



CALIFORNIA TAX CREDIT ALLOCATION COMMITTEE

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DATE: March 14, 2013

TO: Low Income Housing Tax Credit Stakeholders

FROM: William J. Pavão, Executive Director

SUBJECT: Proposed Regulation Changes to CPA Final Cost Certification Requirements and Market Study Requirements

Attached for public review and comment are the California Tax Credit Allocation Committee (TCAC) staff's proposed regulation changes regarding final cost certifications and market studies. The summary below highlights what TCAC staff proposes to present to the Committee for their adoption in May 2013. TCAC staff will conduct a public hearing to solicit comments as follows:

Thursday	State Treasurer's Office
April 11, 2013	915 Capitol Mall, Room 587
	Sacramento, CA 95814
	10:00 a.m. – 11:00 a.m.

TCAC staff will also accept written comments through 5:00 p.m. Friday, April 12, 2013.

In summary, the proposed substantive changes are as follows:

1. Reference existing standards and rules for Certified public Accountant (CPA) independence when preparing the Final Cost Certification for Low Income Housing Tax Credit projects. Also require the CPA to certify regarding their independence. **Section 10322(i)(2)(B), page 1 of the attached draft.**
2. Expand market study waiver provisions to include existing, well-performing tax credit projects that are re-syndicating. Also extend the value-ratio waiver provision to instances where market analysts must use single family homes in those rural areas lacking sufficient three- or four-bedroom market rate comparable units. Finally, allow market study forbearance for scattered-site projects receiving a market study waiver from CDLAC. **Section 10325(f)(1)(B), page 2.**

3. Eliminate redundancy and potential discrepancies between the Sections 10325(f)(1)(B) and Section 10326(g)(1)(B) by holding 4% tax-exempt projects to the same language related to market studies as listed in the 9% Basic Threshold section of the Regulations. **Section 10326(g)(1), page 4.**

Attachment

**2013 Proposed Regulation Change with Initial Statement of Reasons
March 14, 2013**

Section 10322(i)(2)(B)

Proposed Change:

- (B) an audited certification, prepared by an independent Certified Public Accountant under generally accepted auditing standards, with all disclosures and notes. Effective July 1, 2013, the Certified Public Accountant (CPA) or accounting firm shall not have acted in an advisory or consulting capacity a manner that would impair independence as established by the American Institute of Certified Public Accountants (AICPA) Code of Professional Conduct Section 101 and the Securities and Exchange Commission (SEC) regulations 17 CFR Parts 210 and 240. Examples of such impairing services, when performed for the final cost certification client, include bookkeeping or other services relating to the accounting records, financial information systems design and implementation, appraisal or evaluation services, actuarial services, internal audit outsourcing services, management functions or human resources, investment advisor, banking services, legal services, or expert services unrelated to the audit. Both the referenced SEC and AICPA rules shall apply to all public and private CPA firms providing the final audited cost certification, as a project participant under Section 10322(h)(5). In order to perform audits of final cost certifications, the auditor must have a peer review of its accounting and auditing practice once every three years consistent with the AICPA Peer Review Program as required by the California Board of Accountancy for California licensed public accounting firms (including proprietors); and make the peer review report publicly available and submit a copy to CTCAC along with the final cost certification. If a peer review reflects systems deficiencies, CTCAC may require another CPA provide the final cost certification. This certification shall:
- (1) reflect all costs, in conformance with 26 CFR §1.42-17, expenditures and funds used for the project, as identified by the certified public accountant, up to the funding of the permanent loan. Projects developed with general contractors who are Related Parties to the developer must be audited to the subcontractor level; and
 - (2) include a CTCAC provided Sources and Uses form reflecting actual total costs incurred up to the funding of the permanent loan.
 - (3) certify that the CPA has not performed any services, as defined by AICPA and SEC rules, that would impair independence.

Reason:

California Tax Credit Allocation Committee (TCAC or the Committee) regulations Section 10322(i)(2)(B) requires that a final cost certification be prepared by a Certified Public Accountant (CPA) who has not “acted in an advisory or consulting capacity as a project participant.” The Committee adopted this regulation to ensure that the CPA performing the final cost certification for tax credit projects is truly independent.

