

COMPLIANCE AND ASSET MANAGEMENT OPERATIONS MANUAL UPDATED JULY 1, 2014

UNDERWRITING

The strength of VHDA's multifamily portfolio is dependent on a thorough underwriting process at loan origination. The Compliance and Asset Management Department assists Development during this process. The Asset Manager's involvement may include providing information regarding the market, rents, amenities, operating expenses, comparable properties, and/or information regarding the sponsor or management agent. This is accomplished through a team underwriting process.

Asset Managers are encouraged to become involved with new developments during the various underwriting stages and are encouraged to become knowledgeable of the various loan programs/funding sources. As VHDA develops more loan programs and allocates resources through more creative means, it is important for Compliance and Asset Management to remain current in Development's outreach. Organizational Chart, exhibit 1.

PHYSICAL MONITORING

Property inspections are an important part of Compliance and Asset Management's responsibility in monitoring the management and operation of developments financed and/or administered by VHDA. Effective monitoring requires formal announced inspections and informal, unannounced site visits.

At the beginning of the calendar year, each of the regional teams coordinates the schedule for inspections and compliance audits. The schedule and outcome of these inspections and audits is captured in VHDA's rental automation system, known as ProLink. Compliance Audits will be addressed later in this manual.

Every property is scheduled to receive an annual inspection. For unassisted properties, an annual inspection may be waived every other year if the property meets the criteria established on the Inspection Waiver. If the property is under construction, still in underwriting, or not yet final closed, an inspection waiver should be completed stating the reason why the inspection was not done. Therefore, for each active property in ProLink, either an inspection report or inspection waiver will be generated.

Assisted properties (those properties with project based Section 8 rental assistance and Section 236 properties) require annual visits by VHDA given our role as the contract administrator.

The Regional Portfolio Managers and the Director of Compliance and Asset Management reviews the inspection schedule on a quarterly basis to determine the progress and timeliness of the inspections. A calendar year end log will be generated no later than February 10 of the following year. This report will be reviewed and initialed by the Director of Compliance and Asset Management.

FINANCIAL MONITORING

Financial monitoring is an integral and important part of an Asset Manager's responsibility in determining the security of a multifamily loan. The financial condition of a development may be assessed by reviewing its financial submissions. Additionally, an evaluation may be made on a development's adherence to regulatory and program requirements by reviewing financial reports.

VHDA financed properties are required to submit monthly and annual financial operating information through the submission of audited financial statements prepared by a third party auditor, annual operating budgets, and monthly operating summaries. Reporting requirements are based on regulatory requirements and the amount of outstanding mortgage loan balances. Properties with aggregate loan balances less than \$1 million are not required to submit financial operating data unless requested by the Asset Manager. The financial data is captured in ProLink.

RISK ANALYSIS

The Risk Analysis tool within ProLink allows the Asset Managers to determine the overall risk rating of a property given a number of factors including a property's financial and physical condition along with the status of its mortgage payments and history of delinquent mortgage payments. The process for identifying properties of concern and the possibility of foreclosure is referred to as the At Risk/Watch Process which is done at the end of each quarter. This information is used by our Finance Division to calculate the Authority's loan loss reserve. Documentation of this process is noted as exhibit 2.

RESERVE ESCROW ACCOUNTS

Reserve oversight is an important part of an Asset Manager's responsibility in assuring that funding is available to address all/part of a development's long term and/or specific needs. Most every property maintains a Replacement Reserve Account. These are held by VHDA and are funded to meet the needs of the property.

REPLACEMENT RESERVE ACCOUNT

The purpose of this account is to provide a source of funding for capital improvements, extraordinary maintenance, substantial repair, replacement of capital items, or for any other purpose authorized by the Asset Manager.

Asset Managers evaluate reserve balances and funding levels in comparison to the needs of a development; consequently, this is done in conjunction with budget review. Monthly deposits to the reserve escrow may be adjusted (i.e., increased, decreased, deferred, waived) as necessity warrants and determined in discussions with a development's sponsor and/or management agent. Capital Needs Assessments may be completed by a third-party or prepared by a sponsor or management agent.

SPECIFIC RESERVE USAGE AGREEMENTS

Asset Management may establish a unique agreement between an owner, agent, and VHDA on the use of reserve funds over a given period. Such an agreement should be well documented in letter form, signed off on by representatives of the owner/agent, and designate the specific usages of funds held in the reserve as well as deposit and withdraw patterns over a period of time. The practice of establishing a reserve usage agreement is a relatively new tool used by Asset Management, and its purpose is to outline a clear understanding of reserve mechanics. The Director of Compliance and Asset Management will review all such agreements before their proposal to a development's owner/agent.

LOAN ASSUMPTIONS

Another part of Asset Management's responsibility is to determine the validity, feasibility, credit worthiness, and structure for various loan assumption requests that are made to the Authority. Having a process for this review provides efficient and professional service to our customers, and enhances VHDA's sound loan review and asset management practices.

There are three (3) basic loan assumption requests that Asset Management will review:

1. Straight assumption, purchaser is known to VHDA;
2. Straight assumption, purchaser is unknown to VHDA;
3. HUD assumptions (236 or other HUD loans) – All HUD loan assumption requests should be referred to Neal Rogers in Compliance and Asset Management.

During this review process, Compliance and Asset Management will consult with Development, Finance, and Servicing regarding the eventual terms and conditions of the proposed assumption.

MANAGEMENT AGENT CERTIFICATION PROGRAM

VHDA recognizes the importance of professional management as it pertains to the success of properties in the VHDA financed portfolio. Originally designed to support efforts in the our administration of the Low Income Housing Tax Credit (LIHTC) Program, the VHDA Certified Management Agent Program is a fixture for all LIHTC properties receiving allocations since 2007 and all new business done with VHDA beginning in 2013. Any developer/owner seeking VHDA financing must use a VHDA Certified Agent. This involves an application process and periodic renewals, depended on the length of a certification. For smaller and special use properties where retaining a VHDA Certified Agent is not always possible, Compliance and Asset Management will perform a review of a management agent's operations to determine its capability to manage that specific property.

