

U.S. Department of Housing and Urban Development
Pacific/Hawaii
Office of Inspector General for Audit
450 Golden Gate Avenue, P.O. Box 36003
San Francisco, California 94102-3448

August 28, 1996

AUDIT RELATED MEMORANDUM
96-SF-119-0806

MEMORANDUM FOR: Nicholas P. Retsinas, Assistant Secretary for Housing, Federal Housing Commissioner, H

THROUGH: Susan Gaffney, Inspector General, G

FROM: Gary E. Albright, District Inspector General for Audit, 9AGA

SUBJECT: Interim Report
Review of Preservation Activities
Kukui Towers
Honolulu, Hawaii

In response to requests from your Deputy Assistant Secretary for Multifamily Housing Programs and Senator Inouye's office, we are performing a review of preservation activities at Kukui Towers. Although our review continues, the selection of the priority purchaser for Kukui Towers appears to be contrary to existing requirements and lacks the requisite resident support. Also, the \$40 million capital grant attached to the preservation efforts appears to exceed the current value of Kukui Towers. Since the capital grant for Kukui Towers will be recaptured by September 30, 1996 if the sale to a priority purchaser is not accomplished by that date, your immediate attention to Kukui Towers is essential.

BACKGROUND

Kukui Towers is a 380 unit building currently insured under Section 236 of the National Housing Act. It is co-located with another, mirror-image 380 unit building, Maunakea Towers, insured under Section 221. The owners for both buildings are THC-Ginza Joint Venture. In order to preserve affordable housing at Kukui Towers, HUD agreed to provide a \$40 million capital grant tied to the sale of the building to a priority purchaser. The current owner agreed to a mandatory sale, which requires (in HUD handbook 4350.6, paragraph 7-4) acceptance of the first bona fide offer from a qualified resident organization or community based organization (CBO). The owners chose to refinance Maunakea Towers under Section 223(f) of the Act, and this building did not qualify for preservation.

The bona fide offer from any priority purchaser requires support from a majority of the existing residents. When the first bona fide offer is received and accepted, the property sale and capital grant is then contingent upon the priority purchaser's submission of an acceptable plan of action.

For preservation purposes, the property sales price is determined by calculating the best and highest use - recognizing that the best use may not be affordable housing.

INTERIM RESULTS

The HUD Hawaii State Office did not require the owner to accept the first bona fide offer from a priority purchaser.

The Kukui Towers Resident Council submitted the first offer to the owner on March 6, 1996, proposing to submit its earnest money deposit to the escrow company upon the owner's acceptance of its offer. The owner rejected this offer because (1) the Resident Council had not submitted its earnest money deposit with the offer, and (2) the resident support petition did not identify the intended type of homeownership. Our review (of HUD handbook 4350.6, paragraph 7-7) indicated that the Resident Council's support petition met HUD requirements.

Instead, the owner accepted a March 19, 1996 offer from a CBO, Hui Kauhale, Inc., an organization created by Ecumenical Association of Housing (a California based nonprofit organization). The owner accepted Hui Kauhale's offer without the earnest money deposit.

The Resident Council submitted the earnest money deposit on March 27, 1996, but found that the owner had already accepted the CBO's offer - conditioned on the determination that Hui Kauhale qualified as a priority purchaser. The owner reportedly received the CBO's earnest money on March 26, 1996.

The HUD Hawaii State Office concurred in the owner's rejection of the Resident Council's offer, and the owner's acceptance of the CBO's offer as the first bona fide offer.

Hui Kauhale's board lacked the required 1/3 representation by local members, so did not qualify as a priority purchaser. To correct this condition, Hui Kauhale created Kukui Kauhale, Inc. to purchase Kukui Towers. HUD approved Kukui Kauhale as a priority purchaser on March 29, which was (1) three days after the owner accepted the CBO offer, and (2) two days after receipt of the earnest money deposit from the Resident Council.

On May 21, 1996, HUD concurred in the owner's selection of the CBO's offer, even though HUD documents through May 7, 1996 raised questions of the CBO's eligibility at the time the owner accepted the offer.

