

TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS
Internal Audit of the Single-Family Mortgage Revenue Bond (SFMRB) program

Audit Report # 25-005

Executive Summary

The Office of Internal Audit (OIA) performed an audit of the Single-Family Mortgage Revenue Bond program at TDHCA to review, assess, and evaluate activities and internal controls related to operation and administration of SFMRB program, and its compliance with applicable rules and regulations.

Based on our review and analysis, the Single-Family Mortgage Revenue Bond program is operating effectively at TDHCA in providing below-market interest rate loans to eligible Texans. We identified some areas for improvement to contracts and agreements between TDHCA and its vendors. The details of our recommendations and management responses are included in the report.

Observations and Recommendations

- Management should ensure that all contracts and agreements are valid and renewed on time as needed.
- OIA recommends that management include a cybersecurity clause in the contracts with vendors to ensure vendor's compliance with TDHCA's standard in cybersecurity.

Objective, Scope, and Methodology

Our scope for this audit included a review of applicable Texas Administrative Code (Title 10, Section § 2.401), Department's annual Interest Rate Risk Management policy (FY 2025), TDHCA Investment Policy for FY 2025, applicable SOPs, vendors' contracts and service agreements, and evaluating internal controls within SFMRB program.



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

8/28/25
Date Signed



TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

www.tdhca.texas.gov

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

RE: Internal Audit of the Single-Family Mortgage Revenue Bond (SFMRB) program

Dear Board Members:

This report presents the results of the Office of Internal Audit ("OIA") review of the "Single Family Mortgage Revenue Bond" program and its internal controls at TDHCA. This audit was conducted in accordance with applicable audit standards and included objectives to review, assess, and evaluate activities and internal controls related to operation and administration of SFMRB program, and its compliance with applicable rules and regulations.

The SFMRB program was included in the internal audit plan for FY 2025 due to its complexity of operation, number of external parties involved in its operation, and lack of any recent internal audit. For this audit we reviewed applicable rules and regulations, internal SOPs, and contracts and agreements between TDHCA and outside entities.

This report is divided into the following sections:

- A. Overall Result
- B. Background
- C. Scope and Methodology
- D. Roles and Responsibilities
- E. Reviews and Recommendations
- F. External audits

A. Overall Results

Based on our review and analysis, the Single-Family Mortgage Revenue Bond program is operating effectively at TDHCA in providing below-market interest rate loans to eligible Texans. We identified some areas for improvement to management of the contracts and agreements between TDHCA and its vendors. The details of our recommendations are in later sections of the report.

B. Background

The Bond Finance program assists families and individuals with low to moderate income obtain home ownership. The Single-Family Revenue Bond Program (SFMRBP) provides below-market interest rate mortgage loans for qualified single-family homebuyers. The Department's ability to issue tax-exempt municipal bonds produces below-market interest rate mortgage loans. Interest income from municipal bonds generally is exempt from federal, state, and local taxes. Interest rates on "tax-exempt" municipal bonds, therefore, are lower than interest rates on "taxable" bonds. This spread between tax-exempt and taxable bond interest rates creates the subsidy required to achieve and offer below-market interest mortgage rates.

The Department's authority to issue mortgage revenue bonds (MRB) is derived from its enabling legislation and provisions of the Internal Revenue Code. On an annual basis the Department issues only a limited amount of tax-exempt single family MRBs. TDHCA has an established and extensive Mortgage Revenue Bond program, issuing nearly \$1 billion in bonds annually to fund My First Texas Home Mortgage loans and Mortgage Credit Certificates for eligible first-time homebuyers and veterans.

Bond Finance Division at TDHCA is entirely self-funded, and doesn't receive any funds from Federal, State, or local governments. Bond Finance makes quarterly contributions to TDHCA to fund the Department's portion of expenses and shared services. Bond Finance administers the Department's Mortgage Revenue Bond (MRB) and Mortgage Lending Programs and is responsible for managing the Bond Indentures.

The Single-Family Mortgage Loan Program provides first and second lien mortgage loans to very low-, low-, and moderate-income homebuyers through the My First Texas Home Program (MFTH)

and the My Choice Texas Home Program (MCTH). Mortgage loans are originated through participating lenders and must be Federal Housing Administration (FHA) insured, Rural Housing Service (RHS) guaranteed, Veterans Affairs (VA) guaranteed, or insured by private mortgage guaranty insurance and eligible for securitization into Ginnie Mae, Fannie Mae, or Freddie Mac Certificates. TDHCA utilizes SFMRBs and a secondary market To-Be-announced (TBA) Taxable Mortgage Program (TMP) to fund the Program.

