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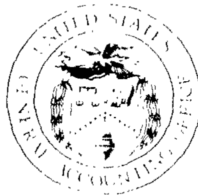
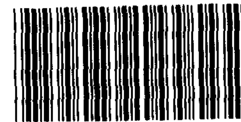
Report to the Chairman, Subcommittee on HUD/Mod Rehab Investigation, Committee on Banking, Housing and Urban Affairs, U.S. Senate

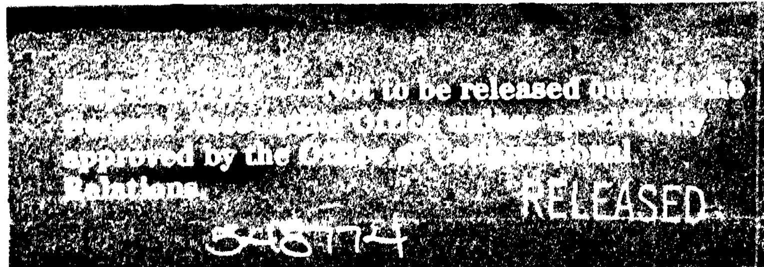
June 1990

RENTAL HOUSING

Inefficiencies From Combining Moderate Rehabilitation and Tax Credit Subsidies







United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-236205

June 19, 1990

The Honorable Bob Graham
Chairman, Subcommittee on HUD/Mod
Rehab Investigation
Committee on Banking, Housing and Urban
Affairs
United States Senate

Dear Mr. Chairman:

You requested information on the financial implications of combining subsidies under the Department of Housing and Urban Development's (HUD) Moderate Rehabilitation Program with the Department of the Treasury's Low-Income Housing Tax Credit Program. For eight housing projects for which sufficient data were available, we agreed to (1) estimate the cash flows (cash proceeds) that developers/owners realized by combining mortgage loans secured by Moderate Rehabilitation Program rental subsidies with the proceeds from low-income housing tax credits and (2) estimate how many additional rental units could have been subsidized had the same level of federal assistance been provided through the Section 8 Certificate or Voucher Programs.

Results in Brief

Developers for the eight projects generally realized cash proceeds that greatly exceeded their costs for acquiring and rehabilitating the properties. These proceeds ranged from about $3,800 to $13,700 per unit and represent 11 to 34 percent of the projects' acquisition and development costs. Developers generated the proceeds by selling their ownership interests in the projects along with the related tax credits and then combining these proceeds with mortgage loans secured by moderate rehabilitation rental subsidies.

We believe that federal housing resources were used inefficiently on these projects for two reasons. First, by combining subsidies under the Moderate Rehabilitation Program with low-income housing tax credits, project developers received more assistance than needed to ensure the projects' financial viability or to compensate them for their limited financial risk. Second, the use of both of these programs was questionable because the projects were located in areas with ample vacant units. Rents in these areas were generally well below the established rents for the eight projects; thus, housing certificates or vouchers could have been provided at lower per-unit costs to the government. We estimate that

more than twice as many housing units could have been subsidized for the same cost to develop these projects had Section 8 certificates or vouchers been made available and used.

Recent legislative changes prohibit joint use of the Moderate Rehabilitation and Tax Credit Programs, and require that state agencies develop and use allocation plans to distribute tax credits. In conjunction with these changes, we believe that HUD and state agencies should ensure that these subsidies are targeted to areas in actual need of additional rental housing units and not to areas where suitable available units exist.

Background

On August 2 and September 29, 1989, we testified before the Senate Committee on Banking, Housing, and Urban Affairs regarding our preliminary analysis of cash flows to the developers of the eight projects discussed in this report.[1] On February 27, 1990, we testified before your Subcommittee on HUD/Mod Rehab Investigation on our detailed findings concerning one of the projects, Sierra Pointe, located in Clark County, Nevada.[2] Each of these hearings explored the effects of combining federal subsidies provided under the Moderate Rehabilitation and Tax Credit Programs.

The Moderate Rehabilitation Program was initiated to preserve and upgrade the supply of rental units for low-income families. The program provides incentives for owners and developers to make improvements to existing structures so they can be brought up to HUD's livability standards. Under the program, owners agree to upgrade substandard rental housing in exchange for guaranteed rental subsidies for 15 years. A recent legislative change revised the minimum required expenditure for improvements from $1,000 to $3,000 per unit.

Once a project is selected for the program and rehabilitated, the owner enters into a rental contract that specifies rents for units in the project. Within specified limits, the rents are set at a level high enough to operate the project and service the debt associated with rehabilitating the project. The low-income family generally pays rent equal to 30 percent of its adjusted income, and HUD subsidizes the difference between this amount and the contract rent.

[1] Project Developer Cash Flows Under HUD's Section 8 Moderate Rehabilitation Program (GAO/T-RCED-89-58, Aug. 2, 1989) and Improving the Efficiency of Federal Housing Subsidies (GAO/T-RCED-89-72, Sept. 29, 1989).

[2] Use of Housing Subsidies (GAO/T-RCED-90-34, Feb. 27, 1990).

