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2005-LA-1002

TO: Milan Ozdinec, Deputy Assistant Secretary, Office of the Deputy Secretary for Public Housing Investments, PI

Joan S. Hobbs

FROM: Joan S. Hobbs, Regional Inspector General for Audit, Los Angeles, 9DGA

SUBJECT: Housing Authority of Maricopa County - Mixed-Finance Development Activities, Phoenix, AZ

HIGHLIGHTS

What We Audited and Why

We reviewed the Housing Authority of Maricopa County's (Authority) development and management of two mixed-finance housing projects–Rose Terrace and Maricopa Revitalization.

The objectives of our review were to ensure that the Authority (1) followed the U.S. Department of Housing and Urban Development's (HUD) approval requirements/conditions related to the disposal of 135 low-income public housing units as part of the overall development of its two mixed-finance housing projects; (2) obtained required approval from HUD for development of the projects; (3) made appropriate amendments to its Annual Contributions Contract (contributions contract) and Declaration of Trust to reflect both the disposition of involved housing units and development of the new mixed-finance units; and (4) made adjustments to its contributions contract unit count for budgetary purposes, including computation of operating subsidy, replacement housing, and capital grant funding eligibility.

What We Found

The Authority did not carry out its replacement housing projects as described in its approved disposition plans or obtain required HUD approval of its mixed-finance proposals for Rose Terrace and Maricopa Revitalization. Although HUD never approved the projects, the Authority went forward with them and invested more than $7.2 million of its Federal assets in the projects. Additionally, since the Authority did not obtain HUD approval for the mixed-finance projects, it also did not or could not make amendments to its Declaration of Trust, which is required by HUD to protect the low-income character of the developments and HUD's interest. The failure to follow HUD's development requirements has put the Authority's $7.2 million investment at risk. The Authority also did not amend its contributions contract to reflect the changes resulting from the two projects. As a result, it has received more than $500,000 of operating subsidy and capital grant funds for the units in these projects to which it is not legally entitled. These deficiencies resulted from a failure of the Authority's former Executive Director to ensure that HUD requirements were met during and after the development of the projects. This was compounded by HUD's failure to provide appropriate oversight to ensure that the Authority carried out its approved low-income public housing unit disposition activities and related replacement housing projects in accordance with applicable requirements.

What We Recommend

We recommend that the Deputy Assistant Secretary for Public Housing Investments require the Authority to work with HUD to ensure the project/units meet the legal and compliance requirements of the mixed-finance development program, including contributions contract and Declaration of Trust amendments. If the projects cannot be brought into compliance, the Authority should be required to refund the questioned costs to its low-income public housing program using nonfederal funds.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We discussed the review results with Authority officials during the audit and at an exit conference held on February 25, 2005. We also provided the Authority with a copy of the draft audit report for comments on February 11, 2005. We received their written response on March 7, 2005. The Authority expressed general agreement with the report conclusions and agreed to work with HUD to implement the report recommendations. The complete text of the Authority's response can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

The Housing Authority of Maricopa County (Authority) was created in 1943, as authorized by the U.S. Housing Act of 1937 and Arizona Revised Statute 36-1404. The Authority operated as an independent entity until February 1992, when Maricopa County took over its administration through the County's Housing Department. Under the County government, the Maricopa County Board of Supervisors functioned as the Board of Commissioners for the Authority. In July 2003, the County again made the Authority an independent entity, and an intergovernmental agreement delegated the authorities under Arizona Revised Statute 36-1404 to the Authority. Currently, each member of the Maricopa County Board of Supervisors appoints one Authority commissioner, and these commissioners serve as the governing board of the Authority. As one of its early actions, the Board of Commissioners replaced the Acting Executive Director with a new Executive Director, who assumed his position in January 2004.

Beginning in 2001, the Authority undertook the development of two mixed-finance housing projects. Both projects were originally considered replacement housing and were to be developed in conjunction with a U.S. Department of Housing and Urban Development (HUD)-approved housing disposition plan. Both involved the use of Low Income Housing Tax Credits (tax credits) in the development of the replacement housing units.