Mortgage Credit Certificate (MCC) is a homebuyer assistance program designed to help lower-income families afford homeownership by allowing a dollar-for-dollar tax credit for some portion of mortgage interest paid per year.

My First Texas Home Program is available to only Veterans and first-time homebuyers (who have not owned a home in the past 3 years). It offers a 30-year low-interest rate mortgage with up to 5% of the 1st lien mortgage amount that can be used for down payment and closing cost assistance.

C. Scope and Methodology

Our scope for this audit included a review of applicable Texas Administrative Code (Title 10, Section § 2.401), Department's annual Interest Rate Risk Management policy (FY 2025), TDHCA Investment Policy for FY 2025, applicable SOPs, vendors' contracts and service agreements, and evaluating internal controls within SFMRB program.

D. Roles and Responsibilities

TDHCA

The Department finances below-market rate mortgage loans to qualified Texas homebuyers; Low-to-moderate income, first-time Texas homebuyer and veteran, through the issuance of Mortgage Revenue Bonds (MRB) and by selling mortgage loans in the TBA market (To Be Announced) through the Department's Taxable Mortgage Program (TMP).

Bond Finance Division

The Bond Finance Division is responsible for structuring, restructuring, administering, and monitoring the Department's SFMRB issues. Bond Finance coordinates all activities related to the issuance and/or remarketing of SFMRBs and notes. Bond proceeds generated by SFMRBs are allocated to the Single-Family Mortgage Loan Program.

Texas Bond Review Board

The Texas Bond Review Board was created in 1987, and is composed of the Governor, Lieutenant Governor, Speaker of the House of Representatives, and the Comptroller of Public Accounts. The Board's mission is to ensure that debt financing is used prudently to meet Texas infrastructure needs and other public purposes, to support and enhance the debt issuance and management

functions of state and local entities, and to administer the allocation of state private activity bonds.

Bond Counsel

Bracewell LLP is the Bond Counsel for TDHCA and is responsible for providing legal services to the Department in connection with the issuance of bonds and the protection of assets pledged to bond indentures, as well as providing ongoing legal services related to the program. Their responsibilities include drafting the supplemental bond indentures, bond resolutions, tax certificates, and other bond-related documents, preparing and filing-required by IRS and State forms, and reviewing and approving of Bond Yield and Mortgage Yields associated with each issuance and bond-financed loan program.

Disclosure Counsel

McCall Parkhurst & Horton assists TDHCA with disclosure documents related to public bond issuance. This includes drafting official statements or portions thereof and continuing disclosure agreements, due diligence process leading up to the issuance of the bonds including a review of past compliance with continuing disclosure agreements and the Annual Comprehensive Financial Report, Website, and other information to ensure consistency and appropriateness of information provided to the market. Disclosure counsel also assists with ongoing management of agreed upon post-issuance compliance responsibilities.

Financial Advisor

CSG ADVISORS is a full service, independent financial advisor firm, and responsible for assisting in structuring bond issues and representing the issuer on matters relating to evaluation of proposed financing plans, selection of underwriters and other service providers, financial integrity of the bonds, control of transaction costs, timing of the bond sale and pricing of the bonds.

Master Servicer

In February 2025, TDHCA began working with *The Money Source* (TMS) as Master Servicer. The Servicer's responsibilities include accepting and recording mortgage payments, paying taxes and insurance from borrower escrow accounts, negotiating workout and modifications of mortgages upon default.

Program Administrator

Hilltop Securities is the Program Administrator for TDHCA's Homeownership programs. They are responsible for providing, managing and maintaining the mortgage loan reservation system used by TDHA lenders. Their role is to oversee the mortgage application process from submission to final approval. Other duties include managing lender relationships and tracking funds, compliance review for adherence with TDHCA guidelines, and Administering the TDHCA Mortgage Credit Certificate program.

TBA Providers

TBA stands for “to be announced” and is a private sector mortgage brokerage model whereby a party, the TBA provider, commits to a price, based on mortgage rate, for mortgage-backed securities (MBS) to be issued in the future and backed by mortgage loans not yet originated. The TBA Administrator provides mortgage loan pricing daily to enable TDHCA to set mortgage rates. The TBA program is designed to improve liquidity. Hilltop Securities tracks TDHCA TBA loan reservations and takes on the pipeline risk by agreeing to purchase MBS from TDHCA at predetermined prices. This results in TBA Administrator taking on all risks associated with the TBA program including market risk extension risk, fallout risk,.. etc.

