

TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS
Internal Audit of the State Housing Tax Credit program

Audit Report # 26-004

Executive Summary

The Office of Internal Audit (OIA) performed an audit of the State Housing Tax Credit program at TDHCA to evaluate and explain the State Housing Tax Credit Program and to evaluate the administrative and internal control procedures related to the program.

Based on our review and testing, the State Housing Tax Credit Program appears to be operating effectively in awarding program funds to incentivize the development and preservation of affordable rental housing for low-income households. We identified opportunities to improve the efficiency and consistency of administrative processes. Details of our recommendations and management responses are provided in the report.

Observations and Recommendations

- OIA recommends that the Division develop and implement standard operating procedures (SOPs) specific to the Texas Housing Tax Credit Program to promote consistency, clarity, and accountability throughout the application and award processes.
- OIA recommends that the program and the Department continue engaging with all stakeholders to establish a clear methodology and criteria for awarding State LIHTCs. This will promote transparency and consistency across applications and awards while helping ensure that the program achieves stronger outcomes.

Objective, Scope, and Methodology

Our audit scope included a review of the Texas Administrative Code (10 TAC §§11.1001–11.1009), Texas Government Code Chapter 2306, Subchapter DD, Texas Tax Code Chapter 171, Subchapter K, and the Qualified Allocation Plan (QAP). We also used a general internal control questionnaire to obtain information and develop an understanding of the program, including its applicable rules, regulations, and internal controls. In addition, we reviewed applications awarded State-LIHTCs during 2024 and 2025 to assess the application and award processes.



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

8/24/26
Date Signed



TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

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

RE: Internal Audit of the State Housing Tax Credit program

Dear Board Members:

This report presents the results of the Office of Internal Audit ("OIA") "Review of the State Housing Tax Credit program." This audit was identified in the Fiscal Year 2026 Annual Audit Plan and included the objectives to evaluate and explain the State Housing Tax Credit Program and to evaluate the administrative and internal control procedures related to the program.

The State Housing Tax Credit Program was identified as high risk in the annual risk assessment and was included in the approved Fiscal Year 2026 audit work plan. The program was selected for audit due to its recent establishment and the absence of any prior audits, creating a need to assess its administration, controls, compliance, and overall program effectiveness.

For this audit, we reviewed applicable provisions of the Texas Administrative Code, Texas Government Code, House Bill 1058, and the Department's Qualified Allocation Plan (QAP). We also conducted a review and testing of the application process and procedures for awarding State Housing Tax Credits.

This report includes the following sections:

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

A. Overall Results

Based on our review and testing, the State Housing Tax Credit Program appears to be operating effectively in awarding program funds to incentivize the development and preservation of affordable rental housing for low-income households.

We identified opportunities to improve the efficiency and consistency of administrative processes. Details of our recommendations and management's responses are provided in subsequent sections of this report.

B. Background Information

TDHCA is the sole authority in Texas to allocate both federal and state housing tax credits. The Department's Low Income Housing Tax Credit (LIHTC) Program is one of the primary mechanisms for directing private capital toward the development and preservation of affordable rental housing for low-income households. Tax credits are awarded to eligible participants to offset a portion of their federal tax liability in exchange for the development or preservation of affordable rental housing. Investors in qualified affordable multifamily residential developments may use LIHTCs as a dollar-for-dollar reduction of their federal income tax liability. The federal LIHTC Program consists of two types of tax credits: Competitive (9%) and Non-Competitive (4%).

The 9% Housing Tax Credit is highly competitive and awarded based on a Regional Allocation Formula (RAF), with additional set-asides for developments at risk of losing affordability and subsidies, developments financed through the U.S. Department of Agriculture (USDA), and developments in which nonprofit organizations have controlling positions within the ownership structure. The non-competitive (4%) Housing Tax Credit Program is coupled with the Multifamily Bond Program where the bonds finance at least 50% of the cost of the land and buildings associated with the development.

Effective January 1, 2024, Texas established the State Low Income Housing Tax Credit (State-LIHTC) Program through House Bill (H.B.) 1058 to encourage additional investment in affordable housing and help address financing gaps resulting from rising construction costs and interest rates. H.B. 1058 amended the Texas Tax Code and Texas Insurance Code to establish a franchise tax credit and an insurance premium tax credit and directed TDHCA to implement and monitor

the new program. The Department allocates State-LIHTCs to eligible developers in an amount not to exceed the federal LIHTCs allocated to the respective development. Beginning in 2024, the Department also issues allocation certificates documenting the State-LIHTCs awarded to qualifying developments. However, the legislation limits TDHCA's authority to allocate these credits after December 31, 2029. Whether the program will be extended beyond 2029 will depend on future legislative action.