Rose Terrace I and II – This is a 120-unit project (separated into a 100-unit phase and a 20-unit phase) located in Avondale, AZ. It was completed around December of 2002 using tax credit financing and approximately $3.8 million provided by the Authority. The funding provided by the Authority was in the form of a $3 million loan, repayable only if there is sufficient project cashflow (final maturity date is 2051), and an additional capital infusion of approximately $767,000. Rose Terrace Development Partnership, LLC, of which the Authority has a very small ownership interest through the managing entity CSA-Rose Terrace, owns the Rose Terrace I and II projects. (Note: CSA stands for Community Services of Arizona, the nonprofit parent entity of CSA-Rose Terrace that has overall control of the project).

Maricopa Revitalization – This project, as approved by HUD in May 2002 (disposition approval), was to consist of 56 single-family scattered-site public housing units that would be sold (transferred) to a new ownership entity, which would then obtain tax credit financing to rehabilitate the units. The units were to be taken off the Authority's Annual Contributions Contract (contributions contract) and then brought back in under a new contributions contract (for operating subsidy only) after completion of rehabilitation. In the end, although all 56 units were sold (ownership transferred) by the Authority, only 35 units were ultimately included in the new ownership entity that received the tax credit financing (Maricopa Revitalization Partnership, LLC). Rehabilitation of the 35 units was completed around October of 2003. Nothing was done with the other 21 units, and they are now owned by CSA-Maricopa Revitalization, LLC, a separate entity formed by Community Services of Arizona and the Authority.

The objectives of our review were to ensure the Authority (1) followed HUD's approval requirements/conditions related to the disposal of 135 low-income public housing units as part of the overall development of its two mixed-finance projects; (2) obtained required approval from HUD for development of the projects; (3) made appropriate amendments to its contributions contract and Declaration of Trust to reflect both the disposition of involved housing units and development of the new mixed-finance units; and (4) made adjustments to its contributions contract unit count for budgetary purposes, including computation of operating subsidy, replacement housing, and capital grant funding eligibility.

RESULTS OF AUDIT

Finding 1: The Authority Failed To Obtain Required HUD Approvals of Its Mixed-Finance Projects – Questioned $7,720,000

The Authority did not develop and manage its two mixed-finance housing projects (Rose Terrace and Maricopa Revitalization) in compliance with pertinent regulations and requirements. It did not obtain HUD approval of the projects before or after development and inappropriately obtained operating subsidy and capital grants for units in the projects without the requisite contributions contract amendments. This resulted in the questionable use of more than $7.2 million of low-income public housing program assets and receipt of more than $500,000 of operating subsidy and capital grants to which the Authority was not legally entitled. Regulations governing the development of mixed-finance housing, 24 Code of Federal Regulations 941, require HUD approval of mixed-finance developments before obligation and expenditure of low-income public housing funds. Such approval is also required for mixed-finance units to be eligible for inclusion under the Authority's contributions contract. Additionally, for units to be eligible for operating subsidy and capital grant funding, they must be under a contributions contract (reference 24 Code of Federal Regulations 990 and 905). In our opinion, the deficiencies noted were a result of negligence by the Authority's former Executive Director, compounded by HUD's failure to provide appropriate oversight. Details relating to each of the two projects are discussed below.

Rose Terrace

The Authority Spent $3.8 Million To Develop Rose Terrace Without HUD Approval

The Authority expended approximately $3.8 million on this project without obtaining HUD approval, as required by pertinent regulations contained in 24 Code of Federal Regulations 941.608 and 970.9 and its contributions contract. Authority funds invested in the project consisted of a $3 million loan, payable only if cash flow is available and with a final maturity date of 2051, and an additional capital investment of approximately $767,000 - $647,000 from its HUD-funded capital and replacement housing grants and $120,000 from other low-income public housing sources.

The funds for the Authority's $3 million loan and approximately $120,000 of additional project capital investment came from the sale of 79 Authority-owned public housing units and associated land. HUD's June 1998 disposition approval for this property called for the construction of at least 75 new units (replacement units) of low-income housing, 40 of which would be public housing units (under a new contributions contract) with 35 additional low-income units subsidized by the tax credit funding (80 additional units were actually built using tax credit financing). Before the start of the project, the Authority was to submit a mixed-finance application to HUD for approval. However, this was not done. Instead, in February 2003, approximately 3 months after the project was completed (December 2002), the Authority submitted a Mixed-Finance Operating Subsidy-Only application to HUD. This delayed application could not be processed because appropriate environmental clearances had not been obtained.

