A Report
to the
Montana
Legislature

Performance Audit

Supporting Low-Income Housing: The Montana Board of Housing and Its Role in Awarding Housing Tax Credits

Montana Board of Housing

June 2024

Legislative Audit
Division

23P-04

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We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Members of the performance audit staff hold degrees in disciplines appropriate to the audit process.

Performance audits are conducted at the request of the Legislative Audit Committee, which is a bicameral and bipartisan standing committee of the Montana Legislature. The committee consists of six members of the Senate and six members of the House of Representatives.

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June 2024

The Legislative Audit Committee
of the Montana State Legislature:

We are pleased to present our performance audit of the Montana Board of Housing, which is allocated to the Department of Commerce.

This report provides the legislature with information about board governance and its annual award of the Low-Income Housing Tax Credit. This report includes recommendations for improving policy and training as well as how the board awards tax credits that support the development and preservation of low-income rental housing. A written response from the board and board staff is included at the end of the report.

We wish to express our appreciation to board members and board staff for their cooperation and assistance during the audit.

Respectfully submitted,

Angus Maciver
Legislative Auditor

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Appointed and Administrative Officials

	Name	City	Term Expires January
Montana Board of Housing	Bruce Posey, Chair	Billings	2025
	Sheila Rice, Vice Chair	Great Falls	2027
	Amber Parish, Secretary	Billings	2025
	John Grant	Helena	2025
	Cari Yturri	Great Falls	2025
	Jeanette McKee	Hamilton	2027
	Tonya Plummer	Kalispell	2025

Department of Commerce

Scott Osterman, Director (through December 2023)

Paul Green, Director (effective January 2024)

Mandy Rambo, Deputy Director

Board of Housing

Cheryl Cohen, Executive Director of the Board and Housing Division Administration

Jason Hanson, Multifamily Program Manager

Montana Legislative Audit Division

Performance Audit

Supporting Low-Income Housing: The Montana Board of Housing and Its Role in Awarding Housing Tax Credits

Montana Board of Housing

A report to the Montana Legislature

Background

Description: The Montana Board of Housing is a seven-member, governor-appointed board allocated to the Department of Commerce. The self-supporting board finances most of its operations and programs by selling tax-exempt bonds in the private sector. The board provides policy direction to staff, authorizes bond issuances, and approves some affordable housing development financing. The programs overseen by the board aim to increase access to affordable housing through homeownership or the development and preservation of affordable rental housing. It oversees the federal Low-Income Housing Tax Credit (LIHTC), the biggest federal affordable rental housing development program. The board awards Montana's annual apportionment of federal tax credits to developers. These federal tax credits are used to subsidize the cost of the rental housing development projects to allow them to remain affordable for low-income households.

Agency: Board of Housing

Program FTE: 36

Program Revenue FY 2023: $24.2 million

Program Expenses FY 2023: $20.7 million

A shortage of affordable housing is a long-standing challenge nationwide. Montana has an estimated shortage of about 17,000 affordable rental homes for low-income renters. The Montana Board of Housing's award of federal tax credits to address this shortage is not in line with standard practice. The board also does not adequately incentivize affordable housing projects for the populations it should. To improve how awards are made in Montana, the board needs a more data-informed understanding of the statewide need for affordable housing, stronger policy incentives for developers, and outreach to specific populations. Additionally, instituting a transparent, structured evaluation of projects when making awards is crucial. Improvements to board policy and more regular training would help ensure the board meets program requirements, adheres to best practices, and serves low-income Montanans most effectively.

KEY FINDINGS:

The board's knowledge of statewide affordable housing need could be augmented by data. The board's current approach to identifying the most urgent need for affordable housing in Montana is not adequately data-informed. As a result, the board cannot align its award policies with statewide needs or properly incentivize low-income housing projects in areas of greatest necessity within the state.

The board directs limited consideration, policy incentives, and outreach to address specific low-income populations' needs. Projects targeting the lowest income and areas of greatest need were not consistently prioritized by the board. Montana serves lowest income and specific populations less than other states.

The board's award of the competitive Low-Income Housing Tax Credit (LIHTC) is not transparent. Rather than a structured evaluation of projects against set criteria as the primary basis for award, the board makes award decisions based on board discretion. This departure from industry standard leads to inadequate prioritization of projects serving lowest income and areas of greatest need.

Board members have varying understandings of conflict of interest and ex parte communication. The board lacks a clear conflict of interest

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policy, and its ex parte communication is unclear. Without clear policies like these, there could be actual or perceived favoritism by the board.

Board members have insufficient training. Training is not a requirement for board members, and training is irregular and often poorly attended. Consequently, some board members lack sufficient understanding of board policies and programs.

RECOMMENDATIONS:

In this report, we issued the following recommendations:
To the board: 5
To the legislature: 0

Recommendation #1 (page 11):
Governance, Risk Assessment, and Planning
We recommend the Montana Board of Housing use a more data-informed method to identify where and what types of affordable housing are most needed across the state and to inform policy in the LIHTC program.

Department response: **Partially Concur**

Recommendation #2 (page 15):
Federal Compliance
We recommend the Montana Board of Housing prioritize LIHTC projects serving the lowest-income Montanans and increase its consideration of the needs of specific populations through increased training to staff and board members, better outreach, and the implementation of policy incentives.

Department response: **Partially Concur**

Recommendation #3 (page 18):
Procurement, Contracting, and Grants Management
We recommend the Montana Board of Housing implement a structured system for evaluating projects against set, board-approved criteria as a primary basis for awarding LIHTC.

Department response: **Partially Concur**

Recommendation #4 (page 20):
Internal Control
We recommend the Montana Board of Housing develop a conflict of interest policy and clarify its ex parte communication policy.

Department response: **Partially Concur**

Recommendation #5 (page 22):
Governance, Risk Assessment, and Planning
We recommend the Montana Board of Housing either seek legislation to make training required for board members or develop a policy to implement a training requirement and schedule.

Department response: **Partially Concur**

Chapter I – Introduction and Background

Introduction

The shortage of affordable housing is a widespread and widely acknowledged issue nationwide and in Montana. The National Low Income Housing Coalition estimates there is a shortage of about 17,000 affordable and available rental units for low-income renters in Montana. One effort to alleviate the affordable housing problem is developing and preserving rent-restricted rental housing. Part of the mission of the Montana Board of Housing (board or MBOH) is to maximize the supply of new and rehabilitated affordable rental homes through efficient use of federal and state resources. The Legislative Audit Committee prioritized a performance audit of the MBOH in fiscal year 2023 to assess the effectiveness of the board. This audit identified needed improvements to board policy and training and how the board awards federal resources for affordable rental housing.

Background

The board is a seven-member, quasi-judicial board appointed by the governor that is allocated to the Department of Commerce. The board is considered Montana's state housing finance agency (HFA) and is self-supporting. It finances most of its operations and programs by selling tax-exempt bonds in the private sector. The board provides policy direction to staff, authorizes bond issuances, and approves some affordable housing development financing. Some of the board's programs (Figure 1) provide direct aid to lower housing costs for individual households through homeownership. Other board programs facilitate the construction and preservation of affordable rental housing.

Figure 1
MBOH Programs

Source: Created by the Legislative Audit Division.

The Low-Income Housing Tax Credit Program

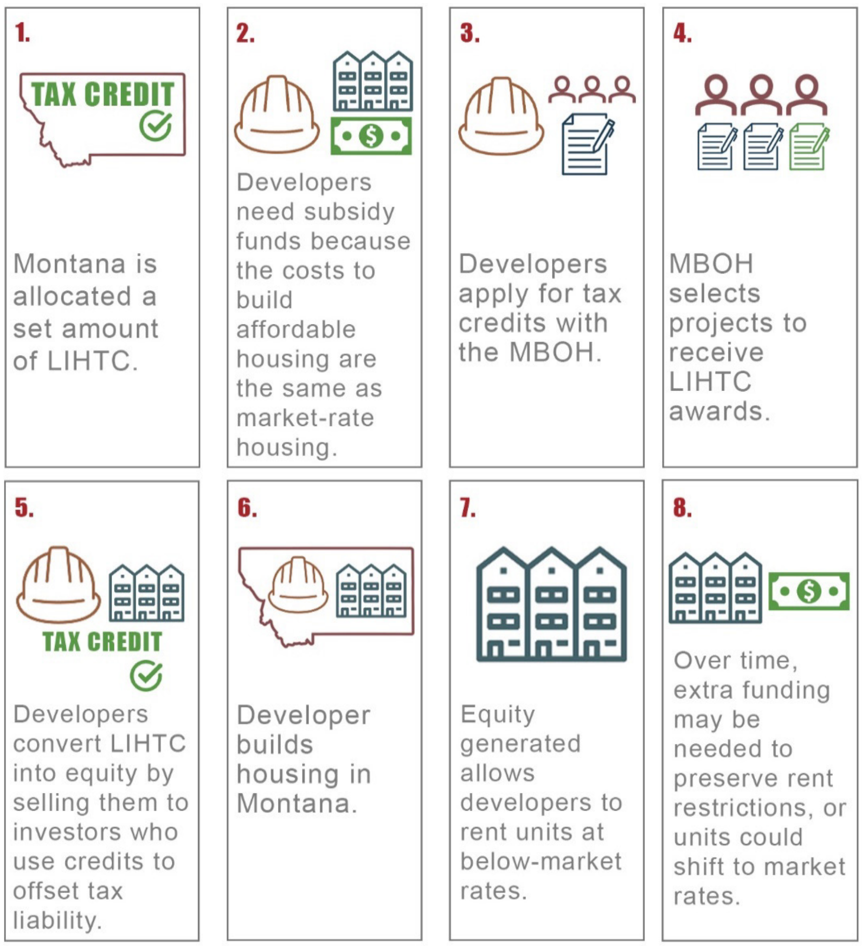
This audit focused on the largest rental housing development program overseen by the board, the Low-Income Housing Tax Credit (LIHTC) program. Unlike most other federal housing programs, which are overseen by the U.S. Department of Housing and Urban Development (HUD), the Internal Revenue Service (IRS) oversees the LIHTC program at the federal level. The Government Accountability Office describes IRS oversight of the LIHTC program as minimal because it is viewed as peripheral to the IRS's main mission.

The LIHTC program is the largest source of funding for developers of new affordable rental housing. The program gives states the authority to award federal tax credits annually to subsidize the cost of rental housing projects targeted to low-income households. Some states (though not Montana) also have a state tax credit that is often used with the federal tax credit to further help fund low-income housing projects. *Low-income housing* generally means housing for households earning up to 80 percent of the area median income (AMI). This is distinct from what's commonly referred to as *workforce housing*, which is intended for households in the 80-120 percent AMI range. Federal law requires the governor or state statute to designate an entity to award tax credits in the state. In Montana, a governor's executive order in 1987 gave the MBOH this designation. Since the program started, more than 10,000 affordable rental units have been created or preserved in Montana.

How the LIHTC Works in Montana

The LIHTC offers developers nonrefundable and transferable tax credits to subsidize the construction and rehabilitation of low-income housing. Developers sell their LIHTCs to outside investors to help fund the project. This allows units in the housing project to be rented at below-market rates. In return, investors use the tax credits to decrease their annual tax liability, generally over 10 years. Figure 2 depicts how the LIHTC is allocated to Montana, resulting in affordable rental units.

Figure 2
How the LIHTC Works in Montana



Source: Created by the Legislative Audit Division.

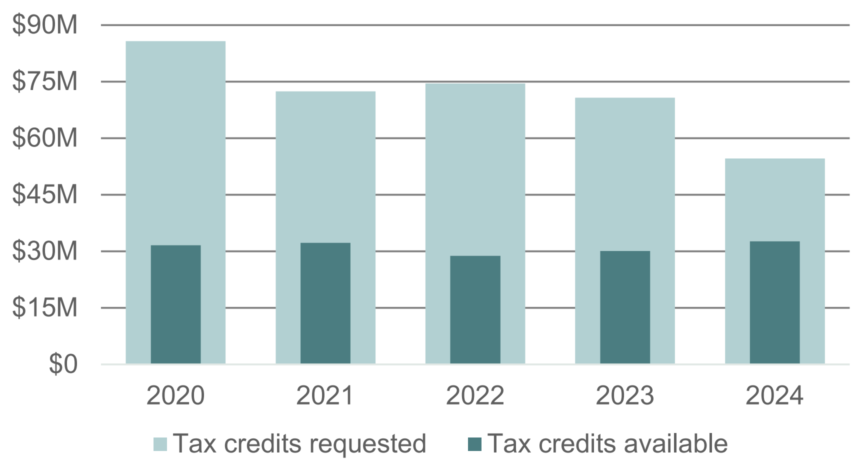
The LIHTC program offers two types of tax credits: a 4 percent credit and a 9 percent credit. The 4 percent credit is typically used in conjunction with federally tax-exempt bonds and subsidizes a smaller percentage of the low-income units in a project. Currently, applying for 4 percent tax credits in Montana is not competitive because there is not enough demand from developers to use all available credits. In Montana, applications for 4 percent credits are processed by board staff and approved by the board as they come in. The 9 percent credit subsidizes a higher percentage of low-income units in a project, and developers competitively apply for it in an annual award cycle.

Each year, developers of affordable rental housing projects apply for a portion of the 9 percent tax credits allocated to Montana. The board selects the projects that are awarded 9 percent tax credits, and there are usually more 9 percent tax credits requested than are available to award (Figure 3).

Figure 3

9% Tax Credits Requested and Tax Credits Available 2020-2024

The total value of 9 percent tax credits requested from developers has exceeded the amount of tax credits available in recent award years.



Source: Compiled by the Legislative Audit Division from board records.

The number of proposed projects requesting tax credits declined from 17 in 2019 to 9 in 2024. Each spring, the board hears all initial 9 percent project proposals and typically invites eight of them to submit a full, more resource-intensive application in the fall. In the fall, the board considers all full applications and makes final 9 percent credit award decisions. The board can typically fund five of the eight projects that submit a full application. The board's 9 percent tax credit awards for 2024 are expected to provide 158 rent-restricted units for low-income households. Given the significant shortage of affordable rental homes compared to the number of units created by LIHTC, it is crucial the board focus on addressing the most urgent needs in Montana.

