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MEMORANDUM FOR: Ellen R. Connolly, Director of New England Multifamily Hub, 1AH

John A. Dvorak

FROM: John A. Dvorak, Regional Inspector General for Audit, 1AGA

SUBJECT: Massachusetts Housing Finance Agency - Multifamily Property Demonstration Disposition Program

INTRODUCTION

We audited the Demonstration Disposition (Demo-Dispo) program administered by Massachusetts Housing Finance Agency (Agency). The objective of our audit was to determine the propriety of the use of funds under the U.S. Department of Housing and Urban Development's (HUD) Demo-Dispo program by the Agency and the extent of the Agency's oversight of the program.

Under the Demo-Dispo program, HUD provided the Agency more than $535 million during the 10-year period ended May 2004. As a result of HUD investing over $535 million under the program, HUD gained 11 revitalized properties with 1,850 units. Our review disclosed that the costs charged by the Agency for the expenses reviewed were supported and reasonable and met the requirements of the agreement between HUD and the Agency.

METHODOLOGY AND SCOPE

To determine the propriety of the use of funds, we:

- Reviewed the Demo-Dispo Agreement, as amended, to determine HUD's and the Agency's responsibilities.

- Reviewed the Agency's written procedures on procurement, management agents, property and management reviews, internal audit, operating budgets, security, accounting procedures, preliminary disposition plans, and final disposition plans to determine if procedures were followed.

- Interviewed Boston Office of Housing staff, Agency staff, and HUD property management system specialists to determine their roles and responsibilities regarding the Demo-Dispo program.

- Reviewed the Agency's operational controls regarding separation of duties, procurement, disbursements, and authorization to ensure that the controls were operating effectively and efficiently.

- Reviewed the Agency's accounting controls to assure the reliability and integrity of financial reporting regarding postcode accounts and disbursement subsystems and controls over use of the HUD property management system.

- Reviewed Agency's controls over the procurement process and discussed the procurement process with staff. Using a non-representative selection of contracts, we examined $59,551,169 in a universe of $297,498,723.[1] We reviewed the expenditure for the contracts for the architect and the construction contractor that had the largest number of construction change orders. Our review was limited to the selected contracts, and the results may not be representative of the entire universe of contract costs.

- Reconciled a difference between the cash disbursement subsystem and general ledger subsystem.

- Selected the following operating expenses to review: architect and engineer fees, asset management, environmental hazard abatement, management fees, payroll, security contracts, and tenant relocation. We used a non-representative sample and based our selection on the total dollar amount of the expense and the dollar value for that expense in any given year in the audit period. We examined $13,245,816 from a universe of $300,733,531. We limited our review to the selected expenses, and the results may not be representative of the entire universe.

- Reviewed four categories of operating expenditures in which HUD directly paid vendors for expenses of the Demo-Dispo program. These four categories were activity supplies, flooring contract, heating fuel, and resident pay and totaled $838,369.

We conducted our audit between June 2004 and November 2004, covering the period August 15, 1994 through May 31, 2004. When appropriate, the audit was extended to include other periods. We conducted our audit in accordance with generally accepted government auditing standards.

[1] The $297,498,723 consists of contract expenditures from operating activities and rehabilitation activities.

BACKGROUND

On September 30, 1993, our office issued a report, Management of Multifamily Property Disposition Inventory Property Disposition Branch, 93-BO-113-0003, which found that the Boston Office's Multifamily Property Disposition Branch lacked the staffing necessary to properly monitor and manage the inventory of 14 projects containing 1,878 dwelling units. This report advised that the 14-project inventory in Boston was the oldest, the most physically deteriorated, and most poorly managed in the country. Crime, drugs, and vandalism plagued these areas. On September 16, 1993, HUD implemented a demonstration program through which HUD would enter into an agreement with a State housing finance agency for the management and disposition of the 14 HUD-owned properties.