The HUD Hawaii State Office did not adequately review the resident support petitions before accepting the owner's selection of the CBO's offer.

HUD handbook 4350.6, paragraph 7-7E, states the CBO will submit a resident support petition that represents a majority interest in the CBO. Paragraph 7-9B requires HUD to determine if the petition is acceptable.

When both the Resident Council and the CBO provided evidence of resident support for their respective offers, it was clear that HUD's followup review was essential. Both the CBO and Resident Council reported a majority of resident support.

Allegations of coercion to sign support petitions were presented by residents to HUD and local and federal elected officials, but HUD took no action before concurring in the CBO's offer. On April 10, 193 Kukui Towers residents provided HUD with written requests to withdraw earlier support for the CBO.

In July 1996, HUD reviewed the CBO's resident support petition and found 65 invalid signatures out of the 301 listed, but considered the balance to remain a majority interest. Our review revealed that:

- at least 53 of the residents that withdrew support from the CBO on April 10 had been included in the original petition.

- at least 36 signatures were either individuals not on the rent rolls or could not be distinguished as a current resident.

Our review indicates the CBO lacked support from a majority of the 380 units (narrowed to one signature per unit). In fact, our analysis indicates that only 40% of the units supported the CBO's petition. Aside from our analysis, HUD's July 1996 review did not consider the 193 units (by itself a majority) which formally withdrew support for the CBO on April 10, 1996.

HUD provided a \$40 million capital grant to preserve affordable housing at Kukui Towers although the grant appears to exceed the property's current value

The sales price for Kukui Towers is approximately \$51 million, as calculated under preservation procedures. However, co-located with Kukui Towers is Maunakea Towers, which is a 380 unit, mirror image building. The HUD Hawaii State Office staff reported that the current appraised value for Maunakea is approximately \$23 million. Also, HUD Hawaii State Office staff reported that Kukui Towers, based on a current appraisal which would consider preservation procedures, would result in a sales price of \$10 to \$15 million less than the current sales price of \$51 million. Basically, the \$40 million capital grant preserves affordable housing for a building that is worth less than the grant.

SUMMARY

Our interim results indicate that HUD did not adequately monitor the preservation activities at Kukui Towers. The three significant concerns disclosed to date are:

- HUD allowed the owner to accept other than the first bona fide offer from a priority purchaser.

- HUD did not assure majority resident support for the CBO.

- HUD is vulnerable to substantial criticism for providing a \$40 million grant to Kukui Towers for preservation when it knows that Maunakea Towers is worth \$23 million and knows that Kukui is overvalued by \$10 to \$15 million.

While your staff in Headquarters agreed to delay closing the sale of Kukui Towers until September 25, 1996, the cited concerns remain unresolved. If closing is not achieved by September 30, 1996, the capital grant for preservation will be returned to the U. S. Treasury.

Aside from the ongoing concerns expressed by residents of both Kukui and Maunakea Towers, we have today received calls or correspondence from the CBO, Resident Council consultant, Senator Inouye, and your staff in Headquarters and Honolulu. The time available to address the preservation concerns at Kukui Towers is short, and our recommendations for action follow.

RECOMMENDATIONS

We recommend that you return the Kukui Towers capital grant funds to the U. S. Treasury.

As an alternative, if you can justify the effective use of the capital grant funds for preservation when the property value does not appear to support the grant amount, we recommend one of the following three options:

1. Arrange for a vote by Kukui Towers residents to determine majority interest in either the CBO or the Resident Council as the priority purchaser. The winner would have to submit a plan of action for HUD approval by September 30, 1996.
2. Arrange for assignment of the \$40 million capital grant from the CBO to the Resident Council, and proceed to closing prior to September 30, 1996.
3. Arrange for a mutually agreeable joint venture between the Resident Council and the CBO to own and manage Kukui Towers. Adjust the plan of action accordingly and close by September 30, 1996.

If you have any questions, please call me on (415) 436-8102.