States are federally required to create a Qualified Allocation Plan (QAP) outlining how they decide which projects get tax credits. The MBOH approves Montana's QAP, which is then approved by the governor and updated yearly. States have considerable flexibility in developing their QAPs to set their own priorities or to place additional requirements on awardees. However, states are required to give preference to projects that serve the lowest-income tenants and remain affordable for the longest period of time. States are also required to consider specific factors, such as project location and project characteristics. To meet program requirements and to best serve low-income Montanans, it is vital the board's governance and approach to awarding tax credits align with best practices.

Scope & Objectives

Our audit focused on the board's rental housing development programs rather than its homeownership programs, as renting is often the only affordable option for low-income families in high-cost markets. The audit centered on the LIHTC program, which is typically the biggest funding source in low-income housing projects and has limited federal oversight. The time frame we reviewed for most of our work was calendar years 2018 through 2022. However, we also observed board activity throughout the audit in calendar year 2023, which included the 2024 tax credit award cycle.

We developed two objectives to assess board governance and the effectiveness of LIHTC decision-making:

1. Does the governance framework of the Board of Housing align with best practices and provide for effective administration and oversight of multifamily housing programs?
2. Does the Board of Housing allocate and approve Low-Income Housing Tax Credits to maximize the number of new or rehabilitated affordable multifamily housing units in areas where it is most needed?

Methodology

To answer our objectives, we completed the following steps:

- Reviewed federal law, rules, and guidance.
- Reviewed state law, rules, policies, and procedures.
- Reviewed board governance best practice and interviewed an expert on board governance.
- Reviewed LIHTC allocation best practice in the industry and interviewed the board's LIHTC consultant.
- Analyzed 2021 state HFA data on board governance and LIHTC allocation from all 50 states from the National Council of State Housing Agencies (NCSHA).
- Interviewed five other states (Wyoming, North Dakota, South Dakota, Michigan, and Vermont) to get an understanding of their board governance practices and LIHTC allocation strategy.
- Interviewed all seven board members individually.
- Interviewed staff.
- Reviewed board meetings from calendar years 2018 through 2022 and observed board meetings and QAP revision meetings in 2023.
- Surveyed LIHTC applicants from calendar years 2018 through 2022. Of the 29 applicants, 14 responded.
- Interviewed seven additional stakeholders, including successful and unsuccessful applicants and a former board member. Applicants we interviewed represented both nonprofit and for-profit and in-state and out-of-state developers.
- Visited two existing LIHTC properties.
- Conducted a file review of LIHTC applications from 2021 and 2022.

- Conducted a spatial analysis to determine the extent to which the board's LIHTC funding decisions in calendar years 2018 through 2022 led to affordable housing where it was most needed. More information about this methodology is included in Appendix A.

Issue for Further Study

Beyond the scope of this audit, we observed that similar boards in other states operate with more autonomy and broader statutory authority than Montana's board. For example, some HFAs are nonprofit organizations external to state government or are a unit of state government with broader statutory authority. In Montana, the board is allocated to the department and staffed by the department, potentially limiting legislative advocacy and reducing agility in HFA programs. Advantages of the board's allocation to a state agency, on the other hand, may include administrative efficiencies, such as leveraging the state's enterprise resources like IT services and payroll.

We also learned other HFAs often manage multiple federal housing grant programs that in Montana are administered by the department. The executive director for the board also serves as the Housing Division administrator within the department, which may limit the autonomy of HFA operations compared to other states. Consolidation of federal housing programs under one entity could allow for a more streamlined funding application process and could maximize the effective use of funding. Further work in this area could provide better insight into the ideal organizational structure and administration of federal and state housing programs.

Chapter II – Targeting Greatest Need and Specific Housing Needs

Introduction

The LIHTC program is one of the primary tools used to address the need for affordable housing in the United States. States should use the LIHTC program to address their state's unique needs and target the most acute needs. States are federally required to give preference to projects that serve the lowest-income tenants and remain affordable for the longest period of time. Within this requirement, states are given considerable freedom in the type and location of housing they prioritize and how they award tax credits. We found that the board does not take a sufficiently data-informed approach to understand where affordable housing is most needed across Montana to inform policy in the LIHTC program. We also found that the board does not always give preference to projects serving the lowest-income Montanans and does not adequately consider specific housing needs, such as underserved populations.

States Use Statewide Data to Inform Policy in the LIHTC Program

In the LIHTC program, states are federally required to have a QAP that explains how the state will consider affordable rental housing project proposals and award tax credits. States usually update their QAPs every year or two. States are federally required to give preference in their QAPs to projects that serve the lowest-income tenants and remain affordable for the longest period of time. Within this requirement, states can decide what they want to focus on and what additional rules they want to set.

The National Council of State Housing Agencies (NCSHA) recommends that states encourage the type, location, and tenancy of affordable housing that is most needed in the state. Some states use statewide data to determine where and what types of affordable housing are most needed. The data used by HFAs in other states is wide-ranging and reflects important statewide indicators of need, such as population characteristics, housing trends, income, and housing affordability. Some states, such as Wyoming and North Dakota, conduct formal statewide housing needs assessments. These are either funded by the HFA or by the HFA and other stakeholders. These states estimated an external statewide housing needs assessment costs between $100,000 and $175,000. In other states, the board plays a significant role in setting the affordable housing priorities for the state, primarily through involvement in QAP revision. Other states understand the importance of considering statewide need when setting requirements and incentives in their QAPs. This approach ensures the types of projects most needed in areas where they are most critical are encouraged.

The Board Does Not Distinguish Where Affordable Housing Is Most Needed in Montana

The board lacks a full understanding of where affordable housing is most needed in Montana. Many members think any project meeting minimum requirements is worth supporting because there's such a great need for housing across the state. Some members focus mainly on spreading tax credits evenly across the state when voting for projects. Board members are also not heavily involved in updating the tax credit award rules in the QAP. While the board gives final approval of the QAP, changes to the QAP are largely made by staff with input from developers. The QAP provides an opportunity for the board to express its preferences more explicitly regarding the location and type of housing most needed in Montana. However, the board does not take advantage of this opportunity to more directly guide low-income housing.

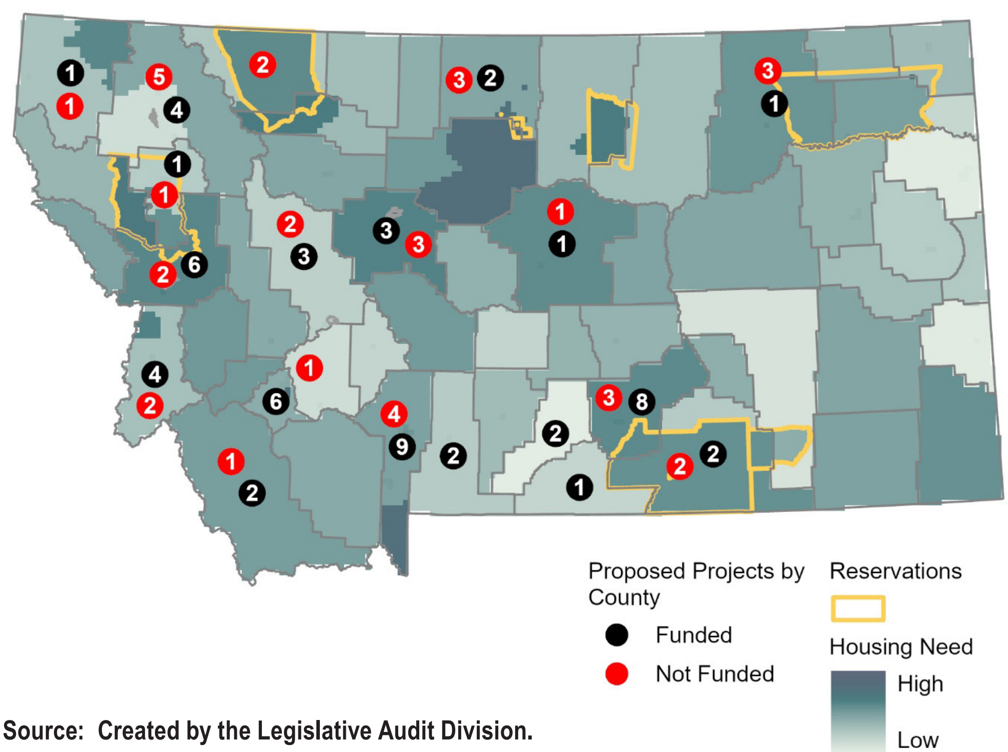
The board's understanding of where affordable housing is most needed is limited and based on minimal statewide data. The statewide data the board gets when making LIHTC awards includes population change and geographic distribution of LIHTC. This is not enough to understand where low-income housing is most needed. The board should consider more data, like income, poverty, and housing costs, to more fully understand the need for affordable housing. Even though LIHTC applicants provide market studies with their applications, they only reflect the local markets. The board mainly relies on data about the projects it is considering, but it does not consider enough information about the big picture of housing needs across Montana. A more data-informed understanding of statewide housing needs would help the board set criteria in the QAP encouraging projects that may not otherwise be considered by developers.

Projects in Areas of Greatest Need Were Not Always Proposed or Funded

To determine where affordable housing was most needed in Montana, we created a suitability model using spatial analysis and mapping software. We developed the model based on similar studies and with input from the board's executive director and the Department of Commerce Research and Information Services Bureau. It is important to note there are other methods and data sources that can be used to understand the greatest need for affordable housing in a state. Our suitability model is just one approach. The result of our model was a map of Montana highlighting the areas where affordable housing was most needed from 2018 to 2022. Our suitability model methodology and a more in-depth discussion of the results can be found in Appendix A. We compared the results of our suitability model to where the board funded LIHTC projects from 2018 to 2022 to determine if it funded projects where they were most needed (Figure 4).

Figure 4

Need for Affordable Housing and LIHTC Projects Proposed in Montana in CY2018-2022

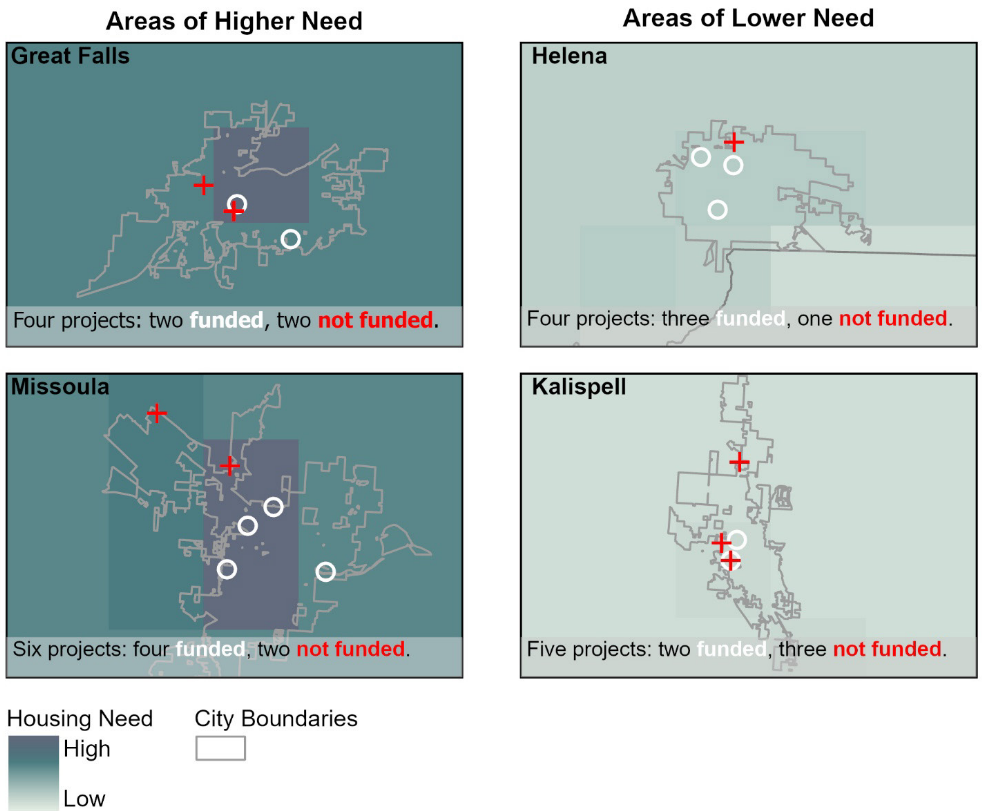


Source: Created by the Legislative Audit Division.

It is important to note that the statewide view of the model may not show the need within a specific city. For example, if one zooms into Billings, Bozeman, Butte, Great Falls, or Missoula, there is a concentration of high need in those cities (Figure 5). However, this is not the case for all major Montana cities. For example, Helena and Kalispell do not show the same level of need as some of the other major cities. This does not imply that Helena and Kalispell do not require affordable housing. Instead, our model indicates that the need in those cities is lower compared to other major cities in Montana.

Figure 5

Some Cities Have Higher Need for Affordable Housing Than Others

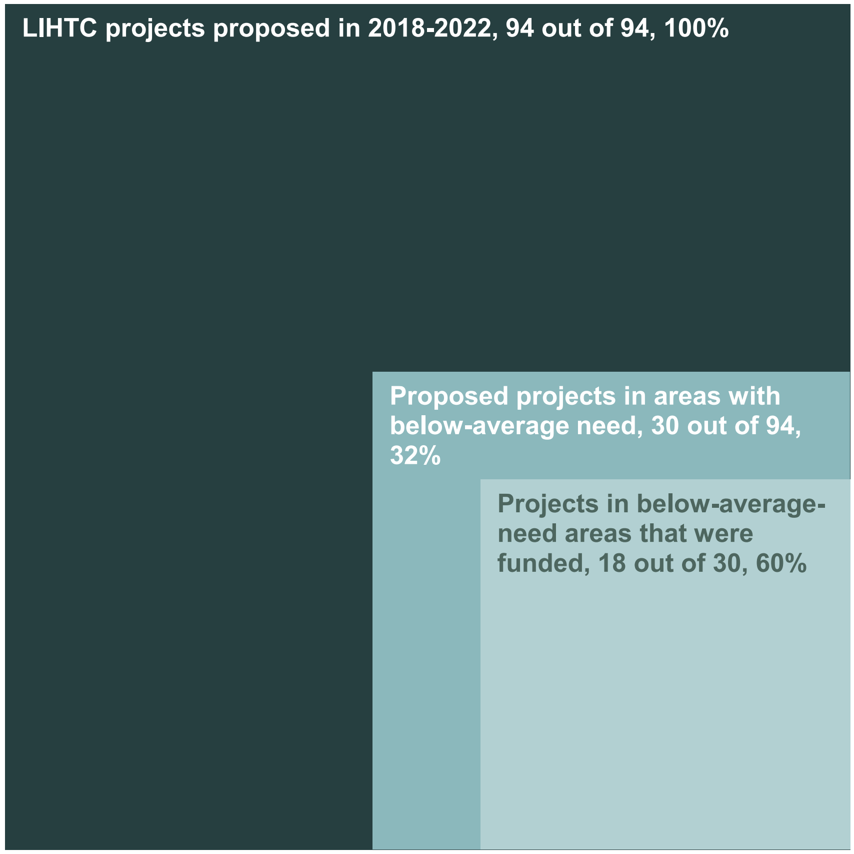


Source: Created by the Legislative Audit Division.

