A REPORT
TO THE
ARIZONA LEGISLATURE

Performance Audit Division

Performance Audit and Sunset Review

Arizona Department of Housing

June • 2010
REPORT NO. 10-05

Debra K. Davenport
Auditor General

The **Auditor General** is appointed by the Joint Legislative Audit Committee, a bipartisan committee composed of five senators and five representatives. Her mission is to provide independent and impartial information and specific recommendations to improve the operations of state and local government entities. To this end, she provides financial audits and accounting services to the State and political subdivisions, investigates possible misuse of public monies, and conducts performance audits of school districts, state agencies, and the programs they administer.

The Joint Legislative Audit Committee

Representative **Judy Burges,** Chair

Representative **Tom Boone**
Representative **Cloves Campbell, Jr.**
Representative **Rich Crandall**
Representative **Kyrsten Sinema**
Representative **Kirk Adams** (*ex efficio*)

Senator **Thayer Verschoor,** Vice Chair

Senator **John Huppenthal**
Senator **Richard Miranda**
Senator **Rebecca Rios**
Senator **Bob Burns** (*ex efficio*)

Audit Staff

Melanie M. Chesney, Director

Shan Hays, Manager and Contact Person
Anne Hunter, Team Leader
Monique Cordova
Winter Morris
Marc Owen

Copies of the Auditor General's reports are free.
You may request them by contacting us at:

Office of the Auditor General
2910 N. 44th Street, Suite 410 • Phoenix, AZ 85018 • (602) 553-0333

Additionally, many of our reports can be found in electronic format at:
www.azauditor.gov

DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

June 2, 2010

Members of the Arizona Legislature

The Honorable Janice K. Brewer, Governor

Mr. Michael Trailor, Director
Arizona Department of Housing

Transmitted herewith is a report of the Auditor General, a Performance Audit and Sunset Review of the Arizona Department of Housing. This report is in response to a November 3, 2009, resolution of the Joint Legislative Audit Committee. The performance audit was conducted as part of the sunset review process prescribed in Arizona Revised Statutes §41-2951 et seq. I am also transmitting within this report a copy of the Report Highlights for this audit to provide a quick summary for your convenience.

As outlined in its response, the Department of Housing agrees with the findings and plans to implement the report's one recommendation.

My staff and I will be pleased to discuss or clarify items in the report.

This report will be released to the public on June 3, 2010.

Sincerely,

Debbie Davenport
Auditor General

Attachment

2910 NORTH 44th STREET • SUITE 410 • PHOENIX, ARIZONA 85018 • (602) 553-0333 • FAX (602) 553-0051

STATE OF ARIZONA
OFFICE OF THE
AUDITOR
GENERAL

Arizona Department of Housing

REPORT
HIGHLIGHTS
PERFORMANCE AUDIT

Our Conclusion

The Arizona Department of Housing (Department) was created in 2002 and administers housing programs that have increased affordable housing opportunities and improved community services. The Department generally does not provide direct services but instead acts as a "pass-through" agency for various services and programs—many targeting the State's rural areas. We reviewed four of the Department's largest programs: Low-Income Housing Tax Credit, Community Development Block Grant, and two home purchase assistance programs. We found that these programs have increased affordable housing opportunities—especially for low-income housing—and have facilitated over 430 projects during state fiscal years 2003 through 2009 that have improved community services in Arizona's rural communities. Further, the Department has a generally sound system for overseeing the programs it administers.

2010

June • Report No. 10 - 05

Affordable housing increased and communities enhanced

Low-Income Housing Tax Credit program—Through this federal program, developers agree to hold a portion of their rental units for low-income households, which earn at or below 60 percent of the area's median income. These households pay an "affordable rent" based on the area's median income and the number of persons and bedrooms in the unit. For example, 50 percent of the median income for Maricopa County for one person is $23,050, and the maximum rent he/she would pay is $576 for a studio unit. In exchange, the developer receives a federal tax credit that can be sold to investors to raise proceeds to build rental properties.

Since 2003, the Department has awarded nearly $82 million in federal tax credits, helping to develop about 7,000 low-income housing units. The Department has distributed these projects throughout the State with 66 percent located outside Maricopa and Pima Counties.

The report describes three recent examples of these projects:

- Matthew Henson Development—A 549-unit project with 445 units reserved for low-income households. Replacing an existing 1940s-built, low-income housing project, Phoenix city officials reported that this development has helped revitalize the downtown area surrounding it.
- Page Commons—A 100-unit senior housing complex located in downtown Gilbert that addressed the need for affordable housing for a growing population of seniors. This too revitalized the downtown Gilbert area, according to Gilbert officials.
- Maddox Estates Townhomes—A 60-unit project that helped address a serious need for affordable housing in Eloy. The development accommodates larger families and provides a pool and recreation area that other housing in the area does not.

Community Development Block Grant (CDBG)—This federal community revitalization program provides grants to benefit low- and moderate-income people by alleviating slum conditions and addressing urgent community needs in Arizona's rural counties. For example, in 2005, the Department awarded the City of Eloy more than $340,000 to connect its water distribution system to an outlying area called Toltec. Before the connection, whenever the Toltec water system would malfunction, Eloy employees had to purchase bottled water and deliver it to Toltec residents who ran out of water. It also created a fire hazard in Toltec because it would disrupt the source of water for fighting fires. The water connection construction has ensured a continuous supply of water to Toltec in the event of a system malfunction.

The report also describes CDBG grant monies to a food bank serving low-income

Photo 1: Matthew Henson Development—Phoenix

Source: Courtesy of Matthew Henson Apartments.

persons in Tombstone and a construction-job-training program for youth in the City of San Luis that has promoted the graduation of at-risk students.

Home purchase programs help Arizonans buy homes—The Homes for Arizonans program provided a portion of the down payment on a home to first-time homebuyers in rural Arizona, and between 2002 and 2009, it provided $30 million in assistance to 2,500 households.

In July 2009, this program gave way to a program using federal stimulus money to help individuals purchase foreclosed homes. Under the Your Way Home program, the Department offers 22 percent of the purchase price in the form of a deferred second mortgage to buyers who are at or below 120 percent of the area's median income. As of March 2010, 462 homes have been purchased with an average assistance of about $30,000 per home.

Department effectively plans, awards, and monitors resources

The Department has developed effective systems for overseeing the housing programs it administers. For example, the Department maintains a strong control environment over the low-income housing tax credit program to ensure compliance with federal Internal Revenue Service requirements regarding eligibility and monitoring. The Department:

- Has developed written operating procedures for staff and compliance manuals for developers, and
- Provides training for property owners.

The Department also conducts thorough on-site inspections and takes appropriate action when it discovers problems. For example, at one development, department inspectors reviewed a random sample of 62 of 102 tax credit units, including reviewing tenant files to ensure eligibility and physically inspecting the units. The Department discovered income verification problems in more than half the sample and problems with about half of the units' physical conditions.

The State has a 5-year plan for CDBG money that addresses the needs of low- to moderate-income persons and addresses slums and urgent community needs. Department staff also follow comprehensive guidelines to review projects and takes actions if there is not satisfactory progress. In one instance, the Department issued a Failure to Progress letter to a town whose water system improvement project was not proceeding in a timely manner. If the town had not addressed the timeliness issues, it would have lost funding and had to repay the monies it had already received.

The Department also oversees lenders and nonprofit counseling agencies helping low-income persons to purchase homes. It does this primarily by using the Internet to receive application information from the lenders and reviewing the information to ensure borrowers fall within the required income guidelines.

TABLE OF CONTENTS

continued

TABLE OF CONTENTS

Tables:

continued

TABLE OF CONTENTS

Tables (Continued):

Figures:

continued

TABLE OF CONTENTS

Photos:

concluded

INTRODUCTION & BACKGROUND

The Office of the Auditor General has conducted a performance audit and sunset review of the Arizona Department of Housing (Department) pursuant to a November 3, 2009, resolution of the Joint Legislative Audit Committee. The audit was conducted as part of the sunset review process prescribed in Arizona Revised Statutes (A.R.S.) §41-2951 et seq. In addition to assessing the Department's operations using the sunset factors specified in statute, this audit focuses on four of the Department's largest programs and examines (1) the accomplishments these programs have achieved and (2) the effectiveness of the Department's oversight of these programs.

Department mission and purpose

The Department was established in 2002 to help address an anticipated housing affordability crisis brought on by a widening gap between income and housing costs.[1] The Department's mission is to provide housing and community revitalization to benefit the people of Arizona. According to the Department, as of 2003, over 10 percent of Arizona families were not in affordable housing, defined as housing that costs no more than 30 percent of the adjusted household income. In 2008, according to U.S. Census Bureau American Community Survey data, approximately half of renter-occupied units and approximately 40 percent of homes with mortgages did not meet the standard for affordability.[2]

In the past several years, housing issues have become prominent concerns because of the housing market meltdown and the related damage to the nation's economy. In Arizona, rapid population growth helped fuel Arizona's affordable housing and foreclosure crisis to nearly the worst of all the states. Nationally, Congress directed stimulus monies to Arizona and other states, including housing-related monies through the Housing and Economic Recovery Act of 2008 (HERA) and the American Recovery and Reinvestment Act of 2009 (ARRA). Some of this stimulus money passes through the Department.

1 Prior to its establishment, the Department's functions were performed by the Department of Commerce. In 2001 the Legislature enacted Laws 2001, Ch. 22, §§12 and 14, which transferred the housing programs within the Department of Commerce first to the Governor's Office of Housing Development beginning January 1, 2002, and ultimately to the new Arizona Department of Housing on October 1, 2002. The same bill that established the Department established the Arizona Housing Finance Authority (Authority). The Authority was established to issue bonds or certificates or provide financial assistance for housing purposes and to temporarily acquire title to real property. Although the Authority is staffed by the Department, it is a separate entity from the Department and is not subject to sunset review. However, some of the Department's programs are administered jointly with the Authority.

2 U.S. Census Bureau. Arizona: Selected Housing Characteristics: 2006-2008. Data Set: 2006-2008 American Community Survey 3-Year Estimates.

The Department provides monies, technical assistance, and compliance oversight to local governments, public housing authorities, nonprofit and for-profit housing developers, tribal entities, social service agencies, and qualifying individuals using a combination of federal and state monies. The monies are provided for such things as increasing the supply of affordable rental housing, assisting communities with area revitalization, and providing home purchase assistance. In addition, monies are used to provide housing and related services for individuals with special needs.

Department responsibilities and programs

The Department administers state and federal monies for a variety of programs.

The Department generally does not provide direct services but instead acts as a "pass-through" agency by administering and overseeing programs and services, several of which are targeted to the State's rural areas. These programs provide federal and state monies to local governments, housing developers, and nonprofit agencies in four areas, described below and shown in Figure 1 (see page 3). Figure 1 also shows the Department's various programs in each of the four areas. Department personnel also provide technical assistance to communities and serve on a state-wide commission that addresses affordable housing needs. Additionally, according to the Department, staff have been involved in the Arizona Foreclosure Prevention Task Force to help coordinate outreach and service efforts for the National Mortgage Foreclosure Counseling program.

Rental housing development and rental assistance—The Department administers two programs targeted to increasing the supply of affordable rental housing or helping low-income, elderly, and special needs renters. Specifically:

- **Low-Income Housing Tax Credit program (tax credit program)**—This U.S. Internal Revenue Service program awards federal tax credits to housing developers.[1] In exchange for these credits, developers agree to hold a portion of their rental units for low-income households and charge affordable rents to qualified tenants in those units. The Department administers and allocates Arizona's portion of the program state-wide. Since 2003, the Department has awarded nearly $82 million in tax credits and helped develop 6,864 low-income housing units. In 2009, the program awarded over $9 million in tax credits to develop low-income housing. The Department also administers the Tax Credit Assistance Program (TCAP) of the ARRA, which provides gap finance loans to help housing developers cover additional construction costs associated with projects in Arizona that have already received an allocation of credits in 2007, 2008, and 2009.

1 Tax credits can be used to reduce federal tax liability for a period of 10 years.

Figure 1: Department of Housing Activities, Programs, and Resources As of March 31, 2010

Housing Development and Assistance			Community Revitalization
Rental Development and Assistance	Owner-Occupied Housing	Homeless and Special Needs Housing	
Tax Credit Administration *Low Income Housing Tax Credits* (IRS tax credits) *Section 1602 Tax Credit Exchange* (2009 federal stimulus monies)[1]	**Home Purchase Assistance** *Homes for Arizonans*[2] (Housing Trust Fund) *Your Way Home* (2008 federal stimulus monies)	**Emergency Housing** *Eviction Prevention and Emergency Housing* (Housing Trust Fund) *Homelessness Prevention and Rapid Re-Housing* (2009 federal stimulus monies)	**Regional and Special Grants,** *Community Development Block Grant* (HUD monies) *Community Development Block Grant -Recovery* (2009 federal stimulus monies)
Gap Finance Loans *Rental Development Gap Loans* (Housing Trust Fund, HOME monies) *Tax Credit Assistance Program* (2009 federal stimulus monies)	**Housing Development and Rehabilitation** *Homeownership Unit Development* (Housing Trust Fund, HOME monies) *Owner-Occupied Rehabilitation* (Housing Trust Fund, HOME, and other HUD monies)	**Special Needs Housing** *Housing Opportunities for Persons with AIDS* (HUD monies) *Shelter Plus Care* (HUD monies) *Supportive Housing Program* (HUD monies)	
Public Housing Authority *Project-Based Contract Administration* (HUD monies) *Section 8 Housing Choice Voucher Program-Yavapai County* (HUD monies)			

1 Federal stimulus resources refer to resources that became available as a result of the HERA and the ARRA.

2 The Department suspended Homes for Arizonans in July 2009 because of instability with its sole funding source, the State Housing Trust Fund.

Source: Auditor General staff analysis of department-provided information, including its fiscal year 2003 through 2009 annual reports, the *FY2005-2009 State of Arizona Consolidated Plan*, the Department's HERA and ARRA action plans, and other department-provided information on programs, activities, and resources.

- **Public Housing Authority**—The Public Housing Authority operates two federal Section 8 programs.[1] First, Project-Based Contract Administration provides oversight and monitoring responsibilities for approximately 110 subsidized properties, representing over 7,900 housing units throughout Arizona. Second, the Public Housing Authority administers the U.S. Department of Housing and Urban Development's (HUD) Section 8 Housing Choice Voucher Program in Yavapai County because the County is not served by a local public

1 The U.S. Housing Act of 1937, Section 8, authorizes rental voucher and existing housing programs intended to help low-income households choose and rent safe, decent, and affordable housing. Regulations are found in 24 C.F.R., Part 982, and the programs are administered by HUD's Office of Public and Indian Housing.

housing authority. The voucher program helps very low-income households limit housing and utilities expenses to 30 percent of their household's income. In 2009, over 8,000 households received over $43 million of Section 8 assistance through the Public Housing Authority programs.

The Department's community revitalization program targets rural areas.

Community revitalization—The Department administers a federal program to revitalize small towns and communities throughout rural Arizona. This program is called the Community Development Block Grant (CDBG) program. It provides federal monies for a wide variety of qualified local housing and community revitalization projects. Distribution criteria requires that projects meet one of three national program objectives: benefiting people with low and moderate income, alleviating slum or blight conditions, or addressing urgent community development needs.

The CDBG program administered by the Department focuses on rural areas. While most major Arizona cities and counties receive CDBG monies directly from HUD, the Department contracts with four regional councils of government to help rural communities prioritize and coordinate local CDBG developments. In fiscal year 2009, according to the Department's Annual Report, the Department administered over $11 million in CDBG funding to community projects and individual homeowners throughout the State. Eighty-five percent of these monies were distributed regionally by the councils of government, while the remaining 15 percent were allocated for state-wide distribution through competitive bids.

Home ownership assistance—The Department administers federal and state monies for home purchase assistance, home ownership education and counseling, and rehabilitation of owner-occupied homes. Specifically the home purchase assistance programs are:

- **Your Way Home**—Using federal stimulus monies, the Department implemented a state-wide home purchase program called Your Way Home. The program helps qualified homebuyers purchase eligible foreclosed homes. Participants' gross income must be no greater than 120 percent of the area's median income for the county where the foreclosed property is located. As of March 12, 2010, the program had facilitated the purchase of 462 homes with nearly $13.7 million expended.

- **Homes for Arizonans**—From June 1998 until July 2009, the Department offered this first-time homebuyer program for Arizona's rural areas. The program was supported jointly by the State Housing Trust Fund and the Arizona Housing Finance Authority (see page 1 for more information on the Housing Finance Authority and page 9 for information on the State Housing Trust Fund). The Department distributed $2.7 million to homebuyers through Homes for Arizonans between January and mid-July of 2009, assisting 226 households. According to the Department, the program was suspended in

July 2009 to make way for the Your Way Home program and because of the uncertainty of continued funding for the program.

