

OFFICE OF THE CITY CONTROLLER



**HOUSING AND COMMUNITY DEVELOPMENT DEPARTMENT
MAYOR'S OFFICE OF ECONOMIC DEVELOPMENT
FUND 2409 – AFFORDABLE HOUSING
PERFORMANCE AUDIT**

Chris B. Brown, City Controller

Courtney E. Smith, City Auditor



**OFFICE OF THE CITY CONTROLLER
CITY OF HOUSTON
TEXAS**

CHRIS B. BROWN

July 5, 2017

The Honorable Sylvester Turner, Mayor
City of Houston, Texas

**SUBJECT: 2018-01 HOUSING AND COMMUNITY DEVELOPMENT DEPARTMENT (HCDD) &
MAYOR'S OFFICE OF ECONOMIC DEVELOPMENT (ECONOMIC DEVELOPMENT)
FUND 2409 – AFFORDABLE HOUSING PERFORMANCE AUDIT**

Mayor Turner:

The Office of the City Controller's Audit Division has completed a performance audit of Fund 2409 as administered by HCDD. Fund 2409 was designated to hold those dollars received from petitioned Tax Increment Reinvestment Zones (TIRZs). TIRZs are special districts created by City Council pursuant to Chapter 311, the Tax Increment Financing Act, of the Texas Tax Code.

The City of Houston has authorized 26 TIRZs. Nine (9) of the authorized TIRZs are petitioned zones. During fiscal years 2015 and 2016, a total of \$41,332,947 in tax increment payments were received from TIRZs and credited to Fund 2409.

Our primary audit objectives were to review the internal controls in place and determine if transactions in Fund 2409 were made in accordance with specific purposes allowed by applicable policies, laws, regulations and ordinances. The audit considered internal controls involving the Fund 2409 revenues and expenditures.

Our engagement scope included operations and transactions occurring during fiscal years 2015 and 2016.

Based on the procedures performed during the audit, we noted that revenue is recorded appropriately and housing expenditures were for valid and appropriate affordable housing activities.

We documented certain exceptions relating to:

- Revenues received for TIRZ 5 and TIRZ 21;
- Expiration of the affordable housing agreement for TIRZ 5; and
- Management of voided and cancelled transactions.

We also noted opportunities to enhance internal controls related to documentation of transactions and to improve cash management.



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TEXAS**

CHRIS B. BROWN

We would like to express our appreciation to the management and staff of HCDD and the Mayor's Office of Economic Development for their time and effort, responsiveness, and cooperation during the course of the audit.

Respectfully submitted,

Chris B. Brown
City Controller

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EXECUTIVE SUMMARY

INTRODUCTION

The Audit Division (AD) of the City Controller's Office has completed a performance/compliance audit of Fund 2409 administered by the Housing and Community Development Department (HCDD). The purpose of the audit was to consider the internal controls and processes related to the receipts and disbursements of monies in Fund 2409. The audit was included in the Fiscal Year 2017 (FY 2017) Audit Plan and was a result of our Enterprise Risk Assessment process.

BACKGROUND

GENERAL STRUCTURE

Tax Increment Reinvestment Zones (TIRZs) are special districts created by City Council (the "Council") pursuant to Chapter 311 of the Texas Tax Code, *Tax Increment Financing Act*, (the "Act"). Section 311.003(a) provides that a governing body of a county or municipality by order or ordinance, respectively, may designate a continuous geographic area in the county or corporate limits of the municipality to be a reinvestment zone to promote development or redevelopment of the area, if the governing body determines that development or redevelopment would not occur solely through private investment in the reasonably foreseeable future. The provisions of Section 311.003 provides that prior to adopting an order or ordinance designating a reinvestment zone, the county or municipality must prepare a preliminary reinvestment zone financing plan and hold a public hearing on the creation of the zone and its benefits to the county or municipality. Under Section 311.005 of the Act, the criteria to be designated as a TIRZ are for an area to:

- (a) Substantially arrest or impair the sound growth of the county or the municipality
- (b) Retard the provision of housing accommodations, or constitute an economic or social liability and be a menace to the public health, safety, morals, or welfare in its present condition

TIRZs are funded through tax increment in accordance with the provisions of Section 311.012 of the Act. Taxes attributable to new improvements (tax increment) are set-aside in a fund to finance public improvements in the zone.

TIRZs are classified as either ***petitioned*** or ***non-petitioned***. Per Section 311.005(4) *petitioned* TIRZs are created through petitions submitted to the governing body of a county or municipality requesting that an area be designated as reinvestment zone by the owners of property constituting at least 50% of the appraised value of the property in the area according to the most recent certified appraisal roll for the county in which the designated area is located. *Non-petitioned* TIRZs are areas designated by a county or municipality through an order or ordinance, respectively.