We found the board did not fund projects in high-need areas consistently. As shown in Figure 4, the board funded many projects in the more needy areas of Montana (e.g., the Butte, Bozeman, Great Falls, and Billings areas). However, several projects were proposed in more needy areas that the board did not fund. For example, the board did not fund one proposal in the West Yellowstone area and two in the Blackfoot reservation area. The board also funded projects in areas that were not as needy relative to other areas of Montana (e.g., Helena and Kalispell). Our model estimated a numerical score reflecting the relative need in each area of Montana. About two-thirds of proposed projects were in areas above the statewide average. However, the board funded more than half of the projects developers proposed in areas with below-average need (Figure 6–see page 10).

Figure 6

Percentage of Funded LIHTC Projects with Below-Average Need



Source: Created by the Legislative Audit Division.

In our model, urban areas tended to have higher estimated need than rural areas. However, the board funded an equal percentage of urban and rural LIHTC projects, focusing more on spreading tax credits across the state. It is important to note that while rural areas may not be as needy as urban areas, according to our model, the affordable housing needs of rural areas should still be addressed.

We also found the board did not receive proposals in some of the more needy areas of Montana. Some more needy areas, like Miles City and the Fort Belknap reservation, had no proposed projects. Staff explained that there are many challenges outside the board's control in where developers choose to site projects, such as a lack of available land and high construction costs. However, the board could set priorities in the QAP to better incentivize developers to propose projects in areas of greatest statewide need.

The Board Cannot Properly Incentivize Affordable Housing Where It Is Most Needed

Absent a clear, data-informed understanding of statewide need, the board makes LIHTC award decisions based on other factors. The board focuses on spreading tax credits across the state and relies on developers to propose projects. Many developers do not perceive statewide needs to be a primary factor in board decision-making. Instead, they believe the board focuses on the geographic distribution of tax credits and what individual board members want. Additionally, developers' use of statewide housing needs data to site projects is limited. Developers often heavily consider where the board has not recently awarded tax credits for siting projects.

Because the board lacks data-driven insight into where affordable housing is most needed statewide, it ends up funding projects in areas with less need and overlooking areas with greater need. With a better grasp of statewide needs, the board could shape LIHTC policy accordingly and prioritize projects more effectively. This could then incentivize developers toward the board's priorities to meet the greatest needs in Montana.

The Board Needs a More Data-Driven Approach to Understand Statewide Need

States should use data to understand the statewide need for affordable housing and to guide priorities and policy in the LIHTC program. The board does not use enough data to understand statewide need. Rather, the board considers limited statewide data when making LIHTC award decisions, heavily emphasizes geographic distribution of tax credits, and hopes developers propose projects where needed. As a result, the board cannot properly encourage affordable housing projects where they are most needed in Montana.

Recommendation #1

We recommend the Montana Board of Housing use a more data-informed method to identify where and what types of affordable housing are most needed across the state and to inform policy in the Low-Income Housing Tax Credit program.

States Give Preference to Lowest Income and Address Their State's Specific Housing Needs

States should focus on the unique housing needs in their state when deciding what projects to prioritize. Federal law says states must give preference to projects that serve the lowest-income tenants and remain affordable for the longest period of time. Within this requirement, states have broad flexibility to address specific housing needs. States are federally required to set aside at least 10 percent of their 9 percent credits for projects developed by nonprofits (referred to as the nonprofit set-aside). However, they can also create more set-asides and policies for certain groups or project types. The NCSHA recommends states consider QAP incentives or other initiatives to ensure they meet specific housing needs, such as those for rural areas,

Set-aside:
A set-aside dedicates a portion of tax credits for a specific purpose. A set-aside creates a separate pool of competition for a state's LIHTC.

Native Americans, and supportive housing. Many states make a concerted effort to serve specific populations such as these. States employ various methods, such as adjusting the scoring of projects, creating set-asides, and doing proactive outreach to specific populations for this purpose.

The Board Does Not Give Preference to Projects Serving Lowest Income

The board cannot show that it gives preference to projects serving the lowest-income Montanans as federal law requires. LIHTC awards are made at the discretion of the board in Montana. The board used point scoring to determine whether projects met the minimum requirements to be considered by the board. However, beyond assuring minimum qualifications were met, these points did not affect the likelihood of award. Montana's QAP assigned more points for projects serving lower income and required all LIHTC properties in Montana to be rent-restricted longer than what is federally required. However, these points were only used to determine whether projects met the required threshold to be considered by the board. They did not guarantee or result in a higher likelihood of award, as "giving preference" in the federal law would imply. It was also unclear from board meetings and interviews how much income targeting matters to board members when picking projects for awarding tax credits. We also observed board members interchanging the term workforce housing (intended for 80-120 percent AMI) with low-income housing (up to 80 percent AMI) in reference to the population intended to be served by LIHTC. This is misaligned from the population intended to be served by the LIHTC program.

The Board Directs Limited Consideration and Outreach to Address Specific Housing Needs

In Montana, developers have little incentive to propose LIHTC projects that address specific housing needs outside of projects for families and seniors. The board decided to have rural and tribal projects presented to it in a separate group from other projects. Staff believe this to be an effective practice in incentivizing and highlighting the need for rural and tribal housing. However, board members had mixed opinions about its effectiveness. We do not believe it is a compelling incentive for rural or tribal housing, as it does not result in a higher likelihood of award.

There is also no rural or tribal set-aside in Montana. The board used to have a rural set-aside, but the board removed it in 2020. One reason we heard for the board opting not to have a set-aside was that Montana is a small-population state that receives a relatively small amount of tax credits compared to other states. We noted that other states with a similar amount of tax credits to award sometimes have additional set-asides. Some examples are new construction in a rural area (Alaska), or for Native American housing (North Dakota and South Dakota). Board members had mixed levels of interest in and opinions on the need for policy incentives, such as a set-aside, to address specific housing needs. Board members told us they would like to get a higher volume of and more variety in LIHTC applications. However, the board does not conduct proactive outreach to a broad range of stakeholders to increase awareness of and interest in leveraging LIHTC.

Other States Use Formal Policy Incentives to Target Specific Populations

Other states use formal policy incentives to target specific populations with their tax credits. Most states have additional set-asides for specific populations (e.g., Native American or special needs) or project types (e.g., new construction, acquisition/rehabilitation, or rehabilitation). Montana does not have any set-asides apart from the required nonprofit set-aside. Only six states had no additional set-asides in 2021: Hawaii, Alabama, Arkansas, Connecticut, Maryland, and Montana. Examples of additional set-asides in the other states we interviewed included:

- Delayed projects (Vermont)
- Native American or tribal (Michigan, North Dakota, and South Dakota)
- Rural (Michigan)
- Elderly (Michigan)
- Distressed (Michigan)

Wyoming did not have a set-aside when we spoke with them, but Wyoming had a set-aside for acquisition/rehabilitation projects in 2021. States with a tribal set-aside noted that tribal projects, while greatly needed, often cannot score as high as other types of projects due to unchangeable characteristics, such as distance to a grocery store, public transportation, a hospital, or other amenities and services. They emphasized that a tribal set-aside helps create equity. In most other states, projects are awarded tax credits based primarily on a structured point-scoring system. Assigning a higher number of points to certain types of projects or for certain populations allows these states to incentivize housing for specific housing needs. Regularly adjusting the scoring allows them to change what the board wants to focus on in their state over time.

Other States Conduct More Proactive Outreach to Specific Populations

Policy incentives in the QAP are one way to address specific housing needs. In addition to policy incentives, some states conduct more outreach to increase the pool of applicants and the opportunity to serve specific populations. Some states are more proactive in building relationships with specific populations, such as Native Americans. The Michigan HFA, for example, included tribal members in its recent QAP revision process through focus groups and tribal liaisons. States that do proactive outreach to specific populations can increase awareness of and opportunity to leverage LIHTC to serve vulnerable or underserved populations.

Developers Are Not Adequately Incentivized to Target Lowest Income or Specific Populations Outside of Families and Seniors

Because of the lack of policy incentives that lead to a higher likelihood of award, developers are not adequately incentivized to put forward projects in Montana serving the lowest income or specific populations. This means the populations intended to be served by LIHTC may not be served most effectively. Data from the NCSHA on state HFAs between 2018 and 2021 showed that Montana served the lowest incomes less than other states and that other states target specific populations to a greater extent.

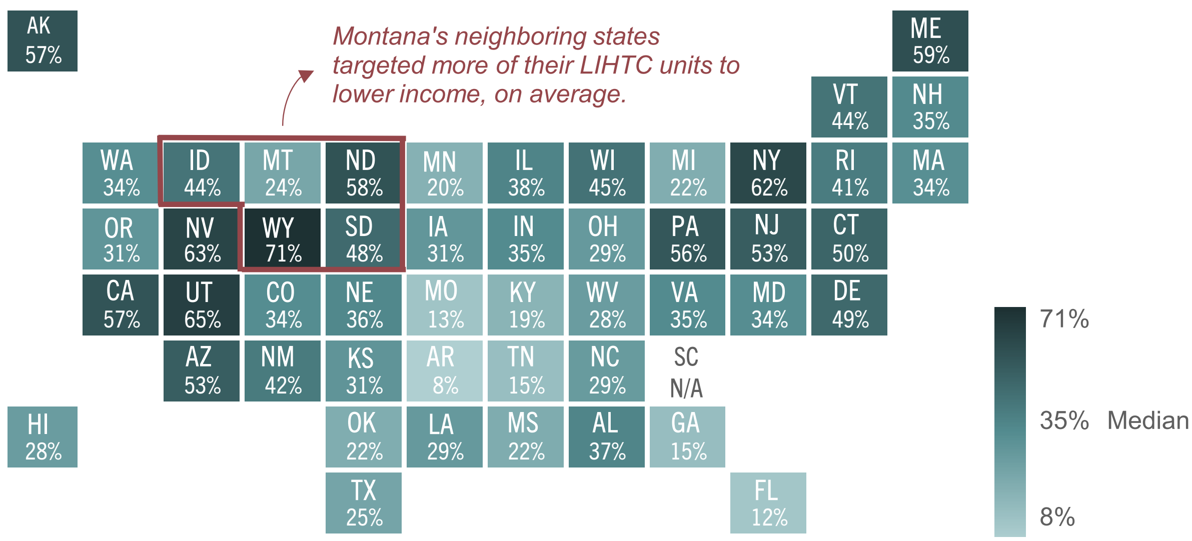
Montana Served Lowest Income Less Than Other States

Montana differs significantly from other states in income targeting. The average percentage of LIHTC units dedicated to the lowest end of the income spectrum between 2018 and 2021 was lower in Montana compared to other states. The 2022 data were not available in a way that allowed for comparison with the four previous years.

Figure 7

Average Percentage of LIHTC Units Targeting Lowest Income 2018-2021

The 2018-2021 average percentage of Montana's LIHTC units serving *very low-income* or *extremely low-income* households was lower than most other states.



Source: Compiled by the Legislative Audit Division from the 2021 NCSHA State HFA Factbook.

Figure 7 shows that most states had deeper income targeting. Between 2018 and 2021, an average of 24 percent of the units allocated credits in Montana were targeted to very low-income (below 50 percent AMI) or extremely low-income households (below 30 percent AMI). In most states, the average percentage of LIHTC units serving the lowest end of the income spectrum was much higher. Montana's neighboring states (Idaho, North Dakota, South Dakota, and Wyoming) all had higher average percentages of LIHTC units targeted to lower income. Montana ranked in the bottom third of states on the average percentage of LIHTC units between 2018 and 2021 targeted to households making below 50 percent AMI. It is important to note there may be factors in addition to policy incentives that could impact a state's ability to target lower income. For example, some states have more funding available to help finance projects, such as a state tax credit.

Other States Dedicate LIHTC Units to a Variety of Specific Populations

Montana also differs significantly from other states in using LIHTC to develop rental units for specific populations. In 2021, Montana did not dedicate LIHTC units to populations other than the elderly or families. Other states dedicate some units for a wide variety of other specific populations, such as people experiencing homelessness, persons with disabilities, persons with AIDS, migrant workers, rural citizens, veterans, and Native Americans. Only five states (Georgia, Hawaii, Rhode Island, Wyoming, and Montana) did not dedicate LIHTC units to populations outside of the elderly and families in 2021. Developers perceive the demand for housing as highest in Montana for families and seniors. They perceive less demand for other populations, such as Native Americans, persons with disabilities, homeless, and veterans, relative to families and seniors. However, many developers expressed interest in developing housing for populations outside of families and seniors.

Additional Training, Outreach, and Policy Incentives Are Needed to Best Serve Lowest Income and Montana's Specific Housing Needs

States must prioritize projects serving the lowest income and ensure they sufficiently address state-specific housing needs. In Montana, there is no formal preference in the QAP for projects targeting the lowest income, and there are effectively no policy incentives to address specific housing needs. Because of this, LIHTC applicants are not adequately incentivized to target the lowest income or specific populations, and the board serves the lowest income and specific populations to a lesser extent than other states. Rather, the board emphasizes the geographic distribution of tax credits, regardless of where in Montana or which populations have the most acute need. The main reasons for this are a lack of understanding of the LIHTC program and Montana's affordable housing needs along with a lack of formal policy incentives and outreach efforts. Sufficient training, outreach, and formal policy incentives, are necessary to better serve the lowest income and address specific housing needs in Montana.

