

August 1, 1997

Audit Memorandum
97-SF-201-1803

TO: Joyce Roberson, Director, Office of Public Housing, California State Office, 9APH

FROM: Glenn S. Warner, District Inspector General for Audit, 9AGA

SUBJECT: San Francisco Housing Authority
Developer Selection for the Hayes Valley HOPE VI Development
San Francisco, California

SUMMARY

In response to a citizen complaint and a referral from a HUD contracting division, we reviewed the San Francisco Housing Authority's procedure for selecting the developer of the Hayes Valley HOPE VI project. We found that the developer was not selected competitively, resulting in the lost opportunity to consider proposals from other potential developers and imparting the appearance of possible favoritism. Nevertheless, we are not recommending corrective action. Reprocuring a developer for Hayes Valley would not be practical or prudent. Also, the housing authority's present selection process appears to be open and competitive.

BACKGROUND

HUD awarded a \$22,055,000 HOPE VI grant in February 1996 to the San Francisco Housing Authority to replace public housing units at the Hayes Valley north and south sites. The HOPE VI program was designed to revitalize severely distressed and obsolete public housing developments by encouraging partnerships with the broader community and blending public housing units within mixed-income communities. HOPE VI was intended to: (1) leverage additional public and private sources of capital by using low-income-housing tax credits, taxable or tax-exempt bonds, private mortgage debt, and other sources; (2) explore strategies which create economically integrated communities; and (3) establish innovative partnerships and approaches to owning and managing public housing.

The housing authority selected the developer of the new Hayes Valley housing several years before the HOPE VI grant award. In August 1993, the housing authority's commissioners authorized negotiations to begin with the firm of McCormack Baron. At that time, the housing authority anticipated the use of federal funds to compensate the developer as it also authorized the use of Section 8 reserves for pre-development expenditures. The housing authority entered into a contract with McCormack on March 9, 1995 to demolish the 294-unit Hayes Valley project, considered to be poorly designed and severely deteriorated, and replace it with 194 larger family units. The contract did not quantify compensation or provide a financing plan or construction plans and specifications for the new development. These particulars were to be determined after further study and negotiations. Much of the subsequent negotiations occurred after March 1996 when HUD temporarily took control of the housing authority from the commissioners at the request of the San Francisco mayor.

As finalized, Hayes Valley Apartments Limited Partnership owns the new development. (Ownership reverts to the housing authority at the end of a 57-year land lease.) The three co-general partners

include developer team members McCormack Baron and Related Companies of California, and a nonprofit affiliate of the housing authority, Hayes Valley Housing Corporation. This nonprofit affiliate qualifies the project for property tax exemptions, provided the housing is for low-income households. Limited partners include SunAmerica Housing Fund (the tax credit investor) and the nonprofit Resident Management Corporation as a special limited partner.

As of March 1997, the funding plans for the development include the \$22,055,000 HOPE VI grant, \$14,240,000 raised through the sale of income-tax credits (administered by the California Tax Credit Allocation Committee) to be sold to private investors, \$3,775,600 in loans insured under HUD's Section 221(d)(4) program, and \$511,626 from other sources, for a total of over \$40.5 million. The project has been demolished at both north and south sites. Construction is underway at the north site, and should begin at the south site after escrow closing scheduled for August 1997.

HUD's Inspector General received a complaint from a citizen in September 1996 and a referral from HUD's Administrative Service Center in Colorado in October 1996. One of the allegations made by the citizen was that the developer was not selected competitively. Also, the contracting division of the HUD service center indicated concerns with the developer's selection. The division had performed an analysis of the housing authority's procurement and contracting operations in September 1996, but did not have sufficient time to review the selection process for the developer.