Zones in the City of Houston have been created for one of the following three reasons:

- to address inner city deterioration;
 - to develop raw land in suburban fringe areas; or
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- to proactively address the decline of major activity centers.

To-date the City of Houston (City) has authorized twenty-six (26) TIRZs, nineteen of which were city-initiated (non-petitioned) and seven zones which were initiated through the petition process. The following table (Table 1) provides a listing of the City’s TIRZs:

TABLE 1

CITY OF HOUSTON TIRZS		
TIRZ #	TIRZ Name	Creation
1	Lamar Terrace	Petition
2	Midtown	Petition
3	Market Square	Non-Petition
4	Village Enclaves ¹	Petition
5	Memorial – Heights	Non-Petition
6	Eastside	Non-Petition
7	OST/Almeda	Non-Petition
8	Gulfgate	Non-Petition
9	South Post Oak	Petition
10	Lake Houston	Non-Petition
11	Greater Greenspoint	Non-Petition
12	City Park	Non-Petition
13	Old Sixth Ward	Petition
14	Fourth Ward	Petition
15	East Downtown	Non-Petition
16	Uptown	Petition
17	Memorial City	Non-Petition
18	Fifth Ward	Non-Petition
19	Upper Kirby	Non-Petition
20	Southwest	Non-Petition
21	Hardy/Near Northside	Non-Petition
22	Leland Woods	Non-Petition
23	Harrisburg	Non-Petition
25 ²	Hiram Clarke/Fort Bend	Non-Petition
26	Sunnyside	Non-Petition
27	Montrose	Non-Petition

TIRZ GOVERNANCE

Each TIRZ is governed by a board of directors. In accordance with Section 311.009 of the Tax Code non-petition TIRZs are governed by between five and fifteen directors, while petition TIRZ boards may on the approval of the governing body of the municipality or county, consists of nine members. The City may delegate to the board any powers granted under state law, except for eminent domain and taxing powers. Section 311.010 of the Tax Code grants powers to the TIRZ board to include;

¹ TIRZ 4 Village Enclaves had accomplished its project plan and was dissolved in 2013

² TIRZ #24 is Harris County TIRZ and as a result is not listed as part of City of Houston’s TIRZ



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land use controls, in special cases; design standards; recommendations for the administration of the zone; and, powers to implement a project and financing plan.

The powers of the TIRZ Board are limited, as they are not authorized to issue bonds, impose taxes or fees, exercise the power of eminent domain or give final approval to the project plan. As a result the City Council created several local government corporations, called Redevelopment Authorities (RAs), to implement each TIRZ's Project Plan. The Redevelopment Authority gets its powers from the Texas Transportation Code Chapter 431 and these powers include the ability to issue bonds and notes, hire consultants, (legal, financial, engineering), and work with developers to further the TIRZ's goals and objectives. Of the City's 26 TIRZ, 21 have an associated redevelopment authority. The tax revenue of the RAs detailed in the June 30, 2016 Consolidated Annual Financial Report was about \$150,034,000.

FUND 2409 RECEIPTS AND EXPENDITURES

Section 311.011(f) of the Act requires that zones created by petition within counties of more than 3.3 million in population set aside at least one third (1/3) of the tax increment generated during the term of the zone to provide low-income or affordable housing. Non-petition zones *may* set aside portions of their tax increment funds earmarked for affordable housing based on the provisions contained in the affordable housing agreements but are not required to do so by state statute.

The City acting in accordance with the provisions of Section 311.011(f) and in fulfillment of the requirements of Section 311.014 to designate a portion of the tax increment to provide for affordable housing, passed Ordinance No. 99-488 on May 19, 1999 to approve the designation of funds held in Fund 2409 (formerly Fund 872), be used by HCDD for low-income housing purposes. As a result, during fiscal years 2015 and 2016, the total amount of \$41,332,947 was credited to Fund 2409 as detailed in the table below:

TABLE 2

FUND 2409 RECEIPTS FOR FYS 2015 AND 2016	
TIRZ NAME	FUND 2409 REVENUE
Lamar Terrace	\$ 2,320,292
Memorial – Heights	2,264,645
Old Sixth Ward	1,235,839
Fourth Ward	2,139,176
Uptown	32,967,000
Fifth Ward	193,638
Hardy/Near Northside	212,357
Total	\$41,332,947

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We performed procedures to ascertain whether tax increment amounts were properly calculated and credited to Fund 2409 in accordance with the statutory requirements of 1/3 of the tax increment for petitioned TIRZs and per contract agreements for non-petitioned TIRZs. The results of our audit procedures are contained in the *Detailed Findings, Recommendations, Management Responses, and Assessment of Responses* section of this Report.