The State-LIHTC program is designed to supplement federal LIHTC awards, increasing the total funding available for affordable housing projects. When combined, federal and state credits can significantly improve the financial feasibility of developments, particularly for projects facing rising costs or thin margins. The program provides \$25 million in annual statewide credits, divided equally between developments receiving federal 9% and 4% LIHTCs. Applicants who are interested in applying for Texas State Housing Tax Credits in conjunction with their 9% federal LIHTC must submit an intent to request those credits no later than the Full application delivery date.

Like their federal counterpart, State-LIHTCs must be claimed over a 10-year period. Additionally, a development subject to recapture of its Federal LIHTCs will also have its State-LIHTCs recaptured in an amount equal to the same percentage of the federal credit recapture. However, unlike the federal LIHTC, the State-LIHTC may be allocated entirely to a single investor regardless of that investor's proportional ownership interest in the project, allowing the state credits to be structured separately from federal credits. The credits may be used to offset Texas franchise and insurance taxes for entities with direct or indirect ownership interests in qualifying affordable housing developments. These credits can be redeemed for each of ten years after the tax credits are issued.

Another benefit of the State-LIHTC Program is the ability to carry forward or backward any unused state tax credits. State-LIHTCs must be claimed in equal installments during each year of the 10-year credit period but cannot exceed the amount of tax due for that year's tax report. Although State-LIHTCs may not be refunded, Texas H.B. 1058 allows any unused State- LIHTCs to be carried back three years (but not before January 1, 2026) or carried forward not more than 10 consecutive years following the initial allocation. This provides additional flexibility for project owners to take full advantage of the State-LIHTC Program, despite not being able to claim the total amount of credits allocated for a particular year.

C. Scope and Methodology

Our audit scope included a review of the Texas Administrative Code (10 TAC §§11.1001–11.1009), Texas Government Code Chapter 2306, Subchapter DD, Texas Tax Code Chapter 171, Subchapter K, and the Qualified Allocation Plan (QAP). We also used a general internal control questionnaire to obtain information and develop an understanding of the program, including its applicable rules, regulations, and internal controls. In addition, we reviewed applications awarded State-LIHTCs during 2024 and 2025 to assess the application and award processes. At the time of the

audit, the Multifamily Finance Division did not have standard operating procedures (SOPs) specific to the State Housing Tax Credit Program.

A SOP is a procedure specific to the operation of an entity or function that establishes the activities necessary to complete tasks in accordance with applicable rules, regulations, and organizational requirements. SOPs define expected practices for processes in which established quality standards exist and provide a consistent framework for performing activities. SOPs play an important role in the effective operation of an organization or division by documenting policies, procedures, and standards necessary to support successful operations. Well-designed SOPs can promote efficiency, consistency, and reliability; reduce the risk of errors; and provide value by establishing clear expectations and accountability for the performance of key processes.

Observation Number	Status Pertaining to the Recommendations and Action to be Taken	Target Completion Date	Responsible Party
26-004-001	OIA recommends that the Division develop and implement standard operating procedures (SOPs) specific to the Texas Housing Tax Credit Program to promote consistency, clarity, and accountability throughout the application and award processes.	12/31/2026	Director of Multifamily Programs

Management Response

Management agrees with this recommendation.

D. Roles and Responsibilities

- **Multifamily Finance division**

The Multifamily Division receives applications annually from organizations and developers seeking an allocation of federal Low Income Housing Tax Credits (LIHTCs). Applications are evaluated, scored, and ranked in accordance with the Qualified Allocation Plan (QAP), which is updated annually through a process that includes public input and approval by the Governing Board. Applicants seeking State Housing Tax Credits (State-LIHTCs) must complete the designated state housing tax credit forms and comply with the Multifamily Application Procedures Manual and applicable Carryover Allocation processes.

Following TDHCA's annual award of federal LIHTCs, the Department selects developments with the strongest applications to receive the limited State-LIHTC allocations. Selected developments may receive State-LIHTCs in an amount up to the amount of federal LIHTCs allocated to the development in the same year.