Low-income housing tax credits were initially authorized in the Tax Reform Act of 1986 as a 3-year program to provide incentives for private investment in low-income housing at a time when many prior tax benefits for real estate development, such as accelerated depreciation, were eliminated. Credit allocation agencies in each state were charged with establishing an allocation process to parcel out tax credits to individual projects. In late 1989, legislation was passed that extended the Tax Credit Program through calendar year 1990, and placed greater responsibility on state credit allocation agencies for administering the program. This legislation also prohibited using the Tax Credit Program in combination with the Moderate Rehabilitation Program. (App. I provides more detail on the Moderate Rehabilitation and Tax Credit Programs.)

Developers' Cash Flows Greatly Exceeded Project Costs

We estimate that the developers of the eight projects we reviewed generated cash proceeds that exceeded their acquisition/rehabilitation costs by 11 to 34 percent. These proceeds ranged from about $287,500 for a 36-unit project to about $2.2 million on a 352-unit project. Proceeds per unit ranged from about $3,800 to $13,700.

Developers generated these proceeds by combining mortgage loan funds secured by Moderate Rehabilitation rental subsidies with the proceeds from investors seeking low-income housing tax credits. Federal subsidies were provided by different administering agencies such as HUD, state tax credit allocation agencies, and local governments, with little or no centralized oversight of the total benefits package provided to any individual project. (App. II summarizes the estimated cash proceeds to developers for each of the projects reviewed.)

Developers assumed less risk than is usually encountered in private development activities because under the Moderate Rehabilitation Program, rental income was guaranteed for 15 years. In addition, because the mortgage loans were government insured, developers could maximize their borrowing capacity and thereby minimize their own cash investment. We could not identify any standards or guidelines governing allowable returns on investment for developing these types of properties with government financial assistance. However, we believe that developers of the projects we reviewed, by combining benefits from both the Moderate Rehabilitation and Tax Credit Programs, generally received more federal subsidies than necessary to ensure the projects' financial feasibility, given that certain normal project risks were minimized.

In an April 1989 report,[3] HUD's Office of the Inspector General (OIG) noted that the rehabilitation costs upon which the rental subsidies were based were improperly inflated, which led to excessive rental subsidy payments from HUD. According to the report, excessive subsidies for the eight projects we reviewed could total as much as $25 million over the 15-year life of the subsidies.

Inefficient Use of Housing Subsidies

It would have been more economical to rely on existing rental housing subsidized by Section 8 certificates and/or vouchers rather than developing the eight projects we reviewed. Certificates and vouchers subsidize the rent payments of low-income households in existing, privately owned housing by paying a portion of recipients' actual rents. The Moderate Rehabilitation and Tax Credit Programs are designed to provide for an adequate supply of low-income housing units, ideally in markets with a shortage of suitable rental units. In housing markets with an adequate supply of rental units, but where the problem is one of affordability, then the use of the existing housing supply with tenant-based Section 8 housing certificates or vouchers becomes a preferred, and less costly form of assistance. In the markets where the eight projects were located, most or all of the authorized certificates or vouchers were being effectively used by tenants that needed low-income housing.

This is best explained by an example used in our February 27, 1990, testimony before your Subcommittee. The 160-unit Sierra Pointe project in Clark County, Nevada, had a $596-per-month rent established for two-bedroom units based on the costs associated with project rehabilitation under the Moderate Rehabilitation Program. Subsidies at this rent level, when adjusted for inflation and combined with awarded tax credits, will total about $23 million over the 15-year subsidy period. In contrast, other two-bedroom units in Clark County were renting for about $425 per month. Subsidizing rents with certificates for 160 units and adjusting for inflation would have required only about $9 million over 15 years.

Looking at the situation another way, about 387 families could have been assisted for the same amount of federal subsidy ($23 million) required to assist 160 families at Sierra Pointe. This represents an increase of about 142 percent, or 227 additional households. The same situation existed, to different degrees, at the other seven projects we

[3]HUD OIG Report 89-TS-103-0005, Apr. 26, 1989.

reviewed. Table 1 summarizes, for the projects reviewed, the additional units that could have been subsidized for the same government investment using Section 8 certificates or vouchers, assuming they were available.

Table 1: Additional Units That Could Have Been Subsidized Using Section 8 Certificates/Vouchers

Project name	Project location	Actual	Using Sec. 8	Additional units: Number	Additional units: Percent
West Dade	Dade County, Fla.	122	166	44	36
Sun Garden	Tulsa, Okla.	207	370	163	79
Sierra Vista	Denver, Colo.	209	583	374	179
Pebble Creek	Arlington, Tex.	352	565	213	61
Balt. Gardens	Las Vegas, Nev.	166	412	246	148
Windsong	Tulsa, Okla.	202	390	188	93
Cleveland Gardens	Las Vegas, Nev.	36	91	55	153
Sierra Pointe	Clark County, Nev.	160	387	227	142
Total		**1,454**	**2,964**	**1,510**	**104**

It should be noted that the greater efficiency of the Section 8 certificates/vouchers in these instances was due to the rental housing markets where the projects were located. Our data show that in each market area, there were probably as many as several thousand vacant units. Five of the projects were in markets characterized by the Congressional Research Service as weak to very weak, i.e., with vacancy rates ranging from 12 to 18 percent. While we could not go back in time to determine the actual condition of available units in these markets, we believe it is reasonable to assume that a sufficient number of suitable units would have been available to house the residents of the eight projects.

