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LM089911

Rehabilitation Of Clifton Terrace Apartments In Washington, D. C.

B-168791

Department of Housing
and Urban Development

BY THE COMPTROLLER GENERAL
OF THE UNITED STATES

089911

3-14-75

SEPT. 23, 1970



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-168191

Dear Mr. Broyhill:

The General Accounting Office has examined into the rehabilitation of the Clifton Terrace Apartments in Washington, D.C., under the below-market interest rate program authorized by section 221(d)(3) of the National Housing Act, as amended (12 U.S.C. 1715 1). The review was made in accordance with your request of October 15, 1969, and subsequent discussions with your staff.

Our principal observations are summarized in the digest appearing at the beginning of the report. As agreed to by your staff, copies of the report are being made available to other interested members of the Congress, the Department of Housing and Urban Development, the Housing Development Corporation--sponsor of the project--and the Winston A. Burnett Construction Company of New York, Inc.--the general contractor.

We did not obtain written comments on matters discussed in the report from officials of the Department, the sponsor, or the general contractor. This fact should be taken into consideration in any use made of the information presented.

We trust that the information furnished will serve the purpose of your request.

Sincerely yours,

A handwritten signature in cursive script that reads "James B. Stacks".

Comptroller General
of the United States

The Honorable Joel T. Broyhill
House of Representatives

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ABBREVIATIONS

BMIR	below-market interest rate
D.C.	District of Columbia
GAO	General Accounting Office
HDC	Housing Development Corporation
HUD	Department of Housing and Urban Development
Office of Standards	Office of Assistant Commissioner for Technical and Credit Standards

D I G E S T

WHY THE REVIEW WAS MADE

As a result of allegations made in a report issued in September 1969 by a private citizen, the Department of Housing and Urban Development (HUD) investigated the rehabilitation of the Clifton Terrace Apartments, Washington, D.C. The 285-unit project is financed with a mortgage loan insured by HUD under its below-market interest rate program authorized by the National Housing Act. The allegations can generally be categorized under two major areas--the project had been approved by HUD for mortgage loan insurance even though it was not economically feasible and the rehabilitation work was of poor quality and was not in accordance with approved specifications.

At the request of Congressman Joel T. Broyhill, the General Accounting Office (GAO) reviewed the results of HUD's investigation which was completed in February 1970. GAO concluded that further examination and analysis of these matters were required because of:

- the nature of the allegations,
- the slow pace of the rehabilitation work coupled with reports of a substantial cost overrun, and
- certain questions raised by HUD's investigation regarding the decision to insure a mortgage loan of \$4.4 million for the project and the adequacy of the rehabilitation specifications.

GAO did not obtain written comments on the matters discussed in the report from HUD, the project sponsor, or the general contractor.

FINDINGS AND CONCLUSIONS

In GAO's opinion, HUD's decision to insure a \$4.4 million mortgage loan for purchase and rehabilitation of the property was not supported by an adequate financial analysis. HUD's policy provides for the assumption of reasonable risks to achieve important social objectives, and, although HUD was aware that there were some economic risks involved in the project, the record did not clearly show that HUD had determined the full extent of the economic risks. (See p. 12.) The basis for a number of decisions made by HUD in approving mortgage insurance for the project appeared questionable, as noted below.

1. GAO believes that HUD's headquarters office should not have approved mortgage insurance for the Clifton Terrace project without benefit of a fair market value appraisal of the property.

Although HUD regulations do not require fair market value appraisals of property to be rehabilitated, HUD's Washington, D.C., insuring office told GAO that it had made an appraisal which indicated a fair market value of about \$1 million. It is possible that the purchase price of \$1.4 million could have been significantly reduced had all parties to the negotiations, including HUD headquarters officials, been aware of this appraisal. (See pp. 13 to 16.)

2. In determining the maximum mortgage to be insured, HUD did not, in GAO's opinion, reasonably estimate the cost of rehabilitating the apartments. HUD's estimate was based on the cost of new construction and did not include the increased costs which should have been expected to result from the arrangements underlying the project, such as:
 - a. contracting with newly established general contractor and subcontractors; and
 - b. employing and training unskilled or semiskilled workers on the project.

Contrary to HUD's regulations in effect at the time, no provision was included in the rehabilitation estimate for a contingency reserve. The general contractor has told GAO that the costs to complete the project will be substantially in excess of the contract amount provided for under the HUD-insured mortgage loan and that it may seek financial relief through HUD. (See pp. 17 to 21.)

3. The estimate of annual operating expenses used by HUD in evaluating the economic feasibility of the proposed mortgage was established in an amount which would permit HUD approval of an insured mortgage of \$4.4 million. In GAO's opinion, this estimate, which was based on 1965-66 operating expense data, was not representative of the operating expenses which could have been reasonably expected to be incurred. (See pp. 22 to 24.)
4. The approved rents appeared somewhat high for serving the optimum number of low- and moderate-income families. Also, the rents may have to be increased if actual operating expenses are higher than those used in HUD's evaluation of the project's feasibility. (See pp. 25 to 28.)

