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April 5, 2002 **2002-FW-1802**

MEMORANDUM FOR: E. Ross Burton
Director, Multifamily Housing Division, 6AHM

/SIGNED/
FROM: D. Michael Beard
District Inspector General for Audit, 6AGA

SUBJECT: Hillcrest Apartments – Upfront Grant
Lafourche Parish Housing Authority
Lafourche Parish, Louisiana

In response to a complaint, we reviewed a $7.7 Million Upfront Grant HUD provided to the Lafourche Parish Housing Authority (Authority). The purpose of the review was to determine if the Authority properly used HUD funds in the development of City Place I & II.

In performing the review, we interviewed HUD staff, Authority personnel, contractors, and others. We also reviewed and analyzed relevant documentation supplied by HUD, the Authority, and contractors.

We issued discussion drafts to the Authority on November 9, 2001, and February 12, 2002. The Authority provided responses on November 21, 2001, and March 7, 2002. Also, HUD officials provided comments to the November 9, 2001 draft on December 4, 2001. We met with HUD officials on March 5, 2002, and with the Authority's Executive Director on March 6, 2002. The Authority provided a written response on March 7, 2002. As a result of our discussions with the Authority's Executive Director and HUD officials and their written responses, we modified our draft including eliminating one finding. Additionally, we have included applicable parts of their response in the finding.

In developing the new properties, the Authority effectively sole-sourced the developer, who in turn sole-sourced the contractor. HUD provided information on the reasonableness of the cost of the new developments and is confident that the amount paid was reasonable. However, due to financial difficulties, one of the new developments has already reverted to the Authority and it appears the other development might also revert to the Authority. We are recommending HUD continue to monitor the status of these developments to ensure HUD does not incur any unnecessary expenses resulting from default or foreclosure on the loan.

Within 60 days, please furnish this office, for each recommendation in this memorandum, the status on: (1) corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is not considered necessary. Also, please furnish us copies of any correspondence or directives issued related to this memorandum.

If you have any questions, please call William Nixon, Assistant District Inspector General, at 817-978-9309.

Attachment

ATTACHMENT

Background and Introduction.

Multifamily Disposition and Upfront Grant Program.

Under the Upfront Grant Program (Grant), HUD provides grants and loans for rehabilitation, demolition, rebuilding, and other related development costs as part of the disposition of a HUD-owned multifamily housing project. HUD must make a determination that a grant or loan would be: more cost-effective than project-based rental assistance; economically viable on a long-term basis; and preserve affordable rental housing in a tight rental market.

Overall, the purpose of multifamily disposition is to "dispose of projects in a manner that will protect the financial interests of the federal government." According to Section 203 of the Multifamily Housing Property Disposition Reform Act of 1994, the disposition must be the least costly among "reasonable alternatives" and address goals of:

a. Preserving certain housing so they are available to and affordable by low-income persons;
b. Preserving and revitalizing residential neighborhoods;
c. Maintaining existing housing stock in a decent, safe, and sanitary condition;
d. Minimizing the involuntary displacement of residents;
e. Maintaining housing for the purpose of providing rental housing, cooperative housing, and homeownership opportunities for low-income persons;
f. Minimizing the need to demolish projects;
g. Supporting fair housing; and
h. Disposing of such projects in a manner consistent with local housing market conditions.

Hillcrest Apartments.

In 1981, HUD insured Hillcrest Apartments (Hillcrest) under Section 223(f) of the National Housing Act. Hillcrest had 202 units at 3 sites located in Larose, Raceland, and Thibodaux, Louisiana. At the time of default, Hillcrest's 3 developments had 157 occupied units, and the majority of its tenants had very low income. When HUD took possession, the complex was vacant. Since HUD subsidized Hillcrest through a Section 8 Housing Assistance Program contract, the complex was eligible for an Upfront Grant. HUD provided Section 8 subsidy for all Hillcrest residents.

In August 1997, HUD foreclosed on Hillcrest's mortgage and paid the outstanding mortgage of $3,338,409. HUD needed to foreclose on the property due to owner neglect.[1] Instead of selling the property to recover some of its losses, HUD transferred it to the Lafourche Parish Housing Authority

[1] To-date, HUD has not imposed administrative sanctions against the owner.

