



**U.S. Department of Housing and Urban
Development**
Office of District Inspector General for Audit
Capital District
Room 3154
451 7th Street, SW
Washington, DC 20410

September 24, 1998

Audit Memorandum
No. 98-AO-219-1804

MEMORANDUM FOR: Charles W. Wehrwein, Deputy Assistant Secretary for Multifamily
Housing Programs, HM

FROM: David J. Niemiec, District Inspector General for Audit, Capital District, 3GGA

SUBJECT: Upfront Grant for Ridgecrest Heights Apartments
CEMI-Ridgecrest, Inc.
Washington, DC

We completed a limited review on the upfront grant awarded to CEMI-Ridgecrest, Inc., for the construction of townhomes on the former site of the Ridgecrest Heights Apartments. CEMI-Ridgecrest, Inc., is a nonprofit corporation consisting of Crawford Edgewood Managers, Inc., (CEMI) and the Ridgecrest Heights Tenants Cooperative Association. The nonprofit corporation was established to perform those acts necessary or appropriate to carry out the obligations under the contract of sale for the Ridgecrest Heights Apartments and the upfront grant agreement with HUD. Our objective was to determine whether HUD followed established guidelines in awarding the upfront grant to CEMI-Ridgecrest, Inc.

Based on our review results and existing HUD guidelines in effect when the upfront grant was awarded, we believe HUD properly entered into a negotiated sale with CEMI-Ridgecrest, Inc., for the Ridgecrest Heights Apartments. Furthermore, nothing came to our attention in the HUD guidelines or HUD background clearance process that would have prevented the principals of CEMI and the representatives of the Ridgecrest Heights Tenants Cooperative Association from active involvement in either the sale, upfront grant, or redevelopment of the Ridgecrest Heights Apartments. However, in order to ensure that the redevelopment effort continues to progress as intended under the grant agreement, we are recommending that HUD: (1) become actively involved in monitoring the sale of the townhomes to ensure that returning Ridgecrest Heights Apartments' tenants who qualified for homeownership in the new development are adequately represented; (2) become actively involved in the establishment and monitoring of the Housing Trust Fund for the future residents of the project; and (3) establish a mechanism for the repayment to HUD of approximately \$10 million from the sale of the townhomes. In addition, we are recommending the recovery of an overpayment of \$22,375 to the District of Columbia Housing Finance Agency for a redevelopment loan paid with grant funds; the recovery from CEMI-Ridgecrest, Inc., of \$5,155 in interest earned on money market accounts established with grant

funds; and the transfer of the remaining balance of \$40,058 from the Ridgecrest Heights Apartments rental account to the Housing Trust Fund to be established for the new residents.

BACKGROUND

Ridgecrest Heights was a 331 unit apartment complex located at 800-843 Bellevue Street, S.E., Washington, DC, that was acquired by HUD through a foreclosure sale in October 1995. The Ridgecrest Heights Tenants Cooperative Association, representing over 51 percent of the tenants who wanted to redevelop the property, consulted with Mr. H.R. Crawford, a developer and property manager and President of Crawford Edgewood Managers, Inc., (CEMI) to propose a plan to acquire the apartments and redevelop the site into new townhomes. In September 1996 HUD sold the property for \$1 to CEMI and the Ridgecrest Heights Tenants Cooperative Association with the agreement that both groups form a joint nonprofit corporation named CEMI-Ridgecrest, Inc., to facilitate the redevelopment effort. In addition, tenants who decided not to participate in purchasing a townhome were provided Section 8 vouchers or certificates and were relocated. Mr. Crawford also arranged with the District of Columbia Housing Finance Agency (DCHFA) for a 5-year tax relief for families who purchase units in the new development and to provide housing purchasing assistance.

In conjunction with the property sale, the HUD District of Columbia Office (DCO) approved an upfront grant for \$24.5 million to fund the Ridgecrest redevelopment. The upfront grant agreement was signed in November 1996. The grant included requirements for the construction of a job skills training center and day care facility, the renovation of a community center, and the demolition and redevelopment of the property into 141 townhomes for mixed-income families. In addition, the grant specified that 30 units would be available for qualifying low-income families returning to purchase the new Ridgecrest development townhomes. The grant agreement also provided that a Housing Trust Fund be established in the amount of \$1,937,215 to assist the new homeowners association in the operation of the Ridgecrest development for a period of 10 years. The trust fund will be created from the proceeds of the initial townhome sales. After the trust fund corpus is established, the proceeds from the townhome sales are to be paid to HUD. The trust fund also reverts to HUD after the 10 year period expires.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our objective was to determine whether HUD followed established guidelines in awarding the upfront grant to CEMI-Ridgecrest, Inc. Our review concentrated on the selection process, status on the property development, general operation of CEMI-Ridgecrest, Inc., and HUD's oversight in administering upfront grants.