Whether the completed project will generate sufficient income to cover operating expenses and mortgage payments can not be determined until the project is in operation. The chances for meeting these financial obligations, however, have been enhanced by a leasing agreement the sponsor has with the National Capital Housing Authority for 50 apartment units, a rent-supplement contract the sponsor has with HUD that will reduce

rents for tenants in up to 57 apartment units, and the possibility of a greater Federal subsidy of the mortgage loan. (See pp. 27 and 28.)

The initial specifications for the rehabilitation work, in certain instances, lacked clarity with respect to the type and quantity of work to be performed and were clarified and revised as the work progressed. GAO's discussions with officials responsible for the inspection of the rehabilitation work and its visits to the project disclosed no instances where the work was not in substantial conformance with the approved plans and specifications, as amended. The progress of the work has been slow and the project is substantially behind schedule. (See pp. 33 to 42.)

RECOMMENDATIONS OR SUGGESTIONS

The Secretary of HUD should require, as a matter of policy, that a fair market value appraisal be made and used in determining the amount to be included in the insured mortgage loan for the purchase of property to be rehabilitated.

The Secretary of HUD should also emphasize that HUD's insuring offices:

- Develop comprehensive work write-ups which would provide a reasonable basis for estimating costs. This should be done with the project sponsor and its architect and contractor.
- Give full recognition in the rehabilitation cost estimates to any secondary objectives of the project.
- Provide an adequate contingency reserve in the estimates of rehabilitation costs, particularly where the scope of work is not well defined and the contractor is newly established.
- Use the most current data available to estimate project operating expenses, and adjust these estimates to give full recognition to forecasts of price trends. (See pp. 31 and 32.)

CHAPTER 1

INTRODUCTION

The General Accounting Office has examined into the rehabilitation of the Clifton Terrace Apartments in Washington, D.C. The sponsor of this project is the Housing Development Corporation of Washington, D.C., and the rehabilitation work is being financed with the proceeds of a loan insured by the Department of Housing and Urban Development pursuant to the below-market interest rate (BMIR) program authorized by section 221(d)(3) of the National Housing Act, as amended (12 U.S.C. 1715 1). Our examination was made in response to a letter dated October 15, 1969, from Congressman Broyhill requesting that we inquire into the status of HUD's investigation of certain allegations concerning the rehabilitation of the Clifton Terrace project.

In subsequent discussions with a member of the Congressman's staff, it was agreed that we would review the results of HUD's investigation, which started in September 1969, and would perform such additional work as we considered necessary to determine the validity of the allegations. The allegations regarding the rehabilitation of the Clifton Terrace Apartments can generally be categorized under two major areas--the project had been approved by HUD for mortgage loan insurance although it was not economically feasible and the rehabilitation work was of poor quality and was not in accordance with approved specifications.

The Clifton Terrace Apartments are located in the Cardozo area of Washington, D.C., at 1308, 1312, and 1350 Clifton Street NW. The apartments, which were constructed in 1916, consist of three five-story concrete and masonry E-shaped buildings.

In June 1967, the Housing Development Corporation (HDC) submitted a proposal to HUD's insuring office located in Washington, D.C. that the purchase and rehabilitation of the Clifton Terrace property be financed with the proceeds of a mortgage loan of \$4.8 million insured by HUD under the BMIR program authorized by section 221(d)(3) of the National Housing Act. HDC is a corporation chartered by the

District of Columbia exclusively for charitable purposes and more specifically for the purpose of providing adequate housing for poor and underprivileged residents of the D.C. area. In connection with its primary purpose of providing housing, HDC has the secondary objectives of increasing employment opportunities for residents of the area and groups being served and of fostering minority businesses.

The BMIR program was intended to provide rental and cooperative housing for low- and moderate-income families at rents lower than those charged in the private market. Under this program, HUD insures a mortgage loan made by a private lending institution at a market rate of interest to finance the purchase of a project site and the existing structures to be rehabilitated and the cost of the rehabilitation work. Upon completion of the rehabilitation work and its acceptance by HUD, the HUD-insured mortgage loan will be purchased by the Government National Mortgage Association and the interest rate will be reduced to a below-market interest rate of 3 percent. Mortgage loans under the BMIR program have a maximum repayment period of 40 years.

After several rejections by HUD of HDC's proposal regarding the purchase and rehabilitation of the Clifton Terrace Apartments and after various meetings between HUD and HDC officials, HUD agreed to process an application for mortgage loan insurance of \$4.4 million. HDC subsequently entered into a contract for the purchase of the property for \$1.4 million.

In July 1968, HUD approved a commitment to insure a mortgage loan of \$4,447,100 for the project. Shortly thereafter, HDC entered into a cost-plus-fixed-fee contract, at an upset (maximum) price of \$2,225,000, with a general contractor--the Winston A. Burnett Construction Company of New York, Inc.--for the complete rehabilitation of the three apartment buildings. The general contractor is a subsidiary of the Burnett-Boise Corporation which is owned by Mr. Winston A. Burnett and by the Boise-Cascade Corporation of Boise, Idaho.