On April 8, 1994, HUD selected the Massachusetts Housing Finance Agency (Agency) as the public sector asset manager to administer the multifamily inventory in Boston, MA. The Agency was responsible for developing cost-effective methods for improving day-to-day management of 14 HUD-owned properties. These properties were the 14 properties identified in the 1993 Office of Inspector General (OIG) audit report. HUD entered into a contract with the Agency on August 15, 1994, to integrate these HUD-owned properties into the Agency's existing operations for the purpose of managing and disposing of them. HUD agreed to waive certain requirements normally imposed on Federal agencies pursuant to the Federal Property and Administrative Services Act. HUD did, however, require the Agency to comply with the competitive bid requirements and procedures set forth in the Management Agreement and the Agency's procurement procedures in procuring the goods and services. On July 28, 1995, HUD and the Agency agreed to add a 15th property to the Demo-Dispo program.

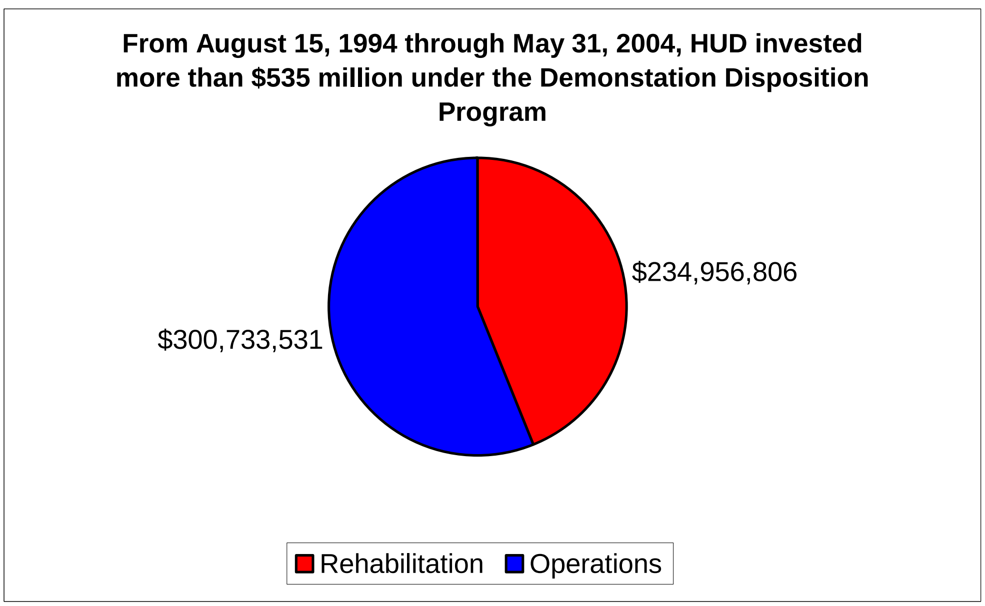
For the 15 multifamily properties subject to this agreement, HUD either owned the property or had taken possession of the property after a borrower stopped paying the HUD-insured mortgage. All 15 properties are located in Boston, MA. and are under the jurisdiction of HUD's Boston office. HUD and the Agency indicated that the 15 properties contained 2,193 units on July 28, 1995. As part of the Demo-Dispo program, the Agency reconfigured the physical layout of several buildings and consolidated certain properties. As a result, the number of units changed to 1,850, and the number of multifamily properties changed from 15 to 11. From August 15, 1994, to December 3, 2004, the Agency renovated these properties and provided interim management services leading to their final disposition. Appendix B delineates the disposition of Demo-Dispo properties.

On November 14, 1996, HUD and the Agency amended their agreement to establish an Indemnification Contingency Fund. Using this fund, HUD and the Agency worked to minimize third-party contractor claims by use of specific terms and conditions in the Demo-Dispo contracts. The Agency required this provision to protect itself against lawsuits or construction arbitrations that might be filed against HUD. Negotiating this contingency delayed bids for construction for 2 years because the Agency would not risk a lawsuit from contractors or tenants. Therefore, HUD established an Indemnification Contingency Fund of $18.7 million of which HUD's obligation to indemnify the Agency is limited to 50 percent of the claim.

In March 2004, the General Accounting Office issued a report, HUD Single-Family and Multifamily Property Programs, GAO-04-390, which identified that HUD had inadequate controls resulting in questionable payments and potential fraud. This report stated that HUD entered into an agreement that made HUD responsible for providing all the money needed to complete the program while the Agency was responsible for developing and monitoring the program. The report identified that HUD granted the Agency the flexibility to make payments off budget. It identified that HUD spent more than $241 million as of September 30, 2002, on expenditures that included abatement of environmental hazards, tenant relocation, and other off budget expenses. As a result, OIG decided to examine operations at the Agency.