Special needs—Finally, the Department administers federal and state monies to provide housing services to targeted populations, such as people with HIV/AIDS, or people facing homelessness or needing emergency assistance. Specifically:

- **Housing Opportunities for Persons with AIDS (HOPWA)**—This program provides monies to nonprofit organizations to assist in providing housing or related services to individuals with HIV/AIDS. Money is passed through to local governments or nonprofit organizations that provide direct assistance to eligible participants. The Department provides administrative oversight for HOPWA programs and reported that in fiscal year 2009, the HUD program monies for HOPWA totaled $185,270.

- **Homeless programs**—These programs competitively award monies to local governments or nonprofit agencies that offer programs to address homelessness problems that may go beyond basic housing concerns. This category addresses needs of populations experiencing serious mental illness, domestic violence, substance abuse, and other issues.

  The Department administers three such homelessness programs. First, under a federally funded rural Continuum of Care process, the Department issues grants for Shelter Plus Care, which provides rental assistance for homeless persons with disabilities, such as serious mental illness, and Supportive Housing Program monies, which are used for housing and services that assist people in the transition from homelessness, as well as services that enable homeless persons to live as independently as possible. The services include such things as child-care, employment assistance, health services, and case management. The Shelter Plus Care program provided $7 million of assistance in fiscal year 2009 and the Supportive Housing Program provided $2.3 million of assistance in fiscal year 2009. Second, the Department administers Eviction Prevention/Emergency Housing grants. Under this program, which, according to the Department, will be discontinued in June 2010, State Housing Trust Fund monies are available for rental security deposits, utility payments, and mortgage payment assistance to deter homelessness. In fiscal year 2009, more than $3.7 million was committed to the Eviction Prevention/Emergency Housing program. Third, the Department administers the Homeless Prevention/Rapid Re-Housing program (HPRP), which uses federal stimulus monies to assist low-income families to retain or secure housing by providing services such as rental and housing relocation assistance and utility payment assistance. The Department was awarded more than $7 million in federal stimulus monies for this program.

The Department administers several programs aimed at assisting the homeless.

Organization and staffing

The majority of department staff are supported with federal monies.

The Department of Housing has a governor-appointed director and two major divisions: Programs and Operations. The Department had a total of 56 full-time equivalent positions (FTEs) for fiscal year 2010, including 2 in the Director's office, and 0 vacancies as of May 5, 2010. In addition, the Department has established 3 new positions for a new federal program that will start in the summer of 2010.[1] According to the Department, only 11 positions are state-appropriated with State Housing Trust Fund monies. The remaining positions are supported with monies from federal resources that are allowed to be set aside for program administration, program fees such as tax credit program application fees, and other non-State General Fund resources.

The **Programs Division** (27 FTE) oversees programs the Department administers and is organized into four areas. Specifically:

- **Community Development and Revitalization** oversees the Department's administration of the CDBG program, and accepts and reviews home ownership applications for State Housing Trust Fund and federal HOME Investment Partnerships Program (HOME) monies.[2] The unit is also responsible for overseeing the Department's home purchase assistance programs such as Homes for Arizonans and Your Way Home.

- **Rental Programs** staff administer the tax credit program and review applications for gap finance loans for projects that have already received tax credits, but require additional funding (see page 10 for more information on the federal stimulus monies).

- **Risk Assessment** officers provide underwriting and risk analysis assessments on proposed rental development program projects. The risk assessment staff also review some types of housing bonds issued by the Arizona Housing Finance Authority for affordable and special needs housing (see page 1 for information about the Arizona Housing Finance Authority).

- **Special Needs** administers the Department's programs that assist people with HIV/AIDS, serious mental illness, or chronic substance abuse, and persons and families who are homeless or victims of domestic violence.

1 In February 2010, the Obama Administration announced its intent to award more that $1.5 billion to the five states hardest hit by the foreclosure crisis. The Department anticipates receiving $125.1 million of these monies, which are authorized by the federal Emergency Economic Stabilization Act of 2008.

2 Federal HOME monies are monies allocated to the Department for both home ownership and rental housing projects.The Rental Programs area reviews applications for rental housing projects and administers rental project monies.

The **Operations Division** (26 FTE) is responsible for finance and accounting, human resources, information technology, and legal services, and houses the Department's Public Housing Authority functions. The Division also has specific program responsibilities in the following area:

- **Housing compliance** officers monitor the long-term compliance of rental development program properties that benefited from the tax credit program as well as federal HOME monies. See Finding 2, pages 31 through 42, for more information on compliance activities.

The Department also provides staff support to the Arizona Housing Commission, an advisory body to the Department, and the Arizona Housing Finance Authority, a separate entity with its own housing assistance programs. Specifically:

- **The Arizona Housing Commission** comprises 24 members from private industry; community-based nonprofit housing organizations; and state, local, and tribal governments, with staff support provided by the Department. The Commission, established by Laws 2001, Ch. 22, §14, is an advisory body to the Department. Some of its statutory duties are to recommend housing strategic planning and policy; coordinate public and private housing finance programs; provide recommendations for better private and public partnerships and initiatives to develop housing; review state housing programs; encourage the development of special needs housing; and advise the Governor, Legislature, and state and local government agencies on public and private actions that affect the cost or supply of housing.

- **The Arizona Housing Finance Authority** (1 FTE) consists of seven governor-appointed board members. One full-time department employee provides staff support. The Department and the Authority also have an interagency service agreement in which the Department provides administrative, operating, and programmatic support to the Authority. The Authority, created in 2002, can issue Multi-Family Revenue Bonds for rental projects, low-interest Single-Family Mortgage Revenue Bonds for first-time homebuyers' primary financing, and Mortgage Credit Certificates to help provide additional income for first-time homebuyers through tax credits.

Funding sources and financial operations

The Department receives monies from a variety of federal and state sources, but none from the State General Fund. In fiscal year 2009, its revenues totaled more than $110 million, as shown in Table 1 (see page 8).[1]

The Department's activities are funded with a combination of state and federal monies.

1 This does not include the value of the Low-Income Housing Tax Credits received from the U.S. Internal Revenue Service. According to the Department's fiscal year 2009 annual report, it received and allocated more than $118.5 million worth of tax credits. The Department reports tax credit figures at the projected 10-year value of the credits at current market prices.

Table 1: Schedule of Revenues, Expenditures, and Changes in Fund Balance [1]
Fiscal Years 2008 through 2010
(Unaudited)

	2008 (Actual)	2009 (Actual)	2010 (Estimate)
Revenues:			
Intergovernmental	$68,040,133	$77,445,907	$123,241,500
Unclaimed property proceeds [2]	33,684,313	28,554,061	10,500,000
Charges for services	3,461,899	1,603,094	2,843,400
Interest and other investment income	2,703,240	932,073	707,000
Loan and other income	1,201,437	659,039	300,000
Other	34,400		
Total revenues	109,125,422	109,194,174	137,591,900
Expenditures and transfers:			
Personal services and related benefits	4,565,920	4,269,446	4,302,800
Professional and outside services	537,702	700,026	443,900
Travel	105,310	99,911	114,500
Food	24,138	84,647	90,000
Aid to organizations and individuals	87,302,569	97,180,758	135,502,700
Other operating	923,380	829,907	846,200
Equipment	75,629	25,965	107,000
Total expenditures	93,534,648	103,190,660	141,407,100
Transfers to the Housing Finance Authority [3]	4,000,000	1,500,000	
Transfers to the State General Fund [4]	13,437,000	32,948,600	13,565,400
Transfers to other state agencies [5]	2,032,262	3,775,738	2,025,000
Total expenditures and transfers	113,003,910	141,414,998	156,997,500
Net change in fund balance	(3,878,488)	(32,220,824)	(19,405,600)
Fund balance, beginning of year	73,734,727	69,856,239	37,635,415
Fund balance, end of year [6]	$69,856,239	$37,635,415	$ 18,229,815

1 Excludes the Arizona Housing Finance Authority because it is a separate entity and is not subject to sunset review.

2 In accordance with A.R.S. §44-313, the Department's State Housing Trust Fund received 35 percent of the proceeds from the sale or conversion of unclaimed properties in the State during fiscal years 2008 and 2009. Laws 2009, 4th S.S., Ch. 3, §12, changed the allocation to $10.5 million beginning in fiscal year 2010.

3 The Department transferred $4 million to the Arizona Housing Finance Authority during fiscal years 2008 and 2009 as part of its intergovernmental agreement with the Authority. During fiscal year 2009, the Department transferred back from the Authority $2.5 million; therefore, the net transfers to the Authority for fiscal year 2009 were $1.5 million.

4 Consists of transfers to the State General Fund in accordance with Laws 2008, Ch. 53, §§2 and 23, and Ch. 285, §§24 and 46; Laws 2009, Ch. 11, §110, and Ch. 12, §144, 1st S.S., Ch. 1, §§4 and 5, and 5th S.S., Ch. 1, §2; and Laws 2010, 7th S.S., Ch. 1, §113.

5 Includes $2 million each year transferred to the Department of Health Services for the development of housing for the seriously mental ill. In addition, fiscal year 2009 includes $1 million transferred to the Department of Economic Security to provide housingservices to homeless youth and $750,000 to the Department of Veterans' Services to create and expand the availability of safe,decent, and affordable housing for veterans experiencing homelessness.

Source: Auditor General staff analysis of the Arizona Financial Information System (AFIS) *Accounting Event Transaction File* for fiscal years 2008 and 2009; the AFIS Management Information System *Status of General Ledger-Trial Balance* screen for fiscal years 2008 and 2009; and department-provided estimates for fiscal year 2010 as of April 9, 2010.

Key categories of funding include:

- **Federal agency programs**—In fiscal year 2009, more than $77 million of the total was received from other government agencies, including HUD. For several HUD-funded programs, the amount of funds made available through the Department is determined using a formula-based system (see Table 6 in Appendix B, pg. b-i).

- **State Housing Trust Fund**—This fund administered by the Department receives proceeds from the State's unclaimed property and investment earnings. The Department received more than $28 million in fiscal year 2009 in accordance with A.R.S. §44-313, which required the Department of Revenue to deposit 55 percent of unclaimed property proceeds into the State Housing Trust Fund, including 20 percent for use in rural areas and areas with state prison facilities. However, the Legislature amended A.R.S. §44-313 beginning in fiscal year 2010, changing the State Housing Trust Fund allocation to a fixed amount of $10.5 million annually.[1]

  State Housing Trust Fund monies are used to support all the Department's programs. For example, they have been used for rental development gap financing loans and for emergency assistance to individuals.[2] In fiscal years 2008, 2009, and 2010, the Legislature transferred $10.2 million, $25.8 million, and $7 million, respectively, from the State Housing Trust Fund to the State General Fund.[3] In addition, in fiscal year 2008, the Legislature transferred the remaining balance of $364,000 in the Housing Development Fund, which had been established to implement a program in areas with state prison facilities, to the State General Fund.

- **Housing Program Fund**—This fund, also administered by the Department, is authorized to receive monies from a variety of fees, investment earnings, and other sources. The fees include fees for reviewing applications for the tax credit program and monitoring long-term compliance with the program; fees for reviewing industrial development authorities' applications to issue bonds to finance certain types of facilities, including rental projects and some medical facilities; and fees or cost reimbursements for any of its programs or duties. In fiscal year 2010, the Department estimated it would collect $5.3 million in fees. Housing Program Fund monies can be used to pay the costs of administering

1 This change was part of the Revenue Budget Reconciliation enacted in Laws 2009, 4th S.S., Ch. 3, §12, which the Governor approved on November 23, 2009, and effective retroactively to June 30, 2009. A.R.S. §44-313 as amended does not designate any of these monies to rural areas or areas with state prison facilities.

2 Gap financing loans are used to fill the gap left by traditional financing methods.

3 These transfers were required by Laws 2008, Ch. 53 and 285; Laws 2009, Ch. 12; Laws 2009, 1st S.S., Ch. 1 and 5th S.S., Ch. 1; and Laws 2010, 7th S.S., Ch. 1. In addition, Laws 2010, 7th S.S., Ch. 1, requires $4.5 million to be transferred from the State Housing Trust Fund to the State General Fund in fiscal year 2011.

any department program. In fiscal years 2008, 2009, and 2010, the Legislature transferred \$2.8 million, \$3.5 million, and \$6.6 million, respectively, from the Housing Program Fund to the State General Fund.[1]

- **Federal stimulus monies**—Starting in 2008, the Department has received additional monies through federal stimulus programs that HUD and the U.S. Department of the Treasury fund. First, the HERA, which created the federal Neighborhood Stabilization Program, provided Arizona with a total of \$121.1 million, of which \$38 million was provided to the Department for use in housing programs state-wide. The remaining monies were provided directly to cities within Maricopa and Pima Counties (see Table 2, page 11). These monies were targeted to areas with high foreclosure rates and were limited to five eligible uses (see textbox). The Department is using \$26 million to fund the Your Way Home program, which assists individuals in purchasing foreclosed homes, \$9.6 million for redeveloping foreclosed, vacant or blighted multi-family properties, and \$2.7 million for planning and administration. Second, the 2009 ARRA authorized Arizona jurisdictions a total of \$153.3 million of additional monies for HUD programs, including the CDBG, homelessness prevention programs, and gap finance loans. The ARRA also authorized states to exchange a portion of their credit program ceiling for cash grants to make awards for building or rehabilitating low-income housing. The Department was awarded \$42.5 million for the HUD programs and \$37.6 million from the U.S. Treasury for the tax credit exchange program.[2] Finally, according to the Department, it will receive \$125.1 million from the Emergency Economic Stabilization Act of 2008 (EESA) beginning in the summer of 2010.

Eligible Uses for 2008 HERA

- Establish financing mechanisms for the purchase and redevelopment of foreclosed homes and residential properties
- Purchase and rehabilitate abandoned or foreclosed homes and residential properties so that they may be sold, rented, or redeveloped
- Establish land banks for foreclosed homes
- Demolish blighted structures
- Redevelop demolished or vacant properties

Source: Auditor General staff analysis of HUD's notice of allocation for the HERA. Federal Register. (2008, October). *Notice of allocations, application procedures, regulatory waivers granted to and alternative requirements for emergency assistance for redevelopment of abandoned and foreclosed homes grantees under the Housing and Economic Recovery Act, 2008*, 73 (194), 58330-58349.

1 These transfers were required by Laws 2008, Ch. 53 and 285; Laws 2009, Ch. 11; Laws 2009, 1st S.S., Ch. 1 and 5th S.S., Ch. 1; and Laws 2010, 7th S.S., Ch. 1. In addition, Laws 2010, 7th S.S., Ch. 1, requires \$1.4 million to be transferred from the Housing Program Fund to the State General Fund in fiscal year 2011.

2 The ARRA also authorized additional monies for the federal Neighborhood Stabilization Program for allocation on a competitive basis, but the Department did not apply for this funding. According to the Department, these monies were intended for local jurisdictions.

Table 2: Housing and Economic Recovery Act of 2008
Neighborhood Stabilization Funding by Jurisdiction
Fiscal Year 2008
(Unaudited)

Jurisdiction	Amount Funded
State of Arizona	$ 38,370,206
Phoenix	39,478,06
Maricopa County	9,974,267
Mesa	9,659,665
Tucson	7,286,911
Glendale	6,184,112
Pima County	3,086,867
Avondale	2,466,039
Chandler	2,415,100
Surprise	2,197,786
Total Arizona	$121,119,049

Source: Auditor General staff analysis of HUD's notice of allocations for the HERA. Federal Register. (2008, October 6). *Notice of allocations, application procedures, regulatory waivers granted to and alternative requirements for emergency essistance for redevelopment of abandoned and foreclosed homes grantees under the Housing and Economic Recovery Act, 2008*, 73 (194), 58330-58349.

In response to fiscal year 2009 fund balance transfers, according to department officials, they reduced spending by reducing the Department's workforce by 18 percent, or 13 positions, and eliminating a division, the Center for Housing Affordability and Livable Communities (Center). The Center was established to provide access to research and the best practices in housing innovation, training, and guidance at the local level and worked to improve Arizona's participation of nonprofit or community-based organizations in community development and affordable housing.

Audit scope and objectives

This performance audit and sunset review focused on four of the Department's programs: the tax credit program, the CDBG program, and two home purchase assistance programs—Your Way Home and Homes for Arizonans. The audit focused on these programs because they serve a large number of citizens and receive a significant amount of federal and state resources. These programs also represent the variety and diversity of programs administered by the Department. With regard to these four programs, the audit focused on two main objectives: (1) analyzing these programs' accomplishments in providing housing and community revitalization and (2) analyzing the effectiveness of the Department's oversight of these programs. In addition, the report includes responses to the 12 sunset factors specified in A.R.S. §41-2954.

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

The Auditor General and staff express appreciation to the Department's director and staff for their cooperation and assistance throughout the audit.

FINDING 1

Department programs increase housing opportunities and enhance communities

The Arizona Department of Housing's (Department) programs have facilitated increased affordable housing opportunities and improved community services across the State. Auditors found evidence of these accomplishments across all four of the programs reviewed in detail. More specifically:

- The Low-Income Housing Tax Credit program (tax credit program) has provided thousands of additional housing units targeted at low-income populations.