The required (after the fact) environmental review was recently completed. However, environmental approval is just the first stage in the approval process. At this time, it is unknown whether all requirements, procedural and legal, were followed during the development phase, which would allow HUD to retroactively approve the project and the expenditure of approximately $3.8 million in Federal funds. In this regard, the application submitted by the Authority in February 2003 was an "operating subsidy only" application that is applicable only if no funds derived from HUD were/are to be used in the development of the project. Since this is not the case, a new mixed-finance application must be submitted to HUD to determine whether retroactive approval of the project is possible. If approval can be obtained, appropriate amendments to the contributions contract and Declaration of Trust (deed restriction) will need to be obtained to protect HUD's and the Authority's interest in the project.

HUD Obligated $104,760 in Operating Subsidy for 40 Units Without a Contributions Contract

The Authority included 40 Rose Terrace units in its operating subsidy application for its fiscal year ending June 30, 2005. HUD approved the Authority's application obligating $104,760 for the 40 units, although these units are not included in the Authority's contributions contract and, therefore, are not eligible to receive an operating subsidy.

When asked why these units were included in the operating subsidy calculations, the Authority's Executive Director stated they were added in anticipation of receiving approval of the contributions contract for the units. He further stated it had been disclosed that the 40 units were in development. However, the Authority has not obtained appropriate approval from HUD for the units. Therefore, the $104,760 of operating subsidy funds for the 40 units represents ineligible funding and must be returned to HUD.

Additionally, the Authority continues to provide maintenance services for the 40 units that have been designated as public housing. Since these units are not under a contributions contract, they are not eligible to receive assistance using the Authority's low-income public housing funds. Accordingly, the Authority should transfer maintenance responsibilities for the units to the Rose Terrace ownership entity until such time as (unless) HUD approves the units for inclusion under its contributions contract.

Maricopa Revitalization

$3.4 Million of Public Housing Assets Were Used for a Mixed-Finance Project Without Obtaining HUD Approval

The Authority used more than $3.4 million of public housing assets for a mixed-finance housing development without obtaining required HUD approval. These assets included the value of 56 public housing units disposed of as part of the transaction and an additional investment of $120,000 of low-income public housing funds.[1]

In May 2002, the Authority received HUD approval to dispose of (sell) 56 public housing units and then rehabilitate them as part of a mixed-finance housing development project using tax credit funds. The units were to be removed from the Authority's contributions contract when sold and then brought back in under a new contributions contract after project completion (after rehabilitation). This disposition approval was subject to obtaining HUD's approval of the mixed-finance application. An application/proposal was submitted in July 2002. However, before HUD initiated its review, the Authority informed HUD that the proposal would be changing and that a new application would be submitted.

No new proposal was submitted by the Authority. However, it went forward with the project, transferring ownership of the 56 units–ultimately 35 units to Maricopa Revitalization, LLC, and 21 units to CSA-Maricopa Revitalization. The 35 units were later included in a tax credit project and rehabilitated. However, the other 21 units were not made part of the tax credit project and were not rehabilitated. The sales price of the 35 units was $2,065,000, which was less than the properties' appraised value of $2,170,050. However, there were no actual sales proceeds.

[1] The $120,000 came from the land sales proceeds related to the Rose Terrace disposition and replacement housing project.

Instead, the Authority took back a $2,065,000 promissory note payable only as the project's cash flow permits and with a final maturity date of May 2019. In addition to the sales price of the properties, the Authority spent $120,000 of public housing funds on the development of Maricopa Revitalization.[2] There was no compensation for the transfer of ownership of the 21 units (valued at $1,147,500) to CSA-Maricopa Revitalization, which still owns the properties. No amendments to the Authority's contributions contract or its Declaration of Trust have been made to account for these ownership changes.

The Authority Received $413,516 of Operating Subsidy and Capital Grant Funds for Units That Did Not Have a Valid Contributions Contract

Although the Authority no longer owns these 56 units, it continues to manage them and receive operating subsidy and capital grant funding in violation of its contributions contract and pertinent regulations (the sale of the units invalidated the existing contributions contract for the units). From the June 2002 sale through September 30, 2004, the Authority received more than $413,000 of questionable operating subsidy and capital grant funding for these 56 units. Although the Authority made adjustments in the Public and Indian Information Center system in September 2004, removing the 56 units from its inventory, these adjustments only affect the computation of capital grant funding eligibility and do not affect the unit count used in the computation of the operating subsidy. Therefore, the Authority continues to receive $12,222 per month of questionable operating subsidy funds.