Our review period was December 1994, when HUD became the Mortgage-in-Possession for Ridgecrest Heights Apartments, through December 1997. We visited and obtained information concerning the upfront grant process from HUD Headquarters, the DCO, the HUD Pennsylvania State Office Multifamily Housing Division, and CEMI's corporate office. During our site work at the CEMI office, we reviewed supporting documentation for the grant drawdowns, as well as bank statements and canceled checks used to account for and disperse

grant funds. We obtained and reviewed HUD's correspondence and guidance memoranda; the contract of sale; the upfront grant agreement; relevant laws and regulations; articles of incorporation, bylaws, and meeting minutes for the Ridgecrest Heights Tenants Cooperative Association and CEMI-Ridgecrest, Inc. We also met and interviewed current and former HUD staff from its Offices of Housing, Budget, and General Counsel as well as representatives from CEMI, and the Ridgecrest Heights Tenants Cooperative Association.

REVIEW RESULTS

Grant Award Process

We believe the DCO properly entered into a negotiated sale with CEMI-Ridgecrest, Inc., for the purchase of the Ridgecrest Heights Apartments and obtaining the related upfront grant. We also believe that the Ridgecrest Heights Tenants Cooperative Association selected Mr. H.R. Crawford and his company (CEMI) as the project manager to partner with in developing a feasible plan to acquire the property from HUD and redevelop the apartment site into townhomes. We found HUD staff were very involved with the tenants' plans for the Ridgecrest development and were aware of the residents' selection of CEMI as the developer prior to accepting HUD's requirement to form a joint nonprofit corporation to facilitate the Ridgecrest redevelopment.

Selection of Participants

We found nothing in the selection process that would have precluded representatives from CEMI, or the Ridgecrest Heights Tenants Cooperative Association from being included in the sale of the Ridgecrest Heights Apartments or the upfront grant transactions involving the Ridgecrest development. We also noted through our review of HUD's Form 2530, Previous Participation Review process, that Mr. Crawford, his company CEMI, and the representatives from the Ridgecrest Heights Tenants Cooperative Association have not been suspended or debarred from participating in HUD programs. The DCO used the information obtained during this clearance process to determine if all participants met the standards established to ensure that all principal/participants in HUD projects will honor their legal, financial, and contractual obligations.

Project Development Status

Our review of CEMI-Ridgecrest, Inc.'s performance under the upfront grant agreement was limited to the initial startup of the Ridgecrest development. We visited the site and held discussions with DCO staff. We noted that the development was ahead of schedule, the majority of the tenants were relocated, and the demolition of the existing structures was approximately 90 percent completed. Approximately \$5.2 million had been drawn down and expended on the initial redevelopment effort. Our review also found that the redevelopment costs included maintenance of the property until the tenants were relocated and the apartments demolished, fees for the developer, demolition costs, legal fees, architectural fees, and other miscellaneous fees related to the startup of the project.

Corporate Structure

Our review of the CEMI-Ridgecrest, Inc., operations noted that Mr. Crawford is both the President and the Treasurer in accordance with the approved articles of incorporation. We believe the management structure gives the appearance that Mr. Crawford retains full operational control over the corporation and the Ridgecrest Heights Tenants Cooperative Association has little involvement. However, the DCO staff agreed to the organizational structure because Mr. Crawford possessed the business knowledge and experience to develop the Ridgecrest Height Apartments' site. This also gave him the authority which he needed to act on behalf of the corporation and to perform the day-to-day operations, such as negotiating and signing contracts, making payments to vendors, etc. We also noted that the corporate bylaws gave Mr. Crawford, as President, the authority and responsibilities to enter into contracts to perform services on behalf of the corporation that are consistent with the terms and purposes in performing its obligations under the HUD agreements.

Lack of Oversight

There was no evidence of continuing HUD staff involvement in monitoring the upfront grant process. However, we noted that a HUD contractor reviews the Ridgecrest project's vouchers and payments to CEMI-Ridgecrest, Inc. We believe HUD needs to continually oversee the entire upfront grant process to ensure that former tenants are actively represented during the homeownership phase of the redevelopment project.

