

May 23, 2017


Mr. Harold Price III, Executive Director
Florida Housing Finance Corporation
227 North Bronough Street, Suite 5000
Tallahassee, FL 32301

Dear Mr. Price:

Attached is our report for Project Number 2016-23, *Management Review of the Low-Income Housing Tax Credit Program's Internal Controls*. The review determined that Florida Housing Finance Corporation has implemented additional controls in their final cost certification review process to strengthen detection measures for the prevention of fraudulent activities. The Office of Inspector General concluded that alongside the measures currently being implemented, additional steps could be taken to strengthen controls in the final cost certification review process.

Management's responses are included in the report.

Sincerely,



Christopher T. Hirst
Inspector General

cc: Ken Reecy, Director of Multifamily Programs
Board of Directors, Florida Housing Finance Corporation

Rick Scott, Governor

Board of Directors: Bernard "Barney" Smith, Chairman • Ray Dubuque, Vice Chairman
Natacha Bastian • Renier Diaz de la Portilla • John David Hawthorne Jr. • Martha Lanahan • Ron Lieberman
Julie Dennis, Florida Department of Economic Opportunity

Harold "Trey" Price, Executive Director

Bernard Smith, Chairman
Trey Price, Executive Director

Martha Lanahan, Audit Committee Chair
Chris Hirst, Inspector General

Final Report

Management Review of the Low-Income Housing

Project #2016-23

Tax Credit Program's Internal Controls

May 23, 2017

SUMMARY

The Office of Inspector General (OIG) conducts reviews of Florida Housing Finance Corporation's (Florida Housing) programs to provide management and other stakeholders with unbiased, timely, and relevant information for use in promoting accountability, stewardship, and efficient operations.

In 2016, principals of Carlisle Development Group (CDG) and Biscayne Housing Group (BHG), two Miami based affordable housing developers, along with several business associates, pled guilty to submitting inflated construction contracts to Florida Housing representatives resulting in the theft of millions of dollars in federal tax credit subsidies. As a result of the Federal investigation of activities related to CDG/BHG, in 2014 Florida Housing began to review and strengthen controls related to the type of construction contracts required and final cost certification process, which provides the basis for the issuance of Low-Income Housing Tax Credits (LIHTC). Executive management also requested Florida Housing's OIG to review these controls and document all efforts of due diligence at the conclusion of the criminal proceedings. The review determined that Florida Housing has implemented additional controls in their final cost certification¹ review process to strengthen detection measures for the prevention of fraudulent activities, like the ones that resulted in the CDG and BHG conspiracy. The OIG concluded that alongside the measures currently being implemented, additional steps could be taken to strengthen controls in the final cost certification process.

In addition, the OIG was requested to conduct a limited review of DAXC, LLC (DAXC), an affiliated entity of Pinnacle Housing Group, Inc. (PHG), a low-income housing developer operating in Miami, Florida. The OIG's review of the DAXC inflated construction contract scheme resulted in additional recommendations for consideration by Florida Housing.

SCOPE, OBJECTIVES AND METHODOLOGY

In 2013, Florida Housing appointed a new Inspector General and OIG staff. Soon after arrival, the Inspector General was informed of the CDG/BHG conspiracy and subsequently included in a meeting discussing Florida Housing's role in the case. This was punctuated with the ongoing criminal investigation by the United States Government (Government) that was likely to result in the indictments and criminal prosecution of the conspirators. Given these circumstances, the consensus of Florida Housing's executive management and the Inspector General was to closely monitor the situation until the culmination of the investigation and prosecution.

¹ The purpose of the final cost certification process is to establish the total actual costs incurred by the developer in the delivery of a low-income housing tax credit development. This assists Florida Housing in determining certain development costs and the amount of subsidy to be allocated to the low-income housing tax credit development.

