



Issue Date	April 28, 2004
Audit Case Number	2004-AT-1007

TO: Michael A. Williams, Director, Office of Public Housing, 4FPIH

*James D. McKay*

FROM: James D. McKay  
Regional Inspector General for Audit, 4AGA

SUBJECT: Housing Authority of the City of Asheville  
Asheville, North Carolina

#### INTRODUCTION

We completed a review of the Housing Authority of the City of Asheville's (Authority) activities with its related nonprofit organizations. The review was performed as part of our audit of the Department of Housing and Urban Development's (HUD) oversight of Public Housing Agency development activities with related nonprofit entities. Our objective was to determine whether the Authority complied with laws and regulations and properly safeguarded resources when it conducted business with its related nonprofit organizations.

To accomplish our objective, we reviewed applicable HUD regulations, the Authority's Consolidated Annual Contributions Contract (ACC), and other requirements. We also interviewed Authority management and staff and reviewed various documents to include financial statements, general ledgers, bank statements, tax credit documents, loan documents, and minutes from Board meetings. To verify the validity of the account balances, we reviewed check vouchers and invoices.

We performed our on-site review from June 16 2003, through June 20, 2003, and generally covered the period May 31, 1996, to September 30, 2002. We performed our review in accordance with generally accepted government auditing standards.

We discussed our review results with the Authority during our review and met with them for an exit conference on March 16, 2004. The Authority provided written comments to our draft on April 15, 2004. Their comments are summarized in the finding and included in their entirety as Appendix B.

In accordance with HUD Handbook 2000.06 REV-3, within 60 days, please provide us, for each recommendation without a management decision, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Additional status reports are required at 90 days and 120 days after report issuance for any recommendation without a management decision. Also, please furnish us copies of any correspondence or directives issued because of the audit.

Should you or your staff have any questions, please contact me at (404) 331-3369, or Gerald Kirkland, Assistant Regional Inspector General for Audit at (865) 545-4368.

### **SUMMARY**

We found the Authority violated its ACC with HUD by inappropriately advancing funds and pledging assets for non-Federal development activities. HUD did not approve the development activities. As of September 30, 2002, management had advanced \$1,850,833 of public housing funds for development expenses on behalf of the owners of two tax credit developments. The advances reduced funds available to operate and maintain the Authority's conventional public housing and other HUD programs, and resulted in cash flow problems for the Authority. Management further violated its ACC by pledging the Authority's full faith and credit for a \$1.3 million letter of credit obtained to fund development activity. In addition, the Authority pledged a \$649,140 certificate of deposit as collateral for a loan. The Authority also entered into inappropriate development and guarantee agreements that placed assets at further risk. The guarantee agreements were extremely one-sided in favor of the investors. Further, the Authority did not properly allocate costs attributable to the non-Federal properties. These actions occurred because the Board of Commissioners did not establish sufficient controls to monitor the Authority's development activities and ensure transactions adhered to Federal regulations.

### **BACKGROUND**

The Authority was created under North Carolina law to provide safe and sanitary housing for persons of low and moderate income. A five member Board of Commissioners appointed by the Mayor of the City of Asheville governed the Authority. Mr. David Jones, Executive Director, managed the day-to-day operations during our audit period. The Authority administered about 1,500 low-income public housing units with subsidies provided by HUD under ACC Number NC007. It also participated in various other HUD programs including Section 8.

The Authority created two nonprofit corporations to serve as general partners in tax credit developments substantially owned by private investors. In May 1992, it created Woodridge Assisted Housing, Incorporated (Woodridge) to serve as general partner for Asheville-Woodridge, Limited Partnership (LP). In August 1996, it created Mountainside Assisted Housing, Incorporated (Mountainside) to serve as managing member of Asheville-Mountainside, Limited Liability Company (LLC). A three member Board governs each of the corporations. The Authority's Executive Director and two Authority Board members made up the Board for Mountainside, but no Authority officers served on the Woodridge Board.

The tax credit properties consisted of existing multifamily developments renovated by the Authority for the LP and LLC. The Authority served as developer for both developments. Costs were partially financed through sale of tax credits. Both developments had large cost overruns.

The Authority's financial records were maintained primarily at its central office located at 165 South French Broad Avenue, Asheville, North Carolina 28802.