We also noted that the upfront grant provides for the establishment of a Housing Trust Fund in the amount of \$1,937,215 that will be created from the initial sales of the townhomes. The funds will be used to assist the new homeowners association in the operation of the development for a period of 10 years and then the money will revert to HUD. After the initial corpus of the trust fund is established, the proceeds from the sale of the townhomes will be remitted to HUD. However, we noted that there were no established mechanisms to create and monitor the trust fund, no repayment procedures after the trust fund period is completed, and no procedures for the remittance of the townhome sales proceeds to HUD. We believe HUD needs to be more involved in the monitoring of this process to ensure the viability and financial commitments of the project are met.

Predevelopment Loan Overpayment

We found that Mr. Crawford, representing the Ridgecrest Heights Tenants Cooperative Association, obtained a \$200,000 predevelopment loan from the District of Columbia Housing Finance Agency (DCHFA). The proceeds of the loan were used in developing the tenants redevelopment proposal, subsequent modifications to the proposal, and other predevelopment costs. The DCFO authorized Mr. Crawford to repay the loan proceeds from the upfront grant when it was approved. Our review of the predevelopment loan drawdowns and charges showed

that DCHFA was overpaid \$22,375. We believe the overpayment occurred because the DCHFA provided the loan funds on a reimbursable basis totaling \$177,625 and not in a lump sum. When the repayment was made from the upfront grant, a check was issued for \$200,000.

Rental Account Funds Disposition

We reviewed CEMI-Ridgecrest, Inc.'s checking accounting records and noted that the Ridgecrest Heights Apartments rental account showed a remaining balance of \$40,058. The account was established to facilitate the maintenance on the Ridgecrest Heights Apartments prior to demolition. We believe these funds should be transferred to the Housing Trust Fund established by the upfront grant agreement to benefit the new homeowners association that will replace CEMI-Ridgecrest, Inc., when the redevelopment and townhomes sales are completed.

Earned Interest Income on HUD Funds

We found that CEMI-Ridgecrest, Inc.'s staff deposited grant drawdowns funds in interest-bearing money market accounts and approximately \$5,155 in interest was earned. We discussed this issue with Mr. Crawford, President of CEMI-Ridgecrest, and he is now depositing the drawdown funds in a non-interest bearing account. We believe the interest earned on upfront grant funds should be returned to HUD.

* * * * *

We provided our draft report to representatives of CEMI-Ridgecrest, Inc., on June 3, 1998, and received their written comments on August 7, 1998. We have included their comments as an attachment to this memorandum. In general, CEMI-Ridgecrest, Inc., agreed with our conclusions and provided their input to assist HUD in monitoring the development, resolving the issues raised in this memorandum, and implementing our recommendations.

RECOMMENDATIONS

We recommend that HUD:

1. Become actively involved in monitoring the sale of the townhomes to ensure that returning Ridgecrest Heights Apartment tenants who qualify for the home ownership in the new development are adequately represented.
2. Become actively involved in the establishment and monitoring of the Housing Trust Fund for the future residents of the project.
3. Establish and monitor a mechanism to ensure the repayment to HUD of approximately \$10,000,000 from the sale of the townhomes.

3. Recover an overpayment of \$22,375 to the DCHFA for the repayment of the redevelopment loan.
4. Recover from CEMI-Ridgecrest, Inc., \$5,155 in interest earned on money market accounts established by deposited upfront grant funds.
5. Require CEMI-Ridgecrest, Inc., to transfer to the Housing Trust Fund the \$40,058 remaining balance in the Ridgecrest Heights rental account which is used to facilitate the maintenance on the Ridgecrest Heights Apartments prior to demolition .

* * * * *

Within 60 days, please give us, for each recommendation made in the report, 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. Also, please furnish us copies of any correspondence or directives issued because of this audit.

If you have any questions, please contact me or Donald W. Cairns, Assistant District Inspector General for Audit, at (202) 708-0351.

Attachments:

- A - Auditee Comments
- B - Distribution

Attachment A (page 1 of 4)**CEMI-RIDGECREST, INC.****916 PENNSYLVANIA AVENUE, S.E., WASHINGTON, D.C. 20003****(202) 547-4300 FAX (202) 547-4017**

August 7, 1998

Mr. Austin B. Groom, Jr.
District Inspector General for Audit
Capitol District
U.S. Department of Housing and Urban Development
451 7th Street, SW - Room 3154
Washington, DC 20410

Re: Ridgecrest Height Apartments, Washington, D.C.
(Walter E. Washington Estates)

Dear Mr. Groom,

Thank you for providing CEMI-Ridgecrest, Inc. ("the Sponsor) the opportunity to review the draft Audit Memorandum prepared by the Office of Inspector General ("OIG") regarding its review of the Upfront Grant for Ridgecrest Heights Apartments, which will be redeveloped as the Walter E. Washington Estates. The draft Audit Memorandum concludes that HUD properly awarded the Upfront Grant and entered into the negotiated sale of Ridgecrest Heights Apartments with the Sponsor. The draft Audit Memorandum goes on to recommend that HUD take additional steps to ensure that the redevelopment effort continues to progress as intended under the Upfront Grant Agreement. We would like to provide you with additional information to assist HUD in monitoring the development and considering the matters discussed in the draft Audit Memorandum.