Recommendation #2

We recommend the Montana Board of Housing prioritize projects serving the lowest income citizens and increase its consideration of the needs of specific populations that may be underserved or vulnerable through increased training to staff and board members, better outreach, and implementing policy incentives that increase the likelihood of award.

Chapter III – Board Discretion in Awarding Tax Credits

Introduction

Within certain federal requirements, states have considerable flexibility in what they prioritize and how they award tax credits. In Montana, LIHTC projects must meet minimum criteria to be considered by the board. However, final award decisions are made based only on board discretion, contrary to standard practice across the country. The board needs a more structured evaluation of projects as a primary basis for tax credit awards to increase transparency, meet program requirements, and set affordable housing priorities for Montana.

Standard Practice Is a Structured Evaluation of Projects Against Set Criteria

Federal law requires states to give certain preferences, such as to lowest income, and consider certain selection criteria. However, it does not mandate how states must weigh or consider them. States can decide this, but their QAPs should clearly describe how selection criteria and preferences are considered when awarding credits. In Montana, tax credit awards are not based on a structured evaluation of projects but solely on board discretion. However, the standard practice is to evaluate projects against set criteria in the QAP, often using point scoring. Other states highlighted that a structured evaluation approach:

- Helps ensure they meet program requirements,
- Allows staff to guide developers in improving future proposals, and
- Encourages proposal alignment with the state's affordable housing goals.

For example, the QAP might assign more points for projects targeted to lower income and more points for projects of a certain type (duplexes, townhouses, etc.). In other states, the board plays a significant role in setting the state's housing priorities, which are then incorporated into the scoring in the QAP. After projects are evaluated and ranked, some states permit discretion by staff and/or the board in final award decisions to prevent issues such as too many projects in one city receiving credits in the same LIHTC award cycle. In contrast, in Montana the board does not set housing need priorities that are incorporated into how projects are chosen, but rather relies on an ad hoc approach based on board discretion at the time of the award.

LIHTC Award Decisions Lack Transparency

The lack of structure in the board's tax credit award decisions reduces transparency and increases the risk of favoritism by board members. During meetings, some board members asked relatively few questions about projects and provided little or no reasoning for voting for the projects they did. It was unclear whether and how targeted income and other criteria affected the likelihood of a tax credit award. Many board members prioritized the geographic distribution of tax credits over other factors like project type or whom a project serves. Some board members specifically favored projects proposed in their own communities.

While some developers spoke positively about the board, others expressed concerns about transparency and board engagement in our survey and interviews. For example, developers described the board's decisions as based "entirely on their own personal criteria" and that they were "subjective." Some developers did not see a clear application of criteria in the QAP in award decisions. Instead, many developers perceived a desire by the board to spread tax credits throughout the state and board members' personal preferences to be most meaningful to the board's decision-making process. Additionally, when award decisions are made solely at board discretion, it is difficult for staff to advise unsuccessful applicants on how to improve in the future.

The Benefits in Structured Evaluation of Projects Outweigh the Risks

Board members and staff perceive significant risks in using scoring in the award process, including: difficulty in developing objective and comprehensive criteria for awarding points; unintended consequences like developers prioritizing scoring points over project quality; and risk of lawsuits. Previous litigation over how projects were scored by staff to meet minimum requirements has made some board members and staff reluctant to use point scoring in tax credit awards. However, the other states we talked to that use point scoring (with or without allowing discretion by staff and/or the board) told us they had not faced legal challenges. Other states indicated they mitigated some of these risks by regularly adapting the scoring to the state's current needs and, while difficult, structuring the scoring to be as objective as possible. Despite the challenges, other states decided the benefits of using a structured evaluation outweigh the risks. Other states see structured evaluation of projects as beneficial for transparency, encouraging developers to target the greatest need as identified by the board and helping developers know how to improve their proposals.

Recommendation #3

We recommend the Montana Board of Housing implement a structured system for evaluating projects against set, board-approved criteria as a primary basis for awarding tax credits.

Chapter IV – Effective Board Governance

Introduction

Given the importance of the LIHTC program, the board's governance must align with best practices. We found the board aligns with best practices and industry standards in some governance areas, such as board member qualification requirements, board size, and term length. However, the board does not follow best practices in important areas for effectively administering the board's affordable rental housing programs, such as the LIHTC program. We found the board does not have a formal policy or process in place for identifying and disclosing members' potential conflicts of interest. Its ex parte communication policy is also unclear. The board needs more and regular training to ensure it is knowledgeable on its policies and programs to administer its affordable housing programs most effectively.

Best Practices Require Proactive Identification of and Board Policy for Conflicts of Interest

State law requires public officials, including members of quasi-judicial boards like the MBOH, to adhere to standards of conduct and a code of ethics. This requires board members to disclose potential conflicts of interest. Simply put, a conflict of interest exists when a board member has a personal or private interest that might interfere or appear to interfere with their duty to make the best decisions for a program it oversees. While the law outlines what constitutes conflicts of interest and mandates disclosure, it does not specify how this should be done. Where state law does not cover the disclosure process, board governance best practices indicate that having a formal conflict of interest policy or procedure is the minimum standard. Additionally, the federal Sarbanes-Oxley Act, which applies to public and privately held companies, establishes standards for conflict of interest policies that the board can consider. It is also best practice for boards to proactively identify potential conflicts. Some states, like Michigan and South Dakota, require candidates to disclose potential conflicts annually or before their appointment. This proactive approach helps maintain transparency and integrity in the board's operations.

Board Members Have Limited Understanding of Key Governance Aspects

Board members have varying degrees of understanding about what constitutes a conflict of interest and how to alert the board. Department employees, including board staff, are required upon hire and annually to complete a form to identify potential conflicts of interest. However, this was not a requirement for board members until recently as a result of our office's most recent financial audit. The board implemented an annual disclosure form for board members and was provided training on conflicts of interest. There was no formal policy or procedure capturing the conflict of interest disclosure process for most of our audit. However, the board was making efforts to address this area toward the end of our audit.

Additionally, board members had limited understanding about ex parte communication and how to avoid it. Ex parte communication refers to communication between parties appearing before the board and a member of the MBOH regarding the merits of a project outside of a public board meeting or other meeting where a quorum is present. As with all quasi-judicial boards, a quorum is required for the board to do business, and the board is subject to Montana's open meeting requirements. While the board has an ex parte communication policy, the policy's references to open meeting laws cause conflation between two separate issues: 1) board members discussing business outside a public meeting with a quorum present, and 2) communication between board members and parties appearing before the board outside the public meeting (i.e., ex parte communication). Neither is permitted, but they are different from each other. The first scenario does not constitute ex parte communication. The second scenario, however, does.

Insufficient Understanding and Implementation of Governance Best Practices Could Result in Actual or Perceived Favoritism

The affordable housing industry in Montana is fairly small, and most actors in it know each other well. The LIHTC applicant pool has been relatively small and consistent in recent years, and multiple current board members have professional or personal ties to present and past LIHTC applicants. Board members with connections to LIHTC applicants have recused themselves from voting on those projects in the past. However, they did not recuse themselves from discussions about the projects. Some developers consider this inappropriate and a conflict of interest. They believe these board members' influence on the discussion remains strong, even if they don't vote.

Developers also called attention to the number of recent LIHTC awards in Billings and Great Falls, where two board members each reside. Board members should be aware of perceived favoritism in voting on projects in their home communities, especially when award decisions are based solely on the discretion of the board. Since some board members do not fully understand conflicts of interest, including the impact of a mere appearance of one, potential conflicts of interest may go undisclosed and unaddressed. This could lead to actual or perceived favoritism when the board makes funding decisions. In small-population states like Montana, connections between applicants and board members may be unavoidable. Because of this, it is even more important for board members to adequately understand and address conflicts of interest and ex parte communication.

Recommendation #4

We recommend the Montana Board of Housing:

A. *Develop a Conflict of Interest policy outlining the process for identifying and addressing board members' potential conflicts of interest, and*

B. *Clarify its ex parte communication policy.*

Other State HFA Boards and Other Montana Boards Get More and Regular Training

Clear policies and sufficient training are key to good board governance. In the five other states we interviewed, the HFA board receives more training more frequently than in Montana. There are also other boards in Montana that receive more and regular training than the MBOH. For example, the Board of Investments (BOI), also administratively attached to the Department of Commerce, has a formal training policy and a more structured training approach. The BOI's training policy requires training to be provided, encourages board members to attend, and sets a regular training schedule. Additionally, some other boards in Montana are statutorily required to get training. The 2023 Legislature statutorily imposed annual training requirements and conflict of interest standards on licensing boards, most of which are attached to the Department of Labor and Industry.

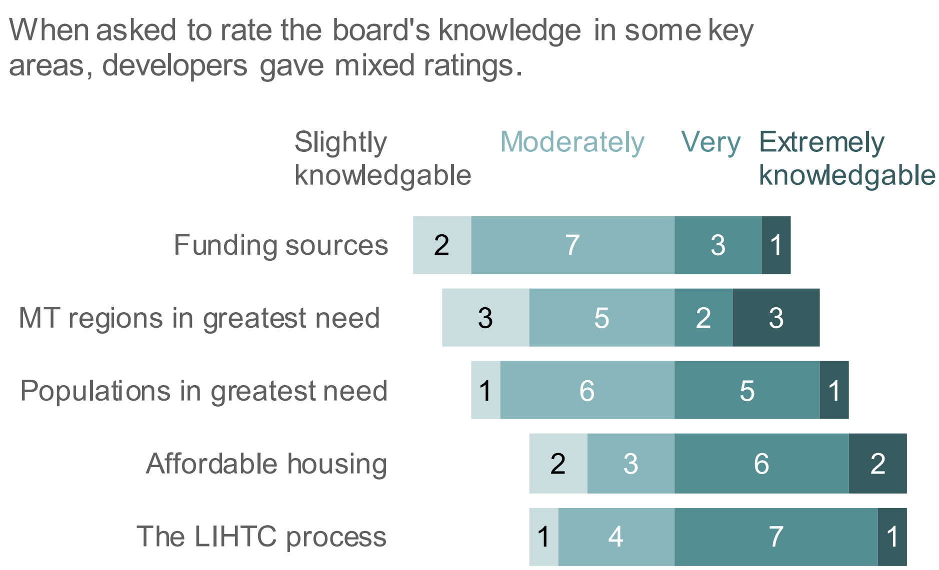
Some Board Members Lack Governance Knowledge, Program Knowledge, and Engagement

Some board members have limited knowledge about MBOH policies and programs and show little engagement during board meetings. We observed that only a couple of board members ask questions or generate discussion during meetings. Half of the board members told us they feel uncomfortable asking questions during meetings. Despite this, all board members mentioned they would like more training. Additionally, board member turnover is a recent challenge to the board's institutional knowledge. Four new board members were appointed in early 2021, and another three new board members were appointed in the summer of 2023.

Some developers believe the board lacks knowledge in important areas. They consider board members ill-informed about key topics, such as MBOH funding sources for affordable housing development and Montana's regions and populations in greatest need of affordable housing (Figure 8).

Figure 8

Developers Think the Board Is Not as Knowledgeable in Key Subject Areas



Source: Compiled by the Legislative Audit Division from survey results.

The lack of knowledge in some of these important areas was a concern stakeholders also shared in open-ended responses in our survey and in interviews. Developers emphasized the need for more training of board members.

The MBOH Does Not Have a Board Training Requirement or a Regular Training Schedule

Training for MBOH members is not a requirement in statute or formalized in policy but is encouraged by staff. New board members have initial onboarding sessions with the board's executive director and staff. After that, board members depend on training opportunities to gain and deepen their knowledge of affordable housing programs. MBOH members do receive some training after onboarding. However, it is not mandatory, takes place irregularly, and is sometimes poorly attended. It is not uncommon for training requirements to be a challenge to implement and adhere to for volunteer, citizen boards. As a result, some board members have limited knowledge of board governance and the board's affordable housing programs. This audit underscores the need for the MBOH to establish a formal training process for its board members, either through policy or legislation. Without consistent, structured training for board members to understand how to make complex funding decisions for affordable housing projects, the MBOH cannot effectively manage its programs.

Recommendation #5

We recommend the Montana Board of Housing

A. *Adopt a policy implementing a training requirement and schedule, or*

B. *Seek legislation to implement a training requirement for MBOH board members.*

Appendix A – Affordable Housing Suitability Model

One of the methodologies performed for this performance audit was a spatial analysis using suitability modeling. The goal of the analysis was to identify the areas in Montana with the greatest need for affordable rental housing, such as LIHTC properties, in calendar years 2018-2022. It is important to note that suitability modeling (and the specific model we developed) is just one of many approaches that can be used to understand the greatest need for affordable housing in a state. Our model allowed us to include various indicators of need (i.e., suitability) that could be weighted differently. We used ArcGIS Pro, a mapping and spatial analysis software, to conduct our analysis. This appendix explains our methodology and discusses the results in further detail.

Model Development

Variables Included in the Suitability Model

To inform model development, we reviewed many studies, reports, and sources on identifying affordable housing needs in states and in local areas. We also obtained input on our model from the board's executive director and from the Research and Information Services staff at the Department of Commerce. Appendix Table 1 shows the final variables in our suitability model and the source of data for each. We transformed all model variables into a common suitability scale.