- The Community Development Block Grant (CDBG) program administered by the Department has addressed and met community needs in rural areas.

- The Department's home purchase assistance programs—Homes for Arizonans and Your Way Home—have aided more than 2,700 Arizona households in achieving home ownership.

Auditors focused on these four programs because they serve a large number of citizens and receive a significant amount of federal and state resources, and they represent the variety and diversity of programs administered by the Department. See Finding 2 (pages 31 through 42) for an assessment of the Department's award process and monitoring practices for these programs.

Tax credit program provides affordable housing opportunities across the State

The tax credit program has created additional affordable housing opportunities for Arizonans. The program uses federal tax credits to help finance low-income housing for families, the elderly, and special needs populations (see textbox, page 14). Since its creation in 1986, the tax credit program has facilitated the construction of 362 properties that provided more than 23,000 affordable housing units in Arizona.

Low-Income Housing Tax Credit program

- The program was established in 1986 and provides the single largest subsidy for low-income rental housing through the Federal Internal Revenue Code.
- Under the program, states are authorized to issue federal tax credits for the acquisition, rehabilitation, or new construction of affordable rental housing.
- The program provides incentives to develop and invest in low-income rental housing because developers can sell the credits to private investors and use the proceeds to help cover acquisition, construction, and other development costs, or developers can use the tax credits to offset taxes on other income.
- Program developments are required to charge affordable rent for qualified low-income tenants, which may include families, senior citizens, and special needs populations.

Source: Auditor General staff analysis of Internal Revenue Code (26 U.S.C. §42); Schwartz, A.F. (Ed.).(2006). *Housing policy in the United States: An introduction.* New York: Routledge; and the Department's 2009 Qualified Allocation Plan.

Auditors' case studies focused on three tax credit program properties in different geographic areas and found that the developments addressed both community and individual needs.

Finding affordable housing opportunities is a challenge facing many Arizonans. According to its 2006 through 2008 American Community Survey data, the U.S. Census Bureau estimates that 328,370 of the renter-occupied units in Arizona, or approximately half, were not considered affordable based on the income level of their occupants.[1] According to the U.S. Department of Housing and Urban Development (HUD), affordable housing is defined as housing that costs less than 30 percent of the household's annual income.

Tax credit program uses federal tax credits to build affordable housing—The tax credit program is a federal program administered at the state level by the Department and is designed to make monies available to develop rental housing for low-income households, which can include the elderly, veterans, and other special needs populations.[2] The annual amount of tax credits available for the Department to distribute is determined by a population-driven formula found in the federal Internal Revenue Code. Project developers that receive a tax credit award from the Department sell the credits to private investors and use the proceeds, which can be supplemented by other monies such as State Housing Trust Fund loans, to build rental properties (see Introduction and Background,

1 U.S. Census Bureau. Arizona: Selected Housing Characteristics: 2006-2008. Data Set: 2006-2008 American Community Survey 3-Year Estimates.

2 For the tax credit program, low-income households are those whose income is 60 percent or less of the area median income.

pages 1 through 12, for information on the State Housing Trust Fund). In return, they must reserve some of their units as low-income units for at least 30 years and charge affordable rent to qualified tenants in those units.[1] "Affordable" means that the rent is no more than 30 percent of the income limitation for the unit, which is based on the median income for the area. For example, as of March 2009, 50 percent of the area median income in Maricopa County for a one-person household is $23,050, meaning the rent charged to this person could not exceed $576 for a studio unit.[2] See Finding 2 (pages 31 through 42) for information on how the Department monitors the tax credit program.

The Department establishes state goals for the tax credit program.

The Department relies on the State's Qualified Allocation Plan to determine how it allocates tax credits. The plan establishes goals and guidance for the tax credit program in Arizona. The Internal Revenue Code requires allocating agencies like the Department to use such a plan in allocating the federal tax credits, and the Department develops a new plan annually. In an effort to assess and address the affordable housing needs across the State, the Department seeks public input on the plan from nonprofit groups, advocacy groups, cities, developers, and others (see Sunset Factor 2, pages 43 through 45) and incorporates the feedback in developing the plan. The 2009 plan sets out 19 goals for the tax credit program, such as maximizing the number of affordable units added and administering the program in a way that encourages timely project completion and occupancy.

The Department distributes tax credits throughout Arizona and ensures that all available tax credits are used. One of the Department's goals is to provide an equitable distribution of tax credits across the State. As seen in Figures 2, 3, and 4 (see pages 16, 17, and 18 respectively), the Department has awarded tax credits to projects located in 14 of Arizona's 15 counties, with the majority of tax credit program projects (66 percent) located outside of Maricopa and Pima Counties.[3] In addition, the Department has set an annual goal of allocating all of the available federal tax credits. If tax credits assigned in a particular year are not allocated to a tax credit program project within 2 years, the credits are forfeited by the State and go into a national pool for reassignment to eligible states. Tax documents submitted to the U.S. Internal Revenue Service (IRS) by the Department indicate that the Department has allocated all of its available tax credits within the 2-year time frame and has never returned credits.[4]

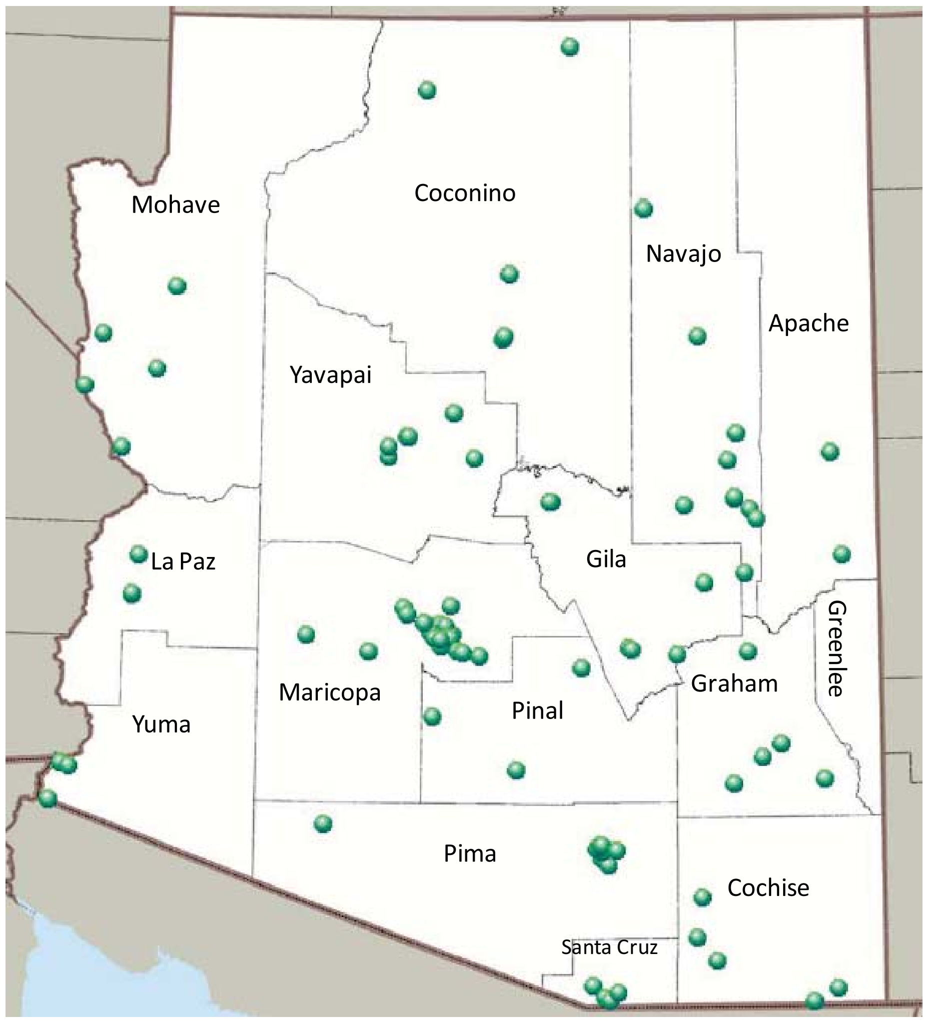
1 Under the Internal Revenue Code 26 U.S.C. §42(g), the developer must either set aside 20 percent of the project's units for people below 50 percent of the area's median income or set aside 40 percent of the units for people below 60 percent of the area's median income. In addition to the rent restriction, the units must be occupied by individuals whose income is below the 50 or 60 percent limit.

2 Area median income varies according to the number of persons in the unit, and allowable rents charged vary according to the number of bedrooms in the unit.

3 According to department data, Greenlee County has no tax credit program projects.

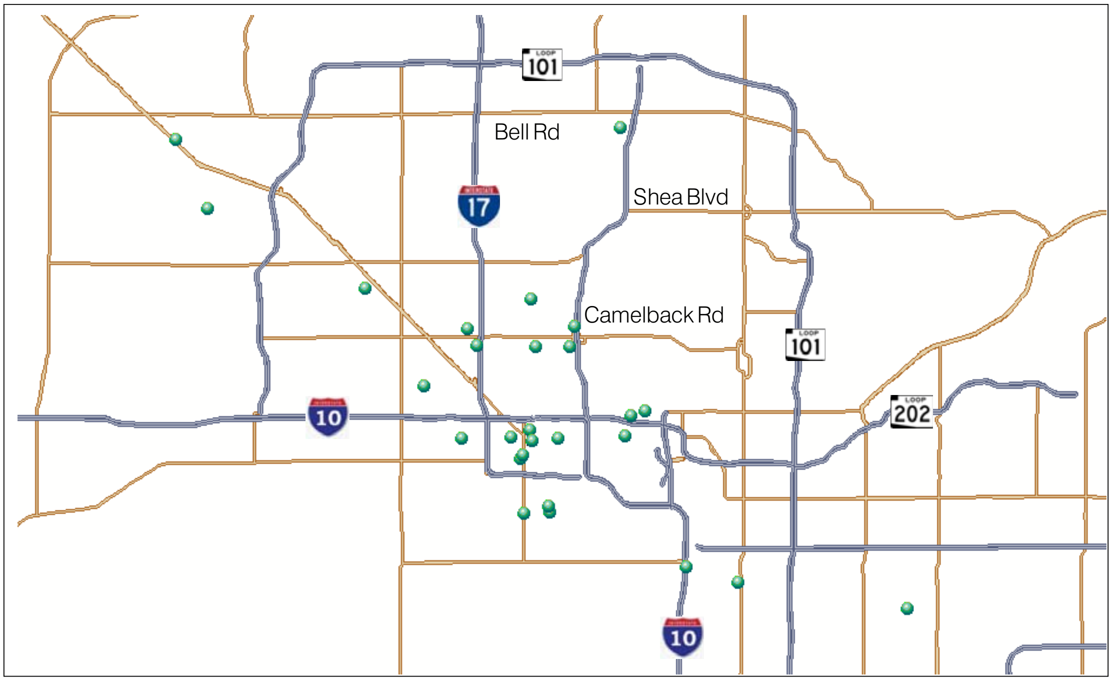
4 The Department had a carryover of $739,352 in credits in 2009 that can be awarded in 2010.

Figure 2: Locations of Tax Credit Program Developments State-wide Calendar Years 2003 through 2009 (Unaudited)



Source: Auditor General staff analysis of department data on tax credit program projects.

Figure 3: Locations of Tax Credit Program Developments in Phoenix Metro Area
Calendar Years 2003 through 2009
(Unaudited)



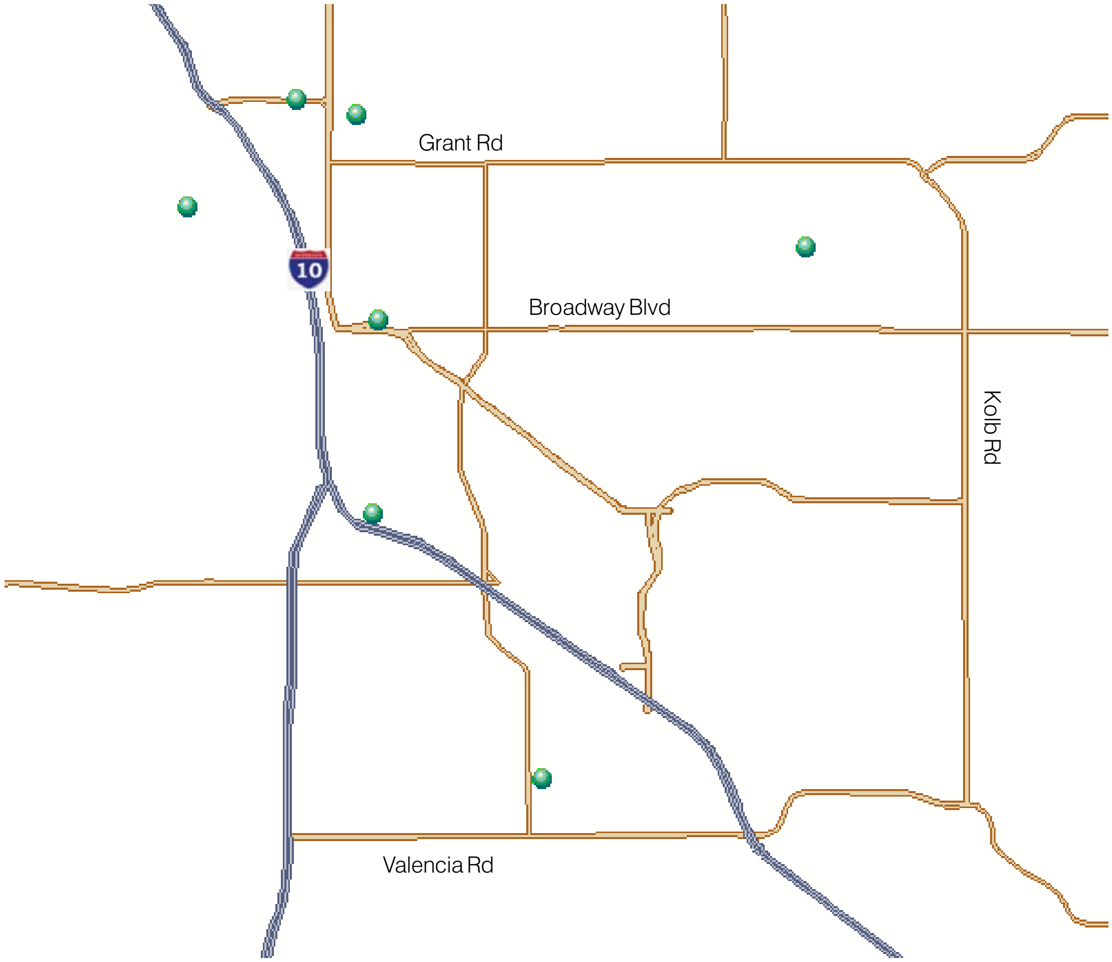
Source: Auditor General staff analysis of department data on tax credit program projects.

Tax credit program has increased affordable rental housing— According to housing literature, the federal tax credit program is the largest and is widely regarded as the most successful program for building affordable housing opportunities in the nation.[1] Since the federal tax credit program's creation in 1986, the State has awarded approximately $164 million in federal tax credits to facilitate the construction of 362 tax credit program projects in Arizona, providing for more than 23,000 affordable housing units.[2] It is by far the Department's largest affordable housing program; by comparison, the Section 8 project-based program provided fewer than 8,000 units of affordable housing state-wide as of June 2009 (see Introduction and Background, pages 1 through 12, for information on the Section 8 project-based program). Since its inception as a stand-alone agency, the Department has awarded tax credits to 117 projects, including 10 that were awarded tax credits in 2009. The anticipated average total cost for the 2009 projects is $11.5 million, with an average of nearly $950,000 in credits allocated to each project.

1 Schwartz, A.F. (Ed.). (2006). *Housing policy in the United States: An introduction.* New York: Routledge; Joint Center for Housing Studies of Harvard University (2009). *The disruption of the low income housing tax credit program: Causes, consequences, responses, and proposed correctives.* Retrieved May 3, 2010, from http://www.jchs.harvard.edu/publications/governmentprograms/disruption_of_the_lihtc_program_2009.pdf

2 Until the Department of Housing was created as a stand-alone agency in October 2002, the Department of Commerce awarded the tax credits.

Figure 4: Locations of Tax Credit Program Developments in Tucson Metro Area
Calendar Years 2003 through 2009
(Unaudited)



Source: Auditor General staff analysis of department data on tax credit program projects.

Tax credit program properties address community needs—Low vacancy rates indicate that tax credit program properties are meeting the demand for affordable housing. The vacancy rate for tax credit properties located outside of Maricopa and Pima Counties was 6.9 percent as of December 31, 2008.[1,2] By comparison, the U.S. Census Bureau estimated Arizona's overall rental vacancy rate from 2006 through 2008 was 9.7 percent. HUD reported that tax credit program properties had considerably lower vacancy rates than the nation's overall rental market in 2005 through 2009 based on a survey of eight investors' portfolios.[3]

1 The 2008 vacancy data was the most recent available as of January 2010. There were 206 vacancies in 56 reporting rural properties out of a total of 3,007 units. The vacancy rate for urban tax credit properties was not readily available.