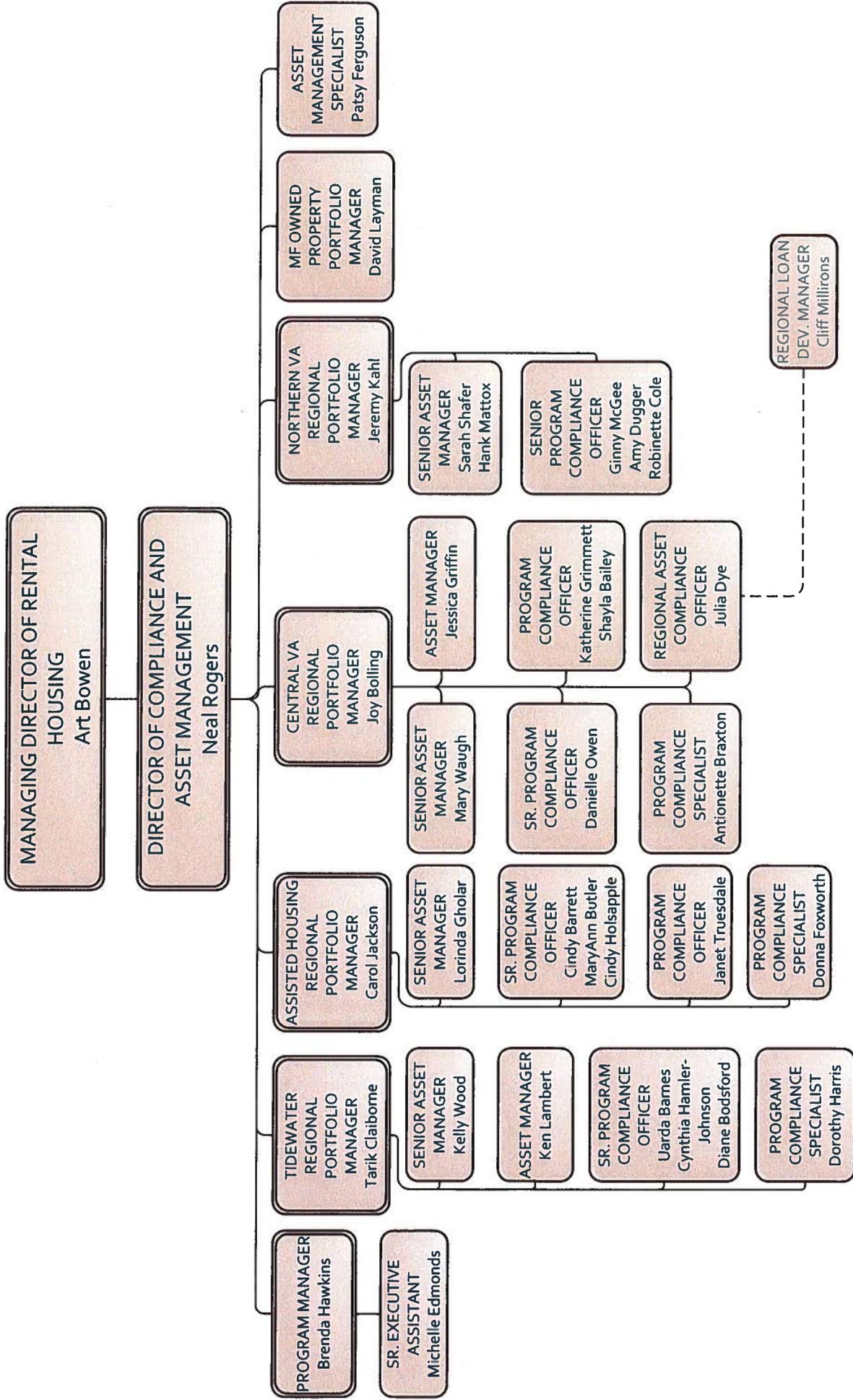
COMPLIANCE MONITORING

VHDA is responsible for the program compliance monitoring of various housing programs and financing regulations for properties throughout our portfolio. These include the HUD Section 8 program for which VHDA is the contract administrator, the Low Income Housing Tax Credit (LIHTC) Program, VHDA program requirements, and IRS tax exempt funding requirements. Compliance audits are performed by Compliance Officers and are scheduled, at a minimum, every three years. The scheduling of compliance audits and recording of the findings is done within the HDS monitoring system. For the federal assisted Section 8 communities, Compliance Officers follow HUD protocol through the use of the Management Occupancy Review (MOR). Internal audit procedures are outlined in exhibit 3.

RENTAL HOUSING

TOTAL FILLED POSITIONS ON THIS PAGE: 33
 Total Positions Under Recruitment on this page: 0
 Total Positions Vacant on this Page: 0

COMPLIANCE AND ASSET MANAGEMENT



At-Risk/Watch Quarterly Report

Properties of Concern:

The Compliance and Asset Management Department will determine, on a quarterly basis, the risk rating for each property in the VHDA financed portfolio. Utilizing the Risk Assessment activity in Prolink, each Asset Manager determines a property's risk assessment based on a variety of information including the status of the mortgage payment, the physical condition of the property, and the financial performance of each property which includes the most recent operating budget, monthly operating information, and audited financial statements. Prolink takes into consideration these and additional factors (see attached) to establish an overall score for the property, which is then associated with a particular risk rating: At-Risk, Watch, or Acceptable. Risk points that total to less than 7.99 indicate an Acceptable rating. 8.00 to 14.99 reflect a property in Watch status, and properties with a point total in excess of 14.99 indicate an At-Risk status. The Asset Manager may adjust the point criteria based on information that may have recently come to his/her attention that is not reflected in the objective information. This must be accompanied with specific comments and reasoning for the adjustment. All properties with an At-Risk/ Watch rating will appear on the Quarterly At-Risk/Watch Report. Properties on the At-Risk/Watch Reports will require additional monitoring by VHDA. Each of these properties will be inspected at least annually and may include additional visits to the property and additional financial reporting requirements.