Appendix Table 1

Variables in Our Affordable Housing Suitability Model and Sources of Data

Variable	Description	Source
Severe housing cost burden	Percentage by county of renter-occupied housing units in Montana that paid 50% of more of household income on gross rent.	US Census ACS 5-year: 2017-2021
Income	The average median household income by county between 2017 and 2021.	US Census SAIPE: 2017-2021
QCT Designation	Whether the census tract was designated a Qualified Census Tract (QCT) by HUD between 2018 and 2022.	US HUD
Poverty	The average percentage of households in poverty by county between 2017 and 2021.	US Census SAIPE: 2017-2021
Rental vacancy rate	The proportion of rental inventory that is vacant for rent by county.	US Census ACS 5-year: 2017-2021
Population change	Percentage change in population by county between 2010 and 2022.	US Census PEP
Existing LIHTC properties	The number of active LIHTC properties in the county prior to 2018.	National Housing Preservation Database
DDA Designation	Whether the county was designated a Difficult Development Area (DDA) by HUD between 2018 and 2022.	US HUD
Walkability	The walkability index by census block group estimated by the U.S. Environmental Protection Agency. This was used as an indicator of proximity to amenities.	National Walkability Index: EPA
Age of housing stock	Percentage of housing units built before 1970 by county.	US Census ACS 5-year: 2017-2021

Source: Compiled by the Legislative Audit Division.

Weighting Model Variables

Next, we weighted the variables in the model. We weighted the variables in our model differently, as some variables are more important indicators of the need for affordable housing than others. For example, while the age of housing stock is a factor that could indicate the need for affordable housing, it is not as important (especially in the LIHTC program) as housing cost burden, income, and poverty. Appendix Table 2 shows how we weighted each variable in the model.

Appendix Table 2
Variable Weighting in the Suitability Model

Variable	Weight
Severe housing cost burden	20%
Income	15%
QCT Designation	15%
Poverty	10%
Rental vacancy rate	10%
Population change	10%
Existing LIHTC properties	5%
DDA Designation	5%
Walkability	5%
Age of housing stock	5%
Total	**100%**

Source: Compiled by the Legislative Audit Division.

Model Sensitivity

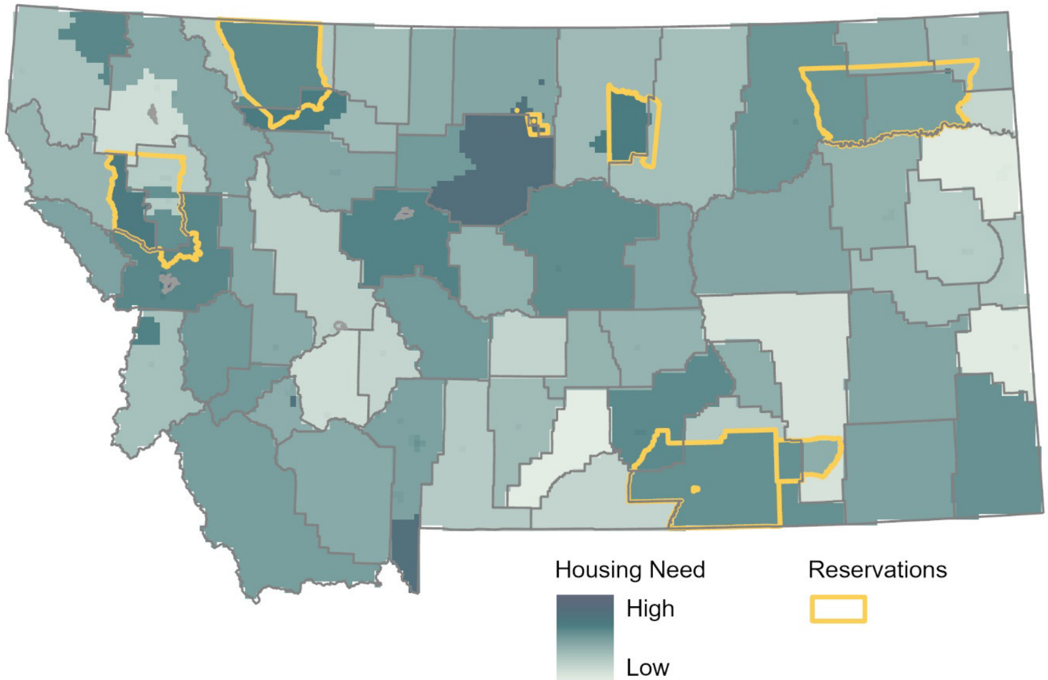
We were unable to do a robust sensitivity analysis due to technical issues with the mapping software. However, we conducted a limited sensitivity analysis by assessing how the results differed when we changed various parameters of the model. We found the results differed very little when changing the way individual variables were transformed into the common suitability scale. However, the model was somewhat sensitive to variable weighting. The concentration of suitability on major cities and/or reservations was somewhat sensitive to variable weighting. For example, increasing the weighting on some variables (e.g., housing cost burden) focused more suitability in major cities, while increasing weighting on other variables (e.g., number of existing LIHTC properties) focused suitability more in rural areas and reservations. While our model was somewhat sensitive to variable weighting, we ultimately chose weighting based on similar studies and the relative importance of each variable in the LIHTC program. We also considered the input of staff.

<u>Results</u>

Suitability Map of Montana

The result of the model was a suitability surface for Montana: a map of Montana showing where affordable housing would have been more or less suitable based on our model. Appendix Figure 1 (see page 25) shows the suitability for affordable housing in Montana between 2018 and 2022, according to our model. The darker areas represent more suitability than lighter areas.

Appendix Figure 1
Suitability for Affordable Housing in Montana 2018-2022



Source: Created by the Legislative Audit Division.

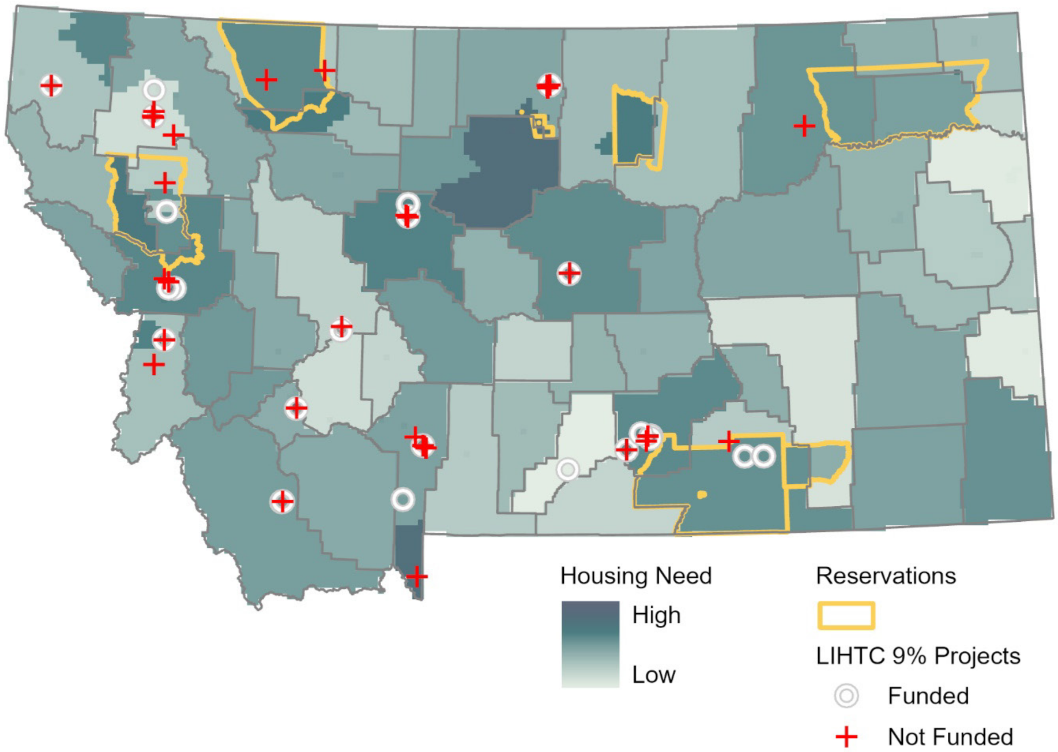
LIHTC Funding by the Board

We used the suitability model to assess the extent to which the board prioritized areas of greatest need. Our suitability model assigned a "suitability score" to each unit of area in Montana. This allowed us to analyze suitability scores and compare the scores of the locations of funded and unfunded projects. First, we looked at all LIHTC projects, both 4 percent and 9 percent (Appendix Figure 2–see page 26). It is important to note that all 4 percent projects that applied were funded, while only some 9 percent projects that applied were funded.

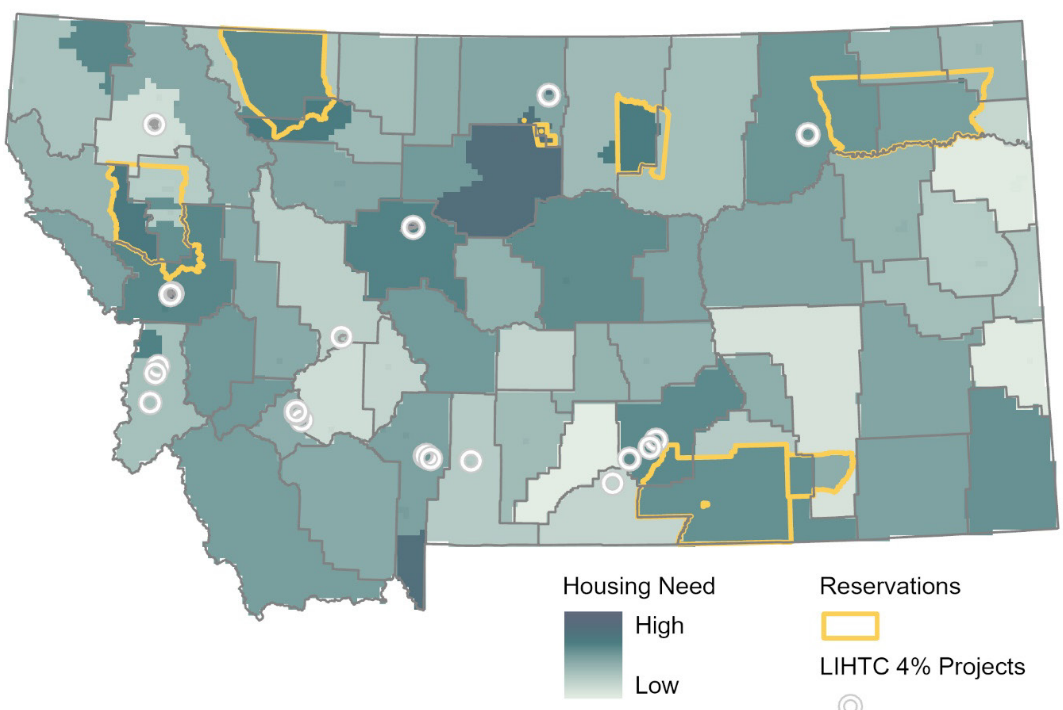
Appendix Figure 2

9 Percent and 4 Percent LIHTC Projects Proposed in Calendar Years 2018-2022

9% LIHTC Projects Proposed in CY2018-2022



4% LIHTC Projects Proposed in CY2018-2022



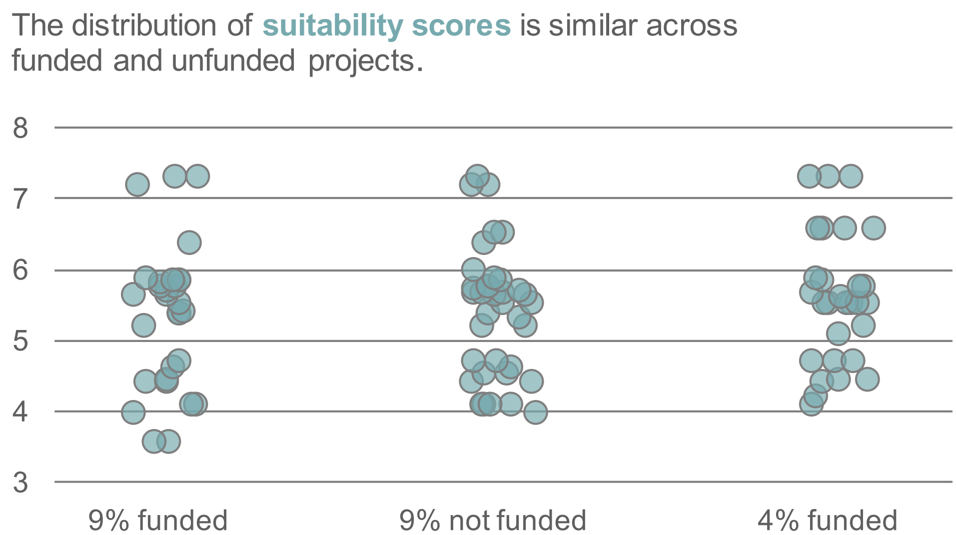
Source: Created by the Legislative Audit Division.

Many funded projects were located in some of Montana's more suitable areas. However, there were projects proposed in some of the most suitable areas that were not funded. There were also more suitable areas in Montana in which developers did not submit project proposals. Additionally, the board funded some projects in the less suitable areas (relative to other areas in Montana).

Our analysis found developers did not always propose projects in more suitable areas of Montana. The average suitability score across Montana was about 5. Of the 65 competitive 9 percent LIHTC applications the board considered, 43 (66 percent) had suitability scores above 5. However, we found the distribution of suitability scores was similar across the funded and unfunded projects (Appendix Figure 3), indicating a lack of prioritization toward areas of greatest need.

Appendix Figure 3

Distribution of Suitability Scores Across LIHTC Projects 2018-2022



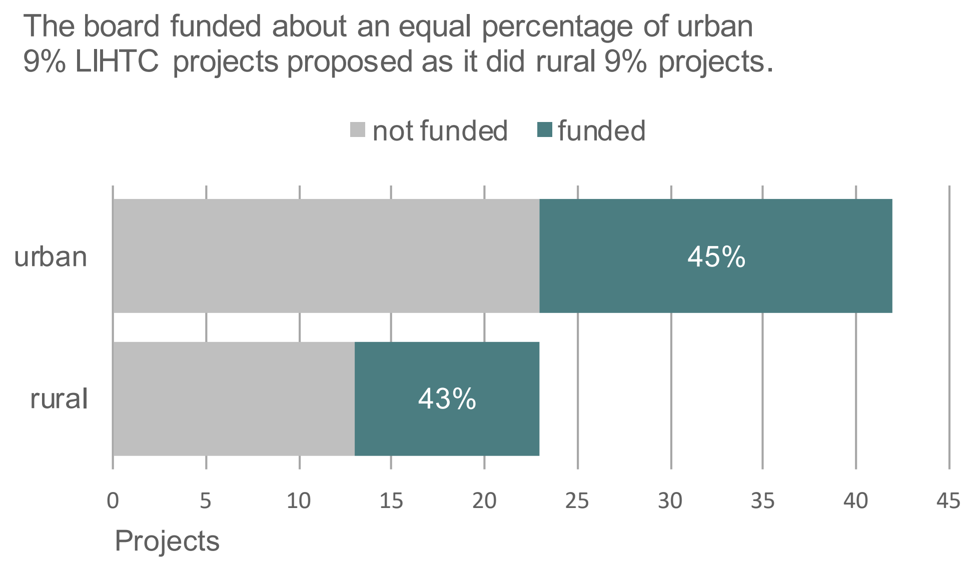
Source: Created by the Legislative Audit Division.