The draft Audit Memorandum recommends that HUD undertake additional monitoring of the development with respect to the following:

- 1) Insuring that former tenants are adequately represented and are given every opportunity to qualify for homeownership;
- 2) Th establishment and monitoring of the Housing Trust Fund;
- 3) The partial repayment of the Upfront Grant from excess proceeds from the sale of the townhouses;
- 4) The need for the Sponsor to attempt to recover an overpayment of \$22,375 to the District of Columbia Housing Finance Agency ("DCHFA);

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- 5) The Sponsor's repayment of interest earned on grant funds placed in a money market account; and
- 6) The disposition of the remaining rental account balance.

We will address each of the recommended action points below.

RESIDENT INVOLVEMENT

The draft Audit Memorandum indicates that HUD should take a more active role in ensuring the involvement of the former residents. We appreciate HUD's interest in this area and we would like to apprise you of our efforts to assist the former residents of Ridgcrest Heights Apartments in becoming homeowners at Walter E. Washington Estates.

The Sponsor has held homeownership workshops and provided counseling to former residents of the Ridgcrest Height Apartments as well as to the community at large. Among other things, we are assisting them in applying for any forms of assistance for which they might qualify, including Home Purchase Assistance Payments (HPAP) from the District of Columbia. We are pleased to report that our efforts have been successful, and that to date, more than 27 former residents have placed deposits to purchase townhouses at the Walter E. Washington Estates. We will continue to work with those former residents who may qualify to become homeowners and who have expressed an interest in doing so.

HOUSING TRUST FUND

The Upfront Grant Agreement provides for the Sponsor to establish a Housing Trust Fund in the amount of \$1, 987,215.00 from proceeds of the sale of townhouses. The Housing Trust Fund is to be invested in an annuity in order to assist the homeowners' association in the operation of the homeownership component of the development for the first 10 years after completion. The draft Audit Memorandum focuses on the need for HUD to monitor the creation and operation of the Housing Trust Fund.

Our counsel is drafting an agreement covering the establishment and operation of the Housing Trust Fund, and we will provide a draft to HUD for advance review to ensure that the terms are acceptable to HUD. We already have deposited \$10,000 into an account with Riggs Bank that will serve as the Housing Trust Fund account, and we expect that Riggs Bank will be the trustee of the Housing Trust Fund. The \$10,000 was transferred to that account from the Ridgcrest Heights rental account.

We would like to discuss with HUD the timing to fully fund the account. While the Upfront Grant Agreement provides that the "initial" proceeds from the sale of units will be paid to the Housing Trust Fund, funds received from the initial sales of the townhouses will be required to pay for the completion of the construction, because of unanticipated development costs. As

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you may already be aware, the cost of development has been increased dramatically due to circumstances beyond the control of the Sponsor. The construction contract has been expanded to include remediation efforts to address severe adverse soil conditions which have greatly increased

the cost of development. Because the Upfront Grant will be exhausted prior to the completion of all the townhouses, we expect that the initial sale proceeds will be needed to complete the development. Therefore, we recommend that the complete funding of the Housing Trust Fund be delayed until the development is completed. There appears to be no need to have the Housing Trust Fund fully funded during construction and while the Sponsor effectively controls the homeowners' association. The sales proceeds generated after the completion of the construction will far exceed the amount required for the Housing Trust Fund.

REIMBURSEMENT TO HUD FROM EXCESS SALES PROCEEDS

The Upfront Grant Agreement provides for the Sponsor to pay to HUD excess proceeds from the sale of the townhouses as partial repayment of the Upfront Grant. The Sponsor will continue to make available to HUD the books and records from which HUD in its monitoring of the funds received from the sale of the townhouses and the disposition of those proceeds.

As explained above, however, the Sponsor has incurred significant unanticipated costs because of severe soil erosion, and thus, the amount of sales proceeds ultimately available for repayment to HUD after the completion of the development and the funding of the Housing Trust Fund will be less than the amount approximated in the draft Audit Memorandum.

