

TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS
An Internal Audit of the Multifamily Asset Management Division Ownership Transfer function
Audit Report #24-001

Executive Summary

The Office of Internal Audit (OIA) performed an audit of the Ownership Transfer function of the Multifamily Asset Management Division. This audit was conducted in accordance with applicable audit standards and included the objectives to review, assess, and evaluate for compliance with applicable rules and regulations. Based on our review and testing, the ownership transfer function appear to be operating effectively in approving development ownership transfers between parties. The auditor has identified the following areas that necessitate improvement, all of which have been detailed in the final audit report.

Observations and Recommendations

- *IA recommends that asset managers ensure that proper letter of explanation and agreement amongst parties is obtained for all non-controlling transfers.*
- *IA recommends that language be added to the appropriate ownership transfer documents addressing the use of draft documents in lieu of final documents for review of ownership transfers. This language should state that any draft documents submitted by owners are accurate representations of final documents, and that no significant material changes would be made to said documents that would impact the outcome of an ownership transfer review.*

Management Response

Management agreed with our recommendations, and detailed response is included in the body of the report.

Objective, Scope and Methodology

Our scope included a review of related Texas Administrative Codes¹, relevant Texas Government Codes², the Qualified Allocation Plan³, relevant federal code⁴, data collected by the division on completed and/or pending ownership transfers, supporting documentation for transfers provided by development owners, board books, and materials found on the TDHCA website for the past 3 years of operation.

Mark Scott

03/12/2024

Mark Scott, CPA, CIA, CISA, CFE, MBA
Director, Internal Audit

Date Signed

¹ TAC Chapter 10.4

² Texas Code §2306.6713, §2306.6726

³ The 2023 and 2024 version

⁴ Federal Code §42



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Board Members of the Texas Department of Housing and Community Affairs ("TDHCA")

RE: Internal Audit of the Multifamily Asset Management Division Ownership Transfer function

Dear Board Members:

This report presents the results of the Office of Internal Audit ("OIA") "*Audit of the Multifamily Asset Management Division Ownership Transfer function*". This audit was conducted in accordance with applicable audit standards and included the objectives to review, assess, and evaluate the ownership transfer function for compliance with applicable rules and regulations.

The Multifamily Asset Management Division rated high on the annual risk assessment due to a lack of prior audits, as well as its importance in ensuring proper processes and approval for each state of the construction process. Three specific functions of the division were chosen for an audit: amendments and transfers, construction status reports, and ownership transfers. This report addresses the ownership transfer function only—the remaining two functions will be addressed in future audit reports.

This report includes the following sections:

- A. Overall Result
- B. Background
- C. Scope and Methodology
- D. Roles and Responsibilities
- E. Testing and Recommendations

A. Overall Results

Based on our review and testing, the ownership transfer function appears to be operating effectively. The auditor has identified two recommended areas for improvement.

B. Background

Asset Management is responsible for development-performance oversight for all multifamily properties. The Asset Management team operates in a proactive manner by enforcing regulatory documents to minimize exposure to the Department and ensure long term financial viability of developments. The ownership transfer process is an indispensable administrative function of the Asset Management Division. In general, this function handles two main ownership changes: 1) the sale or transfer of controlling interest of a development to a new party, and 2) changes of a development's non-controlling interests or limited partners. These two main prongs have different documentation submittal requirements. The sale of a property or transfer of a controlling interest requires detailed documentation to be provided, which includes but is not limited to the following: a letter of explanation, documents regarding the financial health of new parties, experience with managing low-income properties, proof of 30-day tenant notice, and confirmation of compliance with government programs (if applicable). This paperwork is reviewed by the Asset Management team and forwarded to the Executive Director for final approval. It should be noted that the Division may not bar an ownership transfer from occurring without sufficient reasoning. Changes to non-controlling interests or non-controlling limited partners requires less documentation; typically, a letter of explanation, a new organization chart, and an agreement among new parties must be submitted. These changes do not require TDHCA approval to occur. Regardless of the type of transfer, all multifamily development owners must provide written notice, and/or a completed ownership transfer packet at least 45 calendar days prior to any sale, transfer, or exchange of the development or any portion of or controlling interest in the development.

C. Scope and Methodology

Our scope included a review of related Texas Administrative Codes¹, relevant Texas Government Codes², the Qualified Allocation Plan³, relevant federal code⁴, data collected by the division on

¹ TAC Chapter 10.4

² Texas Code §2306.6713, §2306.6726

³ The 2023 and 2024 version

⁴ Federal Code §42

completed and/or pending ownership transfers, supporting documentation for transfers provided by development owners, board books, and materials found on the TDHCA website for the past 3 years of operation.