If the board had prioritized the most suitable areas, the funded ones would have concentrated on higher scores, and the unfunded ones would have concentrated on lower scores, which was not the case. We observed this in a year-by-year breakdown as well. Further, about the same proportion of projects in areas of higher-than-average suitability (45 percent) were funded as projects with lower-than-average suitability. This suggested the board did not prioritize projects in areas of greatest need consistently.

We also considered rural versus urban areas, their suitability scores, and how the board funded projects. Of the 94 total applications (4 percent and 9 percent LIHTC), 66 (about 70 percent) were proposed in urban locations, which we defined as locations with populations of 5,000 or higher from the U.S. Census ACS 2022. Most of the 4 percent projects were in urban areas (24 of the 29). Of the 9 percent projects, 42 (65 percent) of the 65 projects proposed were in urban areas. Urban areas tended to have higher suitability scores than rural areas in our model. However, the board funded about an equal percentage of the rural and urban 9 percent LIHTC projects it considered (Appendix Figure 4–see page 28).

Appendix Figure 4

Funding of Urban and Rural Projects by the Board in 2018-2022



Source: Created by the Legislative Audit Division.

This was in line with what we learned in other audit work: the board primarily emphasizes geographic distribution of tax credits.

Board of Housing

Board Response

GREG GIANFORTE
GOVERNOR

MONTANA HOUSING

PAUL GREEN
DIRECTOR

June 4, 2024

Angus Maciver
Legislative Audit Division
Room 160, State Capitol
PO Box 201705
Helena MT 59620-1705

Dear Mr. Maciver:

In response to your letter dated May 17, 2024, the Montana Board of Housing ("MBOH" or the "Board") has prepared the following response to the Legislative Audit Division's performance audit titled *Supporting Low-Income Housing: The Montana Board of Housing and Its Role in Awarding Housing Tax Credits (23P-04).*

First, Board members and staff would like to thank your audit team for the considerable time and effort involved in assessing the Board's governance structure and its approach to the allocation of federal Housing Credits. This work included but was not limited to: joining Montana Board of Housing public meetings and trainings sessions for over a year, conducting dozens of interviews, deploying a developer survey, and developing a suitability model and corresponding spatial analysis. This work required audit staff to take a "crash course" on the Low-Income Housing Tax Credit ("LIHTC" or "Housing Credits") program, which certainly has its complications and can present challenges even to those working in the field for years or decades.

For background, the LIHTC program was created under the federal Tax Reform Act of 1986 and has been successfully administered in the state of Montana by the Board since 1987. To date, over 11,600 attainable and affordable rental homes have been newly constructed or substantially rehabilitated. These properties have long-term periods of affordability – currently 50 years – and are subject to ongoing compliance monitoring by Board staff.

Years	Competitive Credits (9%)	Noncompetitive Credits (4%)
2021 - 2023	489	1,991
2011 – 2020	2,056	1,267
2001 – 2010	2,003	440
1991 – 2000	2,682	180
1987 – 1990	493	0
Total	**7,723**	**3,878**

GREG GIANFORTE
GOVERNOR

MONTANA HOUSING

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The Board's Multifamily Development team, comprised of just 8 fulltime equivalents, administers the entirety of the Housing Credit program – including application intake, underwriting, contract execution, compliance, federal reporting and asset management - along with all other MBOH multifamily loan programs and tax-exempt bond allocations.

Under federal statute, each state is required to develop a Qualified Allocation Plan ("QAP") which serves as the overarching policy framework for the state's allocation of Housing Credits. As noted in the 2023 National Council of State Housing Agencies (NCSHA) *Recommended Practices in Housing Credit Administration* preamble, "Congress made the states responsible for allocating Housing Credits, underwriting applications for them, and monitoring developments for compliance with program requirements. States take these responsibilities very seriously…As Congress expected, during their more than 30 years of Housing Credit administration, the states have evolved a variety of allocation, underwriting and compliance practices appropriate to meet specific state low-income housing needs and circumstances."

The MBOH has typically updated its QAP on an annual basis. Policy adjustments are informed through an iterative process, including a series of QAP workshops held with applicable stakeholders, engagement with Board members on proposed QAP policies, collaborating with QAP subject matter experts, learning best practices from other state Housing Finance Agencies, and grounded with sound and defensible legal footing. Over the course of 30 years, the Board has implemented a wide variety of policy approaches to its Housing Credit allocation process, and in fact has previously implemented variations of the recommendations included in this performance audit during its long history.

The Board has not included specific corrective action implementation timelines in some of its responses. This is due to the involved nature of the QAP revision process and the complexity of potential unintended consequences or trade-offs that must be thoroughly assessed with appropriate public engagement prior to any final decision making. The Board is currently holding a series of monthly QAP workshops from June through September, to gather input on potential policy adjustments for the 2026 Qualified Allocation Plan. If the Board follows a timeline similar to prior years, the 2026 QAP draft would be released for public comment with a public hearing held in October 2024. The draft would then be presented to the Board at its November 2024 meeting for approval. Finally, the Governor must also approve the plan. The 2025 QAP was approved by Governor Gianforte on December 4, 2023. The QAP must also be adopted as an administrative rule. The resulting 2026 QAP would be in effect for the Board's allocation of Housing Credits in calendar year 2025. Recommendations #1, #2 and #3 include specific policy elements and approaches that would need to be incorporated and adopted in the 2026 QAP before any formal implementation of recommendations can occur. The earliest timeline for implementation of corrective actions under these first three recommendations would be January 2025.

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Recommendation #1:
We recommend the Montana Board of Housing use a more data-informed method to identify where and what types of affordable housing are most needed across the state and to inform policy in the LIHTC program.

Board Response:
The Board *partially concurs* to a limited extent with the recommendation but does not concur with much of the audit report's characterization of Board knowledge and use of data, or the merits or advantages of a statewide need determination.

We disagree with the assertion that the Board's knowledge of the need for affordable housing is lacking or that its approach to identifying the most urgent needs for affordable housing in Montana is not adequately data informed. The Board compiles and uses a robust set of timely and comprehensive data to inform its credit allocation decisions and inform the Board's LIHTC policies, including location and type of projects most needed across the state.

Opinions may differ as to the best or most desirable approach to determining need or the more overt targeting of specific project types or locations. The Auditors plainly prefer a top-down approach in which the Board conducts a statewide study and prioritizes areas based upon the Board's determination of degree of need. The Board has discussed and considered this approach previously, and while it may have some advantages, it also has disadvantages. Such a study would be costly and, by the time any study is completed, it is already outdated. This is particularly the case given that readily available data, such as U.S. Census and American Community Surveys, typically lag by 2-3 years, and use of such data would inform the location of housing built another 2 years into the future. Therefore, the study would likely have to continue in perpetuity in order to remain as current and accurate as possible. Furthermore, such a study would not necessarily reflect the availability of resources, the commitment of local entities or the feasibility of developing actual projects in such areas.

The Board instead reasonably relies upon local governments, housing advocacy organizations and sponsors, supportive services agencies, developers and other stakeholders to identify areas of greatest need in conjunction with actual feasible proposals for projects. This approach assures the availability of land, alignment of financial sources and feasibility, and the necessary support and commitment of local government and housing organizations. Project income and rent levels are then established at the lowest possible levels via pragmatic consideration of available funding.

By determining areas of "greatest need" and dictating project type or location based upon a Board study or determination, the Board would risk incentivizing less feasible, lower quality, more expensive and lower unit-capacity projects. This would undermine obtaining the maximum leverage from the Housing Credit. While needy households would be served, there is no basis from which to conclude that more needy individuals or families would be served or even served as well as under the Board's current approach.

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Indeed, the data shows that there is far more urgent need than available resources are able to address. The Board's Housing Credit awards all address urgent need – the resources are simply inadequate to meet the need. As discussed further below, drawing large distinctions between individuals and families who are all at or below 80% of Area Median Income (AMI) is unwarranted. Given Montana's decades-in-the-making shortage of housing stock, increased in-migration during the COVID-19 pandemic and resulting rapid increases in market rents and home purchase prices, all Montanans with incomes at or below 80% AMI need access to attainable, affordable housing. The areas of greatest need are broadly spread across the state.

As noted in Appendix A of the audit report, the spatial analysis developed by the Auditors "is just one of many approaches that can be used to understand the greatest need for affordable housing in our state." While the Auditors did solicit input from the Board's executive director and the Commerce Research and Information Services Bureau, the final variables and weights assigned to each variable reflect little more than Auditor preference. For example, the assertion that Helena and Kalispell do not show the same level of need as other major Montana cities demonstrates potential flaws with the analysis conducted, but more broadly reflects challenges inherent in leveraging any prescribed data model. It is worth noting that Lewis and Clark county was featured in an April 2022 Washington Post article as having experienced the 5th highest rent increase – 37% - of any county in the county with 1,000 or more multi-family rentals between 2020 – 2022. Additionally, there have been multiple media reports highlighting the city of Kalispell and its struggles to address a growing homeless population.

The *Suitability for Affordable Housing in Montana 2018-2022* map suggests that Carter and Chouteau counties are areas of greatest need. However, the population of Carter county is declining, and Chouteau county is not growing in population. Ekalaka, Carter county seat, has a population of only 419 people. Fort Benton, county seat of Chouteau county, has a population of 1,443. There are more unhoused persons in Bozeman than the entirety of Ekalaka's population. The Housing Choice Voucher Section 8 waiting list in Helena is similar to the entire population of Chouteau county.

There are a wide range of variables that could have been considered, such as Point-In-Time Count data from the federal Homeless Management Information Services (HMIS) system. Additionally, the Rental Vacancy Rate - weighted by the Auditors at 10% - used 5-Year American Community Survey data which includes recreational and seasonally vacant rental homes. The resulting ACS vacancy rate was thus likely higher than the actual vacancy rate.

Moreover, the Auditors failed to inquire about or report as to the reasons that certain Housing Credit applications were not selected or whether the projects that were selected were superior. The report expresses no curiosity and reports no inquiry regarding why no proposals were received from certain locations, including Miles City and the Fort Belknap reservation.

Regarding Tribal or reservation projects, the Board has selected a high percentage of applications for such projects. Currently, there are 36 active LIHTC projects comprised of nearly 800 units located on or near Tribal reservations. This represents 6.75% of the Housing Credit portfolio. As of 2022 (the end year of the audit scope) the Native American/Alaskan Native population of Montana was 5.9%. Additionally, the recollection of Board staff and counsel is that there were compliance and other issues with the developers of some of the previously proposed Tribal or reservation projects. It is important to clarify that there are many possible legitimate reasons for the Board's prior decisions to not award a project, but the audit report appears to assume this is because the Board lacks data or failed to consider degree of need. The reality is that when a Tribal or reservation project is proposed, it has a high likelihood of being awarded absent other extenuating circumstances, because the Board is acutely aware of the significant housing needs in Tribal communities.

Even assuming for the sake of argument that these projects were proposed in "more needy areas," this alone does not require selection or suggest that selection of these projects is warranted. As discussed below, there are numerous other statutory factors and considerations involved in selection – the determination is not and, under federal law, cannot be made purely on relative need or income level. Even assuming that the areas identified by the Auditors are "lowest-income" or "most-needy" areas, projects may not necessarily be developed in those areas due to a variety of other factors and constraints.

Finally, the audit report offers no evidence or rationale to demonstrate that the results of the Auditors' preferred approach would materially improve the results or deliver improved performance of Montana's Housing Credit program.

Corrective Action:
The Board agrees to seek, identify and consider other available data from external sources in addition to data already compiled and used, to the extent such data are determined appropriate, useful and timely.

The Board has considered conducting a statewide housing needs assessment in the past and decided against that approach due to the cost of such an assessment and limited shelf life of data. However, the Board's executive director did share with audit staff that the Montana Department of Commerce is actively working on its next U.S. Department of Housing and Urban Development ("HUD") 5-Year Consolidated Plan. This plan is required for the state's receipt of HUD Community, Planning and Development funds and includes both a Needs Assessment and Market Analysis. Commerce is also undertaking a statewide analysis of fair housing impediments. Once final, these assessments and underlying data will be shared with Board members and further discussions will be held on how this data could be used to further inform LIHTC award decisions.

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Finally, the Board will take steps to increase Board member participation in QAP working group sessions. To date, Board members have been notified and invited to all 2024 QAP work sessions and both Board staff and the Board Chair have strongly encouraged Board members to attend.

Recommendation #2:
We recommend the Montana Board of Housing prioritize LIHTC projects serving the lowest-income Montanans and increase its consideration of the needs of specific populations through increased training to staff and Board members, better outreach, and the implementation of policy incentives.

Board Response #2:
The Board *partially concurs* to a limited extent with the recommendations but does not concur with much of the audit report's discussion or findings regarding need and income levels, its characterization of the Board's process, or the value of set asides. The Board does agree with the value for greater outreach regarding the Housing Credit program but lacks staff capacity for such an outreach program.

Set Asides.

The state of Montana is a vast geographical area comprised of diverse populations and local conditions, including senior, family and special needs populations located in urban, small town, rural and sovereign Native American reservations. Affordable housing needs include both construction of new affordable housing, as well as preservation of existing affordable housing stock through acquisition and rehabilitation of projects that otherwise will be lost to market rate ownership.