2 According to the Department, tax credit property owners and management companies are primarily responsible for marketing and advertising their developments.

3 Collinson, R., & Winter, B. (2010). *U.S. rental housing characteristics: Supply, vacancy, and affordability* [HUD PD&R Working paper 10-01]. Washington, D.C: U.S. Department of Housing and Urban Development.

Case studies of three projects that received tax credit allocations from 2003 through 2006 illustrate the results of these projects in their communities. Specifically:

- **Downtown Phoenix development built to revitalize neighborhood and tackle blight in the community**—Matthew Henson is a large housing development located in downtown Phoenix, near Grant Street and 7th Avenue, designed to revitalize and provide additional affordable housing opportunities in the downtown community (see photo). The development replaced a severely distressed low-income housing project that was originally constructed in the 1940s. As a mixed-income development, Matthew Henson contains 549 housing units, 445 of which are reserved for low-income households. The development was financed in four phases and received tax credit awards each year from 2003 to 2006, totaling nearly $4.3 million in tax credits. The development's main funding source was a $35 million HUD HOPE VI grant that the City of Phoenix received in 2001.[1] In addition to providing housing, the development provides HOPE-VI-sponsored assistance, such as job training, education, transportation, and daycare services for its residents.

  The construction of Matthew Henson has had a positive impact on the downtown community. City of Phoenix officials indicated that one of the major impacts is that the neighborhood surrounding Matthew Henson seems more engaged and interested in ensuring that the area is clean, safe, and properly maintained. A project stakeholder similarly observed that the streets around Matthew Henson are cleaner, the whole feel and look of the neighborhood is improved, and surrounding neighborhoods were starting to make improvements as well. Further, city housing officials indicated that crime had decreased in the area and that this drop was attributed in part to the revitalization brought on by Matthew Henson's construction. Finally, the property also helps its low-income tenants pay affordable rent. Auditors spoke with a resident who said that living in Matthew Henson has provided her with the independence she desired and the cost-savings she needed to address other financial obligations. According to Matthew Henson property management, the tenant paid $875 for a unit that would have cost $925 at the market rate and until recently would have cost $1,025.[2]

Photo 1: Matthew Henson Development—Phoenix

Source: Courtesy of Matthew Henson Apartments.

1 HOPE VI is a federal program developed to eliminate severely distressed public housing.

2 According to property management, the market rate for this unit was gradually reduced between approximately February 2009 and February 2010.

- **Gilbert project addresses need for senior housing**—Page Commons is a 100-unit independent senior housing apartment complex located in downtown Gilbert, near Gilbert and Elliott Roads (see photo). The property was awarded more than $660,000 in tax credits in 2003. According to the developer's application, Page Commons represents Gilbert's first affordable living community dedicated exclusively to seniors. A third-party market study included as part of Page Commons' application for tax credits indicated the need for such a development. In addition, the application cited 2000 census figures, reporting that 45 percent of senior renters surrounding the development in Gilbert paid 35 percent or more of their income on rent, compared to the standard HUD established that households should not devote more than 30 percent of their income on housing costs. Further, the study found that even if all the affordable units within Page Commons were occupied, there would be demand for an additional 1,176 senior units in the market area. According to the property manager, an affordable development dedicated solely to seniors was very important for Gilbert because of the area's growing senior population.

  Besides helping to address a growing housing need, Page Commons has provided revitalization within the Town of Gilbert. The property manager and a Gilbert official indicated that Page Commons' construction leveraged efforts to build a nearby community center, which have concurrently helped to revitalize the surrounding area, remove blight, and serve the senior population. Further, Page Commons' focus on serving seniors has significantly contributed to Gilbert's multi-generational emphasis for that part of town. A Page Commons resident indicated that living in an affordable development allows her more financial independence than she would otherwise have because of the reduced rent that she pays. The resident also indicated that the surrounding area was improved and looked nicer because of the Page Commons' construction.

Photo 2: Page Commons Development—Gilbert

Source: Arizona Office of the Auditor General.

- **Rural tax credit development increases affordable housing**—Maddox Estates Townhomes is a 60-unit affordable housing development located in Eloy, a small rural city in southern Arizona near Interstate 10 and Alsdorf Road (see photo). Maddox Estates was awarded nearly $675,000 in tax credits in 2003 and is designed to serve families in rural Arizona. According to the application the developer submitted, prior to the construction of Maddox Estates, no new multi-family development had been built in Eloy since 1993 and a market study indicated a strong demand for family housing.

  The project has helped address a serious need for affordable housing in Eloy. A market demand study conducted in conjunction with the planning of the development indicated that even if every unit in Maddox Estates were to be occupied, there would still be demand for an additional 322 units in the market area. The study also indicated that three other tax credit properties in the area had only one vacant unit between them. Further, a resident of Maddox Estates told auditors that it was difficult to find other decent affordable housing in Eloy. In addition, prior to Maddox Estates' construction, more than 40 HUD Section 8 vouchers in Eloy went unused because there was not enough available housing for the vouchers' recipients.[1] According to an Eloy Public Housing Authority representative, as of February 2010, all 143 of the Section 8 vouchers available were being used, including 19 within the Maddox Estates development.

  Maddox Estates has provided additional affordable housing opportunities and a nicer living environment for low-income tenants in the area, and a community block watch has been established to try to address crime in the area. The property managers and a community action program manager in Eloy indicated that Maddox Estates helps to provide an additional option for affordable housing in the area and provides amenities that most other affordable housing developments in the area cannot match, such as a pool, a recreation area, and larger apartments with more rooms that can accommodate larger families. Also, because Maddox Estates is one of the newest developments in the area, the individual units provide a nicer living environment as compared to the other older affordable housing opportunities in the area. Even so, both property management and a tenant noted occurrences of crime at the development. The property manager

Photo 3: Maddox Estates Development—Eloy

Source: Arizona Office of the Auditor General.

1 The Section 8 program provides rent assistance vouchers to very-low-income households to enable them to obtain decent, safe, and sanitary housing.

reported that a community block watch has been established to address the issue.

CDBG projects meet community needs across the State

The State's CDBG program assists communities and individuals in the State's rural areas.

The State's CDBG program helps to address the needs of Arizona's rural communities. The program uses federal dollars to fund eligible projects and programs that serve low- and moderate-income persons. In state fiscal years 2003 through 2009, the program has facilitated the implementation of more than 430 projects and programs serving Arizona's rural communities. Auditors' case studies of three projects found that they helped to serve and address community needs.

Department administers CDBG monies to address rural communities' needs—The State CDBG program provides rural communities with resources to address a wide range of community development needs, mainly targeted at low- and moderate-income populations. The CDBG program's primary statutory objective is to develop communities by providing decent housing and a suitable living environment, and by expanding economic opportunities, primarily for persons of low and moderate income. In fact, the State must ensure that at least 70 percent of its CDBG grant funds are used for activities that benefit low- and moderate-income persons. The State may also use its funds to meet urgent community development needs, such as serious health or welfare threats to the community. The Department is responsible for approving applications that are eligible and meet national objectives and state priorities (see Finding 2, pages 31 through 42). In state fiscal years 2003 through 2009, the Department received approximately $13 million per year, on average, in CDBG entitlement funds from HUD to fund eligible programs and projects in communities located in the 13 rural counties in the State. Community projects that receive CDBG funds vary greatly in scope and cost. For example, in state fiscal year 2009, a Prescott Valley street improvement project was awarded more than $720,000 in CDBG funds. In contrast, a Page park improvements project was awarded $17,000 in that same year. In state fiscal year 2009, 59 projects received CDBG funds through the Department.

The State CDBG program administered by the Department is available to approximately 70 eligible units of local government, including cities, towns, and counties in rural areas located outside of "entitlement" jurisdictions. The Department's policy is to allocate 85 percent of CDBG program monies to four rural regions using a population and poverty-based formula, and the Department works with the regions' councils of government to determine how the monies will be distributed.[1] The remaining 15 percent is distributed competitively state-wide to projects that are ready to implement immediately. Communities designated as

[1] The four rural regions are (1) Gila and Pinal Counties, covered by the Central Arizona Association of Governments; (2) Apache, Coconino, Navajo, and Yavapai Counties, covered by the Northern Arizona Council of Governments; (3) Cochise, Graham, Greenlee, and Santa Cruz Counties, covered by the South Eastern Arizona Government Organization; and (4) La Paz, Mohave, and Yuma Counties, covered by the Western Arizona Council of Governments.

entitlement jurisdictions receive CDBG funds directly from HUD. Entitlement jurisdictions in Arizona include all of Maricopa and Pima Counties; the cities of Flagstaff, Prescott, and Yuma; and tribal lands. The Department does not administer CDBG funds allocated to these areas.

CDBG dollars improve community services and opportunities—The Department administered more than $83 million in CDBG grant monies on more than 430 projects and programs in state fiscal years 2003 through 2009. As shown in Figure 5 (see page 24), these monies have been used for projects and programs throughout the State's rural counties. The monies have been used to assist communities in areas such as infrastructure, community, and individual needs. See textbox for examples of how the CDBG monies can be used.

CDBG Program

CDBG funds may be used to address a wide variety of community needs, including construction or renovation of infrastructure projects such as:

- water, wastewater, and solid waste facilities;
- streets, sidewalks, and street lighting;
- parks; and
- flood control projects.

The funds may also be used for construction or improvements of community facilities such as:

- senior, youth, and community centers; and
- health and social services centers.

In addition, the funds may be used to serve individual citizens, such as:

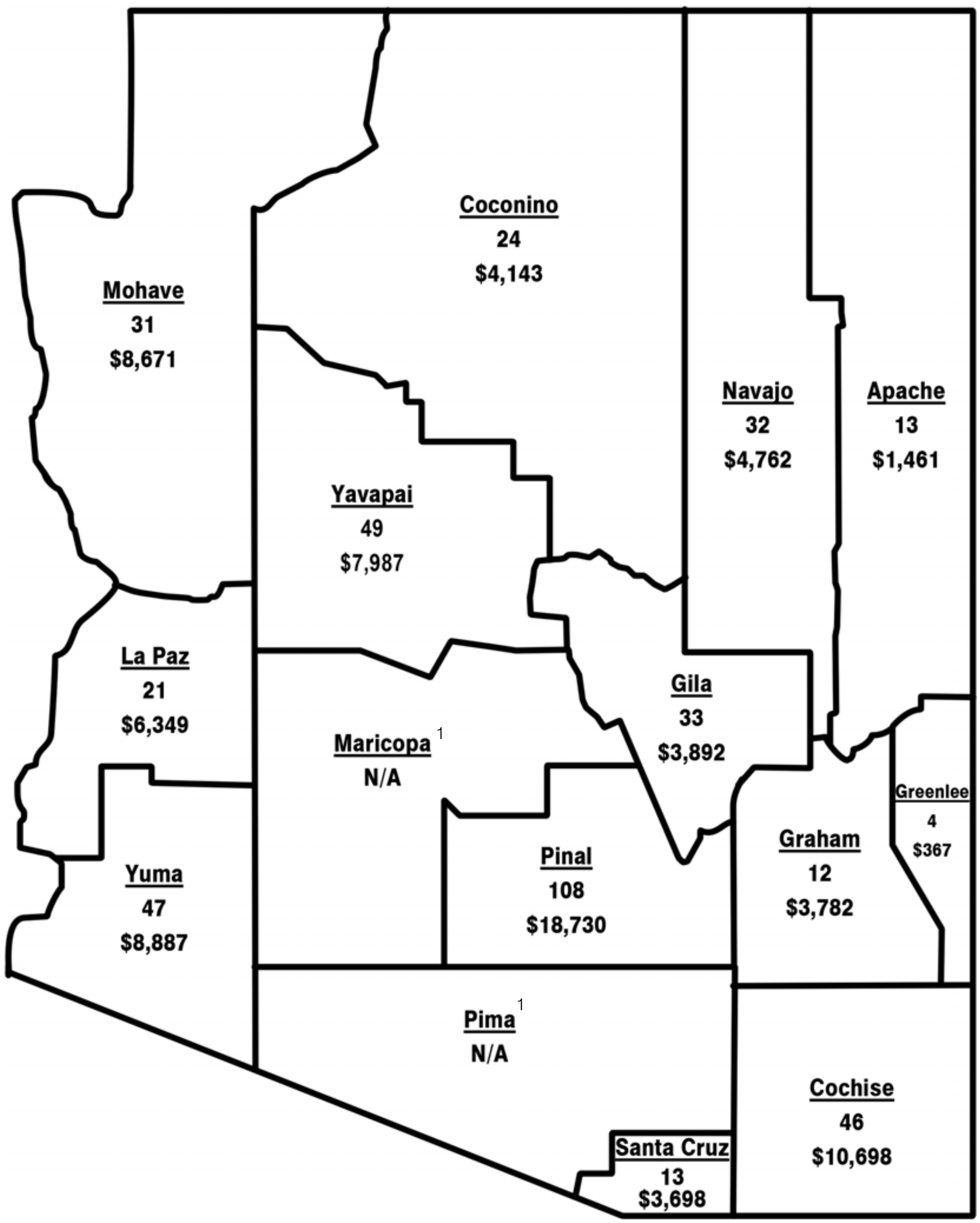
- creation or retention of jobs in carrying out an economic development project; and
- owner-occupied housing rehabilitation and rental rehabilitation.

Source: Auditor General staff analysis of examples in HUD's July 2002 *guide to national objectives* and *eligible activities* for *State CDBG program* and the Department's January 2009 CDBG *application handbook*.

CDBG projects address specific community needs—Three case studies of projects that received CDBG monies from the Department demonstrate the results these projects have had in their communities. Specifically:

- **Water system improvements reduce potential dangers in rural community**—In state fiscal year 2005, the Department awarded the City of Eloy more than $340,000 in CDBG monies to engineer and install approximately 6,600 feet of piping to connect the water distribution system in Eloy proper to the water distribution system in one of its outlying areas called Toltec (see photo on page 25).

Figure 5: Number of CDBG Projects and Dollars Awarded
Fiscal Years 2003 through 2009
(In Thousands of Dollars)
(Unaudited)



1 Not applicable because the Department does not administer CDBG monies in Maricopa and Pima Counties. These counties receive CDBG funding directly from HUD.

Source: Auditor General staff analysis of department CDBG project and award data.

Photo 4: Section of Piping Connecting Water Systems in Eloy

Source: Arizona Office of the Auditor General.

The new piping has allowed the city to address safety and convenience issues. Prior to installing the new piping, both water systems were operated as separate and unconnected pressure zones with a single gas-powered pump to back up the electric pumps. Therefore, when the system in Eloy went down because of an electrical outage, citizens in Toltec lost running water, which presented both cost and safety issues. According to an Eloy official, when the Toltec water system would go out in the past, city employees would have to purchase bottled water for distribution to all of the citizens of Toltec. The loss of water was also a fire hazard because the lack of pressure would disrupt the source of water from the fire supply line for the fire department. By connecting the water systems, Eloy has been able to prevent the loss of water and any inconveniences or potential dangers that come with it. According to a city official, the water system improvements have worked as designed to prevent any additional instances of water loss in Toltec. The official estimated that the system has been used three or four times.

- **Food bank provides needed nutritional resources to community**—In state fiscal year 2007, the Department awarded more than $340,000 in CDBG monies to develop and construct a new building used to house a food bank serving low-income persons in Tombstone and the surrounding communities (see photo on page 26). In addition to food, the food bank also distributes clothing, diapers, soap, shampoo, and medicine, which is all provided free to qualifying low-income customers. The new food bank serves as a replacement for an older food bank that was located in a run-down hospital that had become unsuitable for food storage because of unsanitary conditions and because the number of persons needing assistance was continuing to grow (see photo on page 26).

According to food bank management, with the new building, the food bank has been able to increase the amount of clients it can serve and meet a growing needy population in the area. Management said a decline in tourism has meant that many in Tombstone have lost their jobs or are under-employed. The new building allows the food bank to accept more donations and house more products. The new food bank is required to stay open a minimum of 20 hours per week, which, according to food bank management, is a substantial increase over the old food bank's hours. In addition, because of the new building's CDBG-funded construction , the food bank was also able to obtain additional money from the U.S. Department of Agriculture to purchase shelving and a refrigeration unit, which will be used to store fresh produce. The old food bank in Tombstone was not equipped to store fresh produce and was not large enough to have a refrigeration unit. According to food bank management estimates, the food bank has been able to triple the number of clients it can serve and meet a growing needy population in the area.

Photo 5: Interior of New Tombstone Food Bank

Source: Courtesy of Community Food Bank.