Trustee

The Trustee is the entity responsible for managing the Trust Estate under the indenture. They administer the funds or property specified in the indenture in a fiduciary capacity on behalf of the bondholders. The Bank of New York (BNY) acts as Trustee for TDHCA indentures. BNY corporate trust department serves in a fiduciary capacity for TDHCA holders. They perform duties and responsibilities assigned by the bond trust indenture such as depository for all pledged assets / revenues, and registrar to record and transfer ownership of bonds.

Warehouse Provider

Hilltop Securities serves as the Department’s Warehouse Provider. The Warehouse Provider is responsible for providing funds to the Master Servicer (The Money Source) for the purchase of mortgage-Backed Securities (MBS) that will secure single family mortgage revenue bonds issued by the Department. The warehouse Provider sells the same MBS to the bond Trustee (Bank of New York) as instructed by the Department, typically concurrent with the issuance of the Bonds.

Liquidity Provider

The Texas Comptroller of Public Accounts is the Liquidity Provider for the TDHCA’s variable rate bonds. Variable rate bonds and swaps typically require a liquidity facility. A liquidity facility is a letter of credit, standby bond purchase agreement or other arrangement used to provide liquidity to purchase securities, typically variable rate demand obligations that have been tendered to the issuer or its agent but cannot be immediately remarketed to new investors. The provider of liquidity facility purchases the securities until such time as they can be remarketed. Variable rate bonds have paid down significantly, with the Comptroller providing liquidity for \$89 million on bonds outstanding as of 8/31/2018 and \$6 million as of 4/30/2025.

E. Reviews and Recommendations

As part of this audit, we reviewed the roles and responsibilities of each vendor as it related to the operation of Single-Family Mortgage Revenue Bond program for potential gaps in coverage and controls and evaluated the internal controls currently in place within the program to ensure segregation of duties and proper internal controls. We also reviewed and evaluated contracts and agreements between TDHCA Bond finance division and its outside vendors for completeness and accuracy. We did not identify any areas of gaps in coverage or controls over the operation of

the program, or potential conflict of interest. However, we did identify one agreement that seemed to have expired in 2023 without any renewal notice being issued since then. Further review by the program staff revealed that the expiration date on the agreement was an administrative error and that the agreement should have stated August of 2025 instead of 2023 for expiration date. The program management corrected the error and executed an addendum to the agreement that is valid till August 31st, 2026.

In other contracts we noted that the signature page was not fully signed by all parties to the contract or agreement. Instead, multiple copies of the signature page were placed on file, with each copy being signed by one of the parties, or the authorized signer, to the contract.

Observation Number	Status Pertaining to the Recommendations and Action to be Taken	Target Completion Date	Responsible Party
25-005.01	Management should ensure that all contracts and agreements are valid and renewed on time as needed.	September 30, 2025	Bond Finance Division

Management Response

Management agrees with Observation 25-005.01. Bond Finance has identified a methodology which will enable Purchasing/Procurement to track all contracts that do not require a Purchase Requisition (PR).

Bond Finance will review all current agreements, coordinate with Purchasing/Procurement, and submit PRs on all outstanding agreements by September 30, 2025

Cybersecurity is crucial in today's digital landscape as it protects sensitive information, ensures business continuity, and safeguards personal privacy against the rising tide of cyber threats. Cyber threats, malware, and phishing attacks are becoming more sophisticated. Without effective cybersecurity practices organizations can be vulnerable to these attacks which can lead to significant financial losses and reputational damage.

OIA requested information regarding each vendor's internal controls and cybersecurity measures for review and evaluation. The program provided each vendor's internal policies, SOPs, and other related information in their effort in protecting sensitive information and preventing financial losses. However, the contracts and agreements with these vendors did not seem to include any information about the responsibility of the cybersecurity requirements.

Observation Number	Status Pertaining to the Recommendations and Action to be Taken	Target Completion Date	Responsible Party
25-005.02	OIA recommends that management include a cybersecurity clause in the contracts with the program vendors to ensure vendor's compliance with TDHCA's standard in cybersecurity.	To include in all new contracts	Bond Finance Division.

Management Response

Management agrees with Observation Number 25-005.02 and will include language to ensure vendor's compliance with TDHCA standards on cybersecurity in all new contracts.

F. External Audits

An external audit of the TDHCA Financial Statements is conducted annually by the State Auditor's Office (SAO), which includes the activities of the Single-Family Mortgage Revenue Bond program. The most recent audit resulted in an "Unmodified" (clean) opinion on the fiscal year 2024 financial statements.

We extend our appreciation to staff and management of Single-Family Mortgage Revenue Bond program and Texas Homeownership program for their cooperation and assistance during the course of this audit.

Sincerely,



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

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