Once the funds have been received in Fund 2409 as revenues, they are available to HCDD for low-income housing purposes. The combined expenditures for Fund 2409 in FYs 2015 and 2016 amounted to approximately \$19,430,680 and are incurred as distributed in the different categories of expenditures in the Table 3 below:

TABLE 3

FUND 2409 EXPENDITURES DISTRIBUTION FOR FYs 2015 AND 2016		
CATEGORY	AMOUNT	% OF TOTAL
Payroll and payroll related	\$ 9,274,191	47.7%
HCDD Office Lease Expenditure	1,532,863	7.9%
Other Administrative Support	217,320	1.1%
Subtotal Administrative Support	11,024,374	56.7%
Project and program specific	8,406,307	43.3%
Total FY15 & FY16 Expenditures	\$19,430,680	100.0%

Our audit procedures focused primarily on project costs out of Fund 2409 related to project and program specific expenditures which accounted for 43% of total expenditures as indicated in Table 3, above. This is necessary because our assessment of audit risks involving these expenditures were considered high. Our risk assessment determined that there are strong internal controls involving payroll related expenses so although 57% of the expenses incurred out of Fund 2409 for the fiscal years 2015 and 2016 were payroll related, we did not perform any audit procedures of payroll related expenses. Chapter 311 of Texas Tax Code currently has no cap on the amount or percentage of funds that may be used for administrative expenses.

As a result of our procedures, we identified the top seven (7) projects/vendors that were financed out of Fund 2409 for fiscal years 2015 and 2016. Please see Table 4 below for details:



TABLE 4

TOP SEVEN FINANCED PROJECTS FOR FYS 2015 AND 2016	
PROJECTS	AMOUNT
Leland Woods Redevelopment Authority II	\$2,400,000
Land Assemblage Redevelopment Authority (LARA)	1,000,000
Rebuilding Together Houston	944,988
Texas General Land Office	540,000
Department of Info Resources	440,134
Search	389,731
Fulton Village Redevelopment Corporation	327,896
Total	\$6,042,749

Based on our risk assessment, we selected samples across the top seven projects identified in Table 4 above, including other projects and performed procedures to determine whether the expenditures were properly approved, supported by adequate documentation, and the transactions were allowed under the applicable contract agreement. The results of our audit procedures are contained in the *Detailed Findings, Recommendations, Management Responses, and Assessment of Responses* section of this Report. Although Fund 2409 dollars are required to be committed to projects relating to affordable housing, we observed arising through our testwork that project costs which may be expensed from Fund 2409 are varied and sometimes have a tenuous relationship to affordable housing.

AUDIT SCOPE AND OBJECTIVES

The audit objectives for the engagement were to review the internal controls in place and determine if transactions in Fund 2409 were made in accordance with specific purposes allowed by applicable policies, laws, regulations and ordinances. The audit considered internal controls involving Fund 2409 revenues and expenditures.

The engagement scope included operations and transactions occurring during Fiscal Years 2015 and 2016.

PROCEDURES PERFORMED

In order to obtain sufficient evidence to achieve engagement objectives and support our conclusions, we performed the following steps:

- Obtained and reviewed the appropriate applicable Texas statutes;
- Obtained and reviewed the applicable City Ordinances;
- Interviewed Economic Development personnel involved in calculating and recording affordable housing revenue activities to document their processes and controls;
- Interviewed HCDD personnel involved in reviewing, approving and recording expenditure activities to document their processes and controls;



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- Verified independent third party report of affected properties and their appraised values included in the Tax Increment Calculation Worksheet used in determining tax increment for each applicable TIRZ as a basis for arriving at the amount of revenue to be recorded in Fund 2409. ;
 - Performed procedures to determine whether receipts in connection with affordable housing contributions recorded in Fund 2409 for petitioned and non-petitioned TIRZs were properly determined and in accordance with the requirements of the Act or the applicable affordable housing agreements.;
 - Traced the revenues to the journal entries and to entry in SAP;
 - Determined the terms and conditions for Affordable Housing Agreements with Non-petition TIRZs and reviewed associated documents;
 - Verified the cash receipts were properly recorded in the general ledger (SAP);
 - Obtained and examined payment documentation for a sample of non-payroll expenditures of Fund 2409; and
 - Obtained and reviewed the vendor contracts and determined adherence to the terms and conditions of the contracts.

AUDIT METHODOLOGY

We conducted this performance and compliance audit in accordance with Generally Accepted Government Auditing Standards and in conformance with the International Standards for the Professional Practice of Internal Auditing. Those standards require that we plan and perform the audit to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The scope of our work did not constitute an evaluation of the overall internal control structure of HCDD or Economic Development. Management is responsible for establishing and maintaining a system of internal controls to ensure that City assets are safeguarded; financial activity is accurately reported and reliable; and management and employees are in compliance with laws, regulations, and policies and procedures. The objectives are to provide management with reasonable, but not absolute assurance that the controls are in place and effective.