- **Job training program provides career opportunities**—In state fiscal year 2006, the Department awarded the City of San Luis more than $22,000 in CDBG monies to continue a public service construction training program for youth. According to a program official, the program was initiated in 2003 with a HUD grant, but needed CDBG monies to continue the program. Following the expenditure of CDBG monies, the program received additional HUD grants to continue the job training program and San Luis also agreed to contribute funding to the program from its own resources. The program was structured to serve about ten students at a time in an 8-month training cycle divided equally between the classroom and on the job at construction sites. The program required participants to carry out community service projects, such as cleaning parks and performing rehabilitation work on low-income homes in the community, as well as participate in leadership training. According to the application, the program was designed to address dropout rates, and all of the program's participants would be from low-income households and either dropping out of school or at risk for dropping out. Program participants receive a High School Equivalency Diploma (GED) after passing a series of tests that are administered during the program, and the program continues to offer GED-related help for 2 years after program completion for participants who do not pass the tests.

Photo 6: Interior of Old Tombstone Food Bank

Source: Courtesy of Community Food Bank.

The job-training program has given the youth an opportunity to achieve career success. Program stakeholders indicated that the program provides a great opportunity for the students from low-income families to enhance their skills and gain a marketable education. According to a program supervisor, another important impact of the program is that it serves to open the students' minds and helps them see the great things that they can accomplish. Data provided by a program official shows that 67 percent of the program's enrollees have graduated. In addition, program reports indicate that 1 or 2 years after program completion, approximately 71 percent of graduates had found work or were continuing their education. As of February 2010, in addition to the 10 students who graduated in the CDBG-funded training cycle, 55 students had completed the program.

Home purchase programs facilitate home ownership

The home purchase assistance programs, administered since the Department's inception in 2002, have aided more than 2,900 households in purchasing homes. The Department's two programs have helped first-time homebuyers using millions of state and federal dollars.

Department programs provide home ownership assistance—In addition to administering programs designed to provide affordable rental housing opportunities and improve community services and infrastructure, the Department has also created two programs targeted at assisting households in purchasing a home. The first program—known as Homes for Arizonans—was started in 1998 and suspended in 2009. It used state monies from the Housing Trust Fund to provide down payment assistance to first-time homebuyers in rural Arizona. The second program—known as Your Way Home—was offered to the State's rural areas in May 2009 and state-wide beginning in July 2009. The program uses federal stimulus monies to help individuals purchase foreclosed homes. Table 3 (see page 28) summarizes both programs' expenditures by county since inception.

The Department administers a program that uses federal stimulus monies to help individuals purchase foreclosed homes.

Home purchase programs help Arizonans achieve home ownership—Both of the Department's home ownership programs have helped citizens achieve home ownership. Specifically:

- **Homes for Arizonans**—The Department and the Arizona Housing Finance Authority funded the first program, known as Homes for Arizonans, in an effort to provide first-time homebuyers with down payment and closing cost assistance in rural Arizona. The level of assistance under this program varied

Table 3: Home Purchase Assistance Expenditures by County
October 2, 2002 through July 17, 2009 (Homes for Arizonans)
June 25, 2009 through March 12, 2010 (Your Way Home)

	Homes for Arizonans			Your Way Home		
County	Households Assisted	Dollars Expended	Average Assistance	Households Assisted	Dollars Expended	Average Assistance
Apache	111	$ 915,902	$ 8,251	1	$ 24,266.00	$24,266
Cochise	377	$ 4,106,696	$ 10,893	8	$ 202,917.00	$25,365
Coconino	115	$ 1,551,224	$ 13,489	8	$ 356,698.00	$44,587
Gila	19	$ 248,479	$ 13,078	NA	NA	NA
Graham	51	$ 673,314	$ 13,202	2	$ 49,940	$24,970
Greenlee	2	$ 27,805	$ 13,902	NA	NA	NA
La Paz	2	$ 25,803	$ 12,902	NA	NA	NA
Maricopa	NA	NA	NA	160	$ 4,912,483.00	$30,703
Mohave	103	$ 1,724,080	$ 6,739	25	$ 729,806.26	$29,192
Navajo	250	$ 2,105,007	$ 8,420	12	$ 339,970.00	$28,331
Pima	NA	NA	NA	121	$ 3,737,634.00	$30,890
Pinal	438	$ 5,363,747	$ 12,246	31	$ 702,285.60	$22,654
Santa Cruz	227	$ 3,213,089	$ 14,155	9	$ 222,980.00	$24,776
Yavapai	166	$ 2,274,381	$ 13,701	49	$ 1,530,991.00	$31,245
Yuma	650	$ 7,409,996	$ 11,400	36	$ 861,084.00	$23,919
Total	2511	$ 29,639,525	$11,804	462	$ 13,671,054.86	$29,591

Source: Auditor General staff analysis of Homes for Arizonans and Your Way Home data provided by the Department.

based on the buyer's income. Eligibility was based on income—generally below 80 percent of the area's median income. Buyers with higher incomes were required to use the Arizona Housing Finance Authority's mortgage products and/or programs (see page 7 for information about the Arizona Housing Finance Authority). The program was a rural homebuyer initiative available in all areas of Arizona outside of Maricopa and Pima Counties and was administered by a network of nonprofit agencies and department staff. Buyers were required to contribute at least $1,000 of their own money and participate in pre- and post-purchase counseling. According to the Department, the program was suspended in July 2009 to make way for the Your Way Home program (see page 29) and, because of the uncertainty of its main funding source, the State Housing Trust Fund (see page 9).

Since 2002 the Department has helped over 2,500 families purchase homes.

Homes for Arizonans helped many Arizonans become homeowners. Since the Department's inception in October 2002, the program provided nearly $30 million to assist more than 2,500 households (see Table 3).[1] The Department distributed the greatest portion of these funds in Yuma County, with more than $7.4 million used to assist 650 households.

1 The Homes for Arizonans Initiative originally started in 1998 under the Department of Commerce.

Although some homeowners aided by the program subsequently lost their homes, the overall foreclosure rate appears to compare favorably with performance across the broader population. In all, creditors have foreclosed on 106 homes that received assistance since the Department's inception, which represents a 4.2 percent foreclosure rate. However, 95 of the foreclosures (90 percent) took place during the turbulent housing years of 2008 and 2009 when foreclosures across the country skyrocketed. By comparison, 6.17 percent of all loans in Arizona were in foreclosure as of June 30, 2009.

- Your Way Home—The Department's second homebuyer assistance program, Your Way Home, is federally funded through the Neighborhood Stabilization Program that was established by the federal Housing and Economic Recovery Act of 2008 (HERA). The Department made this program available state-wide beginning in July 2009. Through this program, the Department offers 22 percent of the purchase price in assistance in the form of a deferred second mortgage to qualified homebuyers to purchase an eligible foreclosed home. To be eligible, buyers must have income no greater than 120 percent of the area's median income and must also complete an 8-hour homebuyer education class. The Department has allocated $26 million of its HERA monies for this program. This includes approximately $6 million reallocated from other Housing and Economic Recovery Act uses. The Department decided to make this reallocation in December 2009 because of high demand for purchasing foreclosed homes.

  As of March 12, 2010, Your Way Home had facilitated 462 home purchases across the State with nearly $13.7 million of the available $26 million expended (see Table 3, page 28). The average assistance provided state-wide is approximately $30,000 per home. The Department has assisted the largest number of households in Maricopa County, with 160 households receiving assistance. Pima and Yavapai Counties follow with 121 and 49 households assisted, respectively. Federal law requires the State to use all HERA monies by September 2010. According to Department officials, they expect to commit all of the monies by this date and to expend them by the end of 2010.[1]

This finding contains no recommendations.

1 Public Law 110-289, Sec. 2301(c)(1), (42 U.S.C. §5301 Note), requires the monies to be obligated within 18 months of being received. The Department's official Your Way Home program start date was March 2009.

FINDING 2

Department has generally sound system for planning, awarding, and monitoring housing program resources

The Arizona Department of Housing (Department) has a generally sound system for overseeing the housing programs it administers. Oversight of these programs is critical because the Department does not provide services directly but instead relies on other entities to carry out program goals through monies the Department provides. The Department carries out its oversight in three main ways: developing plans that specify what the State is trying to accomplish in these programs, ensuring that monies are awarded to projects that are consistent with these plans, and monitoring the use of monies once awards are made. In the four programs auditors reviewed—the Low-Income Housing Tax Credit program (tax credit program), the Community Development Block Grant program (CDBG), and state- and federally funded home purchase assistance programs—these oversight mechanisms were well designed and effectively carried out. Auditors did identify one minor discrepancy between department policy and actual practice in the community development block grant program. To fix this discrepancy, the Department should revise its policy rather than change the practice it has been using.

Effective monitoring system is critical to ensuring effective use of resources and program compliance

Because the Department generally does not provide housing services directly, but instead awards federal and state resources to others to carry out program goals, it needs to have effective mechanisms in place to ensure that these other entities are meeting these goals. The amount of money and other resources involved, as well as the programs' complexity, make it all the more important for the Department to have an effective system. For example, between 2007 and 2009, in the four programs auditors examined, the Department has awarded or has plans to award $126.4 million in federal low-income housing tax credits, CDBG, and home purchase assistance monies (see Table 4 for a summary of awarded amounts of monies for these four programs in 2007 through 2009).

Table 4: Monies for Tax Credit Allocations, CDBG, and Home Purchase Assistance Programs
2007 through 2009 [1-4]
(In Millions)
(Unaudited)

			Home Purchase Assistance		
Year	Tax Credit Allocations	CDBG	Homes for Arizonans	Your Way Home	Total
2007	$14.3	$12.0	$7.1		$33.4
2008	14.7	11.8	5.3		31.8
2009	20.4	12.1	2.7	$26.0	61.2
Total	$49.4	$35.9	$15.1	$26.0	$126.4

1 The tax credit allocations are the total allocations that the Department reported to the U.S. Internal Revenue Service (IRS) for calendar years 2007, 2008, and 2009.

2 The annual CDBG monies are the amounts that the U.S. Department of Housing and Urban Development (HUD) awarded to the State CDBG program for federal fiscal years 2007, 2008, and 2009, beginning on October 1, 2006, and ending on September 30, 2009. The Department awarded or will award these CDBG monies during state fiscal years 2008, 2009, and 2010 beginning on July 1, 2007, and ending on June 30, 2010.

3 The Homes for Arizonans monies represent the total amount of loans that the Department approved during calendar years 2007, 2008, and 2009.

4 The $26 million in Your Way Home monies represents the amount the Department designated for mortgage assistance loans out of its total $38.3 million federal Neighborhood Stabilization Program allocation, and not actual loans made in 2009. The program became available in May 2009.

Source: Auditor General staff analysis of the Department's IRS 8610 reports for the Low-Income Housing Tax Credit program for 2007 through 2009, HUD allocation announcements from www.hud.gov, and department data for the Homes for Arizonans and Your Way Home programs.

An effective oversight system needs to accomplish three primary goals: (1) developing priorities for how the monies will be used and communicating program requirements to potential applicants, (2) making award decisions consistent with those requirements, and (3) monitoring projects' or individuals' use of the monies after awards have been made. Before awards are made, the Department's typical activities include annual planning, developing application materials, and evaluating applications. Once an award is made, the Department's typical oversight activities involve in-house monitoring activities, also known as "desk reviews," on-site monitoring, and project closeout. Because much of these programs' funding comes from the federal government, many components of the Department's oversight system involve carrying out federal requirements. Complying with these requirements is an important part of ensuring these funds' continued flow.

Program oversight is important in ensuring the appropriate use of state and federal monies.

Department meets federal tax credit program set-aside and long-term compliance monitoring requirements

The Department employs good planning and monitoring practices to meet federal mandates associated with administering the federal tax credit program. Specifically, the Department consistently complies with IRS requirements for setting aside tax credit allocations for nonprofit developers, considering state needs in allocating tax credits, and performing long-term monitoring of rental housing developments.

Department follows federal mandate and considers other state priorities and needs when making awards—The Department has consistently met the federal mandate to set aside 10 percent of tax credits for nonprofit developers. In addition, based on its 2007 allocation decisions, it also appears to consider areas of greatest need when making allocation decisions.[1] Specifically,

- **Federal nonprofit set-aside mandate consistently met**—Between calendar years 2003 and 2009, according to reports submitted to the IRS, the Department allocated all of the available tax credits, except for $739,352 in 2009 that it can carry over and award in 2010. During those same years, it met and often exceeded the federally mandated 10 percent set-aside requirement for nonprofit housing developers.

- **Department considers state needs when allocating tax credits**—As required by the Internal Revenue Code, 26 U.S.C. §42(m)(1)(A)(i), the Department sets forth Arizona's state-wide priorities annually in a Qualified Allocation Plan (see textbox, page 34). These priorities show the desired mix of projects in rural, urban, and tribal land areas; projects intended to serve seniors or special needs populations; and projects by nonprofit developers.

1 Auditors selected 2007 for in-depth analysis because it was unaffected by tax code amendments that resulted from the passage of the Housing and Economic Recovery Act of 2008 (HERA).

Qualified Allocation Plan (QAP)

A QAP must: (1) set forth selection criteria to be used to determine housing priorities that are appropriate to local conditions, (2) give preferences to the allocation of the tax credits to lower-income households and distressed areas, and (3) provide a procedure the agency will follow for monitoring compliance. The selection criteria in the QAP must include:

- Project location;
- Housing needs, project, and sponsor characteristics;
- Tenant populations for individuals with children and with special housing needs;
- Public housing waiting lists; and
- Projects intended for eventual tenant homeownership.

The QAP must also incorporate public comment and receive a public hearing.

Source: Auditor General staff analysis of 26 U.S.C. §42(m) and the Department's 2009 QAP.

In 2007, the Department met all of the state-specific set-aside goals established in that year's Qualified Allocation Plan. As shown in Table 5 (see page 35), that year, the Department's initial award decisions resulted in nearly 30 percent of the tax credits going to projects that would benefit rural communities, which exceeded the Qualified Allocation Plan's goal of awarding at least 10 percent to such projects. In addition, as shown in Table 5, the Department's initial award decisions resulted in almost 24 percent of available tax credits directed to nonprofit developers.[1]

Department monitors compliance with tax credit program's long-term requirements—The Department also meets federal tax code requirements to monitor tax credit program projects' use for at least 30 years. During this mandatory 30-year compliance time frame, federal regulations require state monitoring agencies to review annual certification reports, conduct periodic on-site inspections that involve verifying tenant income and checking property maintenance, and notify both the property owners and the IRS of any noncompliance issues (see textbox, page 36, for U.S. Department of Treasury compliance monitoring requirements).

1 The tax credit allocation information presented in Table 5 consists of the initial amounts awarded to housing developers through the competitive allocation process, which may differ from a developer's final allocation amount. Some approved projects may in later years receive a supplemental award, known as a "director's discretionary" award.

Table 5: 2007 Initial Tax Credit Awards Compared to 2007 QAP Set-Aside Goals (Unaudited)

	QAP State-Specific Set-Aside Goal		Applications		Awards		
			#	%	#	Amount	%
Nonprofit [1]	20 percent of the State's annual credit authority is set aside for "nonprofit projects."	At least 20%	5	11.4	4	$3,087,439	23.7%
Urban	$4.5 million is available for projects located in Maricopa and Pima Counties. Projects also seeking funding from the U.S. Department of Agriculture's rural development program will be classified as rural.	$4.5 million available	8	18.2	3	2,661,489	20.4%
Rural	Not less than 10 percent of annual credit authority is set aside for projects to be located in rural areas.	At least 10%	21	47.7	6	3,878,365	29.8%
Senior	$1 million for senior projects allocating 100 percent of its units to Seniors (age 62 and over and handicapped) with Support Services.	$1 million	4	9.1	2	1,046,911	8.0%
Tribal	A total of $1.5 million was allocated for projects located on Tribal Lands.	$1.5 million	4	9.1	2	1,457,629	11.2%
Special Needs	A total of $900,000 is available for projects allocating 100 percent of their units to Special Needs Populations.	$900,000 available	1	2.3	1	900,000	6.9%
General	None specified. Applications that do not fall within a specific set-aside category are considered general applications.		1	2.3	0	$0	0
Total			44	100	18	$13,031,833	100

1 Except for the nonprofit set-aside category, all other set-aside categories are established at the Department's discretion as part of the annual QAP revision process. Federal tax code IRC §42(h) requires 10 percent of the State's annual tax credit ceiling to be set aside for nonprofit housing developers.

Source: Auditor General staff analysis of QAP 2007 set-aside goals, 2007 application information by set-aside, 2007 tax credit reservation lists, and Internal Revenue Code 26 U.S.C.§42(h).

The Department maintains a strong control environment for documenting and performing the compliance monitoring activities that the IRS requires. For example:

- **Procedures, manuals, and checklists in place**—The Department has standard operating procedures for its staff and a compliance manual for property owners that thoroughly describe the regulatory requirements and monitoring activities. For example, both manuals describe annual certification procedures and on-site monitoring requirements. The compliance team uses a set of monitoring checklists for both its annual desk reviews and periodic on-site inspections.

