



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

October 31, 1995

Audit-Related Memorandum
96-SF-111-0801

MEMORANDUM FOR: Michael Kulick, Acting Director, Office of Housing, 9DH

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

SUBJECT: Limited Review of LAO Monitoring of
Finley Square Cooperative
Los Angeles, California

INTRODUCTION

We performed a limited review of the HUD Los Angeles Multifamily Housing Management's (LAO) monitoring of Finley Square Cooperative (Project) because of a citizen's allegation that the LAO's monitoring of the project was inadequate. We found that the LAO could have more closely monitored the project's physical and financial condition, and if it had done so it might have ensured more timely corrective actions by the management agent and owners to improve deficiencies in both areas.

BACKGROUND

The project is an 18 unit apartment complex located in South Central Los Angeles, California. Alpha Management managed the project until October 1993. At that time International Realty and Investments (IRI) took over as the management agent.

The project's \$347,000 mortgage was insured by HUD in May 1973 under Section 236 of the National Housing Act and it was current as of December 1994. The project has received Section 8 assistance for all 18 units since September 1977. The LAO designated the project as "troubled" in December 1993 due to regulatory agreement violations, management problems, and failure to promptly respond to its correspondence.

The review generally covered the period January 1991 through December 1994 but was extended to other periods when appropriate. We performed the field work from October 1994 through January 1995. We discussed the results of our review with the LAO staff and have included the comments of the LAO Acting Director of the Office of Housing in this memorandum as appropriate.

REVIEW RESULTS

Our review disclosed that the allegation was valid but limited resources did, and will continue to, restrict LAO's ability to monitor all its projects. We noted instances where LAO should have, but did

not act to correct known problems. Unless work conditions change, insufficient staffing, excessive workloads and other priorities will continue to limit LAO's ability to monitor all projects and take prompt corrective action on all problems. To protect the tenants and preserve the properties, we believe that the LAO will need to encourage greater tenant participation in monitoring and reporting on deficient physical and financial conditions of projects. The deficiencies noted for Finley Square are discussed separately as two subtopics:

Physical Monitoring

HUD staff can usually detect deteriorating physical conditions at projects through annual inspections or through reviews of mortgagees' annual physical inspection reports. Using those methods the LAO was aware of problems at Finley Square. It did not, however, have the resources to closely monitor the problems at Finley Square and those at all of the other projects for which it is responsible.

The project's physical condition deteriorated since the LAO's last annual inspection in October 1992, at which time it reported a satisfactory rating. The LAO did not make an independent inspection in 1993; however, the loan servicer accompanied the management agent (IRI) during its December 1993 physical inspection that disclosed significant health and safety problems in several of the project's units. The LAO, however, did not ensure that the management agent corrected the problems promptly. The LAO also did not make a physical inspection of the troubled project in either 1994 or the first six months of 1995.

We visited the project in October 1994 and observed deficiencies and/or got tenants' comments on potential health and safety problems. We communicated these problems to the LAO staff who then met with the project's Board and IRI in December 1994 to discuss the corrective actions needed.

The loan servicer acknowledged that the LAO had designated the project as troubled in December 1993 and should have made subsequent on-site inspections. She said that the construction analyst was not able to inspect all of the many troubled projects in the LAO's inventory. The construction analyst, in turn, confirmed that he may not have had time to inspect the project even if it had been scheduled. He is the only analyst available to inspect over 50 troubled or potentially troubled projects. He is also responsible for inspecting reserve for replacement work for projects in the LAO area; therefore, he is not able to accomplish all of the inspections that are necessary.

Financial Monitoring

The LAO did not aggressively follow up on indications of the project's declining financial condition. For years the project suffered from insufficient rent revenues and deteriorating financial conditions. For at least six years, December 1985 through April 1992, the project did not submit any requests for a rent increase. During that time, the rents remained at the 1985 level while the project's payables for repairs and maintenance increased from \$14,156 on December 31, 1986 to \$53,021 on December 31, 1993. It appears that the rent revenues were not sufficient to pay for increasing project operating expenses.

The project had large negative surplus cash balances that exceeded \$49,000 each year in 1991, 1992 and 1993. Also, the accounts payables for those periods ranged from \$53,021 to \$59,039, substantially exceeding the \$3,479 limit imposed by the regulatory agreement.

In November 1992 the LAO approved the project's request for a rent increase; however, we believe that financial conditions at the project clearly indicated there was a need for an increase in rents before then.

The LAO staff acknowledged they did not follow up on the deteriorating conditions disclosed in the

financial statements. Despite the staffing/workload problems, the loan servicer agreed that the LAO's past monitoring of the project was not adequate and that it should have made a management review. The LAO last made a management review of the project in September 1988. The loan servicer advised, however, that she and other loan servicers are each responsible for an average of 65 multifamily projects including other troubled and potentially troubled projects.

* * * * *

The LAO disagreed with our draft finding and claimed that it did adequately monitor the project in a timely manner. After Finley Square was designated a troubled project, the LAO assigned it to an experienced senior servicer to address the project's physical and financial problems. The LAO provided a chronology of the loan servicer's actions to show the intensive servicing of the project since November 1993.

We agree that the LAO acted responsibly in November 1993 by assigning a senior servicer to address the project's numerous problems; however, It did not comment on its prior inaction. We believe that the LAO will continue to suffer from heavy workloads and a shortage in staff. To protect the safety and health of tenants and to preserve the physical condition of the projects, LAO should encourage tenants to become more involved in monitoring the physical and financial condition and management of the projects where they live. In addition, loan servicers need to recognize and act promptly whenever indicators reflect changes in a project's financial and/or physical condition.

We are not making any recommendations that are to be controlled under the Departmental Audits Management System but are providing you with this information so that it can be considered to enhance monitoring in the future. Please call Glenn Warner, Assistant District Inspector General for Audit, at (415) 556-1010 if you have any questions.

Attachment: Distribution

DISTRIBUTION

Comptroller, 9AF
Director Housing Division, 9DH (2)
Area Coordinator, Los Angeles Office, 9DS
Director, Accounting Division, 9AF
Assistant to the Secretary for Field Management, SC (Room 7106)
Marta Angueira, Audit Liaison officer, HF (Room 5132) (3)
Acquisitions Librarian, Library, AS (Room 8141)
Director, Participation & Compliance Division, HSLP (Room 6274)
Director, Division of Housing Finance Analysis, TEF (Room 8212)
Chief Financial Officer, F (Room 10166) (2)
Deputy Chief Financial Officer for Operations, FO (Room 10166)
Associate Director, U.S. GAO, 820 1st St. NE Union Plaza, Bldg. 2,
Suite 150, Washington, DC 20002, Attn: Jim Wells