Rehabilitation of the Clifton Terrace Apartments was started in September 1968 and was originally scheduled for

completion by August 1, 1970. According to HUD records, the overall rehabilitation of the three buildings was about 50 percent completed as of August 1, 1970--one building was substantially completed, one was about 50 percent completed, and the third was about 25 percent completed. HUD officials told us that occupancy of the first building was expected to begin in September 1970 and that, in their opinion, the entire project probably would not be completed before August 1971, or about 1 year later than the initially estimated completion date.

CHAPTER 2

HUD INVESTIGATION OF ALLEGATIONS CONCERNING REHABILITATION OF CLIFTON TERRACE APARTMENTS

In February 1970, HUD completed its investigation of the Clifton Terrace rehabilitation project. This investigation was prompted by charges of wrongdoing and misconduct brought against HUD, HDC, and the general contractor in September 1969 in a report entitled "The Clifton Terrace Scandal" by Mr. George Kalavitinos, president of the Citizens United for Responsible Enforcement, Inc. Generally, there were two major areas of allegations--HUD approved the project for mortgage loan insurance although it was economically unfeasible and the rehabilitation work was of poor quality and was not in accordance with approved specifications.

HUD summarized the results of its investigation in a press release issued February 4, 1970. (See the appendix.) HUD stated that its investigation had revealed no evidence of wrongdoing or misconduct in the approval of the project for mortgage loan insurance or in the execution of the rehabilitation work by HDC or the general contractor.

HUD stated that, although its decision to approve the project for an insured mortgage loan had been made with full recognition that the economic feasibility of the project was a "close question," the project was determined to be economically feasible. In view of the benefits to the community, the experimental nature of the project, the opportunity to make use of local minority subcontractors and thereby provide jobs within the community, and the presently proposed unit composition and rent structure, HUD stated that it was still of the view that the completed project would be economically feasible.

HUD stated also that it found that the contractor either had met the original specifications or had met the changes in specifications requested by HDC and approved by the HUD insuring office and that the quality of the work performed and accepted up to the time of HUD's investigation

was at least average for this type of work and met its standards of safety and serviceability.

HUD's investigation into the allegations consisted primarily of a number of internal reviews and resultant reports by its Office of Audit, Office of Assistant Commissioner for Technical and Credit Standards, Office of Assistant Commissioner for Subsidized Housing Programs, and its insuring office. The reviews generally consisted of discussions with HUD personnel, examinations of project files, and a detailed inspection of the rehabilitation work performed on two of the three project buildings. The findings of each of these reviews are discussed below.

HUD's Office of Audit issued a report in January 1970 on its review of the allegations. Its review was directed primarily toward determining whether HUD's review and evaluation of HDC's proposal to rehabilitate the Clifton Terrace Apartments was in accordance with HUD's normal procedures and whether the quality of the rehabilitation work performed was adequate and in accordance with approved specifications. Conclusions reached by the Office of Audit in its report were:

1. HUD's decision to insure a mortgage loan of \$4.4 million for the project, which was \$200,000 more than the amount previously determined by HUD to be the maximum permissible mortgage, was not adequately supported.
2. HUD officials raised no inquiries regarding the feasibility of, or the basis for, the estimated rehabilitation costs, although much consternation was voiced over the site acquisition cost.
3. The work specifications for the project were inadequate and easily misunderstood.

Regarding the inadequate specifications, the Office of Audit found that those covering work on floors, roofs, walls, and windows were ambiguous and had been interpreted differently by various involved parties at different times and that in some cases changes had been made to the specifications after the work had been completed. The Office of

Audit recommended that HUD provide its insuring offices with instructions on the writing of specifications for rehabilitation projects.

HUD's Office of Assistant Commissioner for Technical and Credit Standards issued a report in October 1969 based on an inspection of the rehabilitation work performed on two of the three project buildings. The primary purpose of the inspection was to determine whether the approved plans and specifications were being followed by the general contractor and whether there were any deficiencies in the plans and specifications which would present a life-safety problem or evidence a lack of compliance with the intent of HUD guidelines. The inspection was made by a HUD architect and an engineer who had not previously worked on the Clifton Terrace project.

The report stated that the specifications for some items of work were written rather loosely and required clarification by the architect; that the contractor was complying with the approved plans and specifications for roofing, ceilings, and walls, as amended by change orders approved by HUD; and that the inspection revealed no indication of construction which might result in danger to life safety or to a low standard of livability. The report stated also that a review of the plans, specifications, and rehabilitation work had confirmed the need for instructions to HUD's field offices regarding the development of specifications for rehabilitation work. The report pointed out that most of HUD's field offices had little or no experience regarding the rehabilitation of projects and that all the offices should have the benefit of the experience gained and the problems encountered on such projects as Clifton Terrace.