Recent Reforms to Housing Subsidy Programs

The Congress and HUD have taken steps to better control subsidies under the Moderate Rehabilitation and Tax Credit Programs in response to situations illustrated by the eight projects we reviewed. In general, moderate rehabilitation and tax credit subsidies had in the past been awarded with little regard for the total amount of combined benefits. In many instances, rental subsidies under the Moderate Rehabilitation Program were awarded up to the maximum amount allowed by regulation. Similarly, tax credits were awarded up to the maximum amount allowable on a "first-come, first-served" basis rather than on the needs or merits of individual projects.

Public Law 101-239

One step that the Congress took to control housing subsidies was passing Section 7108 of the Omnibus Budget Reconciliation Act of 1989 (P.L. 101-239, Dec. 19, 1989), which extended the Tax Credit Program through calendar year 1990 and prohibited using tax credits in combination with the Moderate Rehabilitation Program. The act also placed greater responsibility on state credit allocation agencies for administering tax credits.

State allocating agencies are now required to prepare allocation plans for selecting projects to receive tax credits. The agencies also must identify other financial assistance being provided to a project and take this into consideration in deciding the amount of tax credits to be awarded.

The allocation plans prepared by the states will establish the priorities used in selecting projects to receive credits. Local housing needs will be translated into credit priorities considering location, housing needs, and other factors. The objective is to ensure that credit allocations are made to the most worthy projects in amounts needed for project feasibility and long-term viability.

Under the revised program, all project funding sources and uses must be disclosed to and reviewed by the state credit allocation agency. The allocation agency is to determine first if there is a shortfall in project funding, and award credits on the basis of the amount needed to complete project financing within allowable program limits.

Public Law 101-235

Section 127 of the Department of Housing and Urban Development Reform Act of 1989 (P.L. 101-235, Dec. 15, 1989) made several changes designed to improve the efficiency of the Moderate Rehabilitation Program. Among these was a requirement that program subsidies be awarded on a competitive basis.

As of May 15, 1990, HUD had not requested continued funding of the program or drafted regulations to implement the new Moderate Rehabilitation Program requirements. However, as part of HUD's homeless program efforts, moderate rehabilitation subsidies in fiscal year 1990 will be used for single-room occupancy units for the homeless and instances involving natural disasters.

Conclusions

A basic purpose of the Moderate Rehabilitation and Tax Credit Programs is to provide for an adequate supply of housing units for low-

income households. In the past, developers have combined these benefits to generate cash flows that greatly exceeded their property acquisition and rehabilitation costs. Recent legislative changes address this problem. However, as illustrated by the cases we reviewed, these programs also have been used in housing markets with a surplus of available units. In such market areas, more households could have been served if they had been provided with Section 8 certificates or vouchers to help them afford to rent vacant units that already existed.

Certificates and vouchers are generally a more efficient means of providing housing to low-income households in areas where there is an adequate supply of suitable vacant units renting at or below the area's fair market rents.

Recent program changes have addressed the problems associated with the combined use of moderate rehabilitation and tax credit subsidies and have sought to improve the allocation of these benefits. However, in implementing these and future program changes, the Congress, state credit allocation agencies, and HUD may wish to give special attention to ensuring that these programs are used only in markets where an insufficient number of suitable rental units are available.

Matters for Consideration by the Congress

Tax credits are used to produce low-income housing units either through new construction or rehabilitation of existing units. Accordingly, the Congress may wish to consider restricting the use of tax credits generally to areas where vacancy rates are low for suitable units renting at or below the area's fair market rents. The Congress could further require that any deviation from this policy by a state credit allocation agency be documented and subject to review by an authorized representative of the federal or state government.

Our review was conducted between September 1989 and February 1990 in accordance with generally accepted government auditing standards. We gathered pertinent data on eight selected projects that received both Moderate Rehabilitation Program subsidies and low-income housing tax credits. In analyzing the data on these projects, we consulted with a variety of individuals recognized for their expertise in project development, real estate finance, and low-income housing tax credits. We also obtained information from and discussed our analyses with cognizant officials at HUD, PHAs where the projects are located, and state tax credit allocation agencies. As requested, we did not obtain official comments

on our draft report from the parties involved in these projects. (Further details on our scope and methodology are in app. III.)

As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 7 days from the date of this letter. At that time, we will send copies to the Secretary, HUD; the Director of the PHAS and state tax credit allocation agencies where the eight projects are located; and other interested parties. Should you require any additional information on this report, please contact me at (202) 275-5525. Major contributors to this report are listed in appendix IV.