- **Training provided**—The Department conducts periodic training for property owners to help them understand the compliance requirements.

- **Tracking schedules used**—The Department also maintains an on-site monitoring schedule to identify the properties that will be subject to a review. The

Rental Housing Tax Credit Program Compliance Monitoring Requirements

Federal regulations require tax credit program compliance monitoring programs to include four key provisions:

1. Recordkeeping and record retention—A property owner must maintain documentation specified in the federal regulation at least 6 years after federal tax return due dates.
2. Annual certifications and reviews—A property owner must submit an annual report to the state agency certifying the building's continued use as an affordable rental property, and the State agency must review the reports.
3. On-site inspections—Two years after a building has been placed into service, and every 3 years afterward, state agencies should conduct on-site inspections that involve:
   - Income verifications performed on a random sample of 20 percent of the building's designated low-income units.
   - Physical inspections of the units selected for the file review. The inspections must follow the Uniform Physical Condition Standards (UPCS) protocol.
4. Notification of noncompliance—Give prompt written notice to a property owner of any noncompliance issues found in annual reports and on-site inspection. State agencies are required to submit notices of noncompliance to the Internal Revenue Service (IRS) 45 days after the expiration of a 90-day correction period, even if the noncompliance was corrected during the correction period. If property owners resolve a noncompliance issue within 3 years, the IRS requires the State to submit a "back-in-compliance" report.

Source: Auditor General staff analysis of 26 C.F.R. §1.42.5 and *The IRS Guide for Completing Form 8823 Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition* (October 2009).

tracking schedule identifies the inspection date, the responsible staff, the dates that the Department sends out finding notification letters, and if applicable, the date it sends a noncompliance report to the IRS.

This control environment produces results. Auditors found that the Department conducts thorough on-site inspections and takes appropriate action when it discovers problems. For example, during one project's on-site inspection in October 2009, compliance officers conducted physical inspections of 51 occupied and 11 vacant units out of a total 102 tax credit units and reviewed tenant files for the 51 occupied units. The number of units inspected met the federal standard that requires the monitoring agencies to inspect each building in a property and exceeded the federal minimum standard of inspecting and reviewing records for a minimum of 20 percent of the low-income units. The Department found income verification issues in more than half of the sample, such as files without information about child support income or files showing incorrect calculations for the amount of rent that tenants should be paying. Similarly, the Department identified physical inspection issues in nearly half of the units reviewed, such as dysfunctional fire alarms, damaged locks, and damaged appliances.[1]

Department inspections of one tax credit property found problems in approximately half of the files and units.

Finally, the Department reports properties' compliance to the IRS, which decides whether to take action against noncompliant properties. If, within 3 years, a property owner completely addresses the noncompliance issues, federal regulations require the Department to submit a "back in compliance" report. For noncompliant properties, the IRS can withdraw or reduce the amount of tax credits allowed. Department records show that between December 2006 and November 2009, the Department reported 27 noncompliant properties to the IRS—meaning properties that had not corrected their noncompliance during the 90-day correction period—of which 18 were reported as "back in compliance." A department compliance official reported that during her tenure, she was aware of only two rental properties that have been the subject of an IRS action, such as an audit or the revocation of tax credits.

Department provides appropriate oversight for CDBG program

The Department has effective mechanisms in place to administer the CDBG program and monitor projects, and its practices have improved over time. The Department uses appropriate tools and practices to review CDBG applications, assess project eligibility, and conduct in-house and on-site CDBG monitoring. The Department meets its in-house monitoring duties and has improved such practices over time. Auditors identified one issue—the number of on-site inspections to be conducted—in which the Department needs to align its policy with actual practice.

Department uses appropriate tools and practices for planning, allocation, and eligibility determination—The Department meets the U.S. Department of Housing and Urban Development's (HUD) annual planning requirements, and it assesses funding applications to ensure they meet CDBG eligibility and national objective requirements. For example:

1 Followup on these findings was under way as this audit was being completed. The Department communicated its findings to the property owners on November 5, 2009. The owners are required to respond to the findings within 45 days of receiving the Department's notification letter. The Treasury regulations allow for a total 90-day correction period to respond to any findings, and the IRS requires the Department to submit a report detailing any outstanding noncompliance issues no later than 45 days after the end of the correction period. As of March 3, 2010, the Department anticipates that the property owners will have corrected the issues identified during the site visit, and also anticipates that the Department will submit a report to the IRS that will comment on the property's status.

- **Five-year planning completed with required public input**—HUD requires the State to develop a 5-year plan that sets forth state priorities for CDBG monies and to submit an updated action plan annually during this 5-year time frame to identify annual objectives and expected accomplishments the State hopes to achieve. HUD requires that the Department seek public input into its 5-year plans. The State's 2005-2009 Consolidated Plan describes the public participation efforts that the Department undertook prior to completing that 5-year plan. The State intends to submit its 5-year planning document for the period 2010 through 2014 to HUD on May 15, 2010. In September 2009, auditors observed the public meeting the Department scheduled to obtain input for that 5-year planning document.

- **CDBG eligibility aligned with national objectives**—Although federal rules allow CDBG monies to be used for more than 25 kinds of activities, all such activities must still meet a national objective of (1) addressing the needs of low- to-moderate income families, (2) mitigating slum and blight conditions, or (3) addressing an urgent community need. The Department's application review procedures ensure that projects meet CDBG eligibility requirements and national objectives, as well as the State's priorities as set forth in the 5-year plan, prior to awarding CDBG funds. During the application review process, a project specialist and then the management team reviews the CDBG project applications to assess (1) the projects' eligibility under both federal requirements and state priorities, and (2) the communities' readiness to begin a project and the communities' need for technical assistance (see Introduction and Background, page 4, for the CDBG program's description).

The guidance used in making these determinations—as well as in helping applicants prepare—is strong. The Department's CDBG staff rely on comprehensive guidance documents, including an administrative handbook and standard operating procedures. Further, the Department produces a CDBG application handbook to assist the communities that apply for CDBG monies. Both the internal and external guidance documents provide thorough information about CDBG application requirements, contract development, in-house review, and on-site monitoring requirements.

Department uses appropriate tools to meet required in-house review duties—After the Department verifies eligibility, approves a project contract, and awards the funding, the Department monitors the project's progress and expenditures to ensure compliance with contract provisions and HUD requirements. The Department has appropriate tools to perform these duties. For example, the Department has monitoring checklists that cover a variety of contract provisions and federal requirements, such as procurement, labor reviews, environmental reviews, and project expenditures, as well as on-site monitoring checklists designed to check similar activities during a site visit. In addition, the Department updates its procedures as needed.

The Department's in-house monitoring activities appear to be effective and performed in accordance with department policies. The Department monitors projects for (1) compliance with administrative requirements such as procurement, labor standards, and environmental reviews; (2) project progress; and (3) appropriateness of expenditures. Specifically, for the five projects approved between fiscal years 2004 and 2007, auditors examined the following in depth:[1]

CDBG projects are monitored in several areas to ensure appropriate use of federal grant monies.

- The Department ensured that the required procurement, labor standards, and environmental reviews were completed; and provided technical assistance to community officials during each project.

- The Department ensured that projects were making satisfactory progress and payment requests were properly supported and authorized prior to releasing CDBG monies. In one of the five projects, the Department issued a warning letter that could have resulted in the withdrawal of CDBG funds. Specifically, while monitoring a town water system improvement project, the Department sent town officials a Failure to Progress letter to inform them that the project was not proceeding in a timely fashion. Had town officials not addressed the timeliness issues, the Department reported that it no longer would have provided funding for the project, and would have required the community to repay any monies it had already received.

Finally, the Department's in-house review activities appear to have improved over time. When looking at the 2004 through 2007 project file folders sequentially, the files associated with each project show progressive improvement, such as fewer clerical errors, neater and more consistent organization, and an easier ability to track project history.

Department should better align policy with on-site monitoring practice—The Department's actual on-site monitoring practices do not consistently align with its policy. The Department's policies require its project specialists to conduct two on-site monitoring visits to each CDBG project. However, in four of the five projects auditors reviewed, specialists conducted only one on-site visit. CDBG specialists explained that many project-monitoring activities can be performed in-house rather than through an on-site monitoring visit. They said that some "problem projects" require and receive more frequent on-site monitoring. However, in other cases, documentation received through the mail, for example, can adequately verify compliance, progress, and expenditures.

This appears to be a situation in which the policy should be revised to reflect actual practice rather than changing the practice to conform with written policy. In the four projects auditors reviewed that had only one site visit, a variety of administrative controls were in place in addition to the site visit to help ensure appropriate project oversight. For example, for all four projects, the file documentation supported that the Department had assessed the communities' ability to complete the projects. In

1 Auditors reviewed case files for five closed-out CDBG projects from program years 2004 through 2007. Auditors selected four projects from the CDBG formula allocation category awarded to Bullhead City, Eloy, Prescott Valley, and Willcox, and one project from the competitively awarded category awarded to the Town of Parker.

Administrative controls ensure projects meet department requirements.

addition, the files included checklists that provided evidence of monitoring required labor and environmental reviews, and periodic quarterly progress reports. These administrative controls were sufficient to ensure the project met department requirements even though department staff only conducted one on-site visit. The Department should revise its standard operating procedures and its administration handbook to reflect the on-site monitoring practice it is currently following.

Department's various monitoring types provide appropriate oversight for home purchase assistance programs

The Department relies on several types of monitoring, including monitoring conducted through a Web application, to oversee the day-to-day activities of the lenders and nonprofit counseling agencies that perform key functions in home purchase assistance programs. While the Web application is new with the Your Way Home program, the Department continues to use other more traditional monitoring tools.[1] Finally, the Department also monitors the borrower's compliance with loan terms over the long-term, including any payoffs, if required.

Department relies on a Web site to monitor some third-party contractor decisions and lending activities—Starting in May 2009, the Department began to use a Web-based application as its primary mechanism for monitoring the decisions and activities of the third-party lenders and counseling agencies involved in the federally funded Your Way Home program. The Department uses the Web site to oversee two main aspects of the program:

- Transfer of applicant information and program documents—The Department's loan staff use the Web site to receive application information from the primary lender in an electronic format. The information is reviewed according to program guidelines and compared to what the housing counseling agencies send in to the Department. According to department staff, they check the borrower's income, as reported to them by the primary lender and housing counseling agencies, to make sure the borrower falls within the required income eligibility limits.[2] Additionally, the Department posts the loan program documents it generates to the Web site for the housing counseling agencies to retrieve.

1 The Department suspended the Homes for Arizonans program in July 2009 because of the launch of the federally funded Your Way Home loan program and uncertainty about the State Housing Trust Fund's status as a continued source of funding.

2 The Department relies on the contracted housing counseling agencies to check physical documents to verify borrowers' income. For example, the counseling agencies must review the borrower's pay stubs, income-tax statements, and bank statements, and verify the borrower's employment. Because the counseling agencies' activities take place after a primary lender has pre-qualified the borrower for a first mortgage, the borrower's documents and employment are verified twice.

- **Tracking borrower and loan status**—The Department uses the Web site to monitor how many households its preferred lenders have pre-qualified for a first mortgage and referred to nonprofit housing counseling agencies. Similarly, it also uses the Web site to track how many households its contracted housing counseling agencies are pre-qualifying and certifying for a second mortgage to begin the home-buying process. To be certified, an applicant must complete a mandatory home-buyer education class.

Department also performs more traditional in-house monitoring of contracted nonprofit housing counseling agencies—As it did in the suspended state-funded Homes for Arizonans program, the Department also continues to use more traditional tools to oversee the third-party, nonprofit housing counseling agencies involved in Your Way Home. In both programs, the Department has contracted only with nonprofit agencies that HUD has certified as meeting requirements associated with the federal Housing Counseling Assistance Program. In addition to requiring such HUD certification, contracts for both loan programs show that the Department requires the agencies to provide homebuyer education, marketing, borrower qualification, and borrower assistance, such as a property inspection.

Department contracts with HUD-certified nonprofit organizations.

The Department's review of the contracted agencies mainly involves reviewing two types of documents:

- **Monthly progress reports**—In the Homes for Arizonans program, the counseling agencies must submit monthly progress reports that provide information on such things as the number of borrowers served and the total loans processed. The agencies would receive their monthly administrative fee only after the Department had received the required monthly progress report. A review of the Homes for Arizonans contract files for the three counseling agencies for the 2-year contract period spanning July 2006 through June 2008 showed that all three agencies submitted reports for all 24 months included in the 2-year time frame.

- **Loan closeout documentation**—In contrast to the Homes for Arizonans program, the Department reports that it has opted not to require its contracted agencies to submit monthly progress reports in the Your Way Home program. Although the Department included this requirement in its contract and administrative manual, a key department official explained that the Department opted not to require the reports because it receives sufficient loan progress information through the Web site and final loan closeout documents. In lieu of monthly progress reports, the Department instead requires the Your Way Home housing counseling agencies to submit a loan closeout packet that includes the executed promissory note and deed of trust. The packet also includes documentation to support reimbursement for activities the counseling agencies performed for the borrower, such as a property inspection. The Department relies on a checklist to review the information the counseling agencies submit in the closeout packet, and a review of eight Your Way Home loan closeout packets' documents showed evidence that department staff reviewed all of the information they required the agencies to submit to support their reimbursement.

Department monitors loan payoffs, as required—Finally, in the state-funded Homes for Arizonans program, the Department has taken appropriate action to ensure that borrowers meet the required payoff terms when events take place that would change the homeowner's status as the homeowner.[1] Although the loan program does not have a term, it nonetheless places a permanent lien on the property that must be repaid if the home is sold. The loan must also be repaid in the event of a foreclosure. The Department reported that it had received $1.78 million in Homes for Arizonans payoffs during the period January 1, 2002 through December 31, 2009.

Recommendation:

2.1. The Department should align on-site monitoring policies with on-site monitoring practices by revising its standard operating procedures and its CDBG administration handbook.

1 The federally funded Your Way Home program was too new at the time of the audit to assess whether the Department took appropriate steps to meet required payoff terms.

SUNSET FACTORS

In accordance with Arizona Revised Statutes (A.R.S.) §41-2954, the Legislature should consider the following 12 factors in determining whether the Arizona Department of Housing (Department) should be continued or terminated.

1. **The objective and purpose in establishing the Department.**

   The Department was established in 2002 to address the affordable housing issues confronting the State and to provide greater coordination and innovation of housing-related services at the state level.[1] Prior to that time, the Department of Commerce performed the Department's functions.

   To address affordable housing issues, the Department acts as a pass-through agency for state and federal monies and oversees compliance for several housing programs. The state and federal monies are used for projects that range from assisting individuals in becoming homeowners or assisting individuals facing mortgage, rental, or emergency housing problems to developing new affordable housing for seniors or others with special needs. Projects can also focus on community revitalization and include projects such as building food banks or developing or improving community infrastructure. In addition to administering state and federal housing and community programs, the Department provides technical assistance to communities, and serves on councils and commissions that address affordable housing needs.

2. **The effectiveness with which the Department has met its objective and purpose and the efficiency with which it has operated.**

   The Department has generally met its objective and purpose. This audit identified a need for a minor policy change in one program to bring policy into alignment with its oversight practices, which are sound.

   The Department has met its objective of addressing the affordable housing issues confronting the State by overseeing a variety of housing programs including:

   - **Low-Income Housing Tax Credit program (tax credit program)**—This U.S. Internal Revenue Service program, which the Department administers in

1 The same 2001 bill that established the Department, Laws 2001, Ch. 22, §14, also established the Arizona Housing Finance Authority (Authority) in §12. The Authority was established to issue bonds or certificates, or provide financial assistance for housing purposes and to temporarily acquire title to real property, among other duties. Although the Authority is staffed by the Department, it is a separate entity from the Department and is not subject to sunset review.

Arizona, awards federal tax credits to affordable housing developers. The credits are sold to investors, and the proceeds are used to finance the construction or acquisition and rehabilitation of rental units for low- to moderate-income households. This audit found that the tax credit program has provided additional affordable housing opportunities for low-income individuals and families, the elderly, and special needs populations (see Finding 1, pages 13 through 30). In calendar year 2003, the Department's first full year as a stand-alone agency, it awarded $9.4 million in tax credits to projects to develop or rehabilitate 1,190 affordable housing units, and since 2003, it has awarded nearly $82 million in annual tax credits and developed approximately 6,800 low-income housing units. For example, one 2003 project developed an 89-unit apartment complex in Sierra Vista serving predominantly families earning 60 percent or less of the area's median income.

- **Community Development Block Grant program (CDBG)**—From fiscal year 2003 through 2009, the Department reported that it had distributed over $86 million in U.S. Department of Housing and Urban Development (HUD) block grant monies to support over 430 projects throughout the State. These grant monies have been used for a wide variety of projects to meet the national program's objectives: benefiting low- and moderate-income people, addressing slum or blight conditions, or addressing urgent community development needs. According to the Department, most CDBG projects tend to be directed toward benefiting low- and moderate-income people. See Finding 1, pages 13 to 30, for additional information on this program's impact.