Another HUD report on the allegations made regarding the Clifton Terrace project was prepared in October 1969 by an official of HUD's Office of Assistant Commissioner for Subsidized Housing Programs. This report was based on a September 1969 report made by HUD's insuring office and on discussions with insuring office personnel assigned to the project. Major conclusions reached in this report were:

1. The work on the project had begun to move smoothly, and there was a good chance that the project could be completed on schedule.
2. The Clifton Terrace project was the general contractor's first major rehabilitation project, and the New York City-based contractor was hampered initially by organizational problems, not the least of which was establishing and staffing a Washington, D.C., office.
3. The approved rental rates, which were somewhat higher than those originally estimated, were necessary to support the amount of the mortgage loan.
4. The percentage of efficiency and one-bedroom apartment units (about 30 percent) was not unusual for center city apartment buildings.

In January 1970, HUD's insuring office reported on the allegations concerning the rehabilitation work. We were informed by the insuring office director that the report was based on information provided by his staff assigned to the project--primarily the chief architect and the project inspector. The director concluded, in general, that the work was in substantial conformance with the approved specifications, as amended by change orders and architect field orders, and that the quality of work accepted met the objectives of the HUD Minimum Property Standards and was at least average for this type of work.

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In view of

- the nature of the allegations concerning the economic feasibility of the project, the quality of the rehabilitation work and its conformance with the specifications,
- the questions raised by the HUD investigation regarding the decision to insure a mortgage loan of \$4.4 million for the project and the adequacy of the rehabilitation specifications, and

--the slow pace of the rehabilitation work, coupled with reports of a substantial cost overrun by the general contractor, which indicated that HUD may not have given adequate consideration to certain factors inherent in the project due to the size, location, and the extent of the rehabilitation work, and the manner in which the rehabilitation work was to be completed,

we concluded that these matters required further examination and analysis, including discussions with all parties connected with the project. Our findings are presented in detail in the succeeding sections of this report.

CHAPTER 3

HUD'S APPROVAL OF PROJECT

FOR MORTGAGE LOAN INSURANCE

Our examination showed that HUD's decision to approve the Clifton Terrace project for mortgage loan insurance in the amount of \$4.4 million was not supported by an adequate financial analysis. HUD's policy provides for the assumption of reasonable risks to achieve important social objectives, and, although HUD was aware that there were some economic risks involved in the project, the record did not clearly show that HUD had determined the full extent of these economic risks. The basis for a number of decisions made by HUD in approving the project for mortgage insurance appeared to be questionable.

Our examination showed that:

HUD headquarters had approved an acquisition price of \$1.4 million for the project property, although an appraisal reportedly made by its insuring office in Washington, D.C., indicated that the fair market value was significantly below this amount.

HUD's estimate of rehabilitation costs had been developed on the basis of the cost of new construction and did not include the increased costs which should have been expected to result from contracting with newly established general contractor and subcontractors and from employing and training unskilled or semiskilled workers on the project.

HUD's estimate of project operating expenses, which was established in an amount low enough to permit approval of a mortgage loan of \$4.4 million, was not representative of the operating expenses which could be reasonably expected to be incurred by the project.

HUD approved rents for the project which appeared to be somewhat high to serve the optimum number of low- and moderate-income families.

Our comments on these matters are discussed in more detail below.

QUESTIONABLE BASIS FOR DETERMINING AMOUNT OF MORTGAGE LOAN USED FOR ACQUISITION OF PROPERTY

HUD approved for inclusion in the insured mortgage loan for the Clifton Terrace Apartments the amount of \$1.4 million for the purchase of the property, although we were advised by an official of HUD's insuring office that the fair market value of the property was approximately \$1 million.

In approving mortgage loans for rehabilitation projects, HUD procedures provide that the amount to be included in the loan for the purchase of property is the price a prudent investor or sponsor would be justified in paying for the property with the intention of rehabilitating it for occupancy by residents with incomes similar to those of present occupants. The maximum amount to be included in the mortgage loan for the purchase price of property to be rehabilitated is the difference between HUD's estimate of the maximum permissible mortgage loan and the estimated cost of the rehabilitation work, including related fees and interest costs. Therefore this value may or may not approximate the fair market value of the property.

An official of HUD's insuring office told us that, although HUD regulations did not require it, he had made an appraisal of the fair market value of the property to ensure the reasonableness of the proposed acquisition price and that his appraisal indicated a fair market value of about \$1 million. We could not, however, locate a copy of the appraisal, and responsible HUD headquarter officials told us that they were unaware of the appraisal.

In June 1967, HDC proposed to HUD that the purchase and rehabilitation of the Clifton Terrace property be financed with the proceeds of a HUD-insured mortgage loan of \$4.8 million--\$1.8 million for the purchase of the property and \$3 million for the rehabilitation costs. HUD's insuring office determined that the maximum insurable mortgage loan for the Clifton Terrace project was \$3,867,300. Since HDC's

estimate of the cost of rehabilitation work and related items was \$3,020,000, the residual amount permitted by HUD's regulations for purchase of the property was \$847,300--substantially less than the \$1.8 million HDC proposed to pay for the property.