Montana's relatively low and scattered population is best served by providing housing that is generally available to broader classes of individuals or families (such as families, seniors and disabled populations) - all of whom are highly needy - rather than targeting projects to more narrowly defined classes of special populations and thereby limiting availability of the resulting housing to fewer highly needy individuals. Highly specific targeting can also impact a project's operations and result in unintended consequences such as higher vacancy rate and lower rental revenue if the combination of income restriction and other set aside population parameters overly limit the eligible applicant pool.

The Auditors appear to be unaware that, over the years, the Board has tried a variety of set asides targeting particular populations. However, these set asides have not proven effective in practice, we believe - at least in part - because Montana lacks sufficient numbers of specialty populations sufficiently clustered in particular locations. Further, the amount of Housing Credit ceiling a state has to allocate affects its ability to efficiently use set asides. States with larger ceilings are more likely to be able create more competitions with enough LIHTCs to be worthwhile. *See* M. Shelburne, https://www.novoco.com/notes-from-novogradac/qap-set-asides-post-2-10. Over time and based on decades of experience, the Board has limited their use.

Also, special populations can be served in other ways. For example, the Board's QAP allows integration of special services and facilities into projects, such as day care, health care, supportive services and other "community service facilities."

The Board's criteria and approach allow and result in Housing Credit awards to highly needed projects dispersed across the state in all types of locations and serving all categories of the neediest individuals and families in Montana, including but not limited to individuals or families with more narrowly defined special characteristics.

The report states that, given the significant shortage of affordable rental homes compared to the number of units created by LIHTC, it is crucial the Board focus on addressing the most urgent needs in Montana. The Board maintains that it does focus on the most urgent needs of low-income Montanans. However, its ability to support the increased production of units at deeper affordability levels is constrained by available resources.

Lowest-Income Preference and other Mandatory Factors.

The report presents an incomplete and, thus, inaccurate description of the federal requirements and mandatory selection criteria for credit awards under a state's QAP. The report emphasizes one of many mandatory considerations, noting that states are required to give preference to projects that serve the lowest-income tenants and remain affordable for the longest period of time. However, the report fails to acknowledge the numerous additional selection criteria mandated by federal law.

Federal law requires that QAPs give preference to applications for developments:

- serving the lowest income tenants;
- for the longest periods; and
- located in qualified census tracts (QCT) and contribute to a concerted community revitalization plan (CCRP).

The provision provides no explanation of what it means to give such preference to developments serving the lowest income tenants. The Board's QAP already requires that all projects must have an additional 35 years of affordability beyond the initial 15-year Compliance Period required for a total Extended Use Period of 50 years. Federal guidance does clarify that the third preference "fails to apply unless ... a [CCRP] exists that contains more components than the LIHTC project itself."

Federal law further requires that QAP selection criteria must include the following:

- project location,
- housing needs characteristics,
- project characteristics, including use of existing housing as part of a revitalization plan,
- sponsor characteristics,
- tenant populations with special housing needs,

- public housing waiting lists,
- households with children,
- projects intended for eventual tenant ownership,
- the energy efficiency of the project, and
- the historic nature of the project.

Courts have held that federal law does little more than require states to distribute credits pursuant to a Qualified Allocation Plan. Although certain selection criteria must be included in that plan, no specific federal directives mandate *how* the agency must weigh or consider those criteria. Once the criteria are considered, no particular outcome necessarily follows. *See, e.g.*, *DeHarder Investment Corp. v. Indiana Housing Finance Authority*, 909 F. Supp. 606, 613-14 (S.D. Indiana 1995).

The Auditors have focused solely on one of many mandatory factors in the selection process, but these preferences are not absolute. Even the 3 "preference" items may conflict with one another in any given group of applicant projects. Furthermore, such preferences must be balanced with the other mandatory selection factors and any others identified by the particular state housing agency.

For purposes of the LIHTC program, "low-income" means housing for households earning up to 80 percent of the AMI. All households within this income range who lack access to affordable housing are highly needy and, among the population generally, are the lowest income and most needy individuals and families.[1] Federal law caps tenant income but gives project owners a choice of income targeting "set asides" across the range of permitted income levels.

Should only those households with incomes at 20% AMI be served, leaving nothing to address the needs of households with 40-60% of AMI, even though affordable housing is equally unavailable to all of these households? Moreover, due to the high cost of real estate and construction in Montana, often a blend of units from 20% up to 80% is required for the project to be financially feasible, even with LIHTC credits. In other words, the elimination of 80% units in a project could also result in the loss of 20% units as the whole project is rendered infeasible.

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[1] The report asserts the "low-income" range is distinct from "workforce housing" which is intended only for households in the 80-120 percent AMI range. This technical industry distinction was shared with the Auditors by the Board's executive director during the course of the audit. On June 14, 2023, Governor Gianforte signed HB 819 into law, which does include definitions of "Attainable workforce housing" for defined "Eligible households" earning between 60% and 140% of the median household income for the county in which the person resides, or the state, whichever is less. Prior to this legislation, there was no established definition of "workforce housing" in Montana or federal law. The term "workforce housing" is commonly used by industry professionals when describing LIHTC and other "low-income" projects, perhaps to counter a misperception that households residing in such properties are less likely to be wage earners. Lower wage workers with income at or below 80% of AMI are served in LIHTC and "low-income" properties.

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Montana's current QAP encourages and provides for the type, location and income levels of affordable housing most needed in various areas of the state. Under the QAP, the Board selects projects it determines best meet the most pressing affordable housing needs of low-income people in Montana, considering a complex variety of factors, including overall income levels targeted by the projects (including but not limited to deeper targeting of income levels). Under Montana's QAP, all 9% projects must meet the federally required minimum set aside requirements, *i.e.*, the 20-50 test or 40-60 test, both of which must reflect a weighted average targeted income of 53% AMI or below. For projects applying for 4% credits or using the Average Income set aside approach, the weighted targeting must be 60% AMI or below.

However, a proposed project targeting the lowest-income tenants may not be the best project to meet the needs of the lowest-income Montanans. While targeting very low or extremely low incomes, the project may lack substantially in other respects. The development and construction costs may be extremely high, the project may fail to take advantage of other available funding sources, the project may be too highly debt-leveraged, the unit size and configuration may be a poor fit for the location, the project may be poorly designed for long-term durability and sustainability, the project may lack necessary amenities or may offer overly extravagant amenities. The project simply may lack long-term financial feasibility.

Moreover, the income levels targeted and served by a project are limited by the subsidies available to replace higher rents that would be received by targeting relatively higher income and rent levels. The available subsidies vary from state to state. As the Audit report notes "[s]ome states (though not Montana) also have a state tax credit that is often used with the federal tax credit to further help fund low-income housing projects." Currently, at least 23 states provide a state housing tax credit that provides additional subsidy to allow lower income and rent targeting. Additionally, 38 states (though not Montana) administer a state housing trust fund, providing gap financing in the form of loans and/or grants to LIHTC projects to achieve a financially feasible capital stack. Absent sufficient subsidy (including both Housing Credits and other subsidies), the extent of possible rent reductions is limited.

General economic principles influence where Housing Credit subsidized low-income housing can and will be built. Absent additional subsidy, such housing generally would be located where the land costs are relatively low (or even where land is donated) and the maximum allowable LIHTC rents are relatively higher.[2] In exchange for the Housing Credit, the project owner must agree to rent units to defined low-income households at defined reduced rental rates. The project equity raised through the Housing Credit does not necessarily compensate fully for the reduction in rental income under the rent limits. The rental income stream must be factored into the project's cash-flow analysis.

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[2] See *Low-Income Housing Tax Credit Handbook*, § 1.18 (Novogradac and Company 2010 ed.).

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The report acknowledges that the costs to build affordable housing are the same as market-rate housing and that Housing Credit equity (proceeds of sale of credits to investors) helps to fund the project, allowing units in the project to be rented at below-market rent.
Where other subsidies – such as from a state tax credit - are available, projects can cash flow at lower rents. Thus, subsidies such as state tax credits or a state housing trust fund allow projects to charge lower rents and serve lower-income tenants.

The Board agrees that additional outreach and education about the Housing Credit program, particularly to Native American and rural communities, may indeed be of value. However, the Board disagrees that outreach is necessary to interest and attract more desirable numbers and types of project applicants. The Auditors cite no evidence that the entities and organizations interested in affordable housing in Montana are unaware of the program. Rather, the limited availability of 9% Housing Credits and gap financing to achieve a feasible capital stack, the complexity of the process, rising construction costs, restricted availability of suitable building sites and similar factors limit applications for the credits. Still, it has been decades since the availability of 9% Housing Credits exceeded demand in Montana.

Corrective Actions:
The Board will consider adding a more explicit preference for projects targeting lower-income tenants. Any such preference would not be absolute but would be weighed together with other applicable factors and considerations.

The Board will also consider adoption of one or more set asides to incentivize certain types of projects. These set asides could be aimed toward categories commonly funded (*e.g.*, rural, urban, small town, reservation) or special populations determined to be particularly underserved (*e.g.*, unhoused person, individuals discharged from institutional settings), so as to encourage competition in each category and assure awards to projects considered best in each set aside category.

Recommendation #3:
We recommend the Montana Board of Housing implement a structured system for evaluating projects against set, board-approved criteria as a primary basis for awarding LIHTC.

Board Response #3:
MBOH *partially concurs* to a limited extent with the recommendations but does not concur with much of the audit report's discussion regarding the use of scoring and discretion in the Housing Credit award process.

The report argues that the Board needs a more structured evaluation of projects as a primary basis for Housing Credit awards to increase transparency, meet program requirements and set affordable housing priorities for Montana.

Award Basis.

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The report argues that final LIHTC award decisions are "based only on board discretion" and that a lack of structure in award decisions reduces transparency and increases the risk of favoritism. The report states that during Board meetings, some Board members ask "relatively few questions about projects" and provide "little or no reasoning for voting for the projects they did." The report states that many Board members prioritized geographic distribution of Housing Credits over other factors and that some Board members specifically favored projects proposed in their own communities. According to the audit report, some developers described the Board's decisions as based "entirely on their own personal criteria" and that they were subjective.

We disagree that LIHTC awards are "based only on board discretion." To qualify for an award, projects must meet comprehensive threshold and evaluation requirements and criteria. The QAP provides that projects will be selected that the Board determines best meet the most pressing affordable housing needs of low-income people in Montana. This is a complex and subjective determination, not readily reduced to a formula or score. The Board has discretion in making these decisions, but that discretion is informed by the comprehensive and varied policies, priorities and requirements articulated in the QAP and by the detailed information and data on each proposed project and project location.

The MBOH and its Board members correctly perceive that there is great need for more affordable housing in all areas of the state, including urban, small town, rural, reservations, etc., and for all various populations, including families, seniors, Native Americans, disabled and others. The audit report criticizes geographical distribution as a legitimate reason for awards, but this furthers the Board's policy goal of increasing affordable housing as broadly as possible to all areas and low-income populations of the state. The Affordable Housing Tax Credit Coalition (AHTCC), in its October 2023 publication titled *Recommended Practices and Considerations for State Low-Income Tax Credits* (highlighting best practices for state tax credit programs) affirmed that "As a general rule, the more discretion a state housing finance agency (HFA) can exercise in its qualified allocation plan (QAP), which governs the administration of Housing Credit in the state, the better." This article further noted that "Geographic distribution between rural and metro area and other local factors" is one of the "issues that should be left to state discretion in their QAPs."

The Board does not agree that it fails to award Housing Credits to the neediest locations and populations of Montana. The Auditors' parsing of relative need among the lowest-income Montanans (under 80% AMI) draws an overstated distinction – these families and individuals all have the greatest need if they lack access to affordable housing. Similarly, the need is just as great if you lack access to affordable housing in Billings, Helena, Ekalaka or Lame Deer.

While transparency in decisions is desirable, it is not the only goal. Each Board member reviews and considers hundreds of pages of information and data regarding the characteristics of and need for proposed projects. Under these circumstances, Board members have not always fully articulated their reasoning. That does not mean there has been favoritism (the report provides no

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evidence of favoritism) or that credit awards haven't served the neediest Montanans. All awarded projects have served great need while considering numerous additional factors required to be considered under the QAP and federal law.
On the other hand, unfunded projects that the audit report identified in areas of "greatest need" may not have met other significant requirements or may have raised relevant concerns regarding feasibility, developer or owner track record, or similar concerns.

Role of Board Discretion.

The report asserts that the Board's approach is contrary to standard practice across the country, which purportedly is to evaluate projects against set criteria in the QAP, often using competitive point scoring. The report describes how some other states use point scoring systems to target lower income and certain types of housing, although noting that some states permit discretion by staff and/or boards in final award decisions.

We do not agree that the Auditors have established that use of scoring systems is standard or industry best practice. More generally, it is difficult to evaluate the credibility of some of the audit report findings and observations given the report does not articulate how interviewees, experts, visited projects, interviewed states, and other sources were selected or whether such selections were a fair or representative sampling (for example whether such states have state tax credits or other programs which make the lowest AMI projects more feasible or whether real estate and building costs are similar to Montana). Interviewing 5 of 49 other states is not a sufficient basis for reaching this conclusion. Moreover, there is no legal requirement that any Housing Finance Agency use such a system in making credit awards.

The Auditors' reference to best practices or industry standards often lacks support or reference to authority. The Board agrees that the *NCSHA Recommended Practices in Housing Credit Administration* is a valuable tool, and the Board has evaluated and adopted these practices when deemed appropriate. In fact, the Board's executive director served as one of the members on NCSHA's Recommended Practices Task Force which drafted and approved the 2023 Recommended Practices update. Both Congress and the NCSHA recognize that every state is different and is best suited to determine its own approaches. This stance is reflected in the 2023 NCSHA Recommended Practices update preface, which states: "Congress entrusted responsibility for administering the Housing Credit to the states, recognizing that each state is better able than the federal government to prioritize and address the low-income housing needs of its residents. This delegation of authority to the states to administer a major federal tax program is unique and unprecedented. In making it, Congress recognized the value of decentralized decision-making concerning each state's low-income housing needs, while establishing broad standards each state must follow in carrying out their program administration and oversight…Strong and dynamic state administration is key to the Housing Credit's success. NCSHA's Housing Credit recommended practices have allowed states to achieve program excellence while maintaining the flexibility they need to best meet their unique and diverse affordable housing needs."