## **Finding-1 - The Authority Inappropriately Advanced Funds, Pledged Assets, and Guaranteed Performance**

Authority management violated its ACC with HUD by inappropriately advancing funds and pledging assets for non-Federal development activities. HUD did not approve the development activities. As of September 30, 2002, management had advanced \$1,850,833 of public housing funds for development expenses on behalf of the owners of two tax credit developments. The advances reduced funds available to operate and maintain the Authority's Conventional Public Housing and other HUD programs, and resulted in cash flow problems for the Authority. Management further violated its ACC by pledging the Authority's full faith and credit for a \$1.3 million letter of credit obtained to fund development activity. In addition, the Authority pledged a \$649,140 certificate of deposit as collateral for a loan. The Authority also entered into inappropriate development and guarantee agreements that placed assets at further risk. The guarantee agreements were extremely one-sided in favor of the investors. Further, the Authority did not properly allocate costs attributable to the non-Federal properties. These actions occurred because the Board of Commissioners did not establish sufficient controls to monitor the Authority's development activities and ensure transactions adhered to Federal regulations.

### Criteria

Part Two, Section 401D of its ACC allows the Authority to withdraw monies from the General Fund only for: (1) public housing development costs; (2) operating expenditures; (3) purchase of investment securities, as approved by the Government; (4) other purposes specified in this contract or specifically approved by the Government.

Part Two, Section 313 of its ACC specifically prohibits the Authority from transferring, conveying, assigning, leasing, mortgaging, pledging, or otherwise encumbering project assets including rent, revenues, and income. Further, Section 506(2) states that such pledges or encumbrances are considered a substantial default of the contract.

### The Authority Inappropriately Used \$1,850,833 HUD Program Funds

In violation of its ACC, the Authority inappropriately used HUD program funds to renovate the Mountainside and Woodridge tax credit developments. The Authority did not obtain prior HUD approval to use the funds. As of September 30, 2002, the Authority had misused \$1,850,833 for unauthorized development expenses.

During its review of the Authority's audit report and management letter for fiscal year ended September 30, 1998, HUD's North Carolina State Office of Public Housing became aware of the Authority's activities. In an October 12, 1999, letter the former Director of Public Housing instructed the Authority to restore the funds to the appropriate accounts within 30 days.

Following its review of the Authority's September 30, 1999, audit report and management letter, the North Carolina State Office sent a letter dated July 7, 2000, to the Authority. The letter stated that the receivable for the two projects of \$1,819,306 had caused a cash flow problem within all programs. In the letter, the former Director of Public Housing instructed the Authority to settle the issue "as soon as possible." At the time of our review, the funds had not been repaid. HUD identified the funds as belonging to various HUD programs including Public Housing and Section 8. According to the Authority, they were Public Housing funds. The Authority primarily used the funds to pay force account labor.

On February 18, 2004, the current Director of Public Housing met with Authority officials to discuss repayment. In a February 25, 2004, follow-up letter, the Director advised the Authority the documentation provided was not sufficient to validate or support the Authority's contention that the funds were reimbursed. The Director advised the Authority that its actions pertaining to the developments violated several sections of its ACC. Further, the Director advised that the Authority's failure to provide documentation supporting repayment could be construed as a breach of the ACC causing implementation of sanctions. Subsequently, the Authority provided support showing \$874,015 was reimbursed between October 1, 2003, and March 5, 2004.

#### The Authority Placed Assets at Risk

In violation of its ACC, the Authority placed assets at risk by pledging them as collateral for loans and entering into guaranty agreements. On February 8, 1999, the Authority obtained a \$1.3 million line of credit loan to provide bridge financing for the Mountainside and Woodridge developments. The Authority pledged its "full faith and credit" as collateral for the loan.

Also, on December 18, 1997, the Authority pledged a \$649,140 certificate of deposit as collateral for a loan from Highland Mortgage Co. The Authority purchased the certificate of deposit with escrowed funds it received from converting a HUD Section 23 Leased Housing project into conventional public housing units in April 1991. Handbook 7430.1, Chapter 5, required the Authority to report the escrows to HUD. Further, it required that such funds either be remitted to the Department of Treasury or used to reduce HUD's operating subsidy outlay for the project. However, HUD's files did not contain documentation showing the Authority notified HUD the funds existed. Further, we found no other documentation showing that HUD had any knowledge of the funds, or approved their retention or use by the Authority. In the absence of documentation supporting the Authority's actions, HUD should require the Authority to remit \$649,140, plus accrued interest, to the Department of Treasury.