If a property is in a workout status, the property will be reflected on the At-Risk report. This is accounted for in the risk rating criteria. Workout is defined as any troubled debt restructuring of the stated loan document including interest deferrals, short term adjustments to principal and interest payment, and adjustments to reserve payments

Determining the "Potential Loss":

Determining a projected "potential loss" is based on the property's ability to meet its operating expenses and its debt service payments. The variance between the debt that it can support and the outstanding loan balance is the "potential loss" to VHDA. In some cases, we may consider the value of the land to offset a significant potential loss. We recognize that every property has some inherent value, so the possibility of a complete loss is not likely.

For most multifamily income producing properties, the Asset Manager prepares an annualized operating proforma taking into consideration the most recent information available, such as the current budget, most recent financial audit, and current information such as vacancy, delinquency, and concessions. The goal is to arrive at the Net Operating Income (NOI) that will be available to service the existing debt. This process is indicated on the Property Input Sheet. In order to compute the amount of annual debt service that can be supported by the indicated NOI, we take into consideration the current mortgage balances(s), a thirty year term (our typical term for a mortgage loan), the average of the current taxable and tax-exempt interest rates as quoted on the VHDA web site, and the existing interest rates in place for the loans on the property. In an instance where there is more than one loan with different interest rates, we defer to the highest rate which is typically attached to the highest outstanding loan balance. During this analysis, we use the computed NOI for a property and run two computations to determine the amount of debt that can be supported.

The first computation uses the average of the taxable and tax exempt interest rates as listed on the VHDA web site. This rate, a 30 year term, and the NOI will be used to calculate the amount of debt that a property can support assuming a 1.00 DCR. The difference between this amount and the current loan balance(s) is a possible "potential loss".

The second computation uses the same assumptions except for the interest rate. In this scenario, the current interest rate in place of the existing financing is used. As referenced above, in a case where there is more than one loan with different interest rates, we defer to the highest rate which is typically attached to the highest outstanding loan balance. The NOI will be used to calculate the amount of debt that a property can support assuming a 1.00 DCR. The difference between this amount and the current loan balance(s) is another possible "potential loss".

With two possible "potential loss" figures, we will choose the lesser of the two. The computation that results from a scenario using the lower interest rate will allow the NOI to support a higher level of debt. The rationale is that VHDA would likely consider using whichever interest rate puts the property in the best position to succeed. For example, should a purchaser be willing to assume the debt from the owner at the current interest rate, VHDA might consider the possibility of a loan assumption. Alternatively, we could also consider offering the property financing at the current published interest rate.

We recognize that that each property has some value which may exceed the NOI calculated value, particularly in situations where the property will support little or no debt. Also, there are instances where a realistic NOI cannot be calculated as indicated above. For example, there may not be adequate information available to compute an NOI due to the nature of the facility (group home), or the property may be in the early stages of lease-up, generating little income. Therefore, we may consider information such as a recent appraisal, a recent tax assessment (although we may choose to recognize just the value of the land), or a documented recent comparable sale of a comparable property, or a Broker Price Opinion (BPO). These are all third party documented numbers that can be subtracted from the outstanding loan balance, providing a more realistic "potential loss". In an instance in which there exists a third party value and an NOI that can support a certain amount of debt, VHDA will utilize the calculation reflecting the lesser "potential loss". If there is no NOI or third party value available, the loan balance will be the potential loss.

Determining the "Adjusted Potential Loss":

Whether or not there is financial information available to arrive at a NOI, each property on the At-Risk Report may indicate a "potential" loss. We then make one adjustment to this number to arrive at an "adjusted potential" loss.

We subtract any funds that we are holding in reserve accounts. This does not include real estate and insurance escrows, just those in either replacement reserves, miscellaneous reserves or operating reserves. We could apply these directly to the mortgage balance should we choose.

Risk:

For properties with and “At-Risk” status, a potential financial risk to VHDA will be determined using the following criteria:

- 1) Net Operating Income (NOI) that is not able to meet the operating needs and debt service for the property
- 2) inability of the owner to advance funds to the property to meet its obligations or an indication from the owner that he/she will not advance funds to the property
- 3) deteriorating physical condition of the property to the degree that VHDA’s security is at risk with no sustainable plan by the owner to address these problems
- 4) delinquent mortgage payments

A high risk of foreclosure may be indicated if the property’s operations are insufficient to cover its expenses and debt service, the owner cannot, or will not, advance funds to meet these needs, the physical condition of the property is deteriorating, and there is a pattern of delinquent mortgage payments.

A medium risk may exist if the property’s operations are insufficient to cover its expenses and debt service, the owner’s desire and ability to fund deficits is uncertain, the property is not being maintained and managed in a satisfactory manner, and there is no pattern of delinquent mortgage payments.

A low risk of foreclosure may be indicated if the property’s operations are insufficient to cover its expenses and debt service, the owner’s desire and ability to fund deficits is uncertain, the property is being maintained and managed in an acceptable manner, and mortgage payments are current and there has not been a pattern of delinquent mortgage payments.

In addition to those properties demonstrating some level of risk, there are properties that may be in a Watch status. These properties pose no foreclosure risk, but they do demonstrate some of the issues that result in additional monitoring and oversight. The severity of the issues, though, does not rise to the level that would result in a property posing a risk of foreclosure.