OBJECTIVE AND METHODOLOGY

The objective of this review was to determine whether the selection of the Hayes Valley developer was made in accordance with applicable requirements. To accomplish this, we: (1) interviewed knowledgeable individuals including the complainant, housing authority staff, and HUD procurement and HOPE VI program specialists, and (2) examined applicable records and contractual agreements maintained by the complainant, HUD, and the housing authority. Our conclusions consider written comments provided by the Office of Public Housing Investments, the Office of Public Housing at the HUD California State Office, and the contracting division of the Administrative Service Center at the HUD Colorado State Office. We also provided a draft memorandum to the San Francisco Housing Authority and requested its comments. The housing authority provided no written comments, but the housing authority's acting executive director indicated no disagreement in his discussions with us.

RESULTS

In our opinion, the selection of the developer was made without competition, contrary to requirements. This resulted in the lost opportunity to consider proposals from other potential developers and imparted the appearance of possible favoritism. Consequently, there is no assurance the best selection was made. However, it does not appear practical or prudent to stop the progress made-to-date on Hayes Valley to reopen the selection process for a developer. We also noted that developer selection for subsequent HOPE VI developments is competitive.

Grantees of federal funds must comply with the procurement regulations contained in Title 24 Part 85.36 of the Code of Federal Regulations (24 CFR 85.36). Requirements include procurement of products and services through fair and open competition. The housing authority established a procurement policy intended to conform with HUD requirements, as well as those of the State of California and the city. The policy requires competitive solicitation whenever practical.

When the housing authority selected McCormack Baron in 1993 as the developer for the Hayes Valley project, it provided no other potential developer the opportunity to submit a proposal for

consideration. The housing authority chose McCormack because the firm had been competitively selected in 1992 to do the feasibility study for redeveloping Hayes Valley. Also, the housing authority believed the firm had the expertise the housing authority did not have to put together the ownership entity and obtain the private financing. The firm was also involved in similar mixed-finance developments in Atlanta and St. Louis.

The housing authority considered the selection issue for the developer. Its legal counsel concluded that language in the request for proposal (RFP) on the 1992 feasibility study was sufficient to preclude further solicitation. The feasibility study RFP required firms to provide evidence of "the firm's experience with designing, financing, and developing successful urban residential development projects." Apparently, the housing authority believed that a firm that provided evidence of this experience would permit its designation as a qualified developer of the project as well. A housing authority official told us that everything in the RFP indicated that the housing authority was looking for a firm with the capacity to rebuild the site.

We disagree with the above view. The feasibility RFP had no explicit language indicating that the successful bidder would be necessarily selected or be given preference in any future selection of a developer. Also, HUD procurement specialists said that the housing authority cannot arbitrarily select the feasibility contractor as the developer. These two transactions would require separate procurements unless HUD either approved a non-competitive proposal or granted an exception pursuant to 24 CFR 85.36.

HUD officials in the Office of Public Housing Investment, Washington, D.C., told us that the procurement issue had been discussed in 1996 and they concluded that nothing would be gained by reprocurring a developer. In their opinion, reprourement would not change the applicant pool. However, they could not provide any documentation of this decision.

Still, we believe it is not practical or prudent to stop the project to reopen the selection process at this point for the Hayes Valley development. Further, we note that the housing authority publicized a request for proposals for the development of two subsequent HOPE VI sites. In February 1997, the housing authority published a request for proposals for the development of Bernal Dwellings and Plaza East. Four development firms (which do not include McCormack) have submitted proposals. Thus, it appears a competitive selection will be made for the developer of these sites.

Without fair and open competition for selecting the Hayes Valley developer, the housing authority lost an opportunity to consider proposals from other potential developers and imparted the appearance of possible favoritism. However, the lack of competition had no determinable effect on the development's cost since it would be agreed upon later through negotiation. The new mixed-finance developments, such as Hayes Valley, are not well defined when an owner entity/developer is selected. Ownership and financing arrangements, as well as the plans and specifications of the physical project, need to be determined. Therefore, selection based on price is not possible. New regulations contained in Subpart F of 24 CFR 941, effective July 1, 1996, address this situation. Subpart F authorizes housing authorities to select the owner entity/developer based on qualitative factors without initial consideration of price. Negotiation of compensation may be done later. The requirement for a selection based on fair and open competition remains, however.