Furthermore, the amount of funds available for repayment of a portion of the Upfront Grant will be less than anticipated. As indicated in the Upfront Grant Agreement and the "Final Disposition Plan" prepared by HUD, the Sponsor expected to receive a grant from the District of Columbia Development Zones Administration ("DCDZA") in the amount of \$3,631,000.00. The purpose of this grant was to provide a repayment source for a portion of the Upfront Grant. However, DCDZA was unable to make a contribution to the project due to a short-fall in appropriations. Consequently, the amount of repayment of the Upfront Grant from sales proceeds will be reduced by the amount of the DCDZA funds which were expected but not awarded.

In sum, the amount of sales proceeds available for repayment of the Upfront Grant will be reduced by: (i) the amount necessary to address the adverse soil condition; (ii) the amount of funding necessary to complete construction, and (iii) the amount of the DCDZA funding which did not materialize.

OVERPAYMENT TO DCHFA

The draft Audit Memorandum indicates that there is an overpayment to the District of Columbia Housing Finance Agency in the amount of \$22,375. According to the draft Audit Memorandum, the total funds drawn from DCHFA were \$177,625.00. The loan was to be a zero

Attachment A (page 4 of 4)

the amount loaned by DCHFA. Therefore, OIG estimates an overpayment of \$22,375.00. The Sponsor intends to request that DCHFA repay these funds to HUD, or in the alternative, that DCHFA transfer them to the Housing Trust Fund. We will provide HUD with a copy of each request.

RECOVERY OF INTEREST ON GRANT FUNDS

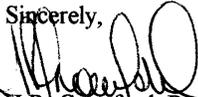
The draft Audit Memorandum notes that HUD has a general policy that grant funds cannot be used for investment purposes or deposited into an interest bearing account, and that \$5,552 in interest earned on the grant funds is not property of the grantee, but rather belongs to HUD. Our records indicate that \$5,154.85 has been earned in interest on grant funds held by the Sponsor. We request that HUD permit the Sponsor to deposit the \$5,154.85 in interest earned on the Upfront Grant funds in the Housing Trust Fund for the benefit of HUD and the Homeowners Association. Remaining grant funds have been transferred to a non-interest bearing account and there should no longer be a problem concerning this policy. We will continue to work with your office to resolve the discrepancy in the amount of earned interest reflected in our respective records.

TRANSFER OF RENTAL ACCOUNT

The draft Audit Memorandum requests that the remaining balance in the Ridgecrest Heights rental account be transferred to the Housing Trust Fund. The draft Audit Memorandum indicates a remaining balance of \$40,058.00. Currently, however, \$21,320.05 remains in that account, as the prior balance has been applied towards the establishment of the \$10,000.00 Housing Trust Fund, operating expenses for the development, and the employment training of the site manager. Records pertaining to this account are available for HUD's review.

We hope that this letter brings you up to date on the development activities and will assist HUD in its monitoring of the Upfront Grant. Should you have any questions, please call me or Cynthia Dickens at 202/547-4300.

Sincerely,



H.R. Crawford, President
CEMI-Ridgecrest, Inc.

cc: Monica Hilton Sussman

Attachment B**Distribution:**

Secretary's Representative, Mid-Atlantic District, 3AS
State Coordinator, District of Columbia Office, 3GS (2)
Director, Baltimore Multifamily Hub, Maryland State Office, 3BHM(2)
Director, Multifamily Housing Director, District of Columbia Office, 3GHM
Director, Administrative Service Center 2AA
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Audit Liaison Officer, 3AFI
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Chief Financial Officer, F (Room 10164) (2)
Deputy Chief Financial Officer for Finance FF (Room 10164) (2)
Comptroller/Audit Liaison Officer, Office of Housing, HF (Room 5132) (5)
Assistant Secretary for Housing, H (Room 9100)
Deputy Assistant Secretary for Multifamily Housing Programs, HM (Rm. 6106)
Director, Housing Finance Analysis Division, REF (Rm. 8204)
Director, Housing and Community Development Issue Area, U.S. GAO, 441 G Street, NW, Room 2474, Washington, DC 20548 (2)
The Honorable John Glenn, Ranking Member, Committee on Governmental Affairs, United States Senate, Washington, DC 20515-4305
The Honorable Fred Thompson, Chairman, Committee on Governmental Affairs, United States Senate, Washington, DC 20515-4305
Ms. Cindy Sprunger, Subcommittee on General Oversight and Investigations, Room 212, O'Neill House office Building, Washington, DC 20515
Mr. Pete Sessions, Government Reform and Oversight Committee, Congress of the U.S. House of Representatives, Washington, DC 20510-6250
The Honorable Dan Burton, Chairman, Committee on Government Reform and Oversight, U.S. House of Representatives, Washington, DC 20515-6143