In most circumstances, a poorly performing property will progress from an Acceptable status to a Watch status and then possibly to an At-Risk status. There may be instances, such as a major casualty loss or a delinquent mortgage payment (as noted on Servicing’s month end delinquency report), when a property may advance directly from Acceptable to At-Risk status. In these instances, a property will need to gradually work its way off the list should the issue be corrected. A property will not go from an At-Risk status to an Acceptable status from one quarter to the next. There must be at least two quarters of improving performance in Watch status before a property returns to an Acceptable status.

The draft reports will be reviewed by the Director of Compliance and Asset Management and the staff, along with the Director of Rental Programs and the Assistant Director of Multifamily Servicing. Once these reports are finalized, they are forwarded to the VHDA Controller, the Rental Development and Servicing Departments, and other departments throughout VHDA.

2014 Internal Audit Procedures

Purpose

This guidance is written to provide awareness and promote consistency among teams conducting file and physical inspections of properties in VHDA's portfolio.

New Adopted Practice

The Director of Compliance and Asset Management has advised staff of the following adopted practices beginning with 2014 inspections:

When performing on-site file and/or physical inspections, under no circumstance should PCO/AM leave written documentation of findings with management or the owner (this includes sticky notes). Verbally communicating concerns is permissible. All findings should be disclosed in the final written report. The final written audit report will provide a response period of 45 days after receipt. The owner will have an opportunity to respond and submit corrections to any findings during the 45 day response period. (This guidance is applicable to all Tax Credit and VHDA Bond Financed properties and Tax Credit properties with Section 8 or Section 236/RAP wherein VHDA is **not** the Contract Administer).

NOTE: The one exception to the policy stated above is when there is a **Life Threatening Hazard** noted during an inspection. The AM or PCO must leave a Notice of Critical Violations with on-site staff (strongly suggest leaving it with supervisory management staff). The Notice of Critical Violations has a 72 hour correction period. The PCO or AM must be precise with identifying the critical violation including the buildings and units affected. Exhibit 6-4 from the 8823 Guide is the Notice of Critical Violations adopted by VHDA. The PCO or AM issuing this notice must request a signed/dated copy from management prior to leaving the property.

Properties under the Section 8, Section 236/RAP program for which VHDA is the Contract Administrator for must adhere to HUD requirement to respond to audits within 30 days after receipt of audit from VHDA.

NOTE: The questionnaire portion of the Report of Occupancy Audit Findings that is typically answered by management should not be mailed to management for completion prior to the date of the audit. The questionnaire must be given to management to complete at the beginning of the audit process on the day of the review. The assigned PCO should review and go over responses given as part of the exit interview.

Notification of Audits

As required by the IRC Section 1:42-5, state agencies are required to give owners reasonable advance written notice of a file or physical inspection of units or buildings. The date on the notification letter starts the beginning of the review. Any **noncompliance found** and corrected by an owner **prior to the date of the notification letter** from the state agency is **not reportable** to the IRS.

As a standard practice, VHDA will give owners a 30 day written advance notice of file and physical inspections for all Tax Credit, VHDA Bond Financed, and combo TC with Section 8/Section, 236/RAP that we do not administer the subsidy contracts. Notice must be a formal letter signed by the assigned PCO. The notice is sent as an attachment via email. (*Refer to 8823 Guide page 19-1, second paragraph under "Definition"*)

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2014 Internal Audit Procedures, Continued

Notification of Audits (continued)

All Section 8 and Section 236/RAP properties for which VHDA is the Contract Administer of the subsidy contracts, HUD require that owners be given at least a two week written notice prior to conducting an MOR.

NOTIFICATION TO THE OWNER (per HUD 4530.1)

The reviewing official is responsible for contacting the owner/agent to schedule a date for the on-site review. Once the on-site review is scheduled, the reviewing official must confirm the scheduled review with the owner/agent in writing at least two weeks in advance. (Refer to Appendix 2 of this chapter.) The reviewing official must also notify the owner/agent of the documents that must be available the day of the review, as indicated on Addendum C of form HUD-9834, and must include Part A of Addendum B of form HUD-9834 for completion by the owner/agent. Additionally, the reviewing official forwards Part A, Sections I, II, and III of the checklist for On-Site Limited Monitoring and Section 504 Reviews (Addendum B) of HUD- 9834 to the owner/agent for completion prior to the on-site management review.

Note: *There are items on Addendum C and Addendum B, Part D that may not be required for the review. Only indicate items that should be made available for the review and add any additional items under "Other" as necessary.*

Random Selection of Units

Section 1:42-5 of the IRC specifies that the state agency must randomly select files and units to be inspected and under no circumstance should the owner be made aware of units or files that will be inspected prior to the date of such inspection. **Note:** If the PCO is conducting the file and physical inspection and the physical inspection is conducted first, the list of files to be reviewed should only be given to on-site staff at the time the file review will be performed.

When selecting files to be reviewed, the assigned PCO should select move-ins that has occurred since the property was last audited. Example: If the last audit was performed 3/15/2011 and the property is scheduled to be audited again 4/24/2014, the PCO should run an occupancy report in HDS by date range to reflect all move-ins within that time frame (3/15/11 – 4/15/14). It is suggested you cut off a few days earlier to allow you time to prepare your list of units to audit.

NOTE: If the property is not a 100% TC property or is Tax Exempt bond financed without Tax Credits, you will need to include in your sampling of files to review new move-ins and recertifications that have taken place within the three year cycle. Properties that are not 100% TC or Tax Exempt Bond financed will take longer to audit because you must review annual recertifications. When auditing a property that is not 100% TC with any type VHDA financing with remainder units at 150% of median or a property is financed with Tax Exempt bonds with the remainder units at 150% of median, the PCO should increase the sampling of units to include at least 5% (*not to exceed 5 units*) of the 150% units. This is to ensure that the owner/onsite staff understands and is satisfying the overall income/occupancy requirement also. The Additional 5 units do not need to have a physical inspection.

Section 8/Section 236/RAP: HUD requires a random selection of units to be reviewed; however, HUD gives a specific breakdown of the types of units to be reviewed for MOR purposes (Move-in, Move-out, Certification/Recertification and Applicant Rejection).