Upon conclusion of the Government’s criminal prosecution of the CDG/BHG conspirators in December of 2016, the former Executive Director of Florida Housing, Steve Auger, requested the OIG to initiate a management review of the events pertaining to the CDG/BHG conspiracy. The objectives of this review were to: (1) document the historical events surrounding the CDG/BHG cases; (2) document the outcome of the Government’s case against the conspirators; (3) identify process changes that have been implemented by Florida Housing’s Multifamily Programs (MFP) to address any identified control deficiencies; (4) identify new and recommend enhancements to existing controls to further strengthen the process; and (5) document the Assistant United States Attorney’s (AUSA) and OIG’s recommendations of additional controls that should be considered to detect and deter fraudulent activity.

In April 2017, Florida Housing’s Executive Director, Trey Price, requested the OIG to expand this review to include the recent events involving DAXC, an affiliated entity of PHG, a low-income housing developer operating in Miami, Florida. As outlined in the criminal Information² (Appendix A), DAXC was charged with the theft of millions of dollars in federal tax credit subsidies by submitting inflated construction contracts to Florida Housing representatives. However, on March 20, 2017, the Government and DAXC entered into a Deferred Prosecution Agreement³ (DPA) (Appendix B) in which DAXC agreed to forfeit \$4.2 million to which they were not entitled, along with an additional \$1 million penalty, totaling \$5.2 million.

Due to the ongoing administrative actions and potential litigation, the OIG conducted a limited review of this matter. The objectives of this part of the review were to: (1) identify process changes that have been implemented by Florida Housing’s MFP to address any identified control deficiencies; and (2) identify new and recommend enhancements to existing controls to further strengthen the process.

To achieve the objectives of this review, the OIG reviewed Section 420, Florida Statutes (F.S.); Chapter 67-48, Florida Administrative Code (F.A.C); Treasury Regulation §1.42-17; CDG/BHG case documentation; DAXC criminal Information and DPA; and MFP final cost certification procedures. The OIG attended new final cost certification process training, interviewed appropriate MFP staff, and coordinated a meeting with the AUSA and staff, who investigated and prosecuted the cases. Additionally, the meeting with the AUSA and staff included representatives from credit underwriters AmeriNational Community Services, Inc., Seltzer Management Group, and First Housing; the State of Florida’s Chief Inspector General; and various Florida Housing senior managers and staff.

BACKGROUND

Carlisle Development Group and Biscayne Housing Group

The Government funds the construction of affordable housing for low-income Americans through the award of federal tax credits to developers known as the Low-Income Housing Tax Credit (“LIHTC”, generally referred to throughout as “tax credits”) program. The Tax Reform Act of 1986 authorized state housing agencies to issue federal tax credits and federal grant monies to developers. These tax credits allow for the reduction of a taxpayer’s annual tax liability. Developers typically sell these tax credits to investors to finance the construction of low-income housing developments. Florida Housing is the designated state housing agency that issues these

² The formal accusation of a criminal offense made by a public official; the sworn, written accusation of a crime.

³ A deferred prosecution agreement is a voluntary alternative to adjudication in which a prosecutor agrees to grant amnesty in exchange for the defendant agreeing to fulfill certain requirements. A case of corporate fraud, for instance, might be settled by means of a deferred-prosecution agreement in which the defendant agrees to pay fines, implement corporate reforms, and fully cooperate with the investigation. Fulfillment of the specified requirements will then result in dismissal of the charges.

federal tax credits in Florida. Florida Housing issues tax credits to developers through a competitive application process where they submit applications to Florida Housing for the construction of proposed low-income housing developments. The selected developer is required to submit their costs to build the proposed development to Florida Housing. This submission includes a contract signed by the developer and general contractor setting forth the actual compensation to be paid to the general contractor to build the development. Florida Housing allocates federal tax credits based on the submitted costs, primarily from the construction contract.