Sincerely yours,

John M. Ols, Jr.
Director, Housing and Community
Development Issues

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Abbreviations

BSPRA	Builders' and Sponsors' Profit and Risk Allowance
FMR	Fair Market Rent
GAO	General Accounting Office
HUD	Department of Housing and Urban Development
OIG	Office of Inspector General
PHA	public housing agency/authority

Description of the Moderate Rehabilitation and Tax Credit Programs

Moderate Rehabilitation Program

The Section 8 Moderate Rehabilitation Program was established by the Housing and Community Development Amendments of 1978 and implemented initially in fiscal year 1979. Recent revisions to the program were made in December 1989 via the Department of Housing and Urban Development Reform Act. The program is designed to provide financial assistance to private parties to upgrade low-income rental properties in their early stages of deterioration, to restore them to standard condition, and to maintain them at that level. The objective of the program is to preserve the supply of affordable housing where needed. The program focuses on rehabilitating existing properties in the earlier stages of deterioration because this is less costly than providing needed units through new construction or by substantially rehabilitating units after years of neglect.

The Department of Housing and Urban Development (HUD) initially identified three specific departmental goals that the Moderate Rehabilitation Program could help to meet: (1) complementing a local government's efforts to preserve or revitalize a neighborhood, (2) assisting lower income families in areas where private rehabilitation is decreasing the amount of moderately priced rental housing, and (3) increasing freedom of housing choice by providing assisted housing in areas for low-income and minority families. State or local officials, such as those in public housing agencies (PHAS), are to determine which objective or combination of objectives is most appropriate to address their housing needs, and whether the program should be targeted to specific neighborhoods.

Under the Moderate Rehabilitation Program, an owner agrees to rehabilitate his/her property up to HUD's Housing Quality Standards, or other higher standards, such as those in local building codes. In return, the owner is guaranteed rent subsidies for 15 years through a Housing Assistance Payments Contract with the local PHA. The contract rent is based on previous rent or on what the owner needs in order to own, manage, and maintain the property, and the debt service associated with rehabilitation of the property. The contract rents can be as high as 120 percent of established Existing Fair Market Rents (FMRS) at the time that the owner and HUD enter into the agreement. Thereafter, the owner can request contract rent increases annually to cover increased operating expenses. HUD establishes Existing FMRS for all counties in the nation that reflect the average rent (45th percentile) for a standard, modest unit in the locality. The FMR is to be reviewed by HUD at least annually and revised as required.

Generally, any type of rental housing which requires rehabilitation costing at least $3,000 per unit (formerly $1,000 per unit) to meet HUD's housing standards is eligible. However, since December 1989, eligibility has been limited to projects consisting of no more than 100 units. Rehabilitation work typically performed under the program includes installing new roofs; electrical rewiring; plumbing repairs and upgrades; heating system improvements; and repair of ceilings, interior walls, and foundations.

The Section 8 Existing Housing Programs are composed of the Moderate Rehabilitation Program and the Section 8 Certificate and Voucher Programs. All are funded by HUD and administered by state or local PHAS throughout the country. PHAs certify families' eligibility for assistance, issue housing assistance certificates and vouchers to eligible families, assist certificate and voucher holders in finding adequate housing units in the private market, and inspect housing units to ensure that they meet HUD's housing quality standards.

Household eligibility criteria and computation of subsidies are similar for all Section 8 subsidies. Eligible families are principally very low-income households earning up to 50 percent of the median income for the area in which they live, and are selected from waiting lists maintained by the local PHA.

With the certificate or voucher, the family shops for a unit that meets HUD's housing quality standards. For certificate holders, the monthly rent must be equal to or less than the Existing FMR for the area. HUD pays the difference between the actual rent and 30 percent of the household's qualifying income.

Voucher holders may rent a unit either below or above the established area FMR. HUD pays the difference between the payment standard based on the FMR and 30 percent of the household's qualifying income. If the actual rent is below the FMR, the family can keep the difference. If the actual rent is above the FMR, the family must pay the difference. All types of rental housing can be used, including mobile homes, group houses, and cooperatives.

As discussed previously, HUD and the owner agree on a contract rent for units under the Moderate Rehabilitation Program. This contract rent can be as much as 120 percent of the FMR for the area. HUD pays the difference between the contract rent and 30 percent of an eligible household's income.

Tax Credits for Low-Income Housing

The Low-Income Housing Tax Credit Program was authorized in the Tax Reform Act of 1986 as a 3-year program to provide an incentive for investors to own and rehabilitate low-income housing. In December 1989, the program was revised and extended through December 31, 1990. Before 1986, low-income housing owners were entitled to other incentives such as favorable depreciation, and special treatment of construction period interest and taxes. With passage of the 1986 act, those incentives were replaced with low-income housing tax credits. Since the credit was established, it has emerged as the primary tax incentive for stimulating low-income housing production and rehabilitation.

The program is administered by the U.S. Treasury Department. Subject to eligibility criteria, it provides a 10-year tax credit to property owners for each unit set aside for at least 15 years for low-income use.