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2014 Internal Audit Procedures, Continued

Audit Requirements

Below is a breakdown of audit requirements for each program type monitored by the Compliance and Asset Management Staff:

VHDA Loan Products

Taxable Bond (This includes, REACH, SPARC, Housing Fund, General Fund, MUMI and Flex Fund)

- The regulatory documents for these type financings indicate that the owner is subject to a review in a manner specified by the agency.
- After a PCO is assigned to a property with a funding source that falls under the Taxable bond requirements, they must update HDS with property and contact information. Within 90 days after notification of the loan closing, the assigned PCO must send an Introduction letter to the owner/management agent. (Standard Introduction letter is on the Q drive/HMNC/programcompliance/AuditForms. *(Combining the intro letter from the PCO and AM is at the team's discretion).*)
- PCO must set up the building information in HDS so that tenant information can be entered by management using WTCMS.
- VHDA has determined that an onsite file review will be conducted on such properties within 1 year after initial occupancy.
- The assigned staff person will audit 10% of the total units not to exceed 10 files. This initial review is to determine if the owner understands the income/occupancy and reporting requirements of the program.
- No more than 5 vacant units should be inspected with the first review.
- After it is determined that the owner is satisfying the income/occupancy and reporting requirements of the program, onsite file reviews may be eliminated. VHDA will rely on data submitted via WTCMS to determine the owner's compliance with income/occupancy requirements. *(Depending on data in WCMS, VHDA reserves the right to reinstate on-site file review.)*
- The assigned staff person must run an Occupancy Report in HDS every three years to determine the owner's compliance with the income/occupancy requirements imposed. The report should be in date range to cover three years. (Example: January 1, 2010 – December 31, 2012).
- **NOTE:** Since VHDA uses the HUD Section 8 income limits for its taxable bond products, staff must use current income limits for determining income eligibility. The income limits are not held harmless of increases and decreases for taxable financed properties.
- Whenever there is a change in ownership or management agent, VHDA reserves the right to conduct a file review within 90 days after the change to assess the new owner/management understanding and implementation of program requirements.
- The assigned PCO is responsible for ensuring that changes in ownership, management and site are updated in HDS promptly. The contact information for all entities must be updated promptly in HDS also.

The review of occupancy reports is to be documented by utilizing the "Annual Review" section under the Property Tab in HDS. The PCO should select **Review Type** of *Desk Audit* and **Review Category** of *VHDA-Other*. The **Review Date** and **Completed Date** may be but not necessarily the same.

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2014 Internal Audit Procedures, Continued

Audit Requirements (continued)

Documenting Review for BED/Special Needs Facilities

Properties serving the special needs population or transient in nature are not subject to file audits due to the privacy of the clients being served and/or length of time participating in the program (high-turnover). Owners of such properties are required to complete and submit annually an Income Occupancy and Certification Report (ES-01). The owner is certifying that he has not moved in any person with income exceeding the overall income limit specified in the commitment or regulatory agreement.

1. The Income Occupancy and Certification Report should reflect occupancy as of December 31st of each year and must be submitted to VHDA by January 31st of the upcoming year.
2. This process is to be documented by utilizing the Annual Review section under the Property Tab in HDS. The PCO should select **Review Type** of *ES-01* and **Review Category** of *Bed-Special Needs*. The **Review Date** and **Date Completed** will most likely be the same. The date the report was actually received should be noted in the comments section as well as any noted concerns.
3. The ES-01 Form should be filed in ProLink following procedures established.

Documenting Reviews for MUMI Properties

Compliance staff should follow the same audit and documentation guidelines noted under loan products. Keep in mind that we only review files with income/occupancy restrictions. Under no circumstance should VHDA staff review files with no income limit restrictions.

MUMI properties will typically have several income/occupancy restrictions associated with them.

Mixed Income with SPARC : The income occupancy requirement may be one of the following

1. 20%@150;80% no limit
2. 20%@80; 20%@120%;60% no limit,

Mixed Use with Mixed Income with SPARC: The income/occupancy requirements an owner may choose:

1. 20% @80%;20%@120%; 60% no limit
2. 20%@150%; 80% no limit

Mixed Use with Mixed Income and REACH

- 30%@80%; 20%@120%; 50% no limit

MUMI with Tax Exempt and SPARC

- 40%@60%AFS;10%@120%;50% no limit

MUMI with Tax Exempt

- 40%@60% AFS;60%@no limit

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2014 Internal Audit Procedures, Continued

Tax Exempt Loans

Generally properties with Tax Exempt bond financing carry IRS income/occupancy restrictions. We typically call them set-asides. Currently Tax Exempt loans in our portfolio have one of the following set-asides for low income households:

1. 20%@80%; 80%@150% (Bonds between 1983 and 1985 were **not subject** to AFS)
2. 20%@80% AFS;80%@150% (Bond during and after 1986 **are subject** to AFS)
3. 20%@50% AFS;80%@150%
4. 40%@60% AFS;60%@150%

It is not uncommon for a property to have taxable and tax exempt bond financing; however, PCO's should always comply with the most restrictive bond requirement which is always going to be Tax Exempt Bonds.

Note: When attending team meetings and the PCO is made aware that the property will receive Tax Exempt financing, the PCO should ask if this is a new property or an acquisition/rehab. With acquisition/rehab properties financed with TE bonds, the IRS require that prior to closing the owner must certify that the property is occupied with the required number of households needed to meet the minimum set-aside selected.