In view of the difference between the amount that HDC proposed to pay for the Clifton Terrace property and the maximum amount permitted by HUD regulations and because HDC's proposed unit composition of the rehabilitated property contained too many efficiency and one-bedroom apartments and therefore would not meet the needs of families in the neighborhood, HUD's insuring office rejected HDC's proposal in August 1967. Subsequent negotiations between officials of HDC and HUD's insuring office failed to resolve these differences, and the proposal was again rejected in September 1967. Shortly thereafter, HDC appealed the rejection to HUD headquarters.

In October 1967, the Secretary of HUD rejected HDC's appeal on the basis that the proposal was not economically feasible. He advised HDC that the maximum mortgage loan which HUD concluded could be insured had been increased to \$4.2 million and that, since rehabilitation and other related costs were estimated at about \$3 million, a loan of that amount would not provide for the payment of more than \$1.2 million for purchase of the property. The increase in the amount of a mortgage loan that could be insured resulted principally from HUD's reassessment of the project's potential rental income.

The Secretary, however, advised HDC that, to meet the proposed purchase price of \$1.8 million, HUD would be willing to consent to HDC's giving the property owner or other investors in the project a \$600,000 note, payable out of surplus project income, which would be over and above the acquisition cost of \$1.2 million that could be paid out of mortgage loan proceeds.

HDC subsequently informed HUD that the owner of the property would be willing to take \$1.4 million to cover the balance of the project's first and second trusts but that a third note holder, a local bank, insisted on receiving

\$250,000 to cover its note balance. HDC stated that it was seeking to have the local bank agree to take an HDC note for \$250,000 and requested HUD's approval of a \$1.4 million acquisition price with the possibility of going to \$1.65 million as long as the total mortgage loan did not exceed \$4.4 million.

A HUD official told us that HUD had to either approve acquisition of the property for \$1.4 million with the proceeds of an insured mortgage loan or forget about it and that, although there were some economic risks involved, the risks were worth taking in view of the social values to be obtained from rehabilitation of the project. Accordingly, in November 1967, HUD agreed to increase the amount of the insured mortgage loan to \$4.4 million to provide for payment of \$1.4 million for the property from mortgage loan proceeds.

HUD advised HDC that an application for mortgage loan insurance would be approved by HUD if (1) the mortgage loan did not exceed \$4.4 million, (2) all savings in rehabilitation costs would be applied to the reduction of rents, and (3) every effort would be made by HDC to have at least 50 of the smaller apartment units leased by the National Capital Housing Authority. HUD also agreed to approve an HDC note payable to the owner of the property for an amount not to exceed \$250,000 in the event that the final acquisition cost exceeded the \$1.4 million that would be provided by the HUD-insured mortgage loan. The note was to be paid from any surplus project income.

HDC subsequently negotiated an agreement with the owner to purchase the property for \$1.4 million and revised its proposal to conform to the above conditions. HDC officials informed us that the owner of the property had agreed to reduce his asking price from \$1.8 million to \$1.4 million because of difficulties he was experiencing in managing the property. As part of the purchase agreement, HDC was to assume immediate management of the property.

HUD's insuring office advised HDC in December 1967 that, on the basis of its review of HDC's revised proposal, it believed that a formal application was warranted. In

April 1968, HDC submitted a formal application to HUD for the insurance of a mortgage loan in the amount of \$4.4 million.

We were informed by officials of HUD's insuring office that, although HUD regulations did not require property appraisals, it was the policy of the insuring office to make appraisals to ensure the reasonableness of the acquisition price included in a proposed mortgage loan. An insuring office official advised us that he had made an appraisal of the Clifton Terrace Apartments, which indicated a fair market value of approximately \$1 million. He stated that the substantial drop in the fair market value of the property from its previous selling price of about \$1,475,000 in 1963 was attributable to deterioration of the buildings from an apparent lack of maintenance which had resulted in over 1,000 violations of the D. C. building code.

The HUD insuring office official advised us that, although he had not informed HUD headquarters of the results of his appraisal, it was made a part of the project file which was available for headquarters' review. We found no record of the appraisal in the project files, and headquarters officials told us that they were unaware of the appraisal.

It appears that, under HUD's procedures, the amount approved by HUD for payment out of the proceeds of a HUD-insured mortgage loan for the purchase of a property to be rehabilitated may not, of itself, represent a reasonable purchase price. Therefore we believe that an appraisal of the fair market value of such a property should be made and should be used by HUD to prevent the possibility of an owner's making an undue profit on the sale of the property.

HUD DID NOT CONSIDER CERTAIN PERTINENT FACTORS
IN DETERMINING THE ESTIMATED COST OF THE
REHABILITATION WORK

HUD, in its determination of the maximum mortgage loan to be insured, did not, in our opinion, make a reasonable estimate of the cost of rehabilitating the Clifton Terrace Apartments. HUD's estimate, which was developed on the basis of the cost of new construction, did not include the increased costs which should have been expected from:

- contracting with newly established general contractor and subcontractors, and
- employing and training unskilled or semiskilled workers on the project.

In addition, no provision for contingencies was included in the rehabilitation cost estimate although HUD regulations at the time required that a reserve of 10 percent of the estimated rehabilitation cost be provided for unanticipated costs considered to be inherent in the rehabilitation of older structures.