In early 2012, the Federal Bureau of Investigation received information from two CDG employees, who had knowledge of criminal activity. Florida Housing was notified of the issue in September of 2012, by the U.S. Department of Housing and Urban Development's Office of Inspector General. In the spring of 2013, a federal grand jury began investigating CDG and BHG. The Government contended that between 2007-2012, CDG CEOs Lloyd Boggio and Matthew Greer conspired with BHG development partners Michael Cox and Gonzalo DeRamon and general contractors Michael Runyon, Rene Sierra, and Arturo Hevia in the theft of millions of dollars in federal tax credit subsidies. This was done by submitting inflated construction cost certifications, based on inflated construction contract costs, to Florida Housing for low-income housing developments. The result led to Florida Housing allocating at least \$34 million in excess federal tax credits for at least eight different low-income housing developments. Prior to trial, all defendants reached plea agreements and were sentenced in December of 2016. A summary of the pleas and sentences is attached to this report as Appendix C.

Upon learning of the CDG/BHG conspiracy in 2013, the Inspector General requested a meeting with the AUSA to discuss: what they uncovered; how they uncovered it; and what additional potential mitigating controls might need to be implemented or strengthened given this information. However, as a matter of protocol, the AUSA was unable to share any requested information with Florida Housing during the ongoing investigation and subsequent trial. The AUSA did indicate that they would be willing to share this information after the case was closed. This resulted in the meeting that occurred on February 15, 2017.

Florida Housing's Enhanced Cost Certification Requirements

In response to being notified of the criminal conspiracy, in 2014 Florida Housing began to strengthen controls related to the LIHTC program, to mitigate the risk of similar fraudulent activities occurring. In April of 2014, Florida Housing initiated rule development which was adopted by Florida Housing's Board of Directors and promulgated on October 8, 2014. This rule change required developers to use a guaranteed maximum price⁴ (GMP) construction contract instead of a stipulated sum construction contract. Another key enhancement resulting from the 2014 rule development was requiring a separate general contractor construction cost certification, aside from the developer cost certification. Furthermore, the construction costs associated with a minimum of eight subcontractors, or those associated with at least 40 percent of the construction costs of the development (whichever is greater) must be audited by an independent Certified Public Accountant (CPA). With the adoption of this enhanced accountability measure, Florida Housing now requires a more demanding and comprehensive cost certification process.

Since the inception of the LIHTC program, Florida Housing, like all other state housing finance agencies, has required a final cost certification. The final cost certification establishes the total actual costs incurred by the awardee in the delivery of an affordable housing development capitalized through tax credits. This final cost certification must be prepared by an independent CPA for the applicant to receive the tax credits.

⁴ A GMP contract is a cost-type contract where the contractor is compensated for actual costs incurred plus a fixed fee subject to a ceiling price. The contractor is responsible for cost overruns, unless the GMP has been increased via formal change order (only because of additional scope increases from the client, not price overruns, errors, or omissions). Savings resulting from cost underruns are returned to the owner. This is different from a stipulated sum contract or lump-sum where cost savings are typically retained by the contractor and essentially become additional profits.

In addition to requiring a GMP contract and a more comprehensive cost certification process, MFP instituted other changes to the Rules governing LIHTC and some of those changes are listed below:

- Ensure that none of the general contractor duties to manage and control the construction of a development are subcontracted;
- Ensure that no construction or inspection work that is normally performed by subcontractors is performed by the general contractor;
- Ensure that not more than 20 percent of the construction cost is subcontracted to any one entity, with the exception of a subcontractor contracted to deliver the building shell of a building of at least five stories which may not have more than 31 percent of the construction cost in a subcontract, unless otherwise approved by Florida Housing for a specific development. With regard to said approval, Florida Housing shall consider the facts and circumstances of each applicant's request, inclusive of construction costs and the general contractor's fees; and,
- Ensure that no construction cost is subcontracted to any entity that has common ownership or is an affiliate of the general contractor or the developer. For purposes of this paragraph, "Affiliate" has the meaning given it in subsection 67-48.002(5), F.A.C., except that the term "Applicant" therein shall mean "General Contractor."

DAXC, LLC and Pinnacle Housing Group, Inc.