CONCLUSIONS AND SIGNIFICANT ISSUES

We believe that we have obtained sufficient and appropriate evidence to adequately support the conclusions provided below as required by professional auditing standards. Each Conclusion is aligned with the related Audit Objective for consistency and reference. For detailed findings, recommendations, management responses, comments and assessment of responses, see the “Detailed Findings, Recommendations, Management Responses, and Assessment of Responses” section of this report.

CONCLUSION 1 – (AUDIT OBJECTIVE #1)

Consider the processes and internal controls related to expenditures.

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- Based on the results of the procedures performed, we determined expenditures were for valid and appropriate affordable housing activities. However, we noted several instances where supporting documentation for payments were inadequate. **(See Findings #1)**. Furthermore, we noted an opportunity for strengthening internal control and improving cash management. **(See Finding #2)**.

CONCLUSION 2 – (AUDIT OBJECTIVE #2)

Consider the processes and internal controls related to recognizing and recording revenues.

- Based on the results of the procedures performed, we determined revenue is recorded appropriately. However we noted certain exceptions relating to:
 - Revenues for non-petitioned TIRZs 5 and 21 for the combined fiscal years 2015 and 2016 which was based on the approved operating budget for both fiscal years were not properly determined in accordance with the provisions of the affordable agreement in operation resulting in combined underfunding for TIRZs 5 and 21, respectively for fiscal years 2015 and 2016. **(See Finding #3)**.
 - Revenue receipts for TIRZ 18 were not recorded in a timely manner. **(See Finding #4)**.
 - The affordable housing agreement under which transactions involving revenue receipts were recorded for TIRZ 5 expired on December 31, 2016 and was not extended. **(See Finding #5)**.

ACKNOWLEDGEMENT AND SIGNATURES

The Audit Team would like to thank the management and staff of HCDD and the Mayor's Office of Economic Development for their cooperation, time and efforts throughout the course of the engagement.



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DETAILED FINDINGS, RECOMMENDATIONS, MANAGEMENT RESPONSES, AND ASSESSMENT OF RESPONSES

**FINDING #1 – INADEQUATE DOCUMENTATION TO SUPPORT EXPENDITURES
(RISK RATING = HIGH)**

BACKGROUND:

Pursuant to Chapter 311 of Texas Tax Code, *Tax Increment Financing Act (the “Act”)*, the City of Houston (the “City”) designated certain areas within the City as Tax Increment Reinvestment Zones (“TIRZs”) in order to promote development or redevelopment of those areas. Section 311.011(f) of the Act provides that one-third (1/3) of the tax increment collected for each petitioned created TIRZ be dedicated to providing affordable housing. Consequent upon this, certain TIRZs have transferred their affordable housing component to the City to administer. The City’s Housing and Community Development Department (“HCDD”) currently has the authority to administer the City’s affordable housing program.

On May 19, 1999, following the passage of Ordinance No. 99-488 by the City Council, the City designated all funds held in Fund 2409 (formerly Fund 872) be used by Housing and Community Development Department for low-income housing purposes.

During the course of the audit we selected 25 samples of non-payroll related expenditures ranging from \$49,000 to \$2,400,000. We performed procedures to determine whether the expenditures were properly authorized and approved, and were in accordance with the provisions of the relevant agreement and approved Requests for Council Action (RCA) authorizing such appropriations.

FINDINGS:

Audit procedures performed revealed there were inadequate supporting documentations for the following items in our sample:

- On January 26, 2016 payment amounting to \$2,400,000 was made to Leland Woods Redevelopment Authority II for paving and developer reimbursement, including reimbursement to Houston Housing Finance Corporation without any supporting documents evidencing work performed.
- There was no support documentation for payment of the sum of \$51,207.76 relating to interest reserve included in the total invoice amount of \$200,000 as payment for contingencies in connection with the satisfaction of obligations of Authority II including transactional and closing costs arising from loan obtained from Allegiance Bank to pay off the loan from U.S. Bank National Association for the continuing development of affordable housing in Leland Woods Subdivision.



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- A \$192,000 payment to Houston Habitat for Humanity, Inc. for 64 storm sewer constructions in the Harrel Park development included support documentation for only 22 of the houses referenced on the invoice.
 - The \$49,000 payment issued to Hou-Tex Redevelopment Authority for gap financing for the construction of four (4) affordable houses on Livingston Street did not contain supporting documentation to evidence work performed.

RECOMMENDATION:

We recommend that HCDD ensure payments and disbursement of funds from Fund 2409 for work performed by vendors is adequately supported by documentation to ensure proper internal control and oversight. In addition, proper documentation is required to ensure that work was performed and completed in accordance with the contract specifications.

**DEPARTMENT MANAGEMENT
RESPONSE:**

HCDD did obtain the fully executed and council approved contract dated 06/08/2015, and an invoice from Leland Woods dated 01/26/2016 signed by the Chief Development Officer, before payment.