Three different categories and two different levels of low-income housing tax credits are available, depending on the type of property involved. When initially implemented, a 9-percent annual credit was in place for 10 years for new construction or substantial rehabilitation where there was no federal subsidy. A 4-percent credit was also in place for new construction or substantial rehabilitation when combined with a federal subsidy, and a separate 4-percent credit was in place for the acquisition of existing property that was used for low-income housing. The percentages were applied to a qualified base of allowable acquisition, construction, or rehabilitation costs.

For properties placed in service after 1987, however, these percentages were redefined. Through the use of an appropriate discount rate, the 9-percent rate was replaced by 70 percent of the present value of the property amortized over 10 years. Similarly, the 4-percent credits were replaced by 30 percent of the present value of the property similarly amortized.

The criterion determining whether a property qualifies for the 70-percent present value or 30-percent present value credit applicable to new construction or substantial rehabilitation is whether other federal subsidies are also used to finance the project. For the tax credit program, federal subsidies include any tax-exempt financing, below-market federal financing, or federally supplied financing, such as a state loan made with a federal grant at a rate below the applicable federal rate. As initially allowed under the Tax Credit Program, federal rental payments under the Moderate Rehabilitation Program were not treated as a subsidy. Therefore, any financial assistance received through the Moderate

Rehabilitation Program was excluded from the determination of how much tax credit was awarded to a project. Accordingly, Moderate Rehabilitation Program rental subsidies were combined with both full acquisition and rehabilitation tax credits to finance a single project. This later was prohibited, however, in the December 1989 amendments to the tax credit legislation.

The low-income housing tax credit program includes a state allocation system. A project must qualify for the credit on the basis of requirements in the U.S. Tax Code but, in addition, the owner must apply to the state in which the project is located. The state tax credit allocation agency has the authority to grant all or part of the tax credits requested, up to the limit of the state's total tax credit allocation.

The state allocation is made pursuant to a state limit, or cap, of 93.75 cents (formerly $1.25) per resident. For example, a state with about 4 million residents would have about $3.75 million (0.9375 x 4 million) worth of credit authority per year. Accordingly, that state could allocate credit authority for projects where the total credits taken in a year by all owners that applied are $3.75 million. When multiplied by the 10-year credit period, there would actually be a total of about $37.5 million in tax credits that could be allocated in that state for that year.

Individuals, corporations, partnerships, and nonprofit entities are eligible to receive low-income housing tax credits. However, passive activity rules limit the amount of taxes that can be offset by the credits for certain groups of taxpayers. The maximum tax credit that an individual can use is $8,250. On the other hand, most corporations can use the tax credit without being subject to the $8,250 limit.

Nonprofit entities that have no tax liabilities can benefit from the credits by selling them to entities, such as corporations and other investors. In fact, because of the limitations on using the credits directly, and because the credits provide dollar-for-dollar reductions in tax liability, interests in credit-eligible projects are commonly sold by all types of owners to investors through syndicators. In this way, the owner converts future tax credits into cash, usually received within 3-4 years of project inception.

Estimated Cash Flow—Sources and Applications of Funds

The following estimates have been refined since our testimony of August 2, 1989, before the Senate Committee on Banking, Housing, and Urban Affairs (GAO/T-RCED-89-58). These refinements now reflect development and cost reviews that have been completed for all projects (except Pebble Creek) as part of the final mortgage endorsement process. Costs have been certified and allowable adjustments made. Accordingly, many figures such as cash investment, development costs, and Builders' and Sponsors' Profit and Risk Allowance (BSPRA) are now actual figures instead of estimates from HUD project files. Disallowed or undocumented project costs or undisclosed sources of funds are not reflected. Because Pebble Creek had not been finally endorsed as of the date of this report, cost figures are still based on estimates from HUD project files.

Table II.1: Estimated Cash Flow—Sources and Applications of Funds, Project 1, Windsong

Sources of Funds		
1 Mortgage Loan	$5,811,300	
2 Tax Credit Proceeds[a]	2,174,623	
3 Owners Cash Investment[b]	320,086	
4 Total Sources of Funds		**$8,306,009**
Application of Funds		
5 Acquisition Costs (from HUD Form 2264)	$2,464,500	
6 Development Costs	3,679,525	
7 Development Fee[c]	735,905	
8 Estimated Escrows and Prepaid expenses (1.5% of Mortgage Loan)[c]	87,170	
9 Gross Total Applications	**6,967,100**	
10 Less: BSPRA[d]	(348,139)	
11 Net Total Applications of Funds		$6,618,916
Proceeds to Developer at Completion of Development		
12 Estimated Proceeds to Developer (4-11+7-3)		$2,102,912
13 Estimated Proceeds to Developer Per Unit (202 Units)		$10,410

[a]Cash value of tax credit proceeds result from developer sale of ownership interest in project. Tax credit data are not subject to 26 U.S.C. 6103. Assumptions regarding value of tax credits as follows:

(1) Syndication proceeds equal 45% of awarded credits.

(2) Credit proceeds disbursed to project owner over 3 years, discounted at 10% per year. Actual tax credits awarded were $5,369,440.