- After a PCO is assigned to a property with Tax Exempt bonds, they must update HDS with property and contact information. Within 90 days after notification of the loan closing, the assigned PCO must send an Introduction letter to the owner/management agent. (Standard Introduction letter is on the Q drive/HMNC/programcompliance/AuditForms)
- PCO must set up the building information in HDS so that tenant information can be entered by management using WTCMS.
- VHDA has determined that an onsite file review will be conducted on such properties within 1 year after initial occupancy.
- The assigned staff person will audit 20% of the minimum set-aside units. PCO should review 5% of the units occupied by the 150%ers (not to exceed 5 units) to ensure management understands those requirements as well as how to process those certifications.
- The audit cycle for Tax Exempt properties is every three years.
- Tax Exempt properties without 100% Tax Credits must recertify the households meeting the low income set-aside annually. This is a full recertification with re-verification of income, student status, etc. The assigned staff person must run an Occupancy Report in HDS annually to determine the owner's compliance with the recertification requirements imposed for the set-aside. The report should be in date range to cover a year. (Example: January 1, 2013 – December 31, 2013).
NOTE: Tax Exempt properties use the tax credit income limits so they are held harmless if income limits decrease. They continue to utilize the highest income limits since receiving TE financing.
- After completing the file/unit inspection, review year, type and category, date scheduled, date of review, date completed and number of files reviewed must be entered into the annual review section of HDS. Remember, the date of completion is the date the audit is mailed to the owner.
- The completed audit after response from owner and corrections are finalized is filed in Prolink.

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2014 Internal Audit Procedures, Continued

Tax Exempt Loans (continued)

VHDA may use Tax Exempt bond financing in MUMI properties also. The income/occupancy requirement to date for those type properties is 40%@60%AFS; 60% no limit. When auditing those properties, the 40%@60% is adjusted by family size and those units must have full recertifications completed by the owner annually.

The PCO will audit 20% of the 40%@60% units. The remaining 60% with no limit are not subject to file reviews. However, since the property has financing with VHDA, the PCO or AM will conduct physical inspections of vacant units with and without income/or occupancy restrictions (not to exceed 5 units).

The same guidance outlined previously for TE loans should be followed for TE with MUMI.

Students in Tax Exempt Properties

When reviewing files of TE properties without Tax Credits, the PCO should be mindful that the low income set-aside units (20/80; 20/50; 40/60) can only house students meeting one of the five exceptions identified by the IRS. Owners may house students not meeting an IRS exception only in those units satisfying the 150% requirement.

It is important that you encourage owners to always have more low income units than required to allow for a cushion. PCO's must run an occupancy report annually to determine if the owner is meeting the Tax Exempt set-aside. At any time, VHDA Bond Counsel may request occupancy reports on TE properties in a specific series. We can easily provide this information by running the reports for a specific year or date range..

If the PCO has entered all the required fields in HDS, the compliance report can be utilized to easily determine if the owner is meeting the set-aside also.

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2014 Internal Audit Procedures, Continued

Tax Credit properties

Tax Credit properties are on a three year audit schedule. VHDA begins the audit cycle for a TC property after the owner indicates that he has begun his credit period and claiming credits on all BINS. The owner will indicate on the 8609 Part II line 10a if he elects to start his credit period the year he places the buildings in service or the year after.

The assigned PCO should always review line 8b of the 8609 to determine how the owner is treating each building. Remember we must audit 20% of the units in each project. Example: an owner may have 10 buildings but he could treat all or some of them as separate or part of a multiple building project. It is very important that PCO review prior to auditing to ensure required number of files and units are inspected. It is highly recommended that PCOs utilize notes to the file feature in HDS to indicate how many units to audit so that it is not an oversight when portfolios change.

The assigned PCO should review the EUA agreement to determine if special provisions with regards to lower income limits or rents are required. You should also make note of special unit requirements such as units for disabled persons. Often times the owner has received points to have a lower set-aside such as 10% of the units with rent at 40% and income at 50%. The owner must satisfy those requirements during the IRS 15 years of compliance and an additional 15+ years during the EUA period. Remember, the EUA only dies when there is a foreclosure. Properties that receive a second allocation of credits have two EUAs to comply with. It is possible that the first EUA is more restrictive than the second. PCO's must ensure that the owner is complying with both.

NOTE: Often times a TC property will also have TE bond financing. It is possible that an owner will opt to take credits the year after placing in service; however, you may need to perform the audit for TE purposes. Remember, Compliance begins on TE properties when 10% of the low income units are occupied. If the owner received credits through the TE bonds the 8609 will not have an allocation year.

The date of the audit notification letter to the owner/management agent triggers the beginning of the audit. It is not the date that you call to schedule the audit although the letter should go out very soon after scheduling. VHDA's standard practice is to give a 30 days' written notice.

After completing the unit and file inspection, the PCO must send the completed written audit to the owner and allow a correction period of 45 days from the date of the audit letter. Extensions on correction periods are reviewed and granted on case by case basis.

The PCO should maintain a tickler to ensure timely receipt of responses for reviews. All reviews must include a response page which serves two purposes:

- (1) The owner acknowledges receipt of the audit
- (2) The Owner provides response to audit in writing with additional documentation as needed/requested.

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2014 Internal Audit Procedures, Continued

Tax Credit Properties continued

After the owner responds to the audit with requested supporting documentation, the owner should then receive notice of close out audit. If the close out results in the issuance of 8823s, the letter should indicate if further action is required. If uncorrected 8823s are issued, PCOs must use the letter that includes the language regarding penalty points and required training for future applications of Tax Credits.

Note: Compliance is responsible for advising allocation annually of any owner with uncorrected 8823 during the TC compliance period and during the EUA period. After the PCO submits uncorrected 8823s for signature, we will implement a policy that the PM will send the owner a letter confirming he is being reported to allocation and penalty points will be assessed on any future allocation requests unless he request training to eliminate the points. The PM will suggest the trainings needed to negate the penalty points based on the type of noncompliance. Remember, owners that receive the 50 points penalty for life threatening noncompliance do not have the option to obtain training to negate those points.