The payment for Houston Habitat for Humanity was processed by PWE. They initially sent partial backup for only 22 homes but later came back with complete back up for all of the 64 homes.

The Hou-Tex Redevelopment Authority submitted additional back up to ensure the completion and sale of the 4 Affordable Homes.

All internal control procedures were followed prior to payments and other disbursements being made. We will, however ensure further documentation of this occurs and staff is trained appropriately.

RESPONSIBLE PARTY:

Housing and Community Development Department.

ESTIMATED DATE OF COMPLETION:

July 1, 2017.

**ASSESSMENT OF
RESPONSE:**

Management response sufficiently addresses the issue identified.

**FINDING # 2 – FAILURE TO INCLUDE PROPER CASH MANAGEMENT OPTIONS FOR FUNDS TRANSFER IN AGREEMENTS
(RISK RATING = HIGH)**

BACKGROUND:

During the course of our audit procedures, we obtained and reviewed all contract agreements relating to the samples selected for our audit work, to determine whether payments were made in accordance with the provisions of the contract agreements. While we did not identify any violation of the procedures contained in the contract agreement in connection with payment of funds, we nonetheless identified in one instance relating to the Leland Woods contract agreement, opportunities for proper cash management and strengthening of internal controls around cash disbursement.

Pursuant to the City Council approved Ordinance 2015-435, a Second Supplemental Agreement (the “Amendment”) to the Six Party Agreement (the “Agreement”) was signed on June 8, 2015, between the City of Houston and 5 other parties; North Houston Bank, Builders Community Development Corporation, Reinvestment Zone Number Twenty-two, City of Houston (the “City”), Leland Woods Redevelopment Authority and Leland Woods Redevelopment Authority II (“Authority II”). Under Article I Section 1 of the Amendment, the City was required to pay from Fund 2409 the sum of \$2,400,000 to Authority II to assist with the development of single family and multi-family housing by encouraging and incentivizing developers committed to providing economic development improvement within the boundaries of the Zone within Leland Woods Subdivision. The amount was to cover costs relating to the satisfaction of obligations of Authority II including transactional and closing costs relating to the sale or lease of the property; the refinance or modification of any loan or other obligation of Authority II relating to the Property.

On January 26, 2016 the sum of \$2,400,000 was transferred out of the treasury account of the City as payment to Authority II.

Title 31 Code of Federal Regulations (CFR) Part 205 “*Rules and Procedures for Efficient Federal-State Funds Transfer*” provides guidelines regarding the federal funds transfer. The provisions of the CFR stipulate the conditions under which payment of federal funds shall be made to non-federal entities. Such rules include the determination whether payment shall be in advance or on reimbursement basis. Advance payment conditions seek to minimize the time elapsing between the transfer of funds from the United States Treasury and the disbursement of funds by the non-federal entity. While payment conditions under a reimbursement basis require the third party entity to pay for program expenditures prior to seeking reimbursement.



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FINDING:

We obtained and reviewed the audited financial statements of Leland Woods Redevelopment Authority II, as of June 30, 2016. We noted that the balance of \$2.4m was yet to be expended in accordance with the provisions of the contract agreement. Further inquiries during the course of the audit at a meeting held with HCDD management on January 11, 2017 at HCDD revealed that the balance of \$2.4m was yet to be applied for the intended purposes resulting in the amount being unexpended for over a year. Such delay in the utilization of the money earmarked for affordable housing projects results from improper cash management techniques which failed to reduce the time elapsing between the transfer of funds from the City treasury and the disbursement by Authority II.

While payment of the amount does not constitute a violation of the provisions of the contract agreement, it is our opinion that adequate provisions were not included in the contract agreement specifically to address best practices in cash management options which indicate whether payment shall be in advance or reimbursement basis as contained in the provisions of U.S. Title 31 Code of Federal Regulations Part 205 "*Rules and Procedures for Efficient Federal-State Funds Transfer*".

RECOMMENDATION:

We recommend that the Housing Department establish procedures to ensure that contracts include clear indication regarding the cash management option to be adopted in connection with the transfer of funds out of Fund 2409 for payment to third parties on transactions involving affordable housing project costs. Such options must state clearly whether payment shall be in advance or on reimbursement basis.

Where payment is in advance, payment methods should minimize the time lapse between the transfer of funds from the City treasury and the disbursement of funds by the third party entity. Conversely, where payment is on reimbursement basis, contact agreements should specify that third party entities make payments with their own funds prior to seeking reimbursements. Such introduction of proper cash management options as identified in the 31 CFR Part 205 identified above will:

1. Minimize possible loss of interest earned for the City of Houston owing to non-utilization of idle funds by the third party recipients
2. Improve the City's cash flows as funds are disbursed only as needed;
3. Provide greater control and oversight over funds
4. Proper monitoring of program activities to ensure that they are in accordance with the contract agreement(s).