The proposed regulation would clarify that the CPA should not act in any capacity that would impair their independence. The proposed regulation would delete the ambiguous reference to an “advisory or consulting capacity” and would instead reference independence rules already

established elsewhere. Specifically, new text would reference both professional conduct standards established by the American Institute of Certified Public Accountants (AICPA) as well as regulations established by the Securities and Exchange Commission (SEC).

The SEC rules are an appropriate model in that they were promulgated by a public regulatory entity protecting investors in publicly held corporations. The proposed TCAC regulation would incorporate specific SEC examples of CPA services that would impair independence. Referencing existing AICPA and SEC rules would also guide certifying CPAs by pointing to existing explanatory resources provided by those professional and regulating entities.

The referenced AICPA Code of Professional Conduct explains actions that impair independence and may be found at:

http://www.aicpa.org/Research/Standards/CodeofConduct/Pages/et_101.aspx#et_101.02.

The listed SEC examples of services that impair independence are explained by the AICPA at: http://www.aicpa.org/InterestAreas/EmployeeBenefitPlanAuditQuality/Resources/AccountingandAuditingResourceCenters/AuditorIndependence/DownloadableDocuments/11_2003_AICPA_SEC_IndependenceRulesComparison.pdf. Within this website, the specific references may be found at the following pages:

Bookkeeping or other services related to accounting records:	page 20
Financial information systems design and implementation:	page 21
Human Resources:	page 22
Appraisal or evaluation services, actuarial services:	page 23
Internal audit, outsourcing services:	page 24
Legal Services, Expert services unrelated to the audit	page 26
Investment advisor, banking services:	page 23
Management functions:	page 17

Finally, the proposed regulations would require that the auditing CPAs certify that they have not engaged in any of the impairing services. These proposed regulations would operationalize the Committee's intent to assure independence more effectively than the current regulatory text.

Section 10325(f)(1)(B)

Proposed Change:

- (B) a market study as described in Section 10322(h)(10) of these regulations, which provides evidence that:
- (i) The proposed tenant paid rents for each affordable unit type in the proposed development will be at least ten percent (10%) below rents for the same unit types in comparable market rate rental properties;
 - (ii) The proposed unit value ratio stated as dollars per square foot (\$/s.f.) will be no more than the value ratios for comparable market rate units;

- (iii) In rural areas without sufficient three- and four-bedroom market rate rental comparables, the market study must show that in comparison to three- and four-bedroom market rate single family homes, the affordable rents will be at least 20% below the rents for single family homes and the \$/s.f. ratio will not exceed that of the single family homes; and
- (iv) The demand for the proposed project's units must appear strong enough to reach stabilized occupancy – 90% occupancy for SRO and Special Needs projects and 95% for all other projects – within six months of being placed in service for projects of 150 units or less, and within 12 months for projects of more than 150 units and senior projects.

The CTCAC Executive Director may waive the value ratio requirement in items (ii) and (iii) above for acquisition/rehabilitation projects with any of the following: 1) existing federal or state rental assistance or operating subsidies and/or 2) an existing TCAC Regulatory Agreement. so long as the following conditions are met: In such cases, the proposed rents and income targeting levels do shall not increase by more than five percent (5%) and the project has shall have a vacancy rate of no more than five percent (5%) at the time of the tax credit application. Such waiver requests must be approved prior to the application submission and must include evidence from the project market analyst, including relevant market study pages, as to why the project is unable to meet the requirement.

Scattered-site projects that have received a waiver of the market study requirement from the California Debt Limit Allocation Committee (CDLAC) per Article 10. Section 5250.3 of the CDLAC Regulations are exempt from the market study requirements of Sections 10322(h)(10), 10325(f)(1)(B), and 10326(g)(1)(B). For such projects, a comprehensive market study as outlined in IRS Section 42(m)(iii) shall mean a written statement by a third party market analyst certifying that the project meets the requirements of Article 10. Section 5250.3 of the California Debt Limit Allocation Committee Regulations.