- **Home ownership assistance programs**—The Department's home ownership assistance programs include the Homes for Arizonans program, which was available from 1998 until July 1, 2009, and the Your Way Home program, which was implemented in fiscal year 2009 using federal stimulus monies. Homes for Arizonans offered first-time home buyers assistance through no-interest loans that only needed to be repaid upon sale of the property or violation of program requirements. Since its establishment in 2002, the program has helped over 2,900 households purchase homes. The Your Way Home program helps qualified homebuyers purchase eligible foreclosed homes and as of March 12, 2010, had distributed nearly $13.7 million of the available $26 million to individual home buyers.

- **Special needs and homeless programs**—Homelessness and other special needs are addressed through four programs that provide monies to local governments, nonprofit organizations, and public housing authorities. These programs provide rental assistance and other services to people with HIV/AIDS, homeless people with disabilities, and people making a transition from homelessness to independent living. First, the Housing

Opportunities for Persons with AIDS (HOPWA) program provides funding to nonprofit organizations to assist individuals with HIV/AIDS. Second, a continuum of care process provides Shelter Plus Care and Supportive Housing Program grants to pay for housing and services such as healthcare, employment assistance, and child care. Third, Eviction Prevention/Emergency Housing grants, which according to the Department will be discontinued in June 2010, provide rental security deposits, utility payments, landlord-tenant mediation, household management assistance, or other services that helped to deter homelessness. Fourth, the Department is administering federal stimulus monies for the Homeless Prevention Rapid Re-housing Program, which assists low-income families in retaining or securing housing.

The audit found that the Department could improve CDBG program oversight by better aligning its policies with its on-site monitoring practices.

3. The extent to which the Department has operated within the public interest.

The Department operates within the public interest by administering several programs that improve living conditions, reduce blight, and assist communities throughout Arizona. For example, programs in the rental development area assist low- and middle-income residents by making safe, affordable housing available through development projects. The CDBG program improves communities by, for example, establishing or upgrading water and sewage systems and establishing or improving other facilities such as libraries, parks, and community centers.

According to the Department, it also operates within the public interest by stimulating the economy through adding jobs and tax income to the State. For example, the tax credit program provides developers with a way to finance low-income rental developments, which creates jobs in areas such as construction, inspection, and building and equipment supplies. The Department also acts in the public interest by conducting oversight of these developments to ensure they are in compliance with federal regulations and restrictions.

In the home purchase area, the Department operates within the public interest by administering the federal stimulus monies earmarked for the foreclosure crisis by providing Arizonans facing mortgage foreclosure access to counseling services. In areas hardest hit by foreclosure, the Department's Your Way Home program, funded by the federal Neighborhood Stabilization Program, helps homebuyers buy foreclosed properties, and as of March 12, 2010, the program had assisted 462 families purchase homes. Department programs also address the housing crisis through rental subsidies and ongoing support services that assist the formerly homeless.

The Department also serves as a Public Housing Authority, which oversees two HUD Section 8 programs.[1] Specifically:

- The Department provides administrative oversight to more than 7,900 individual rental units in approximately 110 HUD-subsidized rental properties throughout Arizona. The Department must assure that the housing is maintained as safe, decent, affordable housing. In addition, the Department reports that it conducts management and occupancy reviews on each property and responds to tenant complaints. Finally, the Department serves as an information source for landlords and Section 8 voucher recipients.

- The Department administers the Section 8 Housing Choice Voucher Program for Yavapai County. This program provides rental subsidies for very low-income households so that participants' rent and utilities expense is limited to 30 percent of their adjusted gross income. Participants receive vouchers that may be used at any qualified rental property in Yavapai County. The Department processes the payments, provides information to landlords and recipients, maintains waiting lists, and annually both recertifies participants and inspects housing units.

4. **The extent to which rules adopted by the Department are consistent with the legislative mandate.**

The Department has authority to promulgate rules, but it is not required to do so. A.R.S. §§35-728(A)(1) and 41-3953(C)(12) give the Department rule-making authority, but the Department has not promulgated any rules.

5. **The extent to which the Department has encouraged input from the public before adopting its rules and the extent to which it has informed the public as to its actions and their expected impact on the public.**

Although the Department has not promulgated any rules, it obtains public input and informs the public of its actions in several ways, including:

- **Web site**—The Department maintains a Web site at www.azhousing.gov that contains information intended to inform the public of its actions, including information about upcoming trainings and free educational sessions. In addition, it posts information on notices and deadlines, such as notices of funding availability, public comment periods, and deadlines for applications for various types of housing funding.

- **Qualified Allocation Plan (QAP) public hearings**—Annually, the Department develops a Qualified Allocation Plan for the tax credit program that sets

1 The U.S. Housing Act of 1937, Section 8, authorizes rental voucher and existing housing programs intended to help low-income households choose and rent safe, decent, and affordable housing. Regulations are found in 24 C.F.R. Part 982, and the programs are administered by HUD's Office of Public and Indian Housing.

forth selection criteria for housing priorities such as locations and needs, and explains the procedure for monitoring compliance. In developing the QAPs for 2007 through 2010, the Department complied with the federal tax code's requirement to present the QAP to the public by posting public meeting notices on its Web site for focus groups and a public hearing, and hosting these meetings to obtain comments on draft QAPs.

- 5-Year Consolidated Plan—Consistent with HUD requirements, the Department seeks public input to develop a 5-year consolidated plan and plan updates that set forth state priorities for CDBG monies. To develop the draft State of Arizona Consolidated Plan 2010-2014, the Department conducted a wide array of events between July 2009 and April 2010 to obtain public input. The final plan was due to HUD on May 15, 2010.

6. **The extent to which the Department has been able to investigate and resolve complaints that are within its jurisdiction.**

This factor is not applicable because the Department is not a regulatory agency and, therefore, has no need to investigate and resolve complaints regarding regulated persons or entities. However, according to department officials, the Department is responsible for following up on residents' complaints involving health and safety issues as part of its role as the public housing authority that oversees HUD-subsidized rental properties throughout the State. In federal fiscal year 2009, the Department received 12 life-threatening health and safety issue complaints and reported 10 of the complaints to the property owners within the 1-hour time frame required by department policy.[1] The Department reported the other 2 complaints within 2½ hours. In addition, the Department receives and records health and safety complaints that are nonlife threatening and reported 5 of these complaints to property owners in federal fiscal year 2009. The Department also responds to general complaints in regard to the subsidized properties; however, department staff could not provide auditors with the number of these types of complaints because although they document the complaints within individual contract files, they do not have an automated method for tracking the number of individual types of complaints.

In its other programs, the Department reviews its subrecipients' policies and processes to ensure that valid and fair complaint processes are in place. For example, the Department's CDBG application handbook and administration handbook outline complaint-handling procedures for the application and contract monitoring phases of the projects, respectively. These policies describe federal civil rights and fair housing laws to ensure nondiscrimination and require grantees to design and implement the program in a nondiscriminatory way, maintain contract files for civil rights and fair housing related requirements, and document all civil rights complaints. In addition, the CDBG program monitoring checklists include complaint-file review at various points throughout a project.

1 Federal fiscal year 2009 was October 1, 2008 to September 30, 2009.

When appropriate, department personnel conduct complaint investigations. For example, in one of the five projects auditors examined in depth, department CDBG staff investigated a homeowner's complaint alleging inflated prices and unnecessary work on a department-funded home rehabilitation project. Department staff researched the complaint and communicated with the homeowner throughout the process until the complaint was resolved. The Department reports that it attempts to respond to complaints regarding CDBG within 30 days and stay within a 30-day communication time frame for more lengthy investigations.

The Department reported that it refers other housing-related complaints to government agencies or other organizations that may be of assistance. For example, members of the public with complaints between private parties, such as landlord/tenant disputes, may be referred to the Attorney General's Office, the Secretary of State, or a private or nonprofit attorney.

7. **The extent to which the Attorney General or any other applicable agency of state government has the authority to prosecute actions under the enabling legislation.**

This factor does not apply because the Department's enabling legislation does not establish any authority that would require prosecuting actions. However, the Department reported that the Attorney General's office is used for advice on compliance enforcement issues such as tax credit program rental properties that are out of compliance with program terms. According to the Department, the Assistant Attorney General has sent letters to noncompliant property owners, which have resulted in property owners bringing their properties back into compliance. The Department also consults the Attorney General's office regarding repayment of monies used for ineligible purposes.

8. **The extent to which the Department has addressed deficiencies in its enabling statutes, which prevent it from fulfilling its statutory mandate.**

The Department has requested or supported bills to address statutory deficiencies. For example:

- In 2008, the Department supported House Bill 2571, which sought to standardize the property tax valuation process for housing developed through the tax credit program. According to the Department, depending on the county, tax credit program developments are faced with varying methods of property tax valuation. If enacted, the bill would have ensured tax valuation consistency for tax credit program projects throughout the State. The bill failed to pass in the Senate and was not enacted.

- In 2009, the Department supported Senate Bill 1317, which proposed to exempt the Department from the state rule-making process. However, the bill was held in the Rules Committee and was not enacted. The HUD and tax credit programs spell out rules and regulations, and, as required by A.R.S. §41-3953(B), the Department has developed guidelines for its affordable housing programs. Although the Department is not required to promulgate rules, department officials explained they would prefer to have, in statute, an exemption from rulemaking for the federal programs they administer so that stakeholders understand that the Department's responsibilities regarding these programs are limited to and governed by federal rules and regulations.

9. The extent to which changes are necessary in the laws of the Department to adequately comply with the factors in the sunset law.

This audit did not identify any needed changes to department statutes.

10. The extent to which the termination of the Department would significantly harm the public's health, safety, or welfare.

Terminating the Department would not significantly harm the public's health, safety, or welfare, but it could affect the State's ability to administer and oversee several programs that provide citizens with low-cost housing opportunities, and communities with funding for both housing and nonhousing projects. These include federal programs such as: (1) the formula-allocated CDBG and HOME block grants, (2) the Shelter Plus Care and Supportive Housing programs, (3) the two Section 8 rental assistance programs, and (4) the tax credit program. It would also affect the State's administration of a variety of housing activities supported with State Housing Trust Fund monies. If the Department were terminated and the State wished to continue to receive federal housing monies, its programs would need to be either transferred to one or more other state agencies, such as the Department of Commerce, which was the state agency responsible for most of the Department's programs before the Department was established in 2002.[1] Department officials reported that returning the Department's functions to the Department of Commerce would not be in the State's best interest because the Department was originally created so that the State would have a dedicated agency to address housing issues, and having a dedicated housing agency adds legitimacy at the federal level. According to a Department of Commerce official, it would be difficult for the Department of Commerce to assume the Department of Housing's functions because of the volume and complexity of the federal programs, and any attempt to consolidate would need to ensure the knowledge and skills required to administer those programs would be retained and transferred to the receiving state agency.

1 According to the Senate Fact Sheet for the bill that created the Department, the action was intended to address a 2000 Arizona Housing Commission call for state leadership to help combat the impending housing affordability crisis that was anticipated because of the widening gap between income and housing costs.

Moreover, in April 2010, Governor Jan Brewer announced her intention to terminate the Department of Commerce and replace it with a new Arizona Commerce Authority. According to department officials, should the State not wish to administer the housing resources it currently administers, the resources would most likely be lost to the State and be placed in a national pool to be divided between all other states.

11. **The extent to which the level of regulation exercised by the Department is appropriate and whether less or more stringent levels of regulation would be appropriate.**

    The Department is not a regulatory agency and has no regulatory authority. Therefore, this factor does not apply.

12. **The extent to which the Department has used private contractors in the performance of its duties and how effective use of private contractors could be accomplished.**

    The Department uses contractors, including private for-profit and not-for-profit organizations, to help carry out some of its functions. For example, as required by federal regulations for the Neighborhood Stabilization Program, it uses HUD-approved counseling agencies to provide required homebuyer counseling to individuals who hope to purchase foreclosed homes. Specifically, the Department contracts with several nonprofit organizations to provide the federally required and federally funded homebuyer counseling for individuals participating in the Your Way Home program, and also has lender participation agreements with many private mortgage lenders to implement the program. In addition, in response to the recent housing foreclosure crisis, it contracts with nonprofit housing counseling agencies to provide counseling services through a toll-free mortgage foreclosure counseling hotline. The monies for this program are received from a federally sponsored nonprofit organization called Neighborworks®.

    Audit work did not identify any additional opportunities for the Department to contract for services.

APPENDIX A

Additional programs and resources

In addition to the four programs discussed in detail in this report, the Department administers several other programs and resources, described below.

Other federal programs and resources include:

- **Section 8 Project Based Contract Administration**—Privately owned properties, which receive rental subsidies through the Section 8 Program of the U.S. Department of Housing and Urban Development (HUD), offer affordable housing to households that are at or below 80 percent of the area's median income. The subsidy or assistance stays with the property—those families residing at a Project-Based Assisted property may receive assistance as long as they are eligible and reside at the property; the assistance does not go with the family when they move. Property owners must adhere to four eligibility-related requirements, including verifying applicant's income and other information, determining the tenant's rent payment, selecting people from a waiting list, and annually reviewing tenant income and adjusting rent payments accordingly. HUD contracts with the Department to administer the program, including completing renewals, annual monitoring of the properties and tenant records, and investigating complaints.

  Program Dollars—$42.4 million in state fiscal year 2009
  Source of Funding—HUD

- **Section 8 Housing Choice Voucher Program (Yavapai County)**—The Housing Choice voucher program operates only in Yavapai County and is a rental assistance program. This low-income program helps limit the rent and utility payments of the recipient household to approximately 30 percent of their income. The voucher program subsidizes the remaining portion of rent, which the Department, in its capacity as a Public Housing Authority (PHA), pays to the property owner. Recipients must select and rent a unit that meets HUD requirements for housing quality and safety. If the PHA determines that the unit is suitable and rent reasonable, it enters into a contract with the owner to make payments on behalf of the household. The voucher program is tenant-based rather than project-based, meaning the assistance can follow the household if they move away from the rental property, and it is limited to low-income households whose income is at or below 80 percent of the area's median income.

Program Dollars—$768,634 in state fiscal year 2009
Source of Funding—HUD

- HOME Investment Partnerships Program (HOME)—The HOME program is one of four allocations distributed annually to states and other government jurisdictions by HUD.[1] Program objectives include expanding the supply of decent, affordable housing for low-income Americans and strengthening the abilities of state and local governments to design and implement strategies for achieving adequate, decent supplies of affordable housing. In 2009, the Department was one of five government jurisdictions that received a HOME allocation, and it had the largest allocation to distribute (see Appendix B, Table 6, page b-i).[2] HOME monies may be used as incentives to develop and support affordable rental housing and new homeownership construction and reconstruction, for tenant-based rental assistance, or to pay for the operating expenses of nonprofit community housing development organizations. The Department has made HOME monies available state-wide and targeted these resources toward providing gap finance loans for rental housing developments, new home construction and acquisition, and owner-occupied housing rehabilitation. The HOME program has a 25 percent federal matching requirement, and the Department reported that it has relied on the State Housing Trust Fund to meet the matching requirement.

  Program Dollars—$7 million in state fiscal year 2009
  Source of Funding—HUD

- Housing Opportunities for Persons with AIDS (HOPWA)—HOPWA is the smallest of the special needs programs. HOPWA provides short- and long-term rental assistance, operates community residences, or makes use of other supportive housing facilities developed to address needs of persons who are living with HIV/AIDS. HUD awards these HOPWA monies to states and other jurisdictions through both a formula allocation and on a competitive basis. States and other jurisdictions that do not qualify for a formula allocation may apply for a competitive grant. The Department receives an annual formula

1 The other allocations that HUD distributes annually include the Community Development Block Grant, Emergency Shelter Grants (ESG), and HOPWA. See Appendix B, Table 6, page b-i, for the annual allocations that HUD awarded to all eligible government jurisdictions in Arizona, including the Arizona Department of Housing, for federal fiscal year 2009 covering October 1, 2008 through September 30, 2009.

2 The other four Arizona jurisdictions that received a federal fiscal year 2009 HOME award include Maricopa County and the cities of Phoenix, Tucson, and Mesa. According to the Department, the nearly $8.8 million in federal fiscal year 2009 HOME monies is being distributed during state fiscal year 2010.

allocation, which it passes through to two nonprofits that provide rental subsidies and services to participating households.

Program Dollars—$185,270 in state fiscal year 2009
Source of Funding—HUD

- **HUD Continuum of Care Homeless Assistance—**The HUD Continuum of Care consists of three competitively awarded funds and one formula-allocated fund created to address the problems of homelessness. The Department operates two of these four programs—Shelter Plus Care and the Supportive Housing Program—in 13 rural counties, and Maricopa and Pima Counties operate their own programs. The Department is the lead agency on the State's Rural Continuum of Care committee, and as this lead agency, it applies on behalf of individual local projects because local entities are not individually eligible to apply. HUD provides the money to the Department, which passes the money through to the providers. According to the program administrator, most of the providers who have been awarded funds in previous years continue to receive funding because experience in providing service is part of the scoring system.