The Authority placed assets at further risk by entering into inappropriate development agreements. On November 13, 1997, the Authority entered into a development agreement with the limited partners of Mountainside in which it pledged to fund development cost overruns. On December 17, 1997, the Authority entered into a similar agreement with the Woodridge limited partners. These agreements required the Authority to make interest free loans to the partnership entities to fund cost overruns during construction. The agreements stated that Authority could only be reimbursed for the loans if its total development cost did not exceed the maximum

contract price. As previously discussed, the Authority advanced over \$1.8 million to fund development cost overruns.

The Authority also entered into guaranty agreements that were extremely one-sided in favor of the investors. On November 13, 1997, and December 17, 1997, the Authority executed agreements with the Mountainside and Woodridge investors, respectively. By signing the agreements, the Authority guaranteed the nonprofits' performance to the investors for almost every conceivable contingency including loss of tax credits, funding of operating deficits, and other general partner obligations set forth in the partnership agreements. Further, the Authority waived its right to defend enforcement of the agreements, and agreed to pay the investors' legal costs for enforcing the agreements against it.

### Cost Allocation

The Office of Management and Budget Circular A-87, establishes principles and standards for determining costs for Federal awards carried out through grants, cost reimbursement contracts, and other agreements with State and local governments and federally-recognized Indian tribal governments. Costs must be allocable to the Federal award. A cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received. Where costs are allocable to multiple activities or cost objectives, a distribution of the costs is required.

The Authority only allocated direct costs associated with construction labor to the tax credit developments. If the Authority does not allocate any other direct/indirect costs, such as the use of equipment, to the tax credit projects, the HUD programs will endure unnecessary costs. Therefore, HUD's future monitoring should include a review of the Authority's cost allocation practices.

### Conclusion

The Office of the Inspector General's Program Integrity Bulletin for Public Housing Commissioners provides that the Commissioners have responsibilities for public housing operations including approving policies and procedures, and ensuring that the public housing agency acts legally and with integrity in its daily operations.

The Authority management and its Board of Commissioners did not fulfill their fiduciary responsibility to the residents, the public, and the Federal Government. Their unauthorized development activities took precedence over safeguarding Authority assets and meeting the Authority's primary mission of providing decent, safe, and sanitary housing to area citizens.

The National Housing Act of 1937, Section 6(j)(4) establishes methods for recovering diverted funds. It provides that HUD may terminate assistance, withhold allocations, reduce future assistance payments, and take other measures. Further, Section 6 provides that upon occurrence of a substantial default, HUD may take possession of the project. Title 24 of the Code of Federal Regulations, Part 24.305, provides causes for debarment. One such cause is the commission of an offense indicating a lack of business integrity or business honesty that seriously and directly

affects the present responsibility of a person. Further, a person may be debarred for violating the terms of a public agreement so serious as to affect the integrity of an agency program.

The actions by the Board and Executive Director caused the Authority to violate the terms of the ACC, and seriously affected the Authority's operations. Those actions warrant HUD taking steps to protect its interest and prevent further risk to Authority residents, the public, and the Federal Government.

### **AUDITEE COMMENTS**

The Authority did not believe that it violated its ACC. It claimed HUD's North Carolina State Office approved certain documents regarding the development activities. The Authority claimed the amount it loaned from HUD funds was \$969,654, not \$1,850,833 as stated in our draft report. The Authority claimed the balance of the funds was from a conventional loan it had incorrectly recorded. It also claimed that as of March 5, 2004, it had repaid all HUD funds except for \$83,972 and anticipates paying that balance by the end of this calendar year.

The Authority claimed it never pledged the Authority's full faith and credit for a \$1,300,000 loan or otherwise as North Carolina law does not permit such a pledge. Further, the pledge of a certificate of deposit in the amount of \$649,140 was required as part of a HUD form, "Completion Assurance Agreement," in lieu of a performance bond for renovations to the Woodridge Apartments. The certificate of deposit was released 3 years ago.

The development agreements for both projects have expired and the only remaining Authority guarantees relate to tax credits. These include guarantees to fund operating deficits. Without the guarantees, the tax credits would be lost.