RESULTS OF REVIEW

Our review disclosed that the Agency spent $535,690,337 from August 15, 1994, through May 31, 2004, for the renovation, interim management, and ultimate disposition of HUD-owned properties. The Agency reconfigured the 15 properties into 11 properties totaling 1,850 apartment units. The review also found that the costs charged by the Agency were supported and reasonable, and met the requirements of the agreement for the cost reviewed. The Agency also handled the rehabilitation budget separately and concurrently with the operations budget for the properties, as required. Under the Demo-Dispo program, the Agency managed the reconfiguration and the renovation of the properties while continuing to operate the 11 properties as housing for low-income families.



Rehabilitation Budget

Our review disclosed that the Agency prepared and obtained HUD approval on 11 separate rehabilitation budgets, one for each property. The Agency charged rehabilitation expenses in the rehabilitation budgets. The rehabilitation expenses include costs for architects, engineers, general contractors, overhead allowances, and environmental hazard abatement including asbestos removal, lead paint abatement, and treatment of soil contamination.

Contracting

The Agency spent $270,767,752 under construction contracts, which included $67,881,543 in change orders (modifications) to these contracts. The change orders covered increased costs for $33,062,852 in general contractors' expenditures and $34,818,691 in environmental hazard abatement costs. Under the Management Agreement, the Agency was required to award the contracts under competitive bid. We reviewed the Agency's award process and determined whether the construction contracts and modifications were necessary for the renovation of the HUD properties. Using a non-representative selection of contracts, we selected to review the property, Roxse Homes, which had contracts totaling $59,551,169 and had the largest number of construction change orders. Our review was limited to the contracts for Roxse Home and may not be representative of the universe. However, we found no major procurement weaknesses in the award and administration of the architect, engineering, and construction contracts for the Roxse Homes property.

Architect's Modifications

The Agency spent $26,730,971 in architects' contracts to complete the renovations for all 11 properties. This included $10,381,303 for the original contracts, $13,435,548 in modifications, and $2,914,120 to modify the Clerks of the Works contract. Roxse Homes had architectural contracts totaling $5,947,249, which included $1,845,731 for the original contract, $3,626,732 in modifications to the contract, and $474,786 in modifications to the Clerk of the Works contract. The review of the contract modifications for Roxse Homes confirmed that all modifications had HUD approval. The Agency also prepared a written justification supporting that each modification was necessary for the renovation of the property. These changes dealt with contaminated soil issues that were outside the original scope of the contract. The changes were prompted when Massachusetts' Department of Environmental Protection required the removal of more than 50,000 cubic yards of topsoil to address soil contamination at Roxse Homes. Our review also found that the modification to the Clerk of the Works contract was for increased construction administrative service costs, and that the Agency had obtained HUD approval for the modification. The increases in administrative service costs were caused by delays due to the abatement of the soil contamination.

Change Orders for Contractors

Roxse Homes had 300 change orders totaling $16,253,806. These change orders included 67 change orders for environmental hazards abatement totaling $5,686,656, and 233 change orders for increases in general contractor costs totaling $10,567,150. We examined 18 change orders whose value was $100,000 or more. The review of the change orders showed that the work listed in the change orders was outside the scope of the original contract, the Agency had written justification to support the change orders, and HUD had approved the change orders. Our review also showed that the Agency's legal department had taken court action against construction contractors, architects, and management agents that did not follow their contracts. In addition, the Agency's legal counsel provided us the names of the violators, the nature of the violations, and the actions taken against the violators.

Operating Budgets

The Agency submitted 11 operating budgets and HUD approved them. The operating budgets included day-to-day expenses such as administration expenses, rental payments for tenant relocation, office salaries, management fees, maintenance salaries, and supplies. We selected seven categories of expenditures totaling $169,622,786 within the operating budgets of $300,733,531. These seven categories were selected because of their dollar value or the unusual nature of the cost involved. These seven categories were:

Architect & engineer fees	$8,107,873
Asset management	$16,851,865
Environmental hazards	$68,246,739
Management fees	$7,579,295
Repairs payroll	$15,451,903
Security payroll/contract	$33,362,035
Tenant relocation	$20,023,077

After testing 100 expenditures totaling $13,245,816, we discontinued our testing because the expenses reviewed were reasonable and necessary for the renovation and management of the properties. We also found that the items were documented; approved by the appropriate Agency staff; and proper expenses of the Demo-Dispo program.