On March 9, 2017, the United States Attorney's Office, Southern District of Florida, filed a criminal Information stating that PHG submitted inflated construction contracts to Florida Housing's representatives for the receipt of federal tax credits and grant monies for four housing developments between 2009–2011. As the criminal Information states, subcontractor DAXC, a related entity to PHG, used an inflated construction contract scheme to defraud the Government of funds.

As outlined in the criminal Information filed by the United States Attorney's Office, the Government alleged that the scheme DAXC used consisted of the following (paraphrased):

- Developer A (PHG) was selected to receive tax credits and grant monies for four housing developments.
- PHG selected its wholly owned Contractor A (Contractor) as the general contractor for the developments.
- The Contractor solicited and received bids from subcontractors for construction line items including the most expensive line item, the concrete shell work. Shell Subcontractor A (Subcontractor) was included as one of the subcontractors submitting bids for the developments.
- PHG and the Contractor did not list the Subcontractor's final bid for concrete shell work in the itemized construction contracts submitted to Florida Housing for the developments.
- The Contractor signed construction contracts for the concrete shell work with its affiliated company, DAXC, at an inflated price for each of the developments even though DAXC did not have the personnel or equipment to complete the shell work. DAXC subcontracted with the Subcontractor to actually complete the shell work at the actual cost of work price.
- The Contractor signed inflated construction contracts with DAXC on the developments with inflated amounts ranging from approximately \$200,000 to \$1.5 million for total inflated costs of approximately \$3.4 million on the four developments.
- PHG then submitted the inflated construction contracts to Florida Housing to receive federal tax credits and grant monies. The inflated contracts resulted in \$800,000 in additional fees

being paid to PHG and the Contractor. DAXC's inflated construction contract scheme resulted in Florida Housing distributing excess federal funds and grant monies totaling \$4.2 million.

- DAXC retained the excess funds distributed from the inflated construction contracts. In November 2011, the Contractors principals received wire transfers of approximately \$2.5 million from DAXC's bank account derived from the inflated construction contract scheme.

On March 20, 2017, the United States Attorney's Office and DAXC entered into a DPA (see Appendix B). By signing the DPA, DAXC acknowledged that at least \$4.2 million was proceeds/involved in transactions in violation of 18 United States Code § 641 and agreed to forfeit that amount, along with an additional \$1 million penalty, totaling \$5.2 million.

OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT'S RESPONSES

Observation 1: Recommendations provided by the AUSA and Management's Responses

During the February 15, 2017 meeting, the AUSA provided Florida Housing with the following observations and recommendations for consideration to add new or enhance existing controls to further detect and deter fraudulent activity:

1. Credit underwriters should be required to provide Florida Housing with copies of proposed development executive summaries such as the Plan and Cost Analysis Report, Market Feasibility Analysis Report, and Appraisal Report. These summaries should be submitted with the underwriting report to provide all parties with the same information upon which to make decisions.

Management Response:

Multifamily Programs staff implemented this recommendation on April 17, 2017, and will require that credit underwriters provide the executive summaries of the Plan and Cost Analysis report, Market Feasibility Analysis report and Appraisal report. MFP staff will review the material as part of their overall credit underwriting report review.

2. Florida Housing should be copied on all emails transmitted between the credit underwriter, the developer, and the general contractor to provide additional transparency between parties.

Management Response:

Due to the volume of emails involved, along with the unknown added value this measure would bring, MFP does not agree with this recommendation. MFP will work with the credit underwriters to ensure that they are more aware of the need to alert MFP staff to unusual situations they encounter during their interactions with Developers and General Contractors. Additionally, this material would be reviewed as part of the proposed post-audit of credit underwriting activities.

3. Florida Housing should consider designating an individual within the MFP to review each development to make sure everything is done correctly. This position may need to be a dedicated position and the individual should have experience in construction cost certification and credit underwriting.