The Authority also claimed to have allocated substantial costs to the projects and followed its plan for allocating costs. It also stated that administrative sanctions are not appropriate because all funds used or advanced and other actions taken were to preserve low-income housing, and there was no evidence of any improper use of the funds. It claimed the activities were authorized by and met the objectives of the United States Housing Act of 1937, as amended. The Act authorizes housing authorities to enter into joint ventures to provide for low-income housing and to assist with or participate in mixed-finance projects. The Authority provided a copy of 42 U.S.C. sec. 1437z-7, which authorizes assistance and participation in the form of loans or guarantees for low-income tax credit mixed-finance projects, which became effective on October 1, 1999.

### **OIG EVALUATION OF AUDITEE COMMENTS**

As stated in the Finding, the Authority violated its ACC requirements by inappropriately advancing funds and pledging assets. While HUD may have approved certain documents regarding the developments, it did not approve use of any HUD funds or the pledging of assets. Further, it did not authorize any loan guarantees. The Authority did not specify what documents HUD approved, but we believe they likely relate to the Woodridge development. Woodridge is a HUD-insured multifamily development as opposed to a public housing development. As such,

HUD's Office of Housing was involved in the rehabilitation to assure all requirements for obtaining HUD insurance were met. The Office of Housing does not have the authority to approve the use of any funds subject to an ACC or authorize pledging of assets or loan guarantees. The Office of Public Housing must do any such approvals. As further stated in the Finding, when the Office of Public Housing became aware of the Authority's activities, it instructed the Authority to restore the funds to the appropriate accounts.

As of September 30, 2002, the Authority's books of record showed it had provided \$1,850,833 for the developments. The Authority provided documentation to the Office of Public Housing supporting that \$874,015 was repaid between October 1, 2003, and March 5, 2004. We reviewed the documentation and confirmed the repayments. The Authority further claimed that \$901,376 of the amount shown on its books of record was from loan proceeds that were incorrectly recorded. However, the Authority did not provide documentation supporting its claim. Further, according to a schedule provided by the Authority at the exit conference, there was a net decrease of about \$37,000 between October 1, 2002, and September 30, 2003. The Authority did not provide any evidence supporting the reduction. We revised the Finding and Recommendation 1A to show the Authority repaid \$874,015. HUD should require the Authority to collect and reimburse its Public Housing program the remaining balance of \$976,818, or provide support showing the funds were repaid or were the result of accounting errors.

Regarding the Authority's claim that it never pledged its full faith and credit for a \$1,300,000 loan or otherwise as North Carolina law does not permit such a pledge, we do not agree. The Authority clearly signed documents pledging its full faith and credit, which violated the ACC. The Authority's cite of Article 4, Chapter 159-46, of the North Carolina General Statutes appears irrelevant since it pertains to the pledging of faith and credit for the payment of principal and interest on bonds. However, we added a recommendation requesting HUD's Office of General Counsel to review the Statute and determine whether it is applicable.

Since the development agreements for both projects have expired, the risk to the Authority has been reduced. However, the Authority is still at risk for any loss of the tax credits. Further, as stated in its comments, the Authority has remaining guarantees to fund operating deficits. While terminating the agreements might result in losing the tax credits, the agreements are in violation of the ACC. The Authority should not have entered into the agreements without prior HUD approval. Further, while 42 U.S.C. sec. 1437z-7 authorizes assistance and participation in the form of loans or guarantees for low-income tax credit mixed-finance projects, it did not become effective until October 1, 1999. The Authority entered into its guarantee agreements in 1997.

Our review of the Authority's records showed that it charged some construction labor costs to the developments. However, it did not allocate any management salaries or overhead costs to the developments.

We believe that given the nature of the ACC violations, administrative sanctions are warranted.



## **RECOMMENDATIONS**

We recommend the Director, Office of Public Housing:

- 1A. Require the Authority to collect and reimburse its Public Housing Program the remaining \$976,818 of the \$1,850,833 due from its affiliates, or provide support showing the funds were repaid or were the result of accounting errors. The Authority should also be advised to make no further advances/expenditures of HUD funds on behalf of non-HUD entities without prior approval from HUD.
- 1B. Determine whether the Authority properly retained, and subsequently pledged, the \$649,139 certificate of deposit attributed to Section 23 Leased Housing escrows. Require the Authority to remit any improperly retained funds to the Treasury.
- 1C. Obtain release of any pledged assets and require the Authority to assure that it will no longer pledge assets.
- 1D. Require the Authority to terminate the inequitable agreements and advise the Authority against making future guarantees without HUD approval. Should the Authority refuse to terminate the agreements, refer the Authority to the PIH Assistant Secretary for default of its ACC.
- 1E. Request HUD's Office of General Counsel to review Article 4, Chapter 159-46, of the North Carolina General Statutes to determine whether it is applicable to the Authority's pledge of assets for loans.
- 1F. Take appropriate administrative sanctions against the Authority's Executive Director and Board members.
- 1G. Review the Authority's allocation of costs to ensure reasonable allocations of salaries and other costs, such as use of office space and equipment. If you determine that costs were not properly allocated, require the Authority to reimburse the appropriate program account(s) from non-Federal funds.
- 1H. Require the Board of Commissioners to establish adequate controls to monitor Authority interactions with affiliated entities and ensure transactions comply with the ACC and other HUD requirements.