D. Roles and Responsibilities

PROGRAM STAFF: The ownership transfer process is supervised by the Director of Multifamily Asset Management. The ownership transfer workload is divided amongst eight Asset Managers, all of which are assigned a geographical area in Texas. Each Asset Manager handles transfer requests originating from their assigned area; however, other Asset Managers may assist other managers with their assignments as needed. The division also employs assistants to help with clerical work and other day to day office tasks. Ownership transfers that involve a major transfer of a controlling party require the written approval of the Executive Director of the TDHCA. The Multifamily Asset Management Division also works in tandem with the Compliance Monitoring team and the Financial Administration Division. The Compliance team helps to ensure that all compliance stipulations are addressed and acknowledged before a transfer occurs. The Financial Administration Division handles payment of fees associated with ownership transfers.

PARTICIPANTS: The participants in the ownership transfer function are the entities and natural persons involved in the transfer of ownership of multifamily housing units. These entities can be for-profit corporations or non-profit entities.

E. Testing and Recommendations

The auditor began the review by cross-referencing Texas government code, Texas administrative code, and federal code with internal manuals and guides provided by the division. The purpose of this test was to review whether division processes adhered to code stipulations. One discrepancy was identified in division operations. Texas government code states that tenant notification should occur before the 30th day preceding the date of submission—however, it appears to be regular practice that tenant notification occurs only a few days before ownership transfer packets are submitted. If the 30 day notification is not met, a tenant could take legal action against the development and TDHCA. The division, however, does ensure that 30 days have elapsed between tenant notification and final approvals of the transfer. The auditor’s review of sample ownership transfers appears to corroborate this fact. As a result, no formal recommendation is issued regarding this discrepancy, as long as the division continues to ensure that the 30 day tenant notification is met.

Next, the auditor reviewed an Excel sheet provided by the division regarding all controlling and non-controlling interest transfers or sales. The data was reviewed for any potentially anomalous data, such as multiple transfers of the same property within a short timeframe, as well as summary review of who is conducting the transfers and for what purposes. It was identified that 70 data entries involved Wells Fargo—one of these transfers was flagged for further review. No additional anomalous data points were identified.

Transfers involving a controlling interest or sale constituted roughly 48% of transfer requests within the past 3 years of operation—this includes property sales, transfer of general partner interest, addition of new controlling members, GP acquisitions of ILP interest, and changes in ownership prior to the issuance of IRS document 8609. Notification of non-controlling interest changes within a development accounted for 50% of data collected—this includes changes to limited partners with no controlling interest, affiliate transfers, related parties with no controlling interest, and involuntary removal of general partner with no replacement. The remaining 2% of transfers lack classification due to being recent transfer requests that are currently being processed.

Lastly, the auditor conducted testing on 13 ownership transfers to confirm that all documentation requirements were met. Three transfers within the past three years were selected by the auditor specifically based on board action items within the past year, lack of classification, or outstanding questions regarding non-controlling transfers to Wells Fargo (as mentioned above). The remaining 10 were selected from the year 2023 only via random sampling. All ownership transfers appear to contain all required documentation, save one non-controlling transfer, which was missing a proper letter of explanation and agreement among parties involved with the development. It was also identified that six transfers contained a draft and/or unsigned copy of the agreement among parties, and that the final agreement was not obtained. Due to the constantly changing nature of large development ownership transfers, the auditor finds it acceptable to review drafts for approval purposes, assuming no major changes are made between the reviewed draft and final agreement. A recommendation regarding this practice, however, is listed below to reduce risk to the division. Recommendations addressing these observations are listed below:

Observation Number	Status Pertaining to the Recommendations and Action to be Taken	Target Completion Date	Responsible Party
24-001.01	IA recommends that asset managers ensure that proper letter of explanation and agreement amongst parties is obtained for all non-controlling transfers.	3/11/2024	Rosalio Banuelos
24-001.02	IA recommends that language be added to the appropriate ownership transfer documents addressing the use of draft documents in lieu of final documents for review of ownership transfers. This language should state that any draft documents submitted by owners are accurate representations of final documents, and that no significant material changes would be made to said documents that would impact the outcome of an ownership transfer review.	8/1/2024	Lee Ann Chance

Management Response:

For Observation Number 24-001.01, Asset Managers have been reminded that the Post Award Activities Manual requires a letter of explanation and agreements among the parties for transfers for non-controlling partners, and Asset Managers have been asked to ensure that this information is collected for future transfers.

For Observation Number 24-001.02, the Post Award Activities Manual and the ownership transfer forms will be revised to clarify that the use of draft documents in lieu of final documents for review of ownership transfers is acceptable. In addition, the owner certification form will be updated to state that any draft documents submitted by owners are accurate representations of final documents, and that no significant material changes would be made to said documents that would impact the outcome of an ownership transfer review.

OIA extends our appreciation to the Asset Management Division and staff for their cooperation and assistance during the course of this audit.

Sincerely,

Mark Scott

Mark Scott, CPA, CIA, CISA, CFE, MBA
Internal Audit Director

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