Management Response:

Prior to receiving this recommendation, the Director of MFP was already in informal discussions with the former Executive Director and the CFO [Chief Financial Officer] about the need for an additional position in MFP (or reporting to the Director of Development Finance), in which the incumbent would have credit underwriting experience and would function as internal oversight for the credit underwriting process through comprehensive post-audits of completed credit underwriting reports. MFP plans to make a formal recommendation to the new Executive Director regarding the creation of this position as soon as is practical. This position would:

- *Work with outsourced credit underwriters on special issues regarding developments in the pipeline;*
 - *Perform comprehensive post-audits of credit underwriting reports looking at source documents:*
 - *To review bottom level source documentation used as the grist for credit underwriting reports with an eye toward crafting policy if needed;*
 - *To ensure credit underwriting consistency and adherence to the Florida Housing approach; and*
 - *To assist in the compilation of data to better manage administration of the MF programs.*
4. Federal law and HUD entrust Florida Housing with monitoring affordable housing funding and the associated risks. During the meeting, AUSA staff stated that relationships between some credit underwriters and developers appeared to be too “relaxed” as opposed to a more formal business relationship. They also stated that the judge found it troubling that developers were paying credit underwriters directly and felt this could lead to problems. Therefore, the AUSA recommended that all payments for services to credit underwriters should go through Florida Housing as a neutral party.

Management Response:

MFP understands the concern expressed by the AUSA, however, in our experience the relationship between the outsourced credit underwriting firms and developer/applicants is appropriately at arms-length, and at times, even slightly adversarial. Additionally, MFP staff assign credit underwriters, they are not chosen by developer/applicants, and the payment is an administrative function convenient for the Corporation. There would be no discernable benefit to inserting the Corporation as the “go-between” in the payment process, but there would be costs associated with such a change. We will continue to monitor the business relationship between the parties to ensure the proper posture is maintained.

5. Florida Housing should receive copies of all general contractors’ Schedule F. This schedule lists subcontract amounts by trade and cost (e.g. estimated plumbing cost: \$75,000.00, estimated electrical cost \$100,000.00, etc.). Florida Housing should also request the general contractor provide a listing of all the subcontractors working on the project. With these two pieces of information, Florida Housing could perform random “spot checks”⁵ to validate that the listed contractors are performing work for the general contractor and that the work completed is reasonably close to the estimated price. This would then help Florida Housing to compare the contract amounts to the final construction cost certification and inquire about any significant discrepancies. It will also affirm to the developers, general contractors, and sub-contractors, that Florida Housing will confirm and ensure the listed subcontractors are performing the work and are reasonably close to the estimated price listed in the Schedule F.

⁵ The AUSA recommended random checks via phone call.

Management Response:

MFP agrees with this recommendation and is currently working to operationalize a process similar to that recommended here. This will require a change to the Servicer contract.

6. Florida Housing should require the implementation of a “Failure to Disclose” agreement, signed by the developers, contractors, and sub-contractors. It should provide for penalties for nondisclosure to Florida Housing of consulting engagements, side-letter agreements, etc. Compliance will work only if the monetary penalties are substantial enough to impact them. Legislative reform may be needed to facilitate implementation of this control.

Management Response:

A Failure to Disclose agreement will be added to future RFAs and would be tied to a long-term “time out” recommendation in accordance with Chapter 67-48.004(2), F.A.C.

7. Florida Housing should conduct analysis and perform cost comparisons on developments based on geographic region; and then, if needed, on the population served (i.e. the elderly, low-income, minority, migrants, etc.). This can help to identify cost anomalies between similar developments that may require further scrutiny.

Management Response:

The Corporation has been working on this process for some time now. Data is currently being captured at the Application and credit underwriting stages of the process, however, the capture of data at final cost certification/final loan draw has not yet been completed. Once the data capture has been accomplished, the Director of Development Finance would be responsible for designing the cost analysis system in coordination with MFP staff, ITS [Information Technology Services] staff, and credit underwriters. The information would be reviewed and comparisons made to other comparable projects, if available. It is also the responsibility of the credit underwriters to identify and request information about outliers in addition to any discussed in the Plan and Cost Analysis report.