Second Round Allocation of Credits

When a property receives a second round of Tax Credits, the Allocation Department does not issue new BIN numbers. Allocation will reissue the 8609 with the same BIN numbers but the credit amounts and PIS dates will be different. The assigned PCO must make sure when they are performing audits for properties with a second allocation that the correct income limits and rents are being utilized.

With the fluctuations in the income limits over the past 4 years, it is possible and likely that owners with a second allocation of credits will have to use lower income and rent limits than the first allocation. Remember, you must use income limits based on PIS dates and the second allocation starts a new PIS date for the property.

Properties that received an allocation of credits prior to 1990 did not have Extended Use Agreements. Properties receiving a second allocation of credits that do not have an EUA in place must verify and certify eligibility of each existing household as if they are new move-ins. If the BIN numbers starts with VA87, VA88, or VA89, did not have EUAs.

Properties that received an allocation of credits in and after 1990 are required to enter into an Extended Use Agreement. When those properties receive a second round of credits, the existing household that qualified the unit as a TC qualified unit under the first allocation continues to qualify the unit under the second allocation provided that no household is comprised of full time students that do not satisfy one of the five exceptions, and the household is comprised of at least one original member that initially qualified the household.

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2014 Internal Audit Procedures, Continued

Auditing Tips

When performing TC file and unit inspections, the PCO must keep in mind that they are monitoring for an owners compliance with:

- Eligibility
- Affordability
- Habitability

- First year review, it is important to check for an owner meeting the set-aside, applicable fraction and rent limits. Although the PCO should review these also the subsequent years, not meeting the minimum set-aside the first year is as not a good thing.

- Check for appropriate income limits based on PIS date or gross floor rents. The PCO is responsible for checking the income limits based on the property's placed in service date. Since properties are receiving second allocations of credits, it is most likely that the income limits for the second allocation is lower than the first so special attention to this is a must. Note: Do not assume that you can determine the appropriate income limits based on the median income. You must look at the income limits as adjusted for family size each year to determine which year's limits to use. Example: Mecklenburg County should still be using 2010 limits for any TC property that placed in service on or before December 31, 2008.

- We conduct the first audit after the owner has placed all buildings in service and begun the credit period on all buildings. You must have 8609s with Part II completed so that you know how to audit the property.

- Audit findings should be specific and precise. PCO should research policy/regulation to accurately address findings.

- Only include information in final write up that is applicable to overall audit review. Example: If there were no issues with WCMS and all information is up to date, there is no need to add a comment in the final report about VHDA's mandate to use WCMS. You may compliment on their commitment to timely report tenant data using WCMS. Only use "can" language if there is a problem and even then you must be specific.

All audits should have a response page for the owner to sign acknowledging receipt of the audit and to address any findings. When you close out the audit, the PCO must ensure that a signed response from the owner is in the final audit report filed in Prolink.

Notification of Noncompliance with Taxable Loans:

If noncompliance with income/occupancy requirements is noted during the review of the three-year occupancy report, the assigned PCO must send notice of noncompliance to the owner and onsite staff as an email attachment. PCO should send the *new* "Report of Desk Review" and a copy of the occupancy report to support findings.

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2014 Internal Audit Procedures, Continued

Understanding Extended Use Agreements

The Extended Use Agreement is an agreement between the state allocating agency and the Owner. Although the IRS requires that all TC properties with allocations beginning in 1990 have an EUA executed between the state and the owner, none of the provisions within that agreement are enforceable by or reportable to the IRS. *IRC §42(h)(6) requires taxpayers to enter into an extended use agreement to provide low-income housing for a period not less than 30 years, beginning at the same time as the 10-year credit period. The agreement is made with the housing agency that allocated the credit and is recorded in the land records. The agreement is often referred to as a "land use restriction agreement" or "LURA." A building is not considered a qualified low-income building, and no credit is allowable, if an extended use agreement meeting all the requirements is not in place.*

During the TC application process, the owners select categories with points in an effort to acquire a high score to be awarded credits. Those categories include things such as targeting a percentage of lower income residents, lower rents for a percentage of units, and setting aside units for the disabled, etc. There are also bonus points that an owner can select. If the owner receives an allocation, he has promised to provide all of the activities that he received points for. These promises start once the EUA is recorded. The owner must comply with such provisions during the IRS 15 years of compliance and extend to the duration of the EUA period....sometimes 50 years.

We typically refer to the EUA period as being the period after the IRS 15 years of compliance ends; however, the Extended Use Agreement is in effect at the same time the 10 year credit period begins and is extended for additional years sometimes 35 additional years..

EUA Period

The EUA period begins the first of the following year after the 15 years of IRS Compliance period ends (this is the period when noncompliance is not reported to the IRS).

VHDA has relaxed some of its monitoring requirements during the EUA period; however, we caution owners who anticipate requesting a second allocation of credits not to relax any requirements.

Tax Credit only Properties in EUA period

- Properties in the EUA period with Tax Credits only and no VHDA financing will receive a desk audit or a reduced file (5) and unit inspection. However, the assigned PCO must audit the property so that it covers the remaining years of the IRS compliance period (20%). We will rely on information submitted via WTCMS to monitor the owner's compliance with income/occupancy requirements or depending on the owner's compliance with WCMS tenant reporting, 5 new move-in files will be reviewed at the time the PCO/AM conducts the physical inspection of 5 vacant units. Every three years the assigned PCO must run an income/occupancy report from HDS and indicate findings under the general review section in HDS. Remember, you must still ensure all units are income eligible and rent restricted, so attention to those areas are critical.
 - Physical inspections of those properties will be conducted in alignment with VHDA's inspection requirements of its loan products. The owner is still required to maintain habitable units during the EUA period.
 - Notification of noncompliance during the EUA period must be sent to the owner as an email attachment specifying the findings. Response period will be 45 days from date of notice. If a site review is performed, PCO must utilize the standard forms currently used for onsite file reviews. If a desk review is performed, the new Report of Desk Review must be completed.
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2014 Internal Audit Procedures, Continued