Conclusion

The Authority has used $7.2 million of Federal low-income public housing assets for these two projects without obtaining HUD approval, without ensuring the legality of the transactions, and without assurance that appropriate legal safeguards are in place to protect its and HUD's interests in the projects (see appendix C). Additionally, it has received more than $500,000 of operating subsidy and capital grant funds for units that are not under a valid contributions contract, necessary for operating subsidy and capital grant funding eligibility. The Authority must work with HUD to attempt to obtain retroactive approval of the projects and regain ownership of the 21

[2] An additional $570,000 of HOME funds were also used on this project. The use of HOME funds for a project receiving an operating subsidy is not allowable under pertinent regulations. This issue will be discussed in a separate report.

units that were not included in the Maricopa Revitalization project. If this cannot be done, the Authority must repay its low-income housing program the $7.2 million of unapproved expenditures. Additionally, the Authority must refund to HUD the $104,760 of ineligible operating subsidy funds it received for Rose Terrace and, absent retroactive HUD approval, refund the $413,516 of questionable operating subsidy and capital grant funds it has received for Maricopa Revitalization.

Recommendations

We recommend that the Deputy Assistant Secretary for Public Housing Investment

1A. Work with the Authority to bring the two projects into compliance with applicable mixed-finance development requirements. If this cannot be done and retroactive approval cannot be obtained, require the Authority to repay the low-income housing program from nonfederal funds the $6,057,259 of low-income housing assets used for the projects (see appendix C);

1B. Require the Authority to refund to HUD the $104,760 of ineligible operating subsidy funds it received for Rose Terrace;

1C. Require the Authority to refund to HUD the $413,516 of questionable operating subsidy and capital grant funding it received for Maricopa Revitalization, unless retroactive approval can be obtained;

1D. Require the Authority to recover the 21 units transferred to CSA-Maricopa Revitalization or refund the value of the properties, $1,147,500, to its low-income housing program using nonfederal funds;

1E. Require the Authority to submit for HUD approval appropriate contributions contract amendments for both projects.

1F. As part of the ongoing approval process, require the Authority to prepare and submit to HUD for approval the appropriate amendments to its Declaration of Trust for the units included in these projects.

SCOPE AND METHODOLOGY

To achieve our audit objectives we reviewed

- Applicable laws, regulations, and other HUD program requirements,

- Project closing documents, available project proposal and evidentiary materials, project accounting records, independent public accountants' reports, project development documents maintained by Community Services of Arizona, Inc., and accounting records maintained by Rose Terrace's current management agent.

We also interviewed appropriate Authority personnel, the project developer, project management agent staff, and HUD program officials.

We performed our review between July and December 2004. The audit period covered the period January 2002 through September 2004.

We performed our review in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

Internal controls is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Compliance with applicable 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.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives

Significant Weaknesses

Based on our review, we believe the following item is a significant weakness:

- The Authority did not have adequate oversight and controls to ensure that its mixed-financed projects were developed and managed in accordance with HUD's requirements (see finding 1).

FOLLOWUP ON PRIOR AUDITS

Prior Report Title and Number

An Office of Inspector General (OIG) audit report related to the Authority was issued in September 2004 (Report # 2004-LA-1007). However, this report dealt with the Authority's management of its Housing Choice Voucher Program and contained no findings related to its mixed-finance development activities.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

Recommendation Number	Ineligible 1/	Unsupported 2/	Funds To Be Put to Better Use 3/
1A		$6,057,259	
1B	$104,760		
1C		$413,516	
1D	$1,147,500		

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.

2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.

3/ "Funds to be put to better use" are quantifiable savings that are anticipated to occur if an OIG recommendation is implemented, resulting in reduced expenditures at a later time for the activities in question. This includes costs not incurred, deobligation of funds, withdrawal of interest, reductions in outlays, avoidance of unnecessary expenditures, loans and guarantees not made, and other savings.

Appendix B

AUDITEE COMMENTS

Housing Authority Of Maricopa County

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March 4, 2005

Joan S. Hobbs
Regional Inspector General for Audit
U.S. Dept. of Housing & Urban Development
611 W. 6th Street, Suite 1160
Los Angeles, CA 90017

Attention: Charles Johnson
Assistant Regional Inspector General, Phoenix

Subject: Housing Authority of Maricopa County, Phoenix, Arizona
Response to Draft Audit Report dated February 11, 2005

Dear Ms. Hobbs:

The Housing Authority of Maricopa County (HAMC), acting through its Executive Director and in consultation with its Board Chairman and staff, is in general agreement with the findings and recommendations as outlined by your Arizona/Phoenix staff.