## MANAGEMENT CONTROLS

Management controls include the plan of organization, methods and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organization, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

We determined the following management controls were relevant to our audit objectives:

- Compliance with Laws and Regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Safeguarding Resources – Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss and misuse.

To assess the relevant controls, we:

- interviewed Authority staff;
- reviewed general ledgers, bank statements, and other accounting and administrative records;
- reviewed the Authority's financial statements.

A significant weakness exists if management controls do not provide reasonable assurance that resource use is consistent with laws, regulations, and policies; and, that resources are safeguarded against waste, loss, and misuse.

Based on our review, we identified the following significant weaknesses:

- Compliance with Laws and Regulations - Authority management violated its ACC with HUD by inappropriately advancing funds and pledging assets for non-Federal development activities. As of September 30, 2002, management had advanced \$1,850,833 of HUD program funds to pay development expenses of privately owned projects.
- Safeguarding Resources - Authority management inappropriately pledged Authority assets for loans needed to fund private development activities. Further, management exposed the Authority to large contingent liabilities through inappropriate pledges and guarantees to private investors.

## **FOLLOW-UP ON PRIOR AUDITS**

The OIG issued two audit reports (99-AT-204-1804) and (99-AT-204-1805) on April 14, 1999. The audits were initiated based on a citizen's complaint.

Report 99-AT-204-1804 reported the Authority had made ineligible payments to public housing residents from its Public Housing Drug Elimination Grant. All recommendations in the report have been closed.

Report 99-AT-204-1805 on the Authority Residents' Council's operation of its Tenant Opportunity Program found the Authority improperly loaned public housing funds to the Residents' Council. Recommendation 2A remains open with a Final Action Target Date of September 1, 2007.

In 2003, we received similar complaints from the same citizen. We reviewed the allegations and found they did not have merit. Thus, we did not perform additional audit work or issue a report.

Darnell and Thompson PC, Certified Public Accountants, completed the most recent audit of the Authority's financial statements for the 12-month period ended September 30, 2002. The report did not contain any findings.

There were no findings or recommendations in any of the reports that affected our audit objectives.

## **ISSUES NEEDING FURTHER STUDY AND CONSIDERATION**

During our review it came to our attention that the Authority had pledged assets in connection with other loans. We did not expand the audit scope to determine whether these asset pledges represented additional ACC or regulatory violations.

On August 31, 2001, the Authority consolidated several outstanding notes into a \$1.3 million loan from Branch Bank & Trust. The loan is secured with a deed of trust on a property referred to as Woodfin. Woodfin is a commercial building in downtown Asheville containing office space and apartments. Documentation indicates the Authority may have purchased the building with a \$504,000 loan from NationsBank. We did not determine whether the Authority used ACC funds to purchase the building, collateralize the loan, or make loan payments. We also did not determine whether maintenance or other expenses incurred with respect to this project were properly allocated.

The Authority secured at least two other loans with Authority assets. On September 28, 2000, the Authority obtained a \$420,029 loan from Wachovia Bank, and on July 28, 2000, it obtained a \$499,000 loan from Mountain Bank. These loans were apparently obtained to fund cost overruns for the tax credit projects. Authority documentation indicated these loans were secured with mortgages the Authority was holding in connection with Eastview Condominiums. Staff described Eastview Condominiums as a HUD HOPE I homeownership project. We did not expand our audit scope to determine whether the Authority violated its ACC or other HUD requirements by pledging the mortgages.

HUD's North Carolina State Office of Public Housing should review these matters and take whatever additional action it deems appropriate if additional violations are found.