EUA period continued

Tax Credit Properties with VHDA Taxable Financing Taxable in EUA Period

- Taxable financed properties with TC will receive a desk audit or a reduced file (5) review during the EUA period. However, the assigned PCO must audit the property so that it covers the remaining years of the IRS compliance period (20%). We will rely on information submitted via WTCMS to monitor the owner's compliance with income/occupancy requirements or depending on the owner's compliance with WCMS tenant reporting, 5 new move-in files will be reviewed at the time the PCO/AM conducts the physical inspection of 5 vacant units. Every three years the assigned PCO must run an income/occupancy report from HDS and indicate findings of compliance under the general review section in HDS.
- Notification of noncompliance during the EUA period must be sent to the owner as an email attachment specifying the findings. Response period will be 45 days from date of notice. If a site review is performed, PCO must utilize the standard forms currently used for onsite file reviews. If a desk review is performed, the new Report of Desk Review must be completed.
- Physical inspections of those properties will be conducted in alignment with VHDA's inspection requirements of its loan products. The owner is still required to maintain habitable units during the EUA period.

Tax Credit Properties with VHDA Tax Exempt Financing in EUA Period

- TC Properties financed with TE bonds will continue to have file reviews every three years. The PCO will only review 20% of the Tax Exempt set-aside (The set-aside may be 20/50, 20/80 or 40/60). Remember, with TE financing the student rule is not relaxed for households satisfying the set-aside. We will rely on data submitted via WCMS on the remainder 150% for auditing purposes.
- Physical inspections will be performed in accordance with VHDA inspection requirements for its loan products. The owner is still required to maintain habitable units during the EUA period.

Tax Credit properties governed by federal programs without VHDA financing in the EUA Period

- Physical inspections are eliminated for Tax Credit properties with no VHDA financing that are governed by other federal programs such as Section 8 project-based, Section 236/RAP, and Rural Housing since these properties are already subject to inspections and consequences under those programs in place.

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2014 Internal Audit Procedures, Continued

EUA Audit Examples

Auditing a property with remaining years of IRS compliance: ABC property's last audit was June 12, 2012. The property will go into its EUA period January 1, 2014. ABC property should be on the audit schedule for 2015. The 2015 audit should cover the remainder the IRS compliance period June 12, 2012 – December 31, 2013. The PCO should audit 20% of the files. Noncompliance noted in files since the June 12, 2012 audit through December 31, 2013 is reportable to the IRS. Files reviewed with move-ins in 2014 are not reportable to the IRS because it is solely EUA period.

Auditing a property in the EUA period: XYZ property's last audit was April 15, 2011. The property went into its EUA period January 1, 2012. The next audit for XYZ should be in 2014. Since the 2011 audit covered the last three years of the IRS compliance period, VHDA may conduct an onsite file audit (5 units) in 2014 in conjunction with the physical inspection or (desk audit) review data in WCMS to ensure compliance with income, occupancy and rent restrictions. ***Remember, uncorrected non-compliance in the EUA period impacts future Tax Credit applications.***

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2014 Internal Audit Procedures, Continued

Desk Audits or reduced file reviews during EUA Period

VHDA will be utilizing data submitted by owners via WCMS to perform desk audits on properties in their EUA period and for properties financed with VHDA Taxable loan products. These properties will continue to be on the three year audit cycle until the (1) EUA period ends and (2) until the VHDA Taxable loan matures or pays off.

Based on the established audit schedule, the PCO/AM will contact the owner to schedule the onsite physical inspection.

- If the property is a VHDA Taxable Loan only, the PCO/AM will confirm date of physical inspection via email with management (since only vacant units are inspected, management is not required to notify residents of the inspection). After the physical inspection and the review of HDS occupancy report is completed, a letter or written notification (Report of Desk Review) is sent to management notifying them of the results of desk review and physical inspection.
- If the property has Tax Credits with or without VHDA Taxable financing, the PCO/AM will confirm the date of the physical inspection and the reduced file review (5 files) via email (again notification to residents is not required since only vacant units will be inspected). After the physical inspection and file review are completed, a formal letter is sent to management notifying them of the results giving them a 45 day correction period to respond. (Remember, noncompliance during the EUA period impacts future applications for Tax Credits).
- If the TC property obtains UTA estimates from the local PHA, the notification letter must request copies of such estimates covering the three year audit period to ensure total rent did not exceed TC maximum allowable rent in any month. This is necessary if performing a desk or file review.
- NOTE: The Report of Desk Review is located on the Q drive under HMNC/Program compliance/Audit Forms.

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2014 Internal Audit Procedures, Continued

Q and A

Question: *presented by Joy Bolling*

Should we ask the owner/management for copies of UTA estimates during the EUA period?

Answer: *presented by Brenda Hawkins*

Owners are required to continue to keep units rent restricted in the EUA period. Owners are also required to obtain UTA estimates annually in the EUA period. Owners using the local PHA utility allowance do not need to obtain approval from the state agency before implementing them; therefore, to ensure owners are not charging excess rent, the assigned PCO will need to request owners using the local PHA Utility Allowances to email them copies of the PHA allowances to cover the three year audit cycle (Tenant rent + Utility Allowance = Total Rent....PCO must ensure the total rent does not exceed the maximum TC rent in any month). Properties using the options of (1) Local Utility Company, (2) HUD Utility Model (3) VHDA Agency Estimate –Earthcraft, (4) Energy Consumption Model, must obtain approval from VHDA prior to implementation.

Currently we are filing all approved UTA estimates for properties using one of the 4 options listed above in the electronic development folder on the Q drive. Under the PC folder, you will see a Utility Allowance folder. Each year since 2009 is listed if the property seeks approval from VHDA. If estimates are in the electronic file, the assigned PCO will **not** need to request copies from the owner/management agent. Future plans are to maintain the UTA information approved by VHDA in ProLink.