For your information, the Board of Commissioners of the HAMC were advised in February 2004 that there were a series of HUD program requirements that had not been completely satisfied with respect to the Rose Terrace Development and Maricopa Revitalization. Additionally, a review meeting was held in February 2005 with the managing general partner of both developments regarding the following areas of concern:

a. Property operations at Rose Terrace and status of PH operating subsidy application.
b. History of Scattered Site Tax Credit development and "why" 21 scattered units not transferred to the tax credit project were not in HAMC ownership.

After several attempts by HAMC staff to arrange review discussions with the mixed finance liaison in the LA HUD office, I, was notified to participate in a conference call in March 2004 with HUD on the status of, and receive instructions, as to what would be required to satisfy all requirements for an amended ACC and subsequent receipt of operating subsidy for Rose Terrace. This resulted in my engaging an environmental consultant to begin an Environmental Assessment for, 1) the disposition/demolition of 74 units at Avondale Homes and O'Neil Terrace and 2) the construction of 100 residential units at Rose Terrace Apartments in Avondale.

As this monumental task was being completed in October/November 2004, we additionally reviewed and updated all required evidentiary documents, including an Amended Mixed Finance Annual Contribution Contract with all necessary and required revisions appropriate to Rose Terrace in December 2004. It was my understanding, based on numerous e-mails and telephone contacts with the mixed finance liaison in LA/HUD, that with the documents outlined above an amended ACC was now approvable. It was anticipated that the approval would take place by the end of December 2004.

With specific reference to your staff findings and recommendations, we eagerly anticipate working with the Office of the Deputy Assistant Secretary for Public Housing Investment and the Phoenix HUD Program Center to comply:

1A. HAMC will bring the Rose Terrace and Maricopa Revitalization into compliance with applicable mixed-finance development requirements through consultation with all appropriate HUD office and staff;

1B. HAMC finance staff, after consultation with HUD FMA and after a complete review of the 2004 budget development process, agrees that $101,074 is operating subsidy was received as a result of calculations used anticipating an approval of an amended ACC for Rose Terrace during fiscal 2004; no funds were applied to Rose Terrace. HAMC will, in consultation with the HUD/Phoenix Program Center and the Office of PH Financial Management, Pittsburg, reduce the 2006 budget as directed by the appropriate HUD office;

1C. HAMC will seek retroactive approvals by working with the Headquarters of the Mixed-Finance office and the Phoenix PH Program Center;

1D. CSA-Maricopa Revitalization has, as of February 25, 2005, transferred all 21 units to HAMC. All final legal documentation is in process; additional consultation is being sought from HUD staff;

1E. HAMC will submit any and all appropriate documents for ACC contract amendments for Rose Terrace and Maricopa Revitalization projects to HUD.

1F. HAMC will submit all appropriate amendments to its Declaration of Trust, impacting the Rose Terrace and Maricopa Revitalization projects.

The Board of Commissioners and staff will use these findings to correct any and all past misinterpretations of regulations and/or lack of timely follow-up to work with the various HUD offices to, as quickly as possible, satisfy the findings recommendations.

Please be advised that it is the mission and goal of this Authority to effectively impact and increase the supply of affordable housing and promote opportunities for economic self-sufficiency leading to home ownership throughout Maricopa County.

Your office can be assured, as we go forward, of the Authority's commitment to timeliness, awareness of regulations, cooperation with HUD program staff and a renewed commitment to the highest quality of performance.

Sincerely

Alphonso Patrick

Alphonso Patrick
Executive Director

Appendix C

SCHEDULE OF AUTHORITY ASSETS USED FOR DEVELOPMENT OF THE ROSE TERRACE AND MARICOPA REVITALIZATION PROJECTS

Project	Description	Amount
Rose Terrace	Loan from land sale proceeds	$3,000,000
Rose Terrace	Other costs paid from land sale proceeds	120,311
Rose Terrace	Capital and replacement housing funds	646,898
Maricopa Revitalization	Value of property sold/transferred to project	2,170,050
Maricopa Revitalization	Advance to project from land sale proceeds	120,000
Subtotal		$6,057,259
Maricopa Revitalization	Value of property transferred to CSA-Maricopa Revitalization but not included in the project	1,147,500
Total		$7,205,759