity reported on Appendix IV.
[2] New tax credit in fiscal year 2008.
[3] Department of Insurance, Financial Institutions, and Professional Registration.

Source: SAO

Tax Credit Redemptions

Table IV.1 shows the redeemed tax credits for fiscal years 2004 through 2007 for all state tax credit programs. We did not audit the information.

Table IV.1: Tax Credit Redemptions by Program

	Fiscal Year			
Program	**2004**	**2005**	**2006**	**2007**
Adoption (Special Needs)	$1,995,882	2,582,546	2,460,245	2,931,967
Affordable Housing Assistance	7,554,503	7,702,860	4,080,564	10,497,793
Agricultural Product Utilization Contributor	1,964,872	1,639,541	1,857,235	2,248,989
Bank Franchise	1,596,458	2,543,523	2,413,631	1,771,165
Bank Tax Credit for S Corporation Shareholders	1,233,830	941,460	1,451,903	1,248,932
Brownfield Jobs/Investment	2,134,891	1,726,687	1,476,143	1,701,409
Brownfield Remediation/Demolition	16,101,975	10,627,870	10,611,324	16,733,274
BUILD Missouri Bonds	9,667,000	3,770,557	5,402,416	6,958,318
Business Facility	7,826,417	4,546,330	5,892,727	6,066,136
Cellulose Casings	429,480	382,540	341,315	574,180
Certified Capital Companies	13,564,932	13,371,610	13,164,904	13,121,442
Charcoal Producers	0	384,609	70,151	180,987
Children in Crisis	n/a	n/a	n/a	168,128
Community Development Corporation/Bank	1,632,669	2,021,628	34,870	2,958
Community College New Jobs Training Bonds	8,061,584	6,847,304	5,771,777	4,920,374
Development	562,622	2,487,152	4,518,483	2,100,685
Disabled Access	87,401	56,761	36,549	11,813
Domestic Violence	475,283	515,035	525,348	696,670
Dry Fire Hydrant	13,169	17,228	805	3,737
Enhanced Enterprise Zone	n/a	9,809,254	5,922,720	6,646,873
Enterprise Zone	19,766,366	15,485,501	14,759,891	13,202,069
Examination Fees and Other Fees[1]	5,844,206[2]	4,962,341[2]	5,413,885	4,881,750
Family Development Account	27,488	12,875	9,237	11,761
Film Production	423,857	322,079	788,596	1,240,972
Guarantee Fee	0	11,224	73,009	68,607
Historic Preservation	66,089,980	74,532,355	103,134,226	132,841,728
Homestead Preservation	n/a	n/a	n/a	2,932,514
Life and Health Guarantee Association[1]	177,712	302,516	4,910	0
Maternity Home	982,747	743,636	760,674	983,509
MDFB Bond Guarantee Credit	0	594,034	0	276,241
MDFB Development and Reserve	0	1,500	0	500
MDFB Export Finance	0	0	0	0
MDFB Infrastructure Development	10,020,578	25,953,799	21,858,725	24,706,809
Missouri Business Modernization and Technology (Seed Capital)	288,174	164,894	60,313	82,977

Appendix IV
Tax Credit Redemptions

Program	Fiscal Year 2004	2005	2006	2007
Missouri Health Insurance Pool[1]	3,687,665	3,688,639	5,497,999	3,672,701
Missouri Low Income Housing	36,916,831	65,392,601	61,963,799	81,646,784
Missouri Property and Casualty Guarantee Association[1]	16,823,462	16,959,512	6,019,763	5,754,394
Missouri Quality Jobs	n/a	n/a	0	1,715,530
Neighborhood Assistance	10,217,628	9,286,880	10,009,497	13,924,340
Neighborhood Preservation	4,001,293	8,461,503	4,627,368	5,549,062
New Enterprise Creation	3,259,307	2,504,561	1,534,647	1,048,997
New Enhanced Enterprise Zone	n/a	n/a	n/a	5,188
New Generation Cooperative Incentive	3,466,068	3,334,935	4,990,666	4,136,380
Pharmaceutical	524,527	142,373	1,672	n/a[3]
Property Tax	95,237,314	99,455,570	96,090,703	93,118,747
Qualified Research Expense	2,038,230	1,626,864	1,006,688	487,320
Rebuilding Communities	1,415,889	1,694,006	1,764,167	1,390,803
Retain Jobs	n/a	0	2,882,995	4,285,366
Shared Care	39,109	33,574	39,247	105,757
Small Business Incubator	167,360	246,807	322,278	179,368
Small Business Investment (Capital)	49,478	109,050	58,189	66,720
Sponsorship and Mentoring Program	0	0	0	0
Transportation Development	3,678,532	3,545,219	980,806	910,421
Winery and Grape Growers	260,397	179,323	69,564	174,736
Wood Energy	1,205,443	3,700,285	3,728,100	2,709,211
Youth Opportunities and Violence Prevention	3,272,225	3,211,185	3,256,950	4,893,591
Totals	$364,784,834	418,634,136	417,741,674	485,590,683

1 Redemptions are on a calendar year rather than fiscal year and based on tax year credit was applied against.

2 Until the fiscal year 2007 budget process the amount reported by the DIFP for this credit was only the examination fee portion and not the other taxes and fees for which credits were also redeemed.

3 The Pharmaceutical tax credit expired in 2001 and tax credits are no longer being redeemed.

Source: Office of Administration, DOR, and tax credit administering agencies