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INDEPENDENT STATE AUDITOR'S REPORT ON CERTAIN ACTIVITIES OF THE MASSACHUSETTS HEALTH AND EDUCATIONAL FACILITIES AUTHORITY

JULY 1, 2007 TO SEPTEMBER 30, 2008

OFFICIAL AUDIT REPORT

JUNE 30, 2009

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In 1968, the Massachusetts Legislature established the Massachusetts Health and Educational Facilities Authority (HEFA) as a self-supporting authority to assist nonprofit organizations by providing low-cost loans, bond issues, and other financial services. HEFA acts as a conduit between nonprofits and lending organizations. It receives no state appropriations or tax revenue but derives revenue by assessing initial and annual administrative fees to the various institutions it assists. HEFA consists of a nine-member board appointed by the Governor, and employs an Executive Director and a staff of 15 employees.

HEFA assists nonprofits through the following programs: tax-exempt bonds, pooled loans, value lease arrangements (capital or operating), purchasing consortium, technical assistance, capital strategy loans, energy conservation financing, New Markets Tax Credit, and the HEFA Charitable Institutional Trust. HEFA's largest program is issuing tax-exempt bonds. During our audit, which covered the period July 1, 2007 to September 30, 2008, we reviewed HEFA's internal controls over administrative and operating costs and its oversight for program activities.

Our prior audit report (No. 2006-0041-3A) noted that since its inception in 1997, this Trust has been underutilized and few grants and loans have been made to assist charitable organizations and governmental entities such as public colleges and universities. Accordingly, this issue was presented to the HEFA Board to determine the appropriate level of use of these funds and to explore new avenues within the Trust's charter that could lead to a better utilization of these funds. Effective June 13, 2006, a resolution was adopted by the Board that expanded the Trust's mission to include financial assistance to community health centers in Massachusetts; promote, through loans, projects that are environmentally friendly and cost-effective; and allocate funds to help defray HEFA Pool Loan program expenses paid by eligible borrowers. During the fiscal year ended June 30, 2008, the Trust awarded grants and other subsidies totaling $601,787.

INTRODUCTION

Background

In 1968, the Massachusetts Legislature established the Massachusetts Health and Educational Facilities Authority (HEFA) as a self-supporting independent authority to assist nonprofit organizations by providing low-cost loans, bond issues, and other financial services. HEFA consists of a nine-member board appointed by the Governor, and employs an Executive Director and a staff of 15 employees.

HEFA receives no state appropriations or tax revenue but derives revenues by assessing initial and annual administrative fees to the various institutions it assists. HEFA is authorized to issue bonds and notes that are neither direct nor indirect obligations of the Commonwealth and acts as a conduit by issuing debt on behalf of nonprofit organizations that are direct recipients of the resulting proceeds. The debtor institutions' revenues or assets of the institutions secure the indebtedness. The Authority is exempt from federal and state income taxes and interest paid on bonds issued by HEFA are also exempt from federal and Commonwealth of Massachusetts income taxes.

HEFA assists eligible nonprofits through the following programs:

- **Tax-exempt Bonds:** Nonprofit institutions that wish to raise funds for capital projects save money by having their bonds issued through HEFA.

- **Pooled Loans:** Nonprofits that can afford to finance capital projects between $1 million and $5 million may borrow funds from a HEFA bond issue, together with other nonprofit borrowers, to reduce their borrowing costs.

- **Value Lease Arrangements (Capital or Operating):** A capital lease is essentially an installment loan. The borrower leases the equipment for a time equal to the economic life of the equipment, and when the capital lease expires, the borrower owns the equipment. An operating lease is for a more limited period, and the lessee does not own the asset at the end of the period.

- **Purchasing Consortium Program:** Nonprofits may participate in a consortium that negotiates competitive electricity and natural gas rates for individual participants.

- **Technical Assistance:** HEFA provides a wide range of services to ensure the lowest cost and most beneficial financing strategy.

- **Capital Strategy Loans:** This program offers preset financing options appropriate for the needs of the borrower.

- **<u>Energy Conservation Financing:</u>** Energy conservation programs are financed at $50,000.

- **<u>HEFA New Markets Tax Credit CDE:</u>** This program provides tax incentives to investors to make investments in healthcare institutions in low-income communities and thereby promotes economic development in these communities.

- **<u>HEFA Charitable Institutional Trust</u>:** The Trust is authorized to make payments to charitable organizations or governmental entities such as public colleges and universities that the Authority may assist in the form of loans, grants, and gifts.

During the fiscal year ended June 30, 2008, HEFA issued 51 conduit debt and lease obligations totaling approximately $3.4 billion for nonprofit health, educational, and cultural institutions, and schools for the handicapped. The total amount of conduit debt and lease obligations outstanding as of June 30, 2008 was approximately $14.5 billion. In addition, during fiscal year 2008, the HEFA CDE allocated $33 million of its New Market Tax Credits, and the Charitable Trust awarded 23 grants totaling $481,425.

Audit Scope, Objectives, and Methodology

Our audit, which covered the period July 1, 2007 through September 30, 2008, was conducted in accordance with applicable generally accepted government auditing standards for performance audits. The objectives of this audit were to (a) review and evaluate HEFA's internal controls over administrative and operating costs to determine their adequacy, (b) review the adequacy of HEFA's program oversight activities to determine how effectively the Authority's programs are functioning, and (c) review actions taken to address the issues raised in our prior audit report (No. 2006-0041-3A).