Market studies will be assessed thoroughly. Meeting the requirements of subsection (B) above is essential, but because other elements of the market study will also be considered, meeting those requirements in subsection (B) will not in itself show adequate need and demand for a proposed project or ensure approval of a given project.

Reason:

The Committee previously adopted a regulation allowing the TCAC Executive Director to waive the value-ratio requirement for acquisition-rehabilitation projects with existing federal or state rental or operating subsidies. This proposed language expands that waiver provision to include existing, well-performing tax credit projects that are re-syndicating. The proposed waiver language would help preserve already-leased up, affordable acquisition/rehabilitation projects in TCAC's portfolio in cases where TCAC deems the value-ratio requirement to be unnecessary.

The proposed language would also extend the value-ratio waiver provision to cases where market analysts must use single family homes in rural areas lacking sufficient 3 or 4 bedroom market rate comparables. TCAC will continue to hold waiver recipients to all other market study requirements, however, and will review such projects for conformity with the TCAC/CDLAC Joint Market Study Guidelines.

Finally, the proposed language allows forbearance on the market study requirement to a specific subset of scattered-site projects receiving a market study waiver from CDLAC.

Section 10326(g)(1)

Proposed Change:

- (g) Basic thresholds. An application shall be determined to be complete by demonstration of meeting the following basic threshold requirements. All basic thresholds shall be met at the time the application is filed through a presentation of conclusive, documented evidence to the Executive Director's satisfaction. Further, in order to be eligible to be considered for Tax Credits under these regulations, the general partner(s) and management companies must not have any significant outstanding noncompliance matters relating to the tenant files or physical conditions at any Tax Credit properties in California, and any application submitted by an applicant with significant outstanding compliance matters will not be considered until the Committee has received evidence satisfactory to it that those matters have been resolved.
- (1) Housing need and demand. Applicants shall provide evidence that the type of housing proposed, including proposed rent levels, is needed and affordable to the targeted population within the community in which it is located. Evidence shall be conclusive, and include the most recent documentation available (prepared within one year of the application date). Evidence of housing need and demand shall include;
- (A) evidence of public housing waiting lists by bedroom size and tenant type, if available, from the local housing authority; and,
- (B) a market study as described in Section 10322(h)(10) of these regulations, which provides evidence that: the items set forth in Section 10325(f)(1)(B) have been met for the proposed tax-exempt bond project.
- ~~(i) The proposed tenant paid rents for each affordable unit type in the proposed development will be at least ten percent (10%) below rents for the same unit types in comparable market rate rental properties;~~
- ~~(ii) The proposed unit value ratio stated as dollars per square foot (\$/s.f.) will be no more than the value ratios for comparable market rate units;~~
- ~~(iii) In rural areas without sufficient three- and four- bedroom market rate rental comparables, the market study must show that in comparison to three- and four-bedroom market rate single family homes, the affordable rents will be at least 20% below the rents for single family homes and the \$/s.f. ratio will not exceed that of the single family homes; and~~
- ~~(iv) The demand for the proposed project's units must appear strong enough to reach stabilized occupancy — 90% occupancy for SRO and Special Needs projects and 95% for all other projects — within six months of being placed in service for projects of 150 units or~~

~~less, and within twelve months for projects of more than 150 units and senior projects~~

Market studies will be assessed thoroughly. Meeting the requirements of ~~subsection~~ Section 10325(f)(1)(B) ~~above~~ is essential, but because other elements of the market study will also be considered, meeting those requirements in ~~subsection~~ Section 10325(f)(1)(B) will not in itself show adequate need and demand for a proposed project or ensure approval of a given project.

Reason:

TCAC holds all projects, 9% and tax-exempt 4%, to the same market study requirements. This proposed change eliminates redundancy and potential discrepancies between the Sections 10325(f)(1)(B) and Section 10326(g)(1)(B) by holding 4% tax-exempt projects to the exact same language as listed in the 9% Basic Threshold section of the Regulations.