HUD's insuring office, in the early stages of its consideration of HDC's proposal for mortgage loan insurance, determined that HDC's estimated rehabilitation cost of about \$3 million--\$2.2 million for construction work and \$800,000 for construction loan interest and various fees--appeared to be reasonable on the basis of a simple comparison of dwelling unit costs for the Clifton Terrace project with similar costs for four other Washington, D.C., rehabilitated housing projects.

In May 1968, after HDC submitted a formal application for mortgage insurance, the insuring office developed its own construction cost estimate of about \$2.5 million. This estimate was later reduced to \$2,282,000 by eliminating the contingency provision of about \$190,000 that had been included and by reducing the amount provided for the architect's fee. Of the reduced estimated cost, about \$2,225,000 was for construction costs and the remainder was for architect's fee and for the purchase of a performance bond.

The general contractor estimates that it will incur construction costs of about \$4.6 million, or about \$2.4 million in excess of the maximum contract amount (\$2,225,000)--which was also the amount approved by HUD for payment for construction work from mortgage loan proceeds. The general contractor told us that it might try to recoup some of its loss on the Clifton Terrace project by petitioning HUD for financial relief. Such a request, if granted by HUD, may require an increase in the amount of the insured mortgage loan. As of August 1, 1970, the contractor had completed about 50 percent of the overall contract and had received contract payments amounting to about \$1 million.

HUD regulations provide that a joint inspection of a rehabilitation project be made by officials of HUD, the sponsor, and the sponsor's architect and contractor as a basis for developing a comprehensive work write-up which, among other things, is to set forth the nature and extent of each item of work required and the estimated cost of such work. We were advised by a HUD official that this method of estimating rehabilitation cost was not considered necessary for the Clifton Terrace project, because the interiors of the buildings were to be substantially gutted. HUD's estimate was developed on a square-foot-cost basis using cost data for a new project built in the Washington, D.C., area, with adjustments for those items which were to be retained, such as the main structure.

We discussed HUD's rehabilitation cost estimate with the insuring office official who developed it. He advised us that, in his opinion, the rehabilitation work could have been done at the estimated amount (\$2,225,000) if a more experienced contractor had performed the work. He stated that the construction delay alone had added substantially to the contractor's cost, because of the general rise in construction costs. We were advised by insuring office officials that the project probably would not be completed before August 1971--1 year later than the scheduled completion date.

We discussed the reasons for the construction delays with officials of the general contractor and were advised that the primary reasons were: (1) the problems associated with the entrance of a black contractor into the white construction industry, such as the reluctance of suppliers to grant normal credit terms, (2) cash-flow problems resulting in work delays due to inadequate funds to purchase needed materials, and (3) unclear specifications which had to be clarified before work could progress. According to the contractor, other reasons for construction delays were:

- Management problems encountered in establishing a new company.
- Establishing and contracting with minority subcontractors.
- Employing and training unskilled and semiskilled workers.
- Problems created by having a number of families living in the project during construction.

HUD's insuring office officials with whom we discussed this matter stated that the contractor's limited experience from an organizational viewpoint was the major factor contributing to the construction delays.

HUD officials told us that, at the time the estimate of rehabilitation costs was prepared, HUD recognized that a newly established general contractor would perform the work and would have the additional burdens of contracting with newly established subcontractors and employing and training unskilled or semiskilled workers on the project but that these factors were not given consideration in developing the cost estimate, because they did not represent items of cost for which provision could be included in the amount of an insured mortgage loan.

Although HUD regulations at the time required that a contingency reserve of 10 percent of the estimated rehabilitation costs be provided for unanticipated costs considered to be inherent in the rehabilitation of older structures, HUD officials stated that the contingency reserve had been eliminated from the rehabilitation cost estimate on the

basis that the buildings were to be gutted and the rehabilitation work would be similar to new construction for which no contingency provision was required.

In January 1969, the HUD regulations were revised to allow the insuring office to use its judgment as to whether a contingency reserve should be included in a rehabilitation project cost estimate. The revised regulations state that the reserve can range from 0 to 10 percent of the costs, depending on job conditions and the experience and financial ability of the project sponsor and the contractor.

The HUD headquarters official who approved the elimination of the contingency provision from the rehabilitation cost estimate for the Clifton Terrace project advised us that, although he had recognized the value of such a provision and would have preferred to include it in the cost estimate, the provision had to be eliminated to bring the estimated rehabilitation cost in line with the proposed insured mortgage loan.

Initially, the general contractor would not agree to a contract at the estimated rehabilitation cost of \$2,225,000, because he did not believe that the amount was sufficient for the work involved. As a result, HDC gave the contractor an unsecured 3-percent note for \$160,000 as an incentive for early completion of the project. The construction contract provided that any savings in construction costs or interest on the construction loan be applied to payment of the note. This action was approved by HUD despite its initial requirement that construction savings be used to reduce rents. (See p. 15.)