Observation 2: Selection of CPA Firms

It was noted during this review that the CPA firms conducting the final cost certifications are selected and compensated by the developers and general contractors. The final cost certifications are ultimately provided to Florida Housing for review as the basis for the issuance of tax credits. Currently, the cost certifications are provided by the CPA firm or the developer.

In accordance with Treasury Regulation §1.42-17(a)(5), the developers and general contractors (taxpayer) are required to hire an independent CPA firm, whose audit of the cost certification (project costs) must be conducted in accordance with generally accepted auditing standards and accompanied by an unqualified audit report. However, Florida Housing’s new final cost certification requirements have emphasized the need for more consistency throughout the final cost certification process. The absence of Florida Housing’s involvement in selecting the CPA firms participating in the completion of the final cost certifications could limit consistency and create unnecessary risk for Florida Housing.

The OIG **recommends** that Florida Housing develop and implement a process whereby Florida Housing establishes an approved pool of CPA firms to conduct final cost certifications for all LIHTC deals. This would allow Florida Housing to provide a more prescriptive approach for completing the cost certification forms, which would inherently create efficiencies in MFP's review process. This would ensure a more consistent, transparent, and objective review of the documentation which Florida Housing relies on to award federal tax credits. Furthermore, this additional control over the final cost certification and audit process would provide a greater level of assurance to Florida Housing's stakeholders.

Management Response:

MFP staff will present this concept at the next Rule development workshop for Chapter 67-48, F.A.C.

Observation 3: Review of the Enhanced Final Cost Certification Process

During fieldwork, the OIG determined that 36 tax credit allocations were awarded in 2015 for pending developments, totaling just over \$55 million, which are subject to the new final cost certification process. To obtain a better understanding of the new process, the OIG attended several MFP training meetings held for the staff responsible for reviewing cost certifications submitted as part of the enhanced process.

MFP acknowledged that a very limited number of final cost certifications have been reviewed due to the recent change in the process and the limited number submitted to date. Therefore, adequacy of the process and compliance with it could not be fully evaluated.

The OIG **recommends** that Florida Housing continue to implement and refine, as necessary, the review process of the final cost certifications for compliance with the new requirements. The OIG also recommends instituting a secondary random review process to ensure staff are accurate and consistent in their reviews.

Management Response:

Multifamily Programs (MFP) has initiated a new workflow paradigm, moving from a "task specific" approach to a "case management" approach, whereby all MFP Tax Credit staff will be assigned deals in the pipeline in teams of two, one as primary and the other staff member as back-up. All MFP staff will be responsible for all aspects of the deals they are assigned, from the point of beginning (Credit underwriting invitation) to the final action (issuing 8609's)⁶ and beyond (amending Extended Use Agreements)⁷. This will ensure that the staff member reviewing each cost certification will be intimately aware of the deal. Staff will be much more likely to recognize when discrepancies are present based on their greater understanding of the deal. Cost certifications will be reviewed by both the primary and back-up members of the team assigned to any particular deal, along with the Assistant Director, as part of this new paradigm. We will also consider instituting a random review process for the Director of Development Finance to ensure that MFP staff are accurate and consistent in their cost certification reviews.

Observation 4: Training for Performing Final Cost Certification Reviews

As stated in Observation 3, the OIG attended several MFP training meetings held for the staff responsible for reviewing cost certifications submitted as part of the enhanced process. The OIG also had follow-up discussions

⁶ IRS Form 8609 is generally used for a developer to obtain a tax credit allocation from the issuing housing credit agency, such as Florida Housing.

⁷ Extended Use Agreement means, with respect to the HC Program, an agreement which, among other requirements, encumbers the development with restrictions required to receive the tax credit allocation.

with MFP staff to gauge their level of confidence in being able to adequately perform the tasks associated with reviewing the new final cost certifications. MFP staff indicated their confidence in conducting the reviews was low due to the process being recently implemented and the level of technical detail required to complete the reviews.

The OIG **recommends** that appropriate Florida Housing staff continue providing support and periodic training to staff relating to the new final cost certification review process until such a time that MFP staff demonstrates proficiency and their confidence levels mature.