DEPARTMENT MANAGEMENT

RESPONSE:

Current management has communicated to both the legal team and the finance team that funding will only be provided on a reimbursement basis unless explicitly

authorized by City Council. Under this policy, the funding for Leland Woods would be held by HCDD until complete documentation for the invoices are received.

In a broader assessment of cash management activities and an earlier commitment to enhance internal controls, an internal review revealed that cash balances in the Fund 2409 account increased as HCDD concentrated their 2011-2014 efforts on leveraging CDBG grant funds related to the Hurricane Ike Recovery Program. The 2409 affordable housing funds provided the resources required to administer the IKE grant, which was a stated condition of the grant. HCDD later began the process to develop and implement a long term affordable housing strategy and since 2016, Mayor Turner's Complete Communities' Initiative has been embedded into this strategy. This more comprehensive plan will be presented to the Mayor and City Council in the second half of 2017. To ensure an accurate accounting for and timely use of 2409 funds, the plan will be reviewed annually in the third quarter of each year.

RESPONSIBLE PARTY:

Housing and Community Development Department.

ESTIMATED DATE OF COMPLETION:

July 1, 2017.

**ASSESSMENT OF
RESPONSE:**

Management response sufficiently addresses the issue identified.

**FINDING #3 – INCORRECT TAX INCREMENT AMOUNTS TRANSFERRED TO FUND 2409 FOR TIRZs 5 AND 21
(RISK RATING = MEDIUM)**

BACKGROUND:

TIRZ 5 was created by Ordinance No. 1996-1337 on December 18, 1996, as a non-petition TIRZ pursuant to Chapter 311 of the Texas Tax Code. On August 25, 2009, an Affordable Housing Agreement (the “Agreement”) was signed, between the City of Houston (the “City”), Reinvestment Zone Number Five, Memorial Heights (the “Zone”) and Memorial-Heights Redevelopment Authority. (“Authority”) The initial agreement set out the terms and conditions regarding the payment of costs to provide affordable housing in or out of the Zone. The initial agreement terminated on December 31, 2016. However, under Ordinance No. 2010-996, passed and adopted on December 8, 2010, an extension of the duration of the reinvestment zone was granted until December 31, 2029.

In accordance with the provisions of Section II subsection 1 of the Agreement, the obligations of the parties regarding funding for the affordable housing costs were to be met through a transmission to the City of an amount shown for affordable housing costs in the City Council approved Operating Budget for the Zone and Authority for the fiscal year, starting from fiscal year 2009 and each subsequent year thereafter until termination,.

TIRZ 21 Hardy/Near Northside was created by Ordinance 2003-1258 on December 17, 2003 as a non-petition TIRZ pursuant to Chapter 311 of the Tax Code. An Agreement was signed between the City of Houston, and Reinvestment Zone Number Twenty-One, (the “Hardy/Near Northside Zone”). The purpose of the agreement was to set out the terms and conditions regarding the payment of costs to provide affordable housing in and out of the Zone. Further, to the provisions of Section II subsection 1 of the agreement, the obligations of the parties regarding funding for the affordable housing costs were to be met, starting from fiscal year 2009 and each subsequent year until termination, through a transmit to the City of an amount shown for affordable housing costs in the City Council approved Operating Budget for the Zone for the fiscal year.

During the course of our audit, we obtained the approved City Council Operating Budgets for fiscal years 2015 and 2016 for both TIRZs, respectively. We performed procedures and compared amounts approved in the budgets for affordable housing costs for each TIRZ, in each fiscal year with the amounts received.

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FINDING:

During fiscal year 2015, Fund 2409 funded by TIRZ 5 was under-funded by \$316,193.27, while in fiscal year 2016, it was overfunded by \$187,248.50 resulting in net underfunding in the amount of \$128,944.77 for the two fiscal years under audit.

Similarly, during fiscal year 2015, Fund 2409 funded by TIRZ 21 was underfunded by \$139,218, while in fiscal year 2016; it was underfunded by \$85 resulting in net underfunding in the amount of \$139,303 for the two years under audit.

The over/under funding amounts revealed by our audit procedures are shown in the tables below:

TABLE 5

TIRZ 5				
Tax Year	Fiscal Year	Amount as per Approved Operating Budget	Amount Received	Over/(Under)
2014	2015	\$1,340,532.00	\$1,024,338.73	\$(316,193.27)
2015	2016	\$1,053,058.00	\$1,240,306.50	\$187,248.50
			Total	\$(128,944.77)

TABLE 6

TIRZ 21				
Tax Year	Fiscal Year	Amount as per Approved Operating Budget	Amount Received	Over/(Under)
2014	2015	\$251,482.00	\$112,264.00	\$(139,218.00)
2015	2016	\$100,178.00	\$100,093.00	\$(85.00)
			Total	\$(139,303.00)

Management representation in response to our inquiries regarding the reason(s) for the under-funding; indicated that budgets for all TIRZs with affordable housing set-aside have a projected amount for affordable housing based on 1/3 of projected increment. As a result, when actual increment is known, the practice is to distribute 1/3 of actual increment for affordable housing which may be less than the budgeted amount in the contract agreement.