(Authority) for $10 in September 1998. HUD also paid an additional $2.2 million[2] in demolition and holding costs. HUD provided the Authority a $7.7 million Grant to replace the housing.

[2] Excludes tenant relocation costs.

Housing Authority of Lafourche Parish and its nonprofit.

In September 1998, HUD awarded the Grant to the Authority. The Authority transferred the Grant funds to its nonprofit, Community Development Corporation of Lafourche. The nonprofit then loaned the funds at 1 percent interest to two profit entities: City Place Thibodaux and City Place Lockport, both limited partnerships. The City Place Partnerships, wholly owned by the developer (Miller and Associates), also obtained FHA insured loans totaling $7.5 million.[3] Miller and Associates used the Grant and FHA loaned funds to build the two new developments in Lafourche Parish. Since the Grant Agreement was between the Authority and HUD, we have addressed the finding to the Authority.

According to HUD's intranet, the Authority has 276 low-rent units and 379 Section 8 vouchers. The Authority is located at S-750 Triple Oaks Drive, Raceland, Louisiana 70394.

[3] Actual mortgage amount was $7,598,100.

Finding 1 - The Authority Effectively Sole-Sourced the Developer and Contractor.

Contrary to procurement regulations and the Grant Agreement, the Authority's nonprofit corporation awarded the development contract to Miller & Associates after receiving only one proposal, and without directly soliciting other experienced real estate developers. The nonprofit did not make a full attempt at competition, as it only ran an advertisement in the local newspaper and not in neighboring major metropolitan areas of New Orleans or Baton Rouge. Hence, the Authority did not obtain adequate development alternatives. Further, Miller & Associates sole-sourced the $13.6 million construction contract. The Authority contended they undertook all actions with HUD knowledge. Nevertheless, the Authority did not follow procurement requirements.

Procurement Requirements

For procurements by competitive proposals, federal regulations[4] require the entity to solicit proposals from an adequate number of qualified sources. If the Authority procured a contract by non-competitive proposals, the regulations[5] require that one of the following apply: (1) item available from only one source; (2) public exigency or emergency; (3) agency authorizes; or (4) after solicitation of a number of sources, competition is determined inadequate. Additionally, HUD's Grant Agreement required three quotes "shall be obtained for any type of goods or services that cost $10,000 or more, unless HUD gives prior concurrence."

The Authority Effectively Sole-Sourced Miller & Associates

Violating these requirements, the Authority's nonprofit corporation awarded the development contract after receiving only one proposal, and without directly soliciting other experienced real estate developers. The nonprofit did not make a full attempt at competition, as it only ran an advertisement in newspapers in Lafourche Parish. The nonprofit did not place advertisements in the nationwide Commerce Business Daily or neighboring metropolitan areas of New Orleans or Baton Rouge. Miller & Associates' office was located in Lake Charles, about 190 miles from the Authority.[6] Incidentally, Miller & Associates did not rely upon the advertisement for notification, the Executive Director informed the owner personally.

The Authority's advertisement did not fully describe the scope of the project. The advertisement stated the Authority sought qualifications from "individuals and/or agencies to perform such services as organization, consultation, application, development, administration, fiscal management and the provision of resident initiatives for affordable housing programs." The Authority may have received a larger response if the advertisement stated it sought a developer to build apartments, with the possibility that a HUD grant would fund 50 percent of the development costs at 1 percent interest.

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[4] 24 CFR 85.36(d)(3)(ii).
[5] 24 CFR 85.36(d)(4)(i).
[6] Miller & Associates also performed accounting services for the Authority.

Based upon HUD's "Previous Participation Certification," Miller & Associates' only previous participation in HUD projects and Section 8 contracts was as a general partner of one 28-unit complex.

Miller & Associates Sole-Sourced the $13.6 Million Construction Contract

Miller & Associates negotiated the $13.6 million construction contract with only one contractor. Miller & Associates did not prepare any cost estimates to determine if the construction cost was reasonable. Also, the contractor did not provide any support for its cost to construct the new developments. HUD did perform cost analysis and HUD has confidence in the costs.

Miller & Associates and the Authority contend the developer was technically not considered a grantee subject to federal procurement regulations. The Authority structured funding of the projects such that Miller & Associates borrowed the grant funds from the Authority's nonprofit. They contend there were no federal procurement requirements that they had to follow in awarding the construction contract.