Representatives of the general contractor told us that they originally had estimated that the rehabilitation work would cost about \$2,519,000 and that, although this estimate exceeded the sum of the contract price and the deferred note by about \$134,000, they had agreed to the contract in the belief that savings could be achieved through using local employees, awarding subcontracts on a time-and-material-plus basis, and through the purchasing of material by the general contractor which would be used by the subcontractors.

The representatives stated that these savings did not materialize. They stated also that the practice of contracting with subcontractors on a time-and-material basis gave the general contractor the onerous task of running a number of additional businesses and put a great drain on his financial and managerial resources without generating the productivity that had been expected. They stated further that substantial increased costs had resulted from the general rise in prices after the contract date of August 1968 and because HDC refused, due partly to the stringency of HUD's regulations, to accept modifications in the specifications which would permit a substantial reduction in the general contractor's costs.

It appears that the rehabilitation cost estimate used by HUD to evaluate HDC's proposal did not provide an adequate basis for making a judgment that the project was economically feasible for an insured mortgage loan of \$4.4 million. In particular, HUD's estimate, which was developed on the basis of the cost of new construction, gave no consideration to the increased cost which should have been expected to result from contracting with newly established general contractor and subcontractors and from employing and training unskilled or semiskilled workers on the project.

ESTIMATE OF OPERATING EXPENSES TOO LOW

HUD's evaluation of the economic feasibility of the proposed Clifton Terrace mortgage loan was based on estimated annual operating expenses established in an amount which would permit its approval of an insured mortgage loan of \$4.4 million. This estimate, in our opinion, was not representative of the expenses which, on the basis of the information available to HUD, could have been expected to be incurred in operating the project.

During the review of HDC's initial project proposal, HUD's insuring office estimated that the annual operating expenses for Clifton Terrace, including provision for real estate taxes, would be about \$850 a dwelling unit. This estimate was derived by averaging the annual unit operating expenses of four housing projects in Washington, D.C., as shown below.

<u>Project</u>	<u>Unit operating expense</u>
A	\$885
B	870
C	826
D	806
Average	\$850 (rounded)

On the basis of the average annual unit operating cost of \$850 for the four projects, HUD estimated that the annual operating expense for the 290 units originally proposed for the Clifton Terrace project would be \$246,500. Approximately this same amount (\$246,943) was shown by HDC in its application for mortgage loan insurance. HUD's approval of the mortgage loan, however, was based on \$236,378, or \$829 a unit for the 285 units approved for rehabilitation under a revised unit composition plan. We were advised by insuring office officials that they had based the decrease in the cost estimate on a review of the cost components making up the four comparables and had applied their judgment as to what the expenses would be.

Although the decrease in estimated annual operating expense from the \$246,943 shown in HDC's application to the revised estimate of \$236,378 used by HUD was only slightly more than \$10,000, the effect of the reduction was significant because HUD's procedures provided for a debt-service criteria test as one method of determining the maximum permissible amount of a mortgage to be insured. Under this test, the net income is divided by the debt-service rate--that is, the rate of interest plus the amortization of the principal--which in this case was about 4.3 percent. On the basis of HUD's determination of the unit operating expense (\$850) for the previously mentioned four housing projects, the maximum permissible mortgage loan would have been about \$4,215,000; whereas the mortgage loan permitted by the use of a cost estimate of \$829 a unit was about \$4,448,000--only slightly above the amount of the mortgage loan approved by HUD.

Regarding the operating cost data obtained by HUD for the four housing projects, the costs for project D did not include any provision for a replacement reserve which is generally required for multifamily projects. Also, real estate taxes were understated for project D, because they were based on the assessed value in effect before the project was rehabilitated and not on the higher assessed value after rehabilitation. In addition, the unit operating expenses--those actually incurred during calendar year 1966 for three of the projects and during calendar year 1965 for the fourth project--did not reflect the general rise in project operating costs during the period 1965 to mid-year 1968, when HUD developed its operating-expenses estimate for the Clifton Terrace project.

At our request, HUD's insuring office, in May 1970, made a new estimate of operating expenses for the Clifton Terrace project, using the most current cost data available at that time for three other housing projects. This estimate showed an annual unit operating expense of about \$703, exclusive of real estate taxes and any provision for a replacement reserve. According to the insuring office's estimate, the annual unit operating cost for Clifton Terrace, after inclusion of estimates for a replacement reserve and real estate taxes, would be \$972, or a total of \$277,026 for the 285 units.

On the basis of the HUD insuring office's May 1970 estimate of the Clifton Terrace project operating expenses, the rents approved for the project under the BMIR program may not generate sufficient income to cover both the operating expenses and the mortgage payments and therefore may have to be increased substantially to offset the higher costs.

RENTAL RATES MAY BE TOO HIGH

Rents approved by HUD for the Clifton Terrace project, although below the BMIR maximums permitted by HUD at the time of approval, appeared to be somewhat high to serve the optimum number of low- and moderate-income families. HUD had recognized this problem, and its initial agreement to approve the project for mortgage loan insurance was based on the condition that construction savings would be used to reduce the rents; however, the condition was subsequently deleted. (See p. 15.) Also, as discussed in the preceding section of this report, the approved rents may have to be increased if actual operating expenses are higher than those used in HUD's evaluation of the project's feasibility. (See p. 24.)