Four Operating Categories of Direct Payments

Under the Demo-Dispo program, HUD directly paid the vendors for certain goods and services delivered to the properties. The direct vendor payments for goods and services involved four categories: (1) activity supplies, (2) flooring contract, (3) heating fuel, and (4) resident payments. Deliveries to the properties were limited to $25,000, and the limit was adjusted to the need of the property. Our review found that the Agency had controls ensuring that deliveries were signed by an authorized person for the management agent and that the $838,369 expended in these four categories was for necessary costs.

Conclusion

Overall, our review disclosed that the Agency established adequate accounting and operational controls to ensure that it supported valid expenditures of $535,690,337 and met the requirements of its agreement with HUD. Under the HUD Demo-Dispo program, the Agency, using HUD funding, renovated neglected properties to provide decent, safe, and sanitary housing for low-income families. Appendix A shows pictures of some of the properties from 1993 (before the Demo Dispo program) and 2004, while appendix B shows the new resident partnerships and/or non-profit owners.

Appendix A

CAMFIELD GARDENS/ESTATES

In 1993, the Camfield Gardens project consisted of a contiguous grouping of three-story and four-story buildings located on Camden Street and Lenox Street. Built in the late 1960s or early 1970s, the complex could house up to 136 families. In 1993, the OIG inspector found air infiltration problems with most of the windows.

Camfield Gardens in August 1993

As part of the reconstruction, the Agency razed the building and reconfigured the property to a series of buildings with town house apartments. In 2004, the renamed Camfield Estates can house up to 102 families.

Camfield Estates November 2004

GENEVA APARTMENTS

In 1993, the Geneva project consisted of low-rise, three-story apartment buildings and one building of row-house style units on Geneva Street. Built in the 1960s or 1970s, this property could house up to 60 families. Before 1993, HUD had boarded up the row-house units due to their very poor condition including sloping floors and mildew. In 1993, the OIG inspector advised that rehabilitation of these row-house units might not be economically feasible and recommended that HUD obtain an engineer's report to make a final determination of the future viability of these units.

Uninhabited row houses at Geneva in August 1993

To renovate Geneva Apartments, the Agency razed all buildings at the property. The Agency constructed new buildings, reconfigured the property to townhouse-style apartments able to house up to 47 families, and landscaped the property.

Courtyard view at renovated Geneva property in November 2004

In 1993, the vacant unit's bathroom (pictured below) is in poor conditions with the bathroom sink on the floor and the toilet missing.

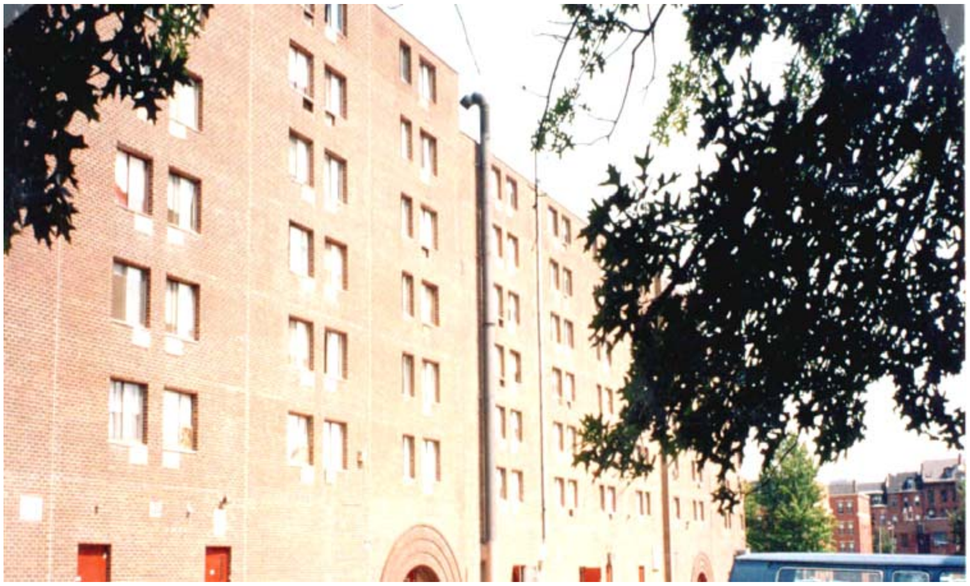
Bathroom of a recently vacated unit at Geneva in August 1993