[b]Estimated cash requirements at final endorsement. For this project, owner also provided $58,113 in letters of credit or certificates of deposit.

[c]Estimated amount on the basis of standard industry practice. Developers fee is estimated at 20% of development cost based on state tax credit agency policy.

[d]BSPRA = Builders and Sponsors Profit and Risk Allowance.

Table II.2: Estimated Cash Flow—Sources and Applications of Funds, Project 2, Sierra Pointe

Sources of Funds		
1 Mortgage Loan	$7,401,300	
2 Tax Credit Proceeds[a]	2,344,286	
3 Owners Cash Investment[b]	506,901	
4 Total Sources of Funds		**$10,252,487**
Application of Funds		
5 Acquisition Costs (from HUD Form 2264)	$3,700,000	
6 Development Costs	4,125,056	
7 Development Fee[c]	825,011	
8 Estimated Escrows and Prepaid expenses (1.5% of Mortgage Loan)[c]	111,020	
9 Gross Total Applications	**8,761,087**	
10 Less: BSPRA[d]	(383,855)	
11 Net Total Applications of Funds		**$8,377,232**
Proceeds to Developer at Completion of Development		
12 Estimated Proceeds to Developer (4-11+7-3)		$2,193,365
13 Estimated Proceeds to Developer Per Unit (160 Units)		$13,709

[a]Cash value of tax credit proceeds result from developer sale of ownership interest in project. Tax credit data are not subject to 26 U.S.C. 6103. Assumptions regarding value of tax credits as follows:

(1) Syndication proceeds equal 45% of awarded credits.

(2) Credit proceeds disbursed to project owner over 3 years, discounted at 10% per year. Actual tax credits awarded were $5,788,360.

[b]Estimated cash requirements at final endorsement. For this project, owner also provided $74,013 in letters of credit or certificates of deposit.

[c]Estimated amount on the basis of standard industry practice. Developers fee is estimated at 20% of development cost based on state tax credit agency policy.

[d]BSPRA = Builders and Sponsors Profit and Risk Allowance.

Table II.3: Estimated Cash Flow—Sources and Applications of Funds, Project 3, Cleveland Gardens

Sources of Funds		
1 Mortgage Loan	$1,214,100	
2 Tax Credit Proceeds[a]	362,941	
3 Owners Cash Investment[b]	73,229	
4 Total Sources of Funds		**$1,650,270**
Application of Funds		
5 Acquisition Costs (from HUD Form 2264)	$650,000	
6 Development Costs	683,102	
7 Development Fee[c]	136,620	
8 Estimated Escrows and Prepaid expenses (1.5% of Mortgage Loan)[c]	18,212	
9 Gross Total Applications	**1,487,934**	
10 Less: BSPRA[d]	(61,773)	
11 Net Total Applications of Funds		$1,426,161
Proceeds to Developer at Completion of Development		
12 Estimated Proceeds to Developer (4-11+7-3)		$287,500
13 Estimated Proceeds to Developer Per Unit (36 Units)		$7,986

[a]Cash value of tax credit proceeds result from developer sale of ownership interest in project. Tax credit data are not subject to 26 U.S.C. 6103. Assumptions regarding value of tax credits as follows:

(1) Syndication proceeds equal 45% of awarded credits.

(2) Credit proceeds disbursed to project owner over 3 years, discounted at 10% per year. Actual tax credits awarded were $896,150.

[b]Estimated cash requirements at final endorsement. For this project, owner also provided $12,141 in letters of credit or certificates of deposit.

[c]Estimated amount on the basis of standard industry practice. Developers fee is estimated at 20% of development cost based on state tax credit agency policy.

[d]BSPRA = Builders and Sponsors Profit and Risk Allowance.

Table II.4: Estimated Cash Flow—Sources and Applications of Funds, Project 4, Sierra Vista

Sources of Funds		
1 Mortgage Loan	$6,549,000	
2 Tax Credit Proceeds[a]	2,078,602	
3 Owners Cash Investment[b]	464,220	
4 Total Sources of Funds		**$9,091,822**
Application of Funds		
5 Acquisition Costs (from HUD Form 2264)	$2,909,105	
6 Development Costs	4,012,240	
7 Development Fee[c]	802,448	
8 Estimated Escrows and Prepaid expenses (1.5% of Mortgage Loan)[c]	98,235	
9 Gross Total Applications	**7,822,028**	
10 Less: BSPRA[d]	(363,020)	
11 Net Total Applications of Funds		**$7,459,008**
Proceeds to Developer at Completion of Development		
12 Estimated Proceeds to Developer (4-11+7-3)		$1,971,042
13 Estimated Proceeds to Developer Per Unit (209 Units)		$9,431

[a]Cash value of tax credit proceeds result from developer sale of ownership interest in project. Tax credit data are not subject to 26 U.S.C. 6103. Assumptions regarding value of tax credits as follows:

(1) Syndication proceeds equal 45% of awarded credits.