- **Real Estate Analysis Division**

The Real Estate Analysis (REA) Division provides the TDHCA Governing Board and staff with comprehensive financial and analytical reports to support informed decision-making regarding the funding of affordable housing developments.

All requests for federal and State Low Income Housing Tax Credits (LIHTCs) are subject to a feasibility analysis and review by the REA Division to assess the financial feasibility and overall viability of proposed developments.

- **Compliance Monitoring Division**

The Compliance Monitoring Division at TDHCA plays an important role in administering the LIHTC Program. The Division conducts physical inspections of each development before approval and issuance of IRS Form 8609 for federal LIHTCs, and the State Tax Credit Certificate for State-LIHTCs. The Division also monitors properties throughout the compliance period, generally conducting monitoring activities at least once every three years.

Housing tax credit benefits may be jeopardized if a development fails to meet applicable state and federal requirements during each year of the 15-year compliance period. Following the initial compliance period, properties are subject to an additional 15-year extended affordability period to help ensure the continued availability of affordable housing.

Due to the recent implementation of the State-LIHTC Program, the Compliance Monitoring Division has not yet conducted compliance reviews of properties receiving State-LIHTCs. Therefore, a review and testing of compliance procedures and records related specifically to the State-LIHTC Program was not performed as part of this audit.

- **Comptroller's office**

For the Texas State Low-Income Housing Tax Credit (State-LIHTC), the Comptroller's role is primarily to administer the credit for state tax purposes. The Comptroller reviews and approves documentation supporting the credit, including TDHCA's allocation certificate and certificates of occupancy for the development. It also establishes the amount of credit and issues the Texas Housing Development Credit Certificate (Form 05-916), which serves as evidence of the established credit.

Other responsibilities of the Comptroller include receiving of the noncompliance report from TDHCA and administering the tax consequences under the applicable provisions. Texas law specifically assigns TDHCA responsibility for compliance monitoring and requires TDHCA to report noncompliance to the Comptroller.

E. Testing and Recommendations

For this audit, we requested a list of all applicants who requested and were awarded State-LIHTCs during the 2024 and 2025 award cycles. At first glance, it appeared that the increase in the number of 30% AMI units in a development declined significantly from 2024 to 2025, resulting in a substantial increase in the average cost per additional unit. However, after discussing the data with program management, we determined that the apparent increase in cost per unit was primarily attributable to differences in the financing options available to developers and specific applications during the two award cycles. In 2024, some applicants received project-based rental assistance in addition to other financing. This additional assistance enabled them to provide a greater number of units at 30% of area median income, resulting in a lower average cost per additional unit. These voucher options were not available to certain applicants in 2025, which contributed to a lower number of additional 30% units and, consequently, a higher average cost per unit.

30% AMI refers to a household earning 30% of the Area Median Income, typically qualifying as extremely low-income for housing programs. HUD develops income limits based on Median Family Income estimates and Fair Market Rent area definitions for each metropolitan area, parts of some metropolitan areas, and each non-metropolitan county. A "30% AMI" designation indicates that a household earns 30% of the median income for that area, placing them in the extremely low-income category for housing eligibility

Currently, the program does not establish a ceiling in the QAP for the amount of credits awarded per additional 30% unit generated. Because the program is relatively new, staff opted to allow applicants to compete on this metric and award credits to the highest-value proposals received each year. The program anticipates that, over the next few years, a consensus will emerge regarding the value of State LIHTCs and the number of affordable units they can reasonably support while still providing meaningful value to applicants.

Observation Number	Status Pertaining to the Recommendations and Action to be Taken	Target Completion Date	Responsible Party
26-004-02	OIA recommends that the program and the Department continue engaging with all stakeholders to establish a clear methodology and criteria for awarding State LIHTCs. This will promote transparency and consistency across applications and awards while helping ensure that the program achieves stronger outcomes.	Ongoing	Director of Multifamily Programs

Management Response

Management agreed with this recommendation.

We conducted this performance audit in accordance with applicable auditing standards. Our observations and recommendations are based on evidence obtained through our review and testing and are aligned with the objectives of the audit.

We appreciate the Multifamily Finance Division and its staff for their cooperation and assistance throughout the course of this audit.

Sincerely,

A handwritten signature in black ink that reads "Mark Scott". The signature is written in a cursive, flowing style.

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

MS/NS