In 2004, a vacant unit's bathroom is clean. The renovated electrical and plumbing fixtures are in working condition.

Bathroom of a recently vacated unit at Geneva in November 2004

GRANT MANOR

In 1993, Grant Manor housed 185 families and consisted of: (a) a seven-story apartment building (b) a low-rise, four-story, apartment building and (c) several buildings of row-house-style units. The complex appeared to have been built in the 1960s or 1970s.



Grant Manor on August 1993

As part of the reconstruction, the Agency abated environmental hazards, upgraded the mechanical systems, reconfigured the unit-mix, replaced roofs, and repaired masonry. In November 2004, the property houses up to 179 families.

Grant Manor on November 2004

ROXSE HOMES

Through intercession by the court after protracted litigation, HUD obtained possession of Roxse Homes on December 23, 1992. HUD instructed the former owners to turn over all records to HUD's contractual management company. At HUD's request, OIG performed a separate audit of Roxse Homes to ensure that all assets of the property were accounted for and turned over to HUD's contractual property manager. Issued June 30, 1993, this audit, Roxse Homes Multifamily Project, 93-BO-212-1007 found that more than $429,000 in potential assets that were not returned to the property when HUD took possession. Because of this separate audit, we did not include Roxse Homes in our 1993 audit of the Multifamily Property Disposition program; thus, OIG does not have any 1993 pictures of Roxse Homes. In 1993, Roxse Homes consisted of 13 buildings containing 364 apartments, retail space, and office space.

Renovated Roxse Homes in November 2004

As part of the reconstruction, the Agency razed Roxse Homes because of the deteriorating structural conditions at the site. As discussed in the Results section of this report, Roxse Homes also had environmental hazards that HUD needed to correct—in particular, soil contamination. In November 2004, the property houses up to 346 families in an eight-story building.

A recently vacated unit at Roxse Homes in November 2004

Appendix B
Demonstration Disposition Program

Property	Final Units	Ownership Type	Disposition Completed
Camfield Estates	102	A resident controlled non-profit corporation	8/13/2003
Fieldstone Apts.	84	A non-profit corporation without any resident association interest	6/2/2003
Franklin Highlands	286	A limited partnership between the resident association and a for profit general partner	12/13/2002
Geneva	47	A partnership between the resident association and an economic property corporation *	9/1/2002
Grant Manor	179	A limited partnership between the resident association (minority interest) and a community property corporation	2/11/2002
Grove Hall	104	A limited liability company with a non-profit as sole partner.**	6/30/2004
Roxse Homes	346	A limited partnership between the resident association (minority interest) and a for profit corporation.	3/4/2004
Theroch	191	A limited liability corporate partnership between the resident association (minority interest***) and a community property corporation	9/3/2004
Sonoma, Maple, Schuyler	100	A limited liability corporate partnership between the resident association (minority interest****) and a non-profit partner	9/15/2004
Washington Heights	175	A limited liability corporate partnership between the resident association (majority interest*****) and a non-profit partner	9/30/2004
Academy Homes II	236	A resident-controlled, non-profit corporation	12/3/2004
Total units	1850		

* This resident association has a goal to transition to tenant ownership 5 years from disposition.
**This resident association may become a member of the Limited Liability Company and co-owner with minority interest upon meeting HUD/Agency guidelines.
*** This resident association may attain sole ownership or co-ownership with majority interest upon meeting HUD/Agency guidelines.
**** After 4 years, this resident association may attain majority ownership and, by year 7, may become sole owner upon meeting HUD/Agency guidelines.
***** After 3 years, this resident association may become sole owner upon meeting HUD/Agency guidelines.