(2) Credit proceeds disbursed to project owner over 3 years, discounted at 10% per year. Actual tax credits awarded were $5,132,350.

[b]Estimated cash requirements at final endorsement. For this project, owner also provided $65,490 in letters of credit or certificates of deposit.

[c]Estimated amount on the basis of standard industry practice. Developers fee is estimated at 20% of development cost based on state tax credit agency policy.

[d]BSPRA = Builders and Sponsors Profit and Risk Allowance.

Table II.5: Estimated Cash Flow—Sources and Applications of Funds, Project 5, West Dade

Sources of Funds		
1 Mortgage Loan	$4,181,100	
2 Tax Credit Proceeds[a]	544,834	
3 Owners Cash Investment[b]	271,610	
4 Total Sources of Funds		**$4,997,544**
Application of Funds		
5 Acquisition Costs (from HUD Form 2264)	$2,457,000	
6 Development Costs	1,937,353	
7 Development Fee[c]	387,471	
8 Estimated Escrows and Prepaid expenses (1.5% of Mortgage Loan)[c]	62,717	
9 Gross Total Applications	**4,844,541**	
10 Less: BSPRA[d]	(193,043)	
11 Net Total Applications of Funds		**$4,651,498**
Proceeds to Developer at Completion of Development		
12 Estimated Proceeds to Developer (4-11+7-3)		$461,907
13 Estimated Proceeds to Developer Per Unit (122 Units)		$3,786

[a]Cash value of tax credit proceeds result from developer sale of ownership interest in project. Tax credit data are not subject to 26 U.S.C. 6103. Assumptions regarding value of tax credits as follows:

(1) Syndication proceeds equal 45% of awarded credits.

(2) Credit proceeds disbursed to project owner over 3 years, discounted at 10% per year. Actual tax credits awarded were $1,345,270.

[b]Estimated cash requirements at final endorsement. For this project, owner also provided $41,811 in letters of credit or certificates of deposit.

[c]Estimated amount on the basis of standard industry practice. Developers fee is estimated at 20% of development cost based on state tax credit agency policy.

[d]BSPRA = Builders and Sponsors Profit and Risk Allowance.

Table II.6: Estimated Cash Flow—Sources and Applications of Funds, Project 6, Baltimore Gardens

Sources of Funds		
1 Mortgage Loan	$5,975,000	
2 Tax Credit Proceeds[a]	1,362,404	
3 Owners Cash Investment[b]	456,279	
4 Total Sources of Funds		**$7,793,683**
Application of Funds		
5 Acquisition Costs (from HUD Form 2264)	$3,715,000	
6 Development Costs	2,656,477	
7 Development Fee[c]	531,295	
8 Estimated Escrows and Prepaid expenses (1.5% of Mortgage Loan)[c]	89,625	
9 Gross Total Applications	**6,992,397**	
10 Less: BSPRA[d]	(242,998)	
11 Net Total Applications of Funds		**$6,749,399**
Proceeds to Developer at Completion of Development		
12 Estimated Proceeds to Developer (4-11+7-3)		$1,119,300
13 Estimated Proceeds to Developer Per Unit (166 Units)		$6,742

[a]Cash value of tax credit proceeds result from developer sale of ownership interest in project. Tax credit data are not subject to 26 U.S.C. 6103. Assumptions regarding value of tax credits as follows:

(1) Syndication proceeds equal 45% of awarded credits.

(2) Credit proceeds disbursed to project owner over 3 years, discounted at 10% per year. Actual tax credits awarded were $3,363,960.

[b]Estimated cash requirements at final endorsement. For this project, owner also provided $59,750 in letters of credit or certificates of deposit.

[c]Estimated amount on the basis of standard industry practice. Developers fee is estimated at 20% of development cost based on state tax credit agency policy.

[d]BSPRA = Builders and Sponsors Profit and Risk Allowance.

Table II.7: Estimated Cash Flow—Sources and Applications of Funds, Project 7, Pebble Creek

Sources of Funds		
1 Mortgage Loan	$8,129,700	
2 Tax Credit Proceeds[a]	2,358,437	
3 Owners Cash Investment[b]	505,471	
4 Total Sources of Funds		**$10,993,608**
Application of Funds		
5 Acquisition Costs (from HUD Form 2264)	$4,000,000	
6 Development Costs	4,533,008	
7 Development Fee[c]	453,301	
8 Estimated Escrows and Prepaid expenses (1.5% of Mortgage Loan)[c]	121,946	
9 Gross Total Applications	**9,108,255**	
10 Less: BSPRA[d]	(397,917)	
11 Net Total Applications of Funds		**$8,710,338**
Proceeds to Developer at Completion of Development		
12 Estimated Proceeds to Developer (4-11+7-3)		$2,231,100
13 Estimated Proceeds to Developer Per Unit (352 Units)		$6,338

[a]Cash value of tax credit proceeds result from developer sale of ownership interest in project. Tax credit data are not subject to 26 U.S.C. 6103. Assumptions regarding value of tax credits as follows:

(1) Syndication proceeds equal 45% of awarded credits.