However, the 1996 Grant guidance stated that the purchaser had to obtain three quotes on each repair over $10,000. In our opinion, the developer was the purchaser performing the repairs (or rebuilding). Even if not specifically directed to compete the construction contract, competition would have ensured the developer obtained the best price for the construction.

Moreover, Miller & Associates negotiated a lump-sum contract with the Contractor. If the Authority's nonprofit had contracted for the construction, FHA guidance would have required it to use a cost-plus contract unless it used competitive bidding in the award of a lump-sum contract. A cost-plus contract requires certification of the costs actually incurred. The cost analyst hired by Miller & Associates to substantiate the construction cost also recommended a cost-plus contract.

During the review, the contractor did not allow access to his records of actual cost, and did not certify to the actual cost because Miller & Associates used a lump-sum contract.[7] According to HUD officials, they performed a cost analysis and have confidence that the construction costs were reasonable.

Authority's Response

In its response, the Authority stated:

> "The Authority did not intentionally attempt to sole-source this or any other services. The CDC selected the developer in Sept. 1997. The developer in turn selected the contractor some time thereafter. The draft Grant Agreement was not provided until mid 1998 and the final Grant Agreement not executed until Sept. 1998. Therefore, the Authority was unaware of what requirements the Grant would contain when it selected the developer.

[7] In subsequent follow-up, it appears the contractor has closed his office in New Orleans and moved out of Louisiana.

> The Authority and the CDC did attempt to satisfy the procurement responsibilities by advertising locally. When only one response was received, the CDC accepted the proposal. We wrote to Jason Gamlin, State Coordinator, HUD transmitting a copy of the advertisement. Presently and in the past, the Authority has always advertised locally for professional and other services and equipment. Our letter to Mr. Gamlin, specifically states only one response was received and accepted. The PHA looked to HUD for guidance in this and all projects it undertakes. Why didn't HUD respond to the PHA in Sept. 1997 when this letter was reviewed and advise that the proper procurement was not followed? This was new program area the PHA had no expertise in. We discussed all aspects of this project with the New Orleans and/or Fort Worth Offices of HUD.
>
> The Authority has attended a seminar hosted by HUD-Cultivating Capacity in early 2000. This seminar has provided a great insight to the responsibilities of a nonprofit. It was very beneficial and had it been provided prior to 1997, I feel certain that the most of the situations you cited could have been avoided."

With or without HUD's knowledge, the Authority's procurement violated regulations and the Grant Agreement. Furthermore, as an entity that receives HUD grants, the Authority should have realized that it would have to follow procurement requirements when developing these complexes. However, the Authority did inform and seek HUD's guidance throughout the process. Further, the Authority has obtained additional instruction on procurement. As a result, we are not making any recommendations regarding the Authority's procurement practices.

Since the Authority did not comply with the procurement regulations in its selection of the developer, HUD has no assurance that the Authority obtained the best development proposal from the most experienced developer. This, combined with the fact that Miller & Associates did not use competition when awarding the construction contract, meant that neither the Authority nor Miller & Associates could provide assurance it spent the Grant in the most efficient or effective manner. Consequently, the Authority might have been able to build the units for less and thus, decreasing the rents. However, because HUD has confidence in the cost, we did not question the cost of the contract.

One of the complexes[8] has reverted to the Authority because Miller & Associates could not operate it successfully. According to its response, the Authority has taken action to increase the affordability of the complex. Specifically, the Authority reduced the rents on 20 2-bedroom units and set the payment standard in the Section 8 Program at 110 percent of fair market rents. In conversations with Miller & Associates, it appears the owner may not be able to continue operating the other complex (City Place I).[9] Thus, it might also revert to the Authority. Therefore, HUD should closely monitor the operations of City Place I to ensure HUD does not incur any unnecessary expenses resulting from default or foreclosure. Further, HUD should continue to ensure the Authority has the capacity to operate these complexes.

We recommend that HUD's Multifamily Branch:

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[8] City Place II in Lockport, Louisiana.

[9] Located in Thibodaux, Louisiana.

1A. Monitor the status of the City Place I development to ensure it does not incur any unnecessary expense resulting from default or foreclosure.

DISTRIBUTION

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