**SCHEDULE OF QUESTIONED COSTS**

<u>Recommendation</u>	<u>Ineligible</u> <sup>1</sup>	<u>Unsupported</u> <sup>2</sup>
1A	<u>\$ 1,850,833</u>	
1B		<u>\$ 649,139</u>
Total	<u>\$ 1,850,833</u>	<u>\$ 649,139</u>

---

<sup>1</sup> Ineligible costs are those that are questioned because of an alleged violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the expenditure of funds.

<sup>2</sup> Unsupported costs are those whose eligibility cannot be clearly determined during the audit since such costs were not supported by adequate documentation.

**AUDITEE COMMENTS**



**"KEEPING THE PROMISE"**

April 15, 2004

Gerald R. Kirkland  
Assistant District Inspector General  
U.S. Department of Housing and Urban Development  
Office of Inspector General  
John Dungan Bldg., Room 116  
710 Locust Street  
Knoxville, Tennessee 37902

Via e-mail and U. S. Mail

Dear Mr. Kirkland:

Thank you again for the courtesies extended to us during the exit interview on March 16, 2004, regarding the draft audit report of the Housing Authority of the City of Asheville sent to me dated March 4, 2004 from Sonya D. Lucas, Acting Assistant Inspector General for Audit in the Office of the Inspector General for Audit, Region 4, Atlanta, Georgia. We have now completed our written comments for inclusion in the published report. Attached please find those written comments. As you will note, we are requesting that the recommendations in the draft audit report, including the recommendation for consideration of sanctions, be amended or removed.

Please let me know if you have any questions.

Very truly yours,

David Jones, Jr., Executive Director

cc: Cleatus B. Tate, Board Chairman

165 SOUTH FRENCH BROAD AVENUE 28801  
P.O. BOX 1898, ASHEVILLE, NORTH CAROLINA 28802  
PHONE (704) 258-1222 FAX (704) 254-2276

MEMORANDUM

TO: Sonya D. Lucas, Acting Regional Inspector General for Audit, 4AGA

FROM: David Jones, Jr., Executive Director, Housing Authority of the City of Asheville

cc: Michael A. Williams, Director, Office of Public Housing, 4FPIH

DATE: April 15, 2004

Re: Housing Authority of the City of Asheville  
Asheville, North Carolina

Pursuant to instructions in the March 4, 2004, letter from you to David Jones, Jr. Executive Director, Housing Authority of the City of Asheville, Asheville, North Carolina, we are providing written comments to the draft audit report of the Housing Authority of the City of Asheville dated March 4, 2004.

SUMMARY

We do not believe the Authority violated its ACC with HUD as mentioned in the draft audit report. Federal and state law authorize the activities undertaken by the Authority. The State Office of HUD in Greensboro, N.C. received and reviewed or approved certain documents regarding the development activities.

The draft audit report refers to using HUD program funds of \$1,850,833. The actual amount loaned from HUD program funds was \$969,653.55. The balance of the \$1,871,029.76 reflected in the Authority's records was from a conventional loan. Part of the conventional loan was incorrectly shown on the Authority's books as a housing receivable on advice of outside CPA's. As of March 5, 2004, before the draft audit report was received and prior to the exit interview on March 16, 2004, and as of the date of these written comments, all of the HUD funds advanced, except for \$83,972.06, has been repaid to the public housing account of the Authority. This information was provided to Gerald R. Kirkland, Assistant District Inspector General, in the form of an "Accounts Receivable Rollforward" report at the exit interview on March 16, 2004. It is anticipated that the balance will be repaid by the end of this calendar year.

There was never a pledge of the Authority's full faith and credit for a \$1,300,000, loan or otherwise as North Carolina law does not permit such a pledge. The pledge of a certificate of deposit in the amount of \$649,140, was required as part of a HUD form entitled "Completion Assurance Agreement" in lieu of a performance bond for renovations to the Woodridge Apartments. That certificate of deposit was released three years ago and all of those funds have been transferred to a public housing account of the Authority. The

development agreements for both projects have expired and most of the guarantees found in the guarantee agreements have expired. The remaining guarantees relate to the tax credits for the projects, which tax credits would be lost without the guarantees remaining in place.

The Authority allocated substantial costs attributable to the projects. The Board of Commissioners was informed at least quarterly of all development activities.

With regard to the recommendations, we comment as follows:

1. Except for a balance of \$83,972.06, all of the total of HUD funds advanced has been repaid to the Authority's public housing account and no further advances will be made. The balance will be repaid by the end of this calendar year.