(2) Credit proceeds disbursed to project owner over 3 years, discounted at 10% per year. Actual tax credits awarded were $5,823,300.

[b]Estimated cash requirements at final endorsement. For this project, owner also provided $487,782 in letters of credit or certificates of deposit.

[c]Estimated amount on the basis of standard industry practice. Developers fee is estimated at 10% of development cost based on state tax credit agency policy.

[d]BSPRA = Builders and Sponsors Profit and Risk Allowance.

Table II.8: Estimated Cash Flow—Sources and Applications of Funds, Project 8, Sun Garden

Sources of Funds		
1 Mortgage Loan	$5,730,200	
2 Tax Credit Proceeds[a]	1,996,747	
3 Owners Cash Investment[b]	278,612	
4 Total Sources of Funds		**$8,005,559**
Application of Funds:		
5 Acquisition Costs (from HUD Form 2264)	$2,559,700	
6 Development Costs	3,641,917	
7 Development Fee[c]	728,383	
8 Estimated Escrows and Prepaid expenses (1.5% of Mortgage Loan)[c]	85,953	
9 Gross Total Applications	**7,015,953**	
10 Less: BSPRA[d]	(358,105)	
11 Net Total Applications of Funds		**$6,657,848**
Proceeds to Developer at Completion of Development		
12 Estimated Proceeds to Developer (4-11+7-3)		$1,797,482
13 Estimated Proceeds to Developer Per Unit (207 Units)		$8,683

[a]Cash value of tax credit proceeds result from developer sale of ownership interest in project. Tax credit data are not subject to 26 U.S.C. 6103. Assumptions regarding value of tax credits as follows:

(1) Syndication proceeds equal 45% of awarded credits.

(2) Credit proceeds disbursed to project owner over 3 years, discounted at 10% per year. Actual tax credits awarded were $4,930,240.

[b]Estimated cash requirements at final endorsement. For this project, owner also provided $51,302 in letters of credit or certificates of deposit.

[c]Estimated amount on the basis of standard industry practice. Developers fee is estimated at 20% of development cost based on state tax credit agency policy.

[d]BSPRA = Builders and Sponsors Profit and Risk Allowance.

Objectives, Scope, and Methodology

The Chairman, Subcommittee on HUD/Mod Rehab Investigation, Senate Committee on Banking, Housing and Urban Affairs, asked us to review certain housing projects which had received both Moderate Rehabilitation Program subsidies and low-income housing tax credits. We were asked to (1) develop estimates of the cash flows to developers/owners who combined Moderate Rehabilitation Program rental subsidies with the proceeds from low-income housing tax credits and (2) determine how many additional rental units could have been subsidized if vouchers and certificates had been used instead. We gathered pertinent data on eight Moderate Rehabilitation Program projects that had received both types of financial assistance. We selected projects that had been placed in service since passage of the initial tax credit legislation in 1986. As requested, we selected only projects that also had been financed with HUD-insured mortgage loans.

Three of the projects—Sierra Pointe in Clark County, Nevada; Baltimore Gardens in Las Vegas, Nevada; and Pebble Creek Apartments in Arlington, Texas—were specifically identified by the Chairman for our review. We selected the other five projects from a group that had been identified by HUD's Office of Inspector General. We selected these five projects because all necessary information was readily available. The five projects were: Windsong and Sun Garden in Tulsa, Oklahoma; Cleveland Gardens in Las Vegas, Nevada; Sierra Vista in Denver, Colorado; and West Dade in Dade County, Florida.

In evaluating these projects, we consulted with a variety of individuals recognized for their expertise in project development, real estate finance, and low-income housing tax credits. We discussed our analyses with cognizant officials at HUD, PHAS where the projects are located, and state tax credit allocation agencies in each project state. As requested, we did not obtain official comments on a draft of this report. We conducted our work during the period September 1989-February 1990 in accordance with generally accepted government auditing standards.

In estimating the cash flows to developers, we developed pro-forma schedules to identify the sources and applications of funds for each of the projects. The sources of funds were determined on the basis of a review of project records maintained by HUD and the mortgage insurers, and discussions with officials at financial institutions who have syndicated tax credits for similar projects. The amount of tax credit awarded to each project was obtained directly from the cognizant state tax credit allocation agencies. The applications of funds were estimated on the

basis of project records and discussions with experts regarding standard industry practice in developing these kinds of projects.

The experts with whom we consulted in developing our estimates agree that our estimates provide a fair and reasonable basis for estimating cash proceeds received by the developers.

In estimating the number of additional units that could have been subsidized if vouchers or certificates had been used instead of moderate rehabilitation subsidies and tax credits, we calculated the present value of the rent subsidies and tax credit proceeds to each project. The present value of the combined financial assistance was conservatively estimated by assuming (1) an annual increase in the moderate rehabilitation subsidy of 1 percent per year for each of the 15 years the subsidy is provided and (2) a 10-percent discount rate for the duration of the assistance period. This amount was compared with the present value of the average annual certificate and voucher subsidy per household in the area where the project was developed and at the time the project was placed into service.

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