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The audit report states that Board members and staff perceive significant risks in using scoring during the award process, including difficulty developing objective criteria, developers prioritizing scoring points over project quality and risks of litigation. The audit report dismisses these concerns out of hand, stating that other states that use "point scoring (with or without allowing discretion by staff and/or the board," had not faced legal challenges.[3] The Auditors also suggest that these risks can be mitigated by regularly adapting the scoring to the state's current needs and structuring scoring to be as objective as possible.

However, the report misconstrues Board and staff concerns regarding *elimination of Board discretion* as reluctance to use *any* structured evaluation process. The Board is not necessarily opposed to using a structured evaluation system, but rather is opposed to allowing point scoring or a similar structured evaluation to solely dictate credit awards.

Until the 2024 QAP, the Board used a point scoring system in its process for evaluation and consideration of projects for credit awards. Under the QAP, projects were evaluated and scored against stated criteria with stated ranges of possible points. Projects were required to meet a minimum threshold score to be considered for an award.

However, under the previous QAPs, scores did not control the selection of projects to receive credit awards. The Board retained discretion to select the projects receiving credit awards according to the following standard:

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[3] Board staff and counsel are skeptical of this assertion. It is more likely that legal challenges are discouraged by the retention of discretion in these states' QAPs or other factors which insulate the agencies from or discourage legal challenges. For example, of the other states interviewed by the Auditors, at least 3 retain award discretion in their QAPs regardless of point scoring: Wyoming ("After determining eligibility and scoring rank, projects are recommended to the WCDA Board of Directors. The WCDA Board of Directors may, at their sole discretion, approve or deny an application recommended by staff."), https://www.wyomingcda.com/wp-content/uploads/2022/09/2023-AHAP.pdf; Michigan ("The allocation of LIHTCs is made at the sole discretion of MSHDA [Michigan State Housing Development Authority]), https://www.michigan.gov/mshda/-/media/Project/Websites/mshda/developers/lihtc/assets/liqap/mshda_li_qap_2024_2025_qap_final.pdf?rev=6810464ab00643eaa6ef8121132d7abe&hash=4BC1F47608D01BE5C3BB1D16700AB9A7; Vermont ("The VHFA [Vermont Housing Finance Agency] Board of Commissioners may, at its sole discretion, reserve or allocate credits to a project regardless of its rank or score, provided the Board finds that the project serves a positive community development need or the public good."), https://www.vhfa.org/sites/default/files/documents/multifamily/Signed_VHFA%202024-25%20Vermont%20Qualified%20Allocation%20Plan_vf.pdf.

The Board will select Applications to receive an Award that it determines best meet the most pressing affordable housing needs of low-income people in Montana, taking into consideration:

- All requirements, considerations, factors, limitations, Development Evaluation Criteria, set asides, priorities, statistical data in this QAP and all federal requirements ("Selection Criteria")
- Development Evaluation Criteria scoring
- All other information provided to the Board regarding the applicant Projects.

The awarding of points under the development evaluation criteria was for purposes of determining that the projects met at least the minimum score required for further consideration and to assist the Board in evaluating and comparing Projects. Scores were only one of several considerations and did not control the selection of projects for award.

The Board has not relied solely on scoring and has retained discretion for important policy and legal reasons. From a policy perspective, the award determinations are complex, inherently subjective and not susceptible to reduction to a scoring formula. A purely score-driven approach likely will lead applicants to design proposals to score more points rather than to provide the best or most needed projects.

From a legal perspective, the presence or absence of Board discretion has extremely important consequences. Lack of Board discretion would mean that: (1) unsuccessful applicants could challenge determinations in court or administrative law forums based upon scoring issues and scoring totals, allowing courts or administrative law judges rather than the Board to decide awards; and (2) the process of awarding tax credits would be a Montana Administrative Procedure Act (MAPA) contested case which must be conducted through a court and trial-type process.

If the determination is non-discretionary, *i.e.*, the highest scoring proposals must be awarded credits, then a project with the highest score is entitled to a credit award and has a due process "property" interest in an award. Therefore, if the highest scoring project is not awarded credits, the developer can sue the credit agency and a court would order the agency to award it credits. Under this approach, applicants can also litigate their scores, seeking a higher overall score that requires they be awarded credits.

However, even where the process includes scoring, there is no property interest or entitlement to an award *if the awarding agency retains sufficient discretion to determine awards*. In *DeHarder Investment Corp. v. Indiana Housing Finance Authority*, 909 F. Supp. 606, 613-14 (S.D. Indiana 1995), a tax credit applicant sued alleging a due process violation in failure to award credits. The Court noted that federal law does little more than require states to distribute credits pursuant to a qualified allocation plan. Although certain selection criteria must be included in that plan, no specific directives mandate *how* the agency must weigh or consider those criteria. In other words, once the criteria are considered, no particular outcome necessarily follows.

Under the QAP considered in *DeHarder*, the agency evaluated applications by assigning points for certain characteristics, but no particular outcome was mandated by a particular score and the QAP made award of credits discretionary. The Court noted that the QAP explicitly cautioned that the agency retained the discretion to award credits irrespective of the number of points awarded - notwithstanding the point ranking system - the agency reserved the right and power to allocate credits to a project irrespective of its point ranking, if such allocation is in compliance with federal law, in furtherance of the QAP's stated housing goals, and determined by the agency to be in the interests of the citizens of the state.

The Court found that the existence of a constitutionally protected property interest depends upon explicitly mandatory language, in connection with the establishment of specified limits on the exercise of discretion. The Court found that the tax credit allocation scheme envisioned by federal law and the QAP appealed to discretion. The allocation criteria did not explicitly use mandatory language that would require an award of tax credits to the plaintiff. Therefore, the Court found that Applicant had no property interest sufficient to invoke due process protection and dismissed the claim. *See also Barrington Cove Limited Partnership v. Rhode Island Housing and Mortgage Finance Corporation*, 246 F.3d 1, 5-6 (1st Cir. 2001).

The same analysis applies under Montana law. The Montana Supreme Court has followed this property interest/due process analysis in the contract procurement process. *ISC Distributors v. Trevor*, 273 Mont. 185, 194, 903 P.2d 170, 175 (1995).

A Montana district court also followed this analysis in a lawsuit seeking an award of LIHTC credits from the Board. In 2012, an unsuccessful tax credit applicant sued the Board, arguing (among other things) that its application was incorrectly scored and should have been awarded more points, and that if correctly scored, the project was among the highest scoring applications and therefore entitled to an award of credits. The applicant asked the Court to order the Board to award credits to its project. *Ft. Harrison Veterans Residence v. Montana Board of Housing*, Montana First Judicial District Court, Lewis and Clark County. Cause No. ADV 2012-356.

The Montana Court ruled that there was no property interest in an award of Housing Credits, citing *DeHarder* and *Barrington Cove.* The Court upheld the Board's determination, finding that the Board's determination was not arbitrary, capricious or unlawful.

Further, if the determination is non-discretionary and the highest scoring project has a due process "property" interest in an award, then constitutional due process requires that the determination be made after opportunity for a hearing. This brings the credit award process within the MAPA definition of a "contested case" ("contested case" means a proceeding before an agency in which a determination of legal rights, duties, or privileges of a party is required by law to be made after an opportunity for hearing).

MAPA contested cases are a court- and trial-type process before an independent administrative law judge ("hearing examiner"). The contested case hearing process requires detailed notice, right to conduct discovery (*e.g.*, depositions), right to subpoena witnesses and documents, filing of motions, briefs and other legal pleadings, all testimony taken under oath, formal rules of evidence apply, right to cross-examine witnesses, and on the record – court reporter and transcript. Requiring such procedures would consume considerable resources and detract from rather than enhance the process. It could also discourage Board service by requiring significant Board member time responding to discovery and being deposed.

The audit report readily dismisses the Board's concerns regarding award by litigation. However, this is not mere speculation. The prior suit challenging the Board's failure to award credits precisely sought such a process and result. The QAP's discretionary award standard was the reason that approach did not become reality.

The Board strongly disagrees with any approach that eliminates Board discretion and subjects the program, the process and the Board to award of tax credits through litigation procedures and encourages legal challenges and award determinations by courts or administrative law judges rather than the Board. The Board understands the desire to assign scores or numbers to projects. Scoring creates an appearance of greater objectivity – the highest score wins. It does not transform an overwhelmingly subjective determination into an objective one; rather, it simply hides the inherent subjectivity with an "objective" veil.

The Board does not necessarily oppose the use of a structured evaluation against specified criteria for the purpose of evaluating and comparing projects, so long as the final award determination is within the Board's discretion so as to avoid a property interest entitlement to awards and applicability of contested case procedures to the award process.

While most states may use numerical scoring, scoring is not mandatory and not all states do so. This is a matter left to individual states to determine how best to approach evaluation and selection of projects. For example, the Colorado Housing and Finance Agency (CHFA) award committee determines awards using subjective decisions (a point raised to auditors by Mr. Shelburne with Novogradac[4]). To our knowledge, Colorado has never been challenged and in fact their legislature substantially increased resources allocated to CHFA in recent years. No method is inherently superior. *See* M. Shelburne, https://www.novoco.com/notes-from-novogradac/qap-selection-criteria-post-4-10.

Corrective Action:

The Board will consider implementing a structured system for evaluating projects against set, Board-approved criteria as a part of basis for awarding Housing Credits. However, any such

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[4] The report does note that the Auditors interviewed Mr. Shelburne (identified as "the board's LIHTC consultant"). However, the report does not note that the Board's General Counsel, Mr. Gould, was also interviewed. In both of cases, the audit report does not appear to include any critical information Mr. Shelburne or Mr. Gould provided to the Auditors.

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provisions must be carefully developed and considered to assure retention of sufficient discretion to preclude creation of a due process property interest.

The Board agrees that, to increase transparency, Board members should provide more detailed explanations for their recommendations and selections of projects to receive awards. This will be addressed in on-going Board trainings and was most recently discussed with Board members during its April 8, 2024 training and strategic planning session.

Again, as noted in response to Recommendation #1, the Board agrees that Board members should significantly participate in developing the criteria and priorities included in the state's QAP.

Recommendation #4:
We recommend the Montana Board of Housing develop a conflict of interest policy and clarify its ex parte communication policy.

Board Response #4:
MBOH *partially concurs* with the recommendations but does not concur with much of the Auditors' characterization of Board policy and training.

While the report correctly indicates that the Board has only recently adopted a *written* Conflict of Interest Policy and annual *written* conflict disclosure requirement, the Board historically has maintained and trained its members on its policies regarding avoidance and disclosure of conflicts and the requirement for recusal from participation where conflicts exist. The Board has provided conflict of interest training to its members at least annually, including training regarding Montana's standards of conduct and ethics for public officers, particular conflict issues that may arise with respect to the Board's programs, how and where to seek guidance regarding possible conflicts, and the disclosure and recusal processes.

Based upon the experience of Board staff and counsel, Board members understand conflict of interest, reach out to staff and counsel for guidance on conflict issues, and voluntarily disclose conflicts and recuse themselves from all related discussion and voting. The report alleges that while Board members with connections to LIHTC applicants have recused themselves from voting on those projects, the Board members did not recuse themselves from discussion about the projects, suggesting that those Board members strongly influenced the discussion. However, we do not recall such situations and the report does not identify any actual occasion where a Board member failed to disclose a conflict or participated in discussions despite recusal from voting due to a conflict of interest.

Similarly, the Board historically has provided training to its members at least annually regarding ex parte communications and the Board's policy on such communications. Whether Board members remember the specific technical terminology involved, we believe Board members have been trained regarding and understand what communications are prohibited.

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Further, we disagree with the Auditors' comment that a Board member discussing business outside a duly constituted meeting does not constitute an ex parte communication. This certainly constitutes a prohibited ex parte communication when such discussion occurs with a party who will be appearing before the Board on a quasi-judicial matter. Further, we disagree that ex parte communications are completely separate and unrelated to open meeting requirements.

Corrective Action:
Effective beginning January 2024, the Board adopted an annual conflict of interest disclosure requirement for Board members. The Board provided conflict of interest training to its members most recently in April 2024. The Board has developed and, at its May 13, 2024 meeting, adopted a conflict of interest policy. See attached copy of Montana Board of Housing (MBOH) Conflict of Interest Policy approved and adopted May 13, 2024.

The Board long ago developed and adopted, and currently maintains, a written ex parte communication policy. The Board historically has provided ex parte communications training to its members at least annually, most recently in April 2024. The Board has initiated review of its current policy and will consider adoption of clarifications to its policy at its October 2024 meeting.

Recommendation #5:
We recommend the Montana Board of Housing either seek legislation to make training required for board members or develop a policy to implement a training requirement and schedule.

Board Response #5:
MBOH *partially concurs* with the recommendation to adopt a training policy implementing a training requirement and schedule. However, the Board does not concur with much of the Auditors' characterization of Board policy and training. Please see discussion regarding Board training under the previous recommendation (#4).

The Board agrees to develop and adopt a policy regarding training, including content, frequency and mandatory attendance. Note that the May 13, 2024 Board Attendance Policy requires attendance at Board trainings.

There are over 150 boards within the state of Montana, with Board members appointed by the Governor and confirmed by the state senate. It is critical that potential appointees have a clear sense as to the time commitment of the position, including board meetings themselves and any required board trainings. There has been considerable work done at the Executive branch to make standardized trainings available to Board members. A coordinated approach to identifying other standardized trainings that could be made available to all state of Montana Board members may be warranted, or at minimum, increased communication to outline the meeting and training time commitment an appointee could expect *prior* to their acceptance of the position.

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We have endeavored in our response to address the most significant issues raised regarding the Housing Credit allocation process and the rationale for the Board's approaches. However, much more could be said about these issues and we reserve the right to provide additional information as this process continues.

In closing, we would like to thank the Legislative Audit Division staff for their work and professionalism. My team and I view these engagements as collaborative opportunities to assess and improve the administration and compliance of our various programs.

Regards,

DocuSigned by:
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cc: Paul Green, Commerce Director
Mandy Rambo, Commerce Deputy Director