2. The \$649,140, certificate of deposit was released three years ago and the funds have been returned to the Authority's public housing account.

3. No assets of the Authority are currently improperly pledged.

4. The development agreements have expired. Most of the guarantees in the guarantee agreements have expired and those remaining are essential to preserve the tax credits for the projects.

5. Administrative sanctions are not appropriate as all of the funds used or advances and actions taken were to preserve low income housing within the Authority's jurisdiction and there is no evidence of any improper use of the funds. The activities were authorized by and met the objectives of the United States Housing Act of 1937, as amended, and the North Carolina law establishing housing authorities. The two projects have been renovated and are currently in use and were recently appraised at values greater than before renovation. At the end of the tax credit time period, the Authority has the first right of refusal to purchase each of the projects.

6. Allocation of costs followed the Authority's plan for allocation of costs.

7. Periodic reports on and reviews by the Board of Commissioners were conducted during the renovation of both projects.

The recommendations should be amended to reflect the information from the exit interview and from these written comments.

#### BACKGROUND

Chapter 157 of the North Carolina General Statutes governs housing authorities in North Carolina. N. C. Gen. Stat. sec. 157-2 establishes findings and declarations of necessity in the State of North Carolina for the provision of safe and sanitary dwelling accommodations for persons of low income and declares that there is a shortage of decent, safe and sanitary housing in North Carolina for persons and families of moderate income



and encourages programs to provide housing for such persons. N. C. Gen. Stat. sec. 157-9 sets forth the powers of housing authorities in North Carolina. That statute authorizes the Authority to provide for the construction, reconstruction, improvement, alteration or repair of any housing project, to borrow and mortgage property. N. C. Gen. Stat. sec. 157-9.2 authorizes the Authority to make or participate in the making of mortgage loans to sponsors of residential housing and to borrow money to carry out and effectuate its corporate purposes. N. C. Gen. Stat. sec. 157-17 authorizes the Authority to enter into mortgages when a project is financed with governmental aid.

The United States Housing Act of 1937, as amended, (the "Act") declares it to be the policy of the United States to assist States and their political subdivisions, including public housing authorities, in remedying the shortage of affordable housing for low-income families. The Act authorizes housing authorities to enter into joint ventures to provide for low-income housing and to assist with or participate in mixed-finance projects which provide low-income housing. A copy of 42 U.S.C. sec. 1437z-7, which authorizes assistance with and participation in the form of loans or guarantees for low-income tax credit mixed-finance projects and became effective on October 1, 1999, is attached.

Woodridge Apartments are owned by Asheville-Woodridge, L.P., and includes 160 units. The apartments were previously owned by a private developer and were a Section 23 project. The acquisition of and renovations to Woodridge Apartments were financed by an FHA insured loan approved by the State Office of HUD in Greensboro, N.C. and insured that the apartments would be operated as affordable housing units. The project is identified as FHA Project Number 053-35684-PM-SR. The note and deed of trust are HUD forms and the amount of funds financed for the project were limited to that approved by HUD. Advances under the construction loan, which was FHA insured, were approved by the State Office of HUD in Greensboro, N.C. The Authority has the sole and exclusive right of first refusal to purchase the project for a purchase price based upon Section 42(i)(7) of the Internal Revenue Code after the close of compliance period for the project. Before the property was renovated it was appraised at \$3,770,000. After renovations, it was appraised as of January 1, 2002, at \$4,250,000.

McCormick Heights Apartments are owned by Asheville-Mountainside, LLC, and contains 100 units. The apartments were previously owned by a consortium of churches who were facing foreclosure of the mortgage on the apartments. Acquisition of the apartments preserved them as affordable housing units. The renovation project was financed through a commercial mortgage lender. The State Office of HUD in Greensboro, N. C. was informed by the Authority on a timely and regular basis of the cost overruns. The Authority has the sole and exclusive right of first refusal to purchase the project under the same terms as for Woodridge Apartments. Before the property was renovated, it was appraised at \$1,110,000. After renovations, it was appraised as of January 1, 2002, at \$1,750,000.