  - **Shelter Plus Care Program—**This program helps homeless people with disabilities. The program provides grants to states, units of local government, or public housing agencies to provide rental assistance so homeless persons with disabilities can obtain permanent housing, and the rental assistance must also be matched with social services.

  - **Supportive Housing Program—**The Supportive Housing Program helps develop housing and related supportive services for people moving from homelessness to independent living. Program monies help homeless people live in a stable place, increase their skills or income, gain more control over the decisions that affect their lives, and help homeless persons to live as independently as possible. Eligible applicants are states, local government, private nonprofits, and public nonprofit community mental health associations.

Program Dollars—$7 million in state fiscal year 2009 for Shelter Plus Care
$2.3 million in state fiscal year 2009 for Supportive Housing
Source of Funding—HUD

- **Homeless Prevention/Rapid Re-Housing (HPRP)—**The Department uses these HUD federal stimulus monies to provide services similar to the state-supported EPEH program. The HPRP monies cannot be used for mortgage assistance, but can be used to assist families at or below 50 percent of the area median income to retain or secure housing. HUD allows the monies to be used for services such as rental and housing relocation assistance, credit counseling, security, or utility deposits and utility payment assistance.

Program Dollars—$7 million to be expended by September 2012
Source of Funding—American Reinvestment and Recovery Act

Other programs that use state resources include:

- Eviction Prevention/Emergency Housing (EPEH)—According to the Department, EPEH will be discontinued on June 30, 2010. EPEH provides housing counseling and financial assistance to individuals and families at risk of homelessness. Services eligible under this program include: grants for security deposits and utility payments, and rent and mortgage foreclosure assistance. EPEH grants are available through the State Housing Trust Fund and are typically acquired through a competitive bidding process. EPEH grants are provided to selected local governments and nonprofit agencies that provide the counseling or assistance.

  Program Dollars—$3.7 million in state fiscal year 2009
  Source of Funding—American Reinvestment and Recovery Act

APPENDIX B

Table 6: U.S. Department of Housing and Urban Development Allocations for All Arizona Jurisdictions Federal Fiscal Year 2009[1]

Jurisdiction	CDBG[2]	HOME[2]	ESG[2]	HOPWA[2]	Total Allocation
Arizona State Program[3]	$12,078,239	$8,762,874	$886,603	$198,919	$21,926,635
Avondale	502,383	0	0	0	502,383
Chandler	1,409,686	0	0	0	1,409,686
Flagstaff	619,558	0	0	0	619,558
Gilbert	702,862	0	0	0	702,862
Glendale	2,237,071	0	97,997	0	2,335,068
Maricopa County	2,223,729	4,283,786	96,516	0	6,614,031
Mesa	3,427,770	1,525,196	150,631	0	5,103,597
Peoria	672,294	0	0	0	672,294
Phoenix	17,105,043	7,058,159	750,024	1,608,397	26,521,623
Pima County	2,703,834	0	114,004	0	2,817,838
Prescott	294,649	0	0	0	294,649
Scottsdale	1,171,440	0	0	0	1,171,440
Surprise	373,123	0	0	0	373,123
Tempe	1,618,057	0	0	0	1,618,057
Tucson	6,180,686	4,464,877	271,691	420,497	11,337,751
Yuma	935,522	0	0	0	935,522
Total Allocations	$54,265,946	$26,094,892	$2,367,466	$2,227,813	$84,956,117

1 Federal fiscal year 2009 began on October 1, 2008, and ended September 30, 2009. According to the Arizona Department of Housing (Department), the federal monies awarded in federal fiscal year 2009 would be distributed during the state fiscal year 2010 beginning July 1, 2009 and ending June 30, 2010.

2 Community Development Block Grant (CDBG); HOME Investment Partnerships Program (HOME); Emergency Shelter Grants (ESG); and Housing Opportunities for Persons with AIDS (HOPWA).

3 The Arizona State Program refers to the monies allocated to and administered by the Department and the Arizona Department of Economic Security (DES). The Department administers the CDBG, HOME, and HOPWA monies, and DES administers the ESG monies.

Source: Auditor General staff analysis of data retrieved from the U.S. Department of Housing and Urban Development Web site www.hud.gov/offices/cpd/about/budget/budget09/indexcfm on July 28, 2009, and the *FY2005-2009 State of Arizona Consolidated Plan*.

APPENDIX C

Methodology

Auditors used a number of methods to study the issues addressed in this report and assess whether internal controls over the Arizona Department of Housing's (Department) programs were properly designed and implemented. First, auditors conducted interviews and performed observations. Specifically, auditors interviewed department and U.S. Housing and Urban Development (HUD) staff, and stakeholders and experts in the housing field, including a Pinal County Public Housing Authority official, members of the Arizona Housing Alliance, and officials from Chicanos Por La Causa, Arizona Multibank Community Development Corporation, and the Drachman Institute. Auditors also observed several sessions of the 2009 Governor's Housing Forum, including a public hearing on the Department's Five Year Consolidated Plan, and sessions on Community Development Block Grant (CDBG) program, the Low-Income Housing Tax Credit program (tax credit program), and the federal stimulus monies the State received.

Second, auditors reviewed documents and reports regarding housing issues and the recent housing crisis. Specifically auditors reviewed statutes; state and department budget documents; and department internal documents, including policies and procedures, application guides, and customer satisfaction surveys. Federal documents reviewed included the Housing and Economic Recovery Act of 2008 (HERA), the American Recovery and Reinvestment Act of 2009, Internal Revenue Code 26 U.S.C. §42, the U.S. Code of Federal Regulations (C.F.R.) Titles 24 and 26, HUD performance reviews of the Department, and a HUD Office of the Inspector General report. In addition, auditors reviewed literature and reports on housing issues, such as *The State of Housing in Arizona 2000, the Arizona Town Hall on Housing*, November 2008, and a special investigative report regarding the Texas Department of Housing and Community Affairs, and reports published by the Arizona Department of Administration's General Accounting Office and the U.S. Government Accountability Office, as well as other articles pertaining to housing policy and the Low-Income Housing Tax Credit.

Auditors also used the following specific methods:

- **Finding 1**—To assess the impact of the Department's tax credit program, The CDBG, and home purchase assistance programs across the State, auditors analyzed programmatic data the Department provided. Specifically, auditors used tax credit program data from 1987 to 2009, CDBG data from fiscal years 2003 through 2009, and home purchase assistance data from 1998 through 2010. Auditors also reviewed funding applications for each of the highlighted tax credit and CDBG projects and conducted site visits to three tax credit developments and one CDBG project. Further, auditors interviewed various stakeholders involved with the individual tax credit and CDBG projects, including city officials, property managers, program administrators, developers, community organizations, and tenants in tax credit properties.

- **Finding 2**—To assess the adequacy of the Department's oversight of the tax credit program, the CDBG, and home purchase assistance programs, and whether the Department's internal controls over these programs were properly designed and implemented, auditors (1) identified the applicable federal statutory and regulatory requirements that govern each program; (2) obtained additional federal guidance if available to understand each program's compliance requirements; (3) obtained policies, procedural manuals, monitoring checklists, and other tools that the Department used for program monitoring; and (4) performed specific test work activities to evaluate how well the Department's monitoring activities conformed to applicable legal standards and department policy. Auditors also interviewed relevant program staff to discuss any questions that arose as a result of the testing. For each specific housing program:

    - **Tax Credit Program**—Auditors reviewed U.S. Treasury Department regulations at 26 C.F.R. §1.42, documented and evaluated Qualified Allocation Plans (QAP) for the period 2003 through 2010, reviewed the tax credit program Compliance Manual and Housing Compliance Standard Operating Procedures, analyzed information on actual allocations reported to the IRS in 2003 through 2009, evaluated the Department's 2007 tax credit program application information and allocation decisions to assess how the Department's award decisions measured up to set-aside goals published in the 2007 QAP, documented 2004 through 2009 Information Bulletins to verify that the Department published public hearing notices for the QAP drafting process in those years, and observed and evaluated the public participation process for the 2010 QAP drafting process between November and December 2009. Auditors also observed the Department's housing compliance team conducting a site visit and inspection of a tax credit property on October 28, 2009.

- o **CDBG Program**—Auditors reviewed HUD's State CDBG Program regulations at 24 C.F.R. 570, Subpart I; HUD's *Guide to National Objectives and Eligible Activities for State CDBG Programs* (HUD, July 2002); and the Department's CDBG application and administration handbooks, standard operating procedures, and checklists for in-house and on-site monitoring.

  Auditors also performed case file reviews on five closed-out CDBG projects from fiscal years 2004 through 2007. Auditors selected four projects from the CDBG formula allocation category and one project from the competitively awarded category. The file review assessed procedures over time and also examined the documentation of compliance with state and federal requirements in four areas: (1) project eligibility and community readiness; (2) administrative requirements such as procurement, labor standards, and environmental reviews; (3), adequate project progress and communication; and (4) expenditure review and approval. See Table 7 for more information on the projects selected.

Table 7: CDBG Projects Reviewed
Fiscal Years 2004 through 2007

Fiscal Year	Community	Project Description	Amount
		Formula Allocation Grants	
2004	Prescott Valley	Housing rehabilitation	$220,545
2005	Eloy	Water system improvements	341,032
2006	Bullhead City	Housing rehabilitation	846,530
2007	Willcox	Community center improvement	304,791
		Competitive Allocation Grants	
2006	Parker	Flood drainage	365,000

1 Amounts do not include administration, which totaled $6,094, $0, $6,250, $40,000, and $0, respectively, for the five projects.

Source: Auditor General staff selection of files for review based on an analysis of all of the Department's CDBG projects for state fiscal years 2004 through 2007.

- **Home Purchase Assistance**—Auditors reviewed the HERA and related Neighborhood Stabilization Program (NSP) regulatory requirements published in the *Federal Register*, Vol. 73, No. 194, Oct. 6, 2008; auditors reviewed Homes for Arizonans program information published in the State of Arizona 5-year Consolidated Plan for 2005-2009 and its December 2008 NSP Action Plan, and the Homes for Arizonans and the NSP Your Way Home administrative handbooks. Auditors also reviewed the Department's Request for Proposals for an NSP program consultant and the agreement with the final awardee, agreements the Department made with preferred lenders, and contracts with nonprofit housing counseling agencies that were involved in both the Homes for Arizonans and NSP loan programs. Auditors also reviewed the contract files for each counseling agency and loan closeout documents that the Department maintains. Finally, auditors assessed the types of controls that the Department put in place when it developed the Web-based application it uses to adminster the NSP Your Way Home program.

- To provide information for the report's Introduction and Background, auditors summarized information from the Joint Legislative Budget Committee's appropriations reports for fiscal years 2009 and 2010, the Department's 2003 through 2009 annual reports, the Department's Web site, and other agency-provided documents.

- To respond to the sunset factors, auditors relied on work conducted to complete the audit report's Introduction and Background and findings. In addition, auditors used information obtained from the Governor's Regulatory Review Council, the Office of the Attorney General, and the Arizona Department of Commerce. Auditors also used additional information obtained from the Department regarding statutory changes it has supported, complaints it has received, its complaint process, department officials' views on the potential impacts of terminating the Department, and the Department's use of contractors.

AGENCY RESPONSE

JANICE K. BREWER
Governor

MICHAEL TRAILOR
Director

STATE OF ARIZONA
DEPARTMENT OF HOUSING
1110 WEST WASHINGTON, SUITE 310
PHOENIX, ARIZONA 85007

(602) 771-1000 WWW.AZHOUSING.GOV
FAX: (602) 771-1002

May 26, 2010

Debra K. Davenport, CPA
Auditor General
State of Arizona Office of the Auditor General
2910 North 44th Street, Suite 410
Phoenix, AZ 85018

RE: Arizona Department of Housing Performance Audit and Sunset Review

Dear Ms. Davenport:

We are writing to provide our comments to the performance audit and sunset review of the Arizona Department of Housing (Department) conducted as part of the sunset review process prescribed in Arizona Revised Statutes § 41-2951 et seq. In addition to assessing the Department's operations using the sunset factors in the statute, the audit focused on four of the Department's largest programs and examined the accomplishments these programs have achieved and the effectiveness of the Department's oversight of these programs.

We are pleased with the findings identified in your report which concluded that the Department programs increase housing opportunities and enhance communities. We believe that your report supports our contention that the programs of the Department are important in increasing the quality of life in Arizona: providing affordable housing opportunities across the state, supporting projects to meet community needs, and increasing home ownership. We are also pleased with the audit's conclusion that the Department operates a sound system for planning, awarding, and monitoring housing program resources.

The Department takes its fiduciary responsibility in administering approximately $200 million in public resources annually with extreme seriousness. Since the Department was created in 2002, it has overseen over $1.7 billion in public assets comprised of state and federal monies, federal tax credits, and the bond issuances of the Arizona Housing Finance Authority. We believe that your report supports the Department's assertion that the improvements brought by the Department's programs are immeasurable and operate within the public interest, given the wide range of benefits derived from these investments, enhancing housing affordability and community stability all the while putting significant resources back into the Arizona economy.

As the legislature contemplates the renewal of the Department's authorizing statutes, we would like to point out that unlike many state agencies the housing department has always been self-sufficient, relying on zero General Fund support to finance its operations. As a result, the Department considers itself an asset, providing valuable programs and services at no cost to other functions of the state. The Department operates primarily through federal entitlement and competitively awarded grants, as well as fees charged for services.

The only state resource that the Department has historically utilized has been an allocation of 55 percent of the state's Unclaimed Property fund, which until this past fiscal year provided resources to the Department approaching $30 million annually for the State Housing Trust Fund. Unfortunately, this fund was significantly reduced in FY2010 when the legislature capped future annual allocations to $10.5 million. This reduction will significantly hamper the Department's ability to address some of the state's most difficult housing challenges, since it provided a flexible resource capable of funding many housing-related activities that are prohibited under federal housing programs as well as required match for some federally supported activities.

Ironically, though the Department has received only modest state support, through the above mentioned resource, it has lost over $69 million since 2008, this amount having been swept by the legislature to support the General Fund. As a result, the Department has downsized its staffing by 25 percent since that time, and is, as the old adage goes, "doing more with less." The Department hopes in the future, when the state recovers from the current economic crisis, that the Housing Trust Fund will once again receive an annual allocation of 55 percent from the Unclaimed Property fund or approximately $30 million per year to assist with Arizona's housing needs.

The aforementioned reduction in state resources has come at a time when the Department has been tasked with addressing a housing crisis of historical proportions. Thankfully while state resources have shrunk, as your report correctly identifies, federal resources have increased, enabling the Department to address some of these critical issues including funding for foreclosure counseling and mitigation efforts, eviction prevention, and other resources to divert the threat of homelessness in these tough economic times. The Department projects that some of these resources will remain available to Arizona residents until approximately 2013, when federal stimulus programs are expected to conclude.

In response to the audit's recommendation, identified on page 42 at 2.1, which recommends that the Department's CDBG handbook be revised to align on-site monitoring policies with its practices, the finding of the Auditor General is agreed to and it should be noted that the audit recommendation has already been implemented.

On behalf of the staff of the Arizona Department of Housing, I would like to thank the Sunset Review team who worked with the Department to conduct this important performance audit. We appreciate the opportunity that this review gave the Department to highlight what it has accomplished in its short history. We look forward to our continued service to the citizens of Arizona as we move into our second decade.

Sincerely,

Michael Trailor
Director

Performance Audit Division reports issued within the last 24 months

08-03 Arizona's Universities—Capital Project Financing
08-04 Arizona's Universities—Information Technology Security
08-05 Arizona Biomedical Research Commission
08-06 Board of Podiatry Examiners
09-01 Department of Health Services, Division of Licensing Services—Healthcare and Child Care Facility Licensing Fees
09-02 Arizona Department of Juvenile Corrections—Rehabilitation and Community Re-entry Programs
09-03 Maricopa County Special Health Care District
09-04 Arizona Sports and Tourism Authority
09-05 State Compensation Fund
09-06 Gila County Transportation Excise Tax
09-07 Department of Health Services, Division of Behavioral Health Services—Substance Abuse Treatment Programs
09-08 Arizona Department of Liquor Licenses and Control
09-09 Arizona Department of Juvenile Corrections—Suicide Prevention and Violence and Abuse Reduction Efforts
09-10 Arizona Department of Juvenile Corrections—Sunset Factors
09-11 Department of Health Services—Sunset Factors
10-01 Office of Pest Management—Restructuring
10-02 Department of Public Safety—Photo Enforcement Program
10-03 Arizona State Lottery Commission and Arizona State Lottery
10-04 Department of Agriculture—Food Safety and Quality Assurance Inspection Programs

Future Performance Audit Division reports

Board of Chiropractic Examiners