The housing authority entered into a disposition and development agreement with McCormack on March 9, 1995, about a year prior to the issuance of the new procurement regulation. Cost as well as financing of the Hayes Valley development were undefined at the time the housing authority awarded the development contract. Once the development contract was awarded, disposition and development agreement required McCormack to submit a financing plan and construction plans and specifications to the housing authority and the Hayes Valley Resident Management Corporation for

approval. Subsequent negotiations were made for an agreed-upon budget for demolishing the existing Hayes Valley structures, constructing new improvements, and the amount of compensation the developer would receive.

The housing authority, through CVR Associates (under contract with HUD to manage the housing authority), CGMS (financial advisors) and the legal firm of Goldfarb and Lipman negotiated with McCormack after the HUD takeover of the housing authority. The following are some favorable results that we noted.

- The housing authority negotiated a contract clause permitting the housing authority to replace McCormack as property manager for cause. The Resident Management Corporation can come to the housing authority with the cause. SunAmerica, the major limited partner, would choose the replacement.
- Reducing the developer's interest. According to CGMS, the housing authority's financial advisors, McCormack Baron's percentage of partnership interest was lowered from 6% to 3.4% on Hayes Valley North through negotiations. Also, McCormack will be required to reduce their partnership interest percentage to cover any development funding shortages at Hayes Valley South.

Although the selection of the developer violated requirements for open competition, we have no recommendations. Reprocuring a developer for Hayes Valley would not be practical or prudent. Also, the housing authority's present selection process appears to be open and competitive.

COMMENTS FROM HUD AND HOUSING AUTHORITY OFFICIALS

We solicited comments on our review results and conclusions from the Office of Public Housing Investments, the Office of Public Housing at the HUD California State Office, the contracting division of the Administrative Service Center at the HUD Colorado State Office, and the San Francisco Housing Authority. The housing authority provided no written comments; however, the acting executive director indicated no disagreement when we discussed the review results with him. HUD officials voiced general concurrence.

The HUD contracting division emphasized that a competitive environment might have resulted in better and less expensive alternatives.

The Office of Public Investments (OPI) expressed doubt on whether the federal procurement regulations applied. The developer had already been selected when the disposition and development agreement was submitted for OPI's evaluation. OPI approved the "disposition" by negotiated "sale" in August 1995 upon a finding of commensurate social benefit as provided under 24 CFR 970.9(a).

We believe that the non-competitive selection of the developer in 1993 violated public policy as expressed in the housing authority's procurement procedures. Further, the housing authority had intended to use federal funds, at least in part, to compensate the developer. Nevertheless, we are not recommending corrective action for the reasons mentioned previously.

Please call senior auditor Mark Pierce at (415) 436-8101 if you have any questions.

DISTRIBUTION

Director, Office of Public Housing, California State Office, HUD
Director, Contracting Division, Administrative Service Center, Colorado State Office, HUD
Deputy Assistant Secretary, Office of Public Housing Investments, HUD
Director, Office of Public Housing Partnerships, HUD
Director, Production Branch, Office of Housing, California State Office, HUD
Secretary's Representative, California State Office, HUD
Office of Comptroller, Texas State Office, HUD
Director, Field Accounting Division, California State Office, HUD
Assistant to the Deputy Secretary for Field Management, HUD
Director, Administrative Service Center, Colorado State Office, HUD
Comptroller, Office of Public and Indian Housing, HUD
Chief Financial Officer, HUD
Deputy Chief Financial Officer for Finance, HUD
Director, Office of Troubled Agency Recovery, HUD
Director, Housing and Community Development Issue Area, U.S. General Accounting Office
Senator John Glenn, Committee on Governmental Affairs, U.S. Senate
Senator Fred Thompson, Committee on Governmental Affairs, U.S. Senate
Representative Pete Sessions, Government Reform and Oversight Committee, U.S. House of Representatives
Subcommittee on General Oversight and Investigations, U.S. House of Representatives
Acting Executive Director, San Francisco Housing Authority