## FINDING – 1

### The Authority inappropriately advanced funds, pledged assets and guaranteed performance

The draft audit report refers to using HUD program funds of \$1,850,833. The actual amount loaned from HUD program funds was \$969,653.55. The balance of the \$1,871,029.76 reflected in the Authority's records was from a conventional loan. As of March 5, 2004, and prior to the date of the exit interview on March 16, 2004, and as of the date of these written comments all of the HUD funds advanced, except for \$83,972.06, has been repaid to the public housing account of the Authority and the balance will be repaid to that account by the end of calendar year 2004. This information was provided to Gerald R. Kirkland, Assistant District Inspector General, in the form of an "Accounts Receivable Rollforward" report at the exit interview on March 16, 2004. All of the funds were used to complete needed renovations to two low income housing developments within the Authority's jurisdiction. The construction and permanent loans for the Woodridge Apartments project were FHA insured. Notes, deeds of trust and other loan documents for Woodridge Apartments were HUD documents. All advances from the construction loan were reported to and approved by the State Office of HUD in Greensboro, N.C.

The Authority is not authorized by statute to pledge its full faith and credit as it has no taxing power under North Carolina state law. The Local Government Bond Act, found in Article 4 of Chapter 159 of the North Carolina General Statutes, sets forth the only way in North Carolina that a local government can pledge its full faith and credit. In order to do so, the local government unit must have the power to levy taxes and raise other revenues. The specific statutory reference is found in N. C. Gen. Stat. sec. 159-46. There is no authority in Chapter 157 of the North Carolina General Statutes, which sets forth the procedure to establish public housing authorities and grants them powers, to levy taxes or otherwise raise revenues or to pledge their full faith and credit.

State and federal law authorize public housing authorities to participate in and assist with mixed-finance projects developed by a partnership or limited liability company. Those projects may be assisted by private sources, which may include low-income housing tax credits. Public housing authorities may participate or assist with mixed-finance projects in the form of a grant, loan, guarantee or other form of investment.

The certificate of deposit in the amount of \$649,140 was from a Section 23 project known as Deaverview Apartments. When the housing bonds for the construction of the project were paid off in 1991, there were excess funds on deposit and those were returned to the Authority. A final budget for the close out of the project was submitted to and approved by the State Office of HUD in Greensboro, N.C. The Authority followed HUD guidelines for making its final budget report on the Section 23 Project to HUD. Those funds were deposited in an Authority account and were used as the deposit to secure the Completion Assurance Agreement required for HUD Project No. 053-35684-PM-SR, the Woodridge Apartments FHA insured project. When the construction loan for the Woodridge Apartments project was paid off by the permanent loan, the Completion Assurance Agreement was satisfied and the certificate of deposit was released. The funds were then

deposited in the public housing account of the Authority.

The "development agreement" for each project has expired as the agreements only covered construction and completion of the projects. The projects have been completed.

Some of the guarantees found in the "guaranty agreement" for each of the projects have expired. The remaining guarantees are as follows:

1. Funding of operating deficits during the "Operating Guarantee Period" in an amount up to \$350,000 for Woodridge and up to \$225,000 for Mountainside. The operating guarantee for Woodridge expires in May of 2005 and for Mountainside in February of 2006.
2. Making certain non-reimbursable payments, which are the same operating deficits, limited to an amount up to \$350,000 for Woodridge and \$225,000 for Mountainside.

The remaining guarantees, therefore, insure that the projects will achieve the tax credits and make the project viable. Without them, both projects would have to be restructured with the loss of the tax credits and the community would face the prospect of losing 260 units of affordable housing.

The Authority allocated costs according to its adopted plan.

Reports on each project were made to the Board of Commissioners on at least a quarterly basis.

#### CONCLUSION

While there were funds advanced from public housing monies for completion of each of these projects, the Authority's actions were authorized by federal and/or state law and both projects were completed and resulted in improved properties whose appraised values are greater than before the improvements were made. Except for \$83,972.06, all of the public housing funds have been repaid and that balance will be repaid by the end of calendar year 2004. The improvements to both projects result in maintenance of 260 units of low income housing in the Authority's jurisdiction. The Authority is granted the sole and exclusive first right of refusal to purchase each of the projects after the tax credit compliance period ends. At no time was the full faith and credit of the Authority pledged. There is no evidence of any misuse of funds. The remaining guarantees should stay in place for the limited time left in order to insure the continued existence of tax credits for the projects. None of the remaining guarantees would create a material impact on the financial stability of the Authority. Based on the actions being authorized by federal and/or state law, the restoration of the funds and other actions taken, the maintenance of two low income housing projects totaling 260 units in the Authority's jurisdiction, on which the Authority holds the sole and exclusive first right of refusal for purchase, no sanctions are warranted and no further action should be contemplated.