RECOMMENDATION:

We recommend that each of the TIRZs be appropriately funded in accordance with the provisions of the affordable housing agreement in operation. This is necessary in order to fulfill the requirements under which the TIRZs were created.

DEPARTMENT MANAGEMENT

RESPONSE:

The controller's audit has brought to our attention that while the preponderance of our tri-party/affordable housing agreements with the redevelopment authorities and tax increment reinvestment zones (TIRZs) require that one third of the annual **'actual'** increment be dedicated to affordable housing, there are two TIRZ affordable housing agreements that are exceptions and requires that one third of a projected budgeted amount be dedicated to affordable housing. For convenience and predictability, we believe that the methodology of applying actual increment, as is the case for most TIRZs, is more straightforward, concise and reflects actual revenue collections. Therefore, our office intends to modify the two agreements from defining budgets as the criteria for affordable housing dedication to utilizing actual increment and ensure that all TIRZs consistently utilize the same methodology.

RESPONSIBLE PARTY:

Office of Economic Development and Finance Departments

ESTIMATED DATE OF COMPLETION:

The accounting adjustment will be made no later than end of the current fiscal year (June 30, 2017) and the amendment will be presented to council during the FY18 budget cycle (before end of calendar year 2017).

ASSESSMENT OF RESPONSE:

Management response sufficiently addressed the issues identified.

**FINDING #4 – TIRZ 18 AFFORDABLE HOUSING AMOUNT NOT RECEIVED WITHIN 30 DAYS OF TAX INCREMENT PAYMENT
(RISK RATING = LOW)**

BACKGROUND:

TIRZ 18 was created by Ordinance No. 1999-766 on July 21, 1999, as a non-petition TIRZ pursuant to Chapter 311 of the Texas Tax Code. On April 20, 2010 an Affordable Housing Agreement (the “Agreement”) was signed between the City of Houston, (the “City”), the Reinvestment Zone Number 18 (“Fifth Ward Zone”) and Fifth Ward Redevelopment Authority (the “Authority”) setting forth the terms and conditions regarding payment of costs to provide affordable housing in and out of the Fifth Ward Zone.

The provisions of Section II subsection 1, provides that Fifth Ward Zone and the Authority shall transmit the funds to the City no later than June 30th of each fiscal year. The Zone and the Authority shall not be required to make the transfer if the City has not made payment of tax increments as required under the Tri-Party Agreement. Where the Zone and the Authority cannot make the required transfers due to the City’s delay in making transfer of tax increment revenue as required under the Tri-Party Agreement, the Zone and the Authority shall make the required payment within 30 days of receiving transfer from the City.

During the course of our audit, we performed procedures to ascertain compliance with the Tri-Party Agreement regarding the timeline for the transmission of funds to the City by the Zone and Authority. We obtained the dates the City made payments of tax increment to the Zone and Authority. We then compared to the dates the City received funds from the Zone and Authority to ascertain whether receipt occurred within 30 days in accordance with the requirements of the Tri-Party Agreement.

FINDING:

Audit procedures revealed the following exceptions regarding the timeline transfers were received by the City from the Zone and Authority. During fiscal year 2015, the Zone and the Authority made the required payment to the City after 145 days, while in fiscal year 2016, payment was made after 42 days, which is in violation of the requirements under the Tri-Party Agreements that payment shall be made after 30 days following the receipt of tax increment from the City (see table below):



TABLE 7

TIRZ 18 Funding Receipt				
Fiscal Year	Date Tax Increment Issued to Authority	Date Funds due to the City	Date Funds Received by City	Variance (No of Days)
2015	06-25-2015	06-30-2015	11-16-2015	145
2016	06-23-2016	06-30-2016	08-11-2016	49

Management representation to our inquiries regarding reason(s) for the delay in meeting the timeline for making the transfer due to the City; indicated that the Executive Director of the Authority could not recall the provisions of the agreement in connection with the timeline for payment to the City. However, it is believed that efforts are in place to ensure that the FY17 Payment will be on the TIRZ’s next meeting agenda along with the budget to be presented to its board to ensure that it is approved before it is due to the City.

RECOMMENDATION:

In order to have the funds available for affordable housing projects, we recommend that funds be made available to the City by the Zone and Authority within 30 days of receiving transfers from the City in accordance with the provisions of the Tri-Party Agreement.