Management Response:

MFP Tax Credit staff will be given continuous training on cost certification review with the assistance of the Director of Development Finance using a case study approach to ensure that all staff understand and apply a consistent approach to the cost certification review process. These case studies will be performed on a quarterly basis to ensure continued learning opportunities and adherence to the new review process. We also plan to include several training sessions for MFP staff through other industry-related experts:

- *MFP staff will be trained by credit underwriters on the construction documentation analysis that they perform in the course of crafting draft underwriting reports.*
- *Our newly-hired Assistant Director, an MAI [Member of Appraisal Institute] appraiser, will also train staff on valuation scenarios and how these might be manipulated to inappropriately inflate eligible basis.*
- *Lastly, we will have a training session with one or more of the CPA firms that submit cost certifications for affordable housing developers to better understand what documentation the CPA firms receive from developers and to craft policy on what additional documentation should also be submitted to or processes required by the Corporation.*

Observation 5: Additional Oversight and Assurance

Risk is any threat to achieving Florida Housing's mission or the likelihood that an event or action may negatively impact Florida Housing. Each year, the OIG conducts a risk assessment to identify areas within Florida Housing with the perceived highest level of risk. The results of the 2015 and 2016 annual risk assessments indicated the LIHTC program is a high-risk area. The level of risk identified was discussed with MFP management, including possible assistance by the OIG to provide assurance that controls were in place to mitigate the risk. However, due to ongoing improvements to the cost certification process and the pending criminal investigations, it was determined to delay any reviews by the OIG until the process improvements were substantially complete and the criminal prosecution was finalized.

Historically, Florida Housing has not employed staff possessing experience in credit underwriting or construction auditing, who tend to have a higher level of understanding of the nuances of the construction process. Currently, MFP is planning to add at least one staff member with credit underwriting experience to provide additional oversight of the external credit underwriting process. While this addition will provide some assurance as it relates to credit underwriting, the internal capacity to conduct construction audit related services will remain a deficiency.

The OIG **recommends** that Florida Housing consider additional staff dedicated to performing specialized reviews related to LIHTC developments, such as construction audit services. Depending on the specific expertise of any staff added, the position could be placed in the MFP, the OIG, or in both areas, if deemed necessary. Due to the nature of the work involved, requirements for adherence to standards, and to provide a level of independent review, separate from operations, strong consideration should be given to placing one position within the OIG.

This would provide Florida Housing stakeholders with additional independent assurance that the risks related to the LIHTC program were being managed to an acceptable level.

The OIG also **recommends** that Florida Housing provide professional training to key staff members, especially those who are in a position to detect anomalies during the final cost certification review process. Ideally, the training would be conducted by recognized industry experts.

Management Response:

In response to this observation and as part of a new process to use CNAs [Capital Needs Assessment] to determine the scope of multifamily rehabilitations, MFP will formally propose to add a construction expert to MFP staff. This staff person may require knowledge, skills and abilities up to and including either engineering or architectural accreditation. MFP has also embarked on an aggressive training regime for housing credit staff, to improve the oversight required for cost certification.

Observation 6: DAXC, LLC and Pinnacle Housing Group, Inc.

The United States Attorney's Office, Southern District of Florida, filed a criminal Information (see Appendix A) on March 9, 2017 and DPA⁸ on March 20, 2017, (see Appendix B), stating that Developer PHG submitted inflated construction contracts to Florida Housing's representatives for the receipt of federal tax credits and grant monies for multiple housing developments between 2009–2011. As outlined in the criminal Information (see Appendix A), subcontractor DAXC, a related entity to PHG, used an inflated construction contract scheme and because of the inflated construction contracts, Florida Housing allocated approximately \$4.2 million in excess federal funds. On March 20, 2017, the United States Attorney's Office and DAXC entered into a DPA (see Appendix B). As part of the agreement, DAXC agreed to forfeit the \$4.2 million, along with an additional \$1 million penalty, totaling \$5.2 million.