Our audit methodology included reviewing HEFA's fiscal years 2008 and 2007 annual reports and financial statements; expense files on travel and conferences, monthly credit card use, and employee function expenses; the various borrower assistance programs' policies, processes, and procedures; minutes of HEFA Board meetings; trustees', bond counselors', and HEFA's annual reports to board members; and selected reports of the independent financial advisor used to assess each nonprofit's ability to participate in HEFA programs.

To evaluate program oversight activities, we reviewed file data for 13 of HEFA's 2008 conduit debt financings and lease obligations financings for compliance with the provisions of HEFA's enabling act and amendments. In addition, we interviewed the Executive Director and selected staff members.

We found no indication that HEFA's program oversight activities were performed unsatisfactorily. Those activities included Board member reviews of each HEFA loan, gift, or grant for compliance with HEFA program polices and procedures and HEFA's enabling act; expert assistance by outside legal services; trustee reports on loans; and advice from bond counselors and insurers. These activities were conducted as part of the loan approval process and included attestation to each prospective borrower's eligibility. We determined during the period of our review that there have been no instances of default by any HEFA borrower and that all loans are in compliance with their loan covenants.

We performed certain tests to ascertain that HEFA was in compliance with applicable state and federal laws; Board of Trustees' rules and regulations; and bond, loan, grant, and contract provisions. This testing was performed in order to obtain reasonable assurance that HEFA's representation of its financial and operational performance was free of misstatements. The results of our testing disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

AUDIT RESULTS

PRIOR AUDIT RESULTS RESOLVED – CHARITABLE INSTITUTIONAL TRUST ACTIVITY

Our prior audit report (No. 2006-0041-3A) noted that since its inception in 1997, this Trust has been underutilized and few grants and loans have been made to assist charitable organizations and governmental entities such as public colleges and universities. HEFA officials indicated to us at that time that this issue would be presented to its Board to determine the appropriate level of use for these funds and to explore new avenues within the Trust's charter that could lead to a better utilization of these funds. Effective June 13, 2006, a resolution was adopted by HEFA that expanded the trust's mission to include financial assistance to Massachusetts community health centers; promote, through loans, projects that are environmentally friendly and cost-effective; and allocate funds to help defray HEFA Pool Loan program expenses paid by eligible borrowers. The Trust established the following recommended annual goals for allocation of earnings:

- 70% of the earnings for the Community Health Center Grant Program.
- 20% of the earnings for the Pool Loan Program subsidy.
- 10% of the earnings for administrative cost reductions.

In addition, the Trust established the annual goal of allocating 5% of the three-year average of net assets for the Green Loan Program.

In order to fund these initiatives, the Trustees, in their sole discretion, will determine the actual annual distributions and allocation percentages; however, the minimum annual distributions shall be the lesser of 5% of the Trust's net assets, or the actual investment income from the prior fiscal year. The stated goal of this allocation process is to distribute and utilize the Trust's earnings while preserving the principal. Accordingly, the distribution and allocation of funds for fiscal year 2008 was computed as follows:

The lesser of:

5% of the Net Assets ($12.34 million) at June 30, 2007	$617,000
100% of Investment Earnings for FY 2007	$601,805

During the fiscal year ended June 30, 2008, the Trust allocated $601,805, or 100%, of prior year's investment earnings, to the following:

- $481,443 (80%) for the Community Health Center Grant Program.
- $ 60,181 (10%) for the HEFA Pool Loan Program.
- $ 60,181 (10%) for the reduction of administrative costs.

Actual fiscal year 2008 grants payments totaled $601,787, of which $481,425 was awarded to the following 23 Massachusetts community health centers:

Brockton Neighborhood Health Center, Inc.	$25,000
Brookside Community Health Center	$10,250
Cape Cod Free Clinic & Community Health Center	$25,000
Caring Health Center, Inc.	$25,000
Codman Square Health Center	$19,850
Family Health Center of Worcester, Inc.	$25,000
Geiger-Gibson Community Health Center	$10,000
Greater New Bedford Community Health Center, Inc.	$25,000
Harvard Street Neighborhood Health Center, Inc.	$17,000
Island Health Inc.	$25,000
Joseph M. Smith Community Health Center	$25,000
Lowell Community Health Center, Inc.	$25,000
Manet Community Health Center	$23,980
Martha Eliot Health Center	$25,000
Mattapan Community Health Center	$25,000
Mid-Upper Cape Community Health Center	$10,000
Neponset Health Center	$10,000
North End Community Health Center	$25,000
North Shore Community Health Center	$25,000
Sidney Borum Jr. Health Center	$24,520
South Cove Community Health Center	$7,000
South End Community Health Center, Inc.	$25,000
Upham's Corner Health Committee, Inc.	$23,825
Total FY 2008 Grants Awarded:	$481,425

In addition, the Trust also expended the requisite $60,181, or 10%, for the HEFA Pool Loan Program and $60,181, or 10%, to reduce administrative costs.

Accordingly, we have determined that HEFA has properly addressed the concerns raised in our prior audit report and has taken appropriate corrective action to ensure an appropriate level of use of the Trust's assets and income.