DEPARTMENT MANAGEMENT RESPONSE:

We appreciate the audit’s finding and subsequent recommendation regarding the timely remittance to Fund 2409 and the delayed payments received from TIRZ No. 18. We understand all payments have been remitted and that the account is appropriately funded but that the payments were not made within the 30-day timeframe as described in the tri-party/affordable agreement between the redevelopment authority and the TIRZ. We intend to enhance the Fund 2409 internal controls to ensure that all payments are remitted within a timely manner.

RESPONSIBLE PARTY:

Office of Economic Development.

ESTIMATED DATE OF COMPLETION:

No later than June 2017.

ASSESSMENT OF RESPONSE:

Management response sufficiently addresses the issue identified.



FINDING #5 – EXPIRED TRI-PARTY AGREEMENT FOR TIRZ 5
(RISK RATING = LOW)

BACKGROUND:

By the provisions of Ordinance No. 1996-1337 (the “Ordinance”) approved on December 18, 1996, the City Council designated Reinvestment Zone Number Five, Memorial Heights (the “Zone”) as a non-petition TIRZ pursuant to Chapter 311 of the Texas Tax Code, to provide development or redevelopment over the area known as Memorial Heights. The Ordinance specified a termination date of December 31, 2016 for the Zone. On August 25, 2009, an Affordable Housing Agreement (the “Agreement”) was signed, between the City of Houston (the “City”), The Zone and Memorial-Heights Redevelopment Authority (the “Authority”). The Agreement dated August 25, 2009, set out the terms and conditions regarding the payment of costs to provide affordable housing in or out of the Zone. Similarly, the Agreement had a termination date of December 31, 2016.

On December 8, 2010, the City Council passed and approved an Ordinance No 2010-996 which extended the duration of the Zone until December 31, 2029. However, no similar extension was granted to the Agreement between the City, the Zone and the Authority under which activities relating to affordable housing were carried out. The Agreement expired on December 31, 2016.

During the course of our audit, we obtained and reviewed the Agreement. In addition, we performed procedures to ascertain compliance with the provisions of the Agreement.

FINDING:

During the course of our audit, we noted under Section IV subsection 3, *General Provisions*; the Agreement expired on December 31, 2016. Further audit procedures performed through research and inquiry of key management personnel revealed no extension was granted to the Agreement upon expiration as of December 31, 2016. Such extension to the Agreement is considered necessary especially following the extension of the termination date of Reinvestment Zone under Ordinance No. 2010-996 to December 31, 2029, as failure to do so may render transactions involving affordable housing projects invalid.

RECOMMENDATION:

We recommend that management extend the life of the Agreement which expired on December 31, 2016. This is necessary to accommodate transactions involving affordable housing projects that may need to be embarked upon following the extension of the termination date of the Reinvestment Zone to December 31, 2029.



DEPARTMENT MANAGEMENT

RESPONSE:

Beginning in fiscal year 2009, TIRZ 5, which is an unpetitioned TIRZ and therefore not required to dedicate increment for affordable housing, agreed to enter into an affordable housing agreement to commit to contribute to the affordable housing program and would remit based on a projection of one third of its increment. The termination date for the affordable housing agreement was established as December 13, 2016 and the TIRZ's obligation expired at the end of last year. As part of the annual TIRZ review with the mayor each year, we assess existing contract provisions to determine if any amendment is warranted and proposals are presented to the TIRZ, the redevelopment authority and city council. We will do the same this year.

RESPONSIBLE PARTY:

Chief Development Officer, Mayor Turner and City Legal.

ESTIMATED DATE OF COMPLETION:

N/A

ASSESSMENT OF RESPONSE:

Management response sufficiently addresses the issue identified.



EXHIBIT 1

ACKNOWLEDGEMENT STATEMENT

**HOUSING AND COMMUNITY DEVELOPMENT DEPARTMENT
AND
MAYOR'S OFFICE OF ECONOMIC DEVELOPMENT**

Acknowledgement Statement

Date: July 3, 2017

Chris B. Brown
City Controller
Office of the City Controller

**SUBJECT: PERFORMANCE/COMPLIANCE AUDIT FUND 2409 – AFFORDABLE HOUSING
ACKNOWLEDGEMENT OF MANAGEMENT RESPONSES**

I acknowledge that the management responses contained in the above referenced report are those of the Chief Development Office for the Economic Development Division and Housing and Community Development Department (HCDD). I further acknowledge confirmation from the Controller's Office, that our responses to the audit findings are satisfactory in addressing and resolving the issues presented. I also understand that this document will become a part of the final audit report that will be posted on the Controller's website.

Sincerely,

A handwritten signature in black ink, appearing to read 'A. Icken', written over a horizontal line.

Andrew F. Icken
Chief Development Officer
Office of the Mayor

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