Prior to the Government's discovery of this illegal activity by DAXC, MFP recognized a potential deficiency in Rule 67-48.0072(17), F.A.C and instituted a rule change on October 9, 2013. This change included the requirement listed below:

(g) Ensure that no construction cost is subcontracted to any entity that has common ownership or is affiliated with the General Contractor unless otherwise approved by the Board for a specific Development. With regard to said approval, the Board shall consider the facts and circumstances of each Applicant's request, inclusive of construction costs and ownership interests in the Development.

The OIG **recommends** that Florida Housing continue its proactive approach in reviewing and determining rules that require enhancement, to prevent similar situations moving forward.

Management Response:

MFP staff strengthened the Rule provision regarding the prohibition of related-entity subcontractors in the 2017 rule making. This provision will be adopted on May 24th. MFP also strengthened the Rule with a provision that prohibits general contractors from performing tasks normally performed by subcontractors. This provision

⁸ A deferred prosecution agreement is a voluntary alternative to adjudication in which a prosecutor agrees to grant amnesty in exchange for the defendant agreeing to fulfill certain requirements. A case of corporate fraud, for instance, might be settled by means of a deferred prosecution agreement in which the defendant agrees to pay fines, implement corporate reforms, and fully cooperate with the investigation. Fulfillment of the specified requirements will then result in dismissal of the charges.

streamlines the cost certification process further. MFP has an ongoing review of the rules governing the HC process, and plans to continue to add provisions providing for better cost certification of housing credit developments.

INSPECTOR GENERAL COMMENT

In an effort to create fraud awareness with the entities doing business with Florida Housing, the Inspector General (IG) recommends that a high-level designee, for the developer and general contractor, as well as their pertinent staff, undergo mandatory fraud and detection awareness training, to include the Whistle-blower Act⁹, which will be conducted by the OIG.

The IG will share this report with the National Council of State Housing Agencies (NCSHA), for distribution to all state housing agencies and others who participate in the LIHTC program, in order to increase awareness of areas for potential improvement nationally.

ACKNOWLEDGEMENT

The Office of Inspector General would like to extend our appreciation to the management and staff of MFP and the United States Attorney's Office for their assistance and cooperation during this review.

AUSA Michael Sherwin¹⁰ acknowledged the Florida Housing management and staff regarding the CDG/BHG investigation and prosecution as expressed in his March 6, 2017 letter to Florida Housing (Appendix D), in which he stated:

None of the success of this prosecution, however, could have been achieved without the assistance of the Florida Housing Finance Corporation (FHFC). From extensive document production, to witness interviews, to facilitating meetings between federal agents and numerous private underwriters, FHFC played a central role in the Carlisle investigation. . .

This review was conducted using guidance from the *International Standards for the Professional Practice of Internal Auditing*, published by the Institute of Internal Auditors. The review was conducted by David Merck CIA, CISA, CISSP-ISSMP, CAP, CPM and Melanie Yopp CFE, CGAP, CIGI, CIGA under the supervision of Justin Evans, Director of Auditing, CIA, CFE, CIGA, CPM.

⁹ The Whistle-blower's Act, §112.3187-112.31895, F.S., is intended to protect current employees, former employees, or applicants for employment with state agencies or independent contractors from retaliatory action. Whistle-blower designation is determined by the OIG in consultation with the Governor's Chief Inspector General's office. If a complaint meets whistle-blower criteria, the whistle-blower's identity is protected from release and an investigation is conducted pursuant to §112.3189, F.S.

¹⁰ AUSA Sherwin and staff investigated and prosecuted the CDG/BHG criminal cases.

APPENDICES

Please see separate appendix for copies of the following documents:

1. Appendix A - Criminal Information - Pages 1-11
2. Appendix B - Deferred Prosecution Agreement - Pages 12-29
3. Appendix C - Summary of Pleas and Sentences - Pages 30 - 32
4. Appendix D - AUSA Sherwin letter - Pages 33 - 35