The following table shows the range of monthly rents needed to serve the greatest needs of families in the Cardozo area, based on a HUD survey in September 1967; HUD's approved rents for Clifton Terrace in July 1968; and the maximum rents permitted in D.C. under the BMIR program about the time the Clifton Terrace project was approved.

Number of bed-rooms	Range of rents needed in Cardozo area		HUD-approved rents for Clifton Terrace	BMIR maximum rent	
	Optimum rent	Maximum rent		April 1967 to April 1968	April 1968 to June 1969
0	\$70 to \$ 75	\$ 85	\$ 90	\$ 98	\$103.33
1	85 to 95	105	113 to \$117	119	125.00
2	95 to 110	130	132 to 135	140	147.50
3	-	155	150 to 155	161	170.00
4	-	175	160 to 164	182	191.67

Although the approved rents were lower than the BMIR maximum rents established for the Washington, D.C., area, they were substantially above the optimum rents for the area, as indicated by HUD's September 1967 survey.

HUD's insuring office made an analysis of the income of tenants who had occupied the Clifton Terrace Apartments 6 months or longer as of September 18, 1967, to compare the relationship between their existing income and rents with

the relationship that would exist between their income and the rents to be applicable after the project was rehabilitated. A reported bias in the analysis was that the projections of tenant income were based on a stable employment situation, whereas the types of jobs held by the tenants did not indicate stable employment. The following information was developed by the analysis.

1. The majority of the tenants needed larger apartments than they were then occupying to meet HUD occupancy standards.
2. The average monthly income of the tenants was \$462, ranging from \$347 to \$650 a month.
3. The tenants were paying an average 22 percent of their income for gross rent, ranging from 14 to 31 percent.
4. On the basis of rents proposed by HDC, the tenants would pay an average 28 percent of their income for gross rent, ranging from 20 to 38 percent.
5. On the basis of needed rents, as determined by HUD, the tenants would pay an average 31 percent of their income for gross rent, ranging from 22 to 42 percent.

Although we could not make a comparison of the tenants' income with the rents approved by HUD for Clifton Terrace because the data used by the insuring office in the above analysis was not available, the approved rents approximate those originally proposed by HDC and therefore the analysis presented in item 4 above provided an indication of what this relationship would be.

BMIR projects are intended to serve low- to moderate-income families--those whose income is too high for admission to public housing but not high enough to obtain decent private housing. HUD has established maximum-income limits, by metropolitan areas, for admission into a BMIR project.

HUD has established maximum rents for these projects on the assumption that families earning the maximum income permitted should not pay more than 20 percent of their income for rent. HUD regulations provide that rents for BMIR projects are to be established as far below the maximum rents as possible to enable the projects to serve more families within the low- to moderate-income range. We were advised by a HUD insuring office official that HUD normally attempts to establish the rental rates so that families in the middle of the low- to moderate-income range will not pay more than 20 percent of their income for rent.

We discussed the rents established for the Clifton Terrace project with a HUD official who agreed that the rents were too high to serve the families in the area, but he stated that it was necessary to establish rents at those levels to obtain sufficient income to support the mortgage loan. He advised us that this was characteristic of many BMIR projects, because the subsidy provided by the program through the reduced interest rate of 3 percent was insufficient to accomplish the program purpose of providing housing within the means of low- to moderate-income families.

As a condition of HUD's approval of the Clifton Terrace project, HDC was to make every effort to have a number of the smaller units leased by the National Capitol Housing Authority. We learned that HDC had been successful in this regard and that the Authority had agreed to lease 50 of the 61 one-bedroom units.

Although a lack of funds prevented HUD's agreement to HDC's request for a rent-supplement contract at the time the application for mortgage loan insurance was being considered, a rent-supplement contract was subsequently entered into in September 1969. The contract provides for annual supplement payments of about \$45,600 for up to 57 units, or 20 percent of the 285 units in the project. Under the contract, monthly rent-supplement payments for eligible tenants at Clifton Terrace will average \$60 a unit and will permit a reduction in the approved rents of about 40 to 48 percent, depending on the size of the apartment.

At the close of our review, HDC's and HUD's plans provided for transferring the Clifton Terrace project from the

BMIR program to the newer section 236 program. The 236 program is intended to reduce a project's monthly rental rates to a level that lower income families can afford through HUD's payment of all interest in excess of 1 percent on a HUD-insured mortgage loan and of the mortgage insurance premiums on behalf of the project owner. We were told by officials of HUD's insuring office that the minimum rental rates for apartments at Clifton Terrace under the 236 program would approximate those approved for the project under the BMIR program. If the project is not transferred as contemplated, however, the approved BMIR rents may not generate sufficient income to cover both the insuring office's May 1970 updated estimate of operating expenses and the mortgage payments.

LARGE NUMBER OF EFFICIENCY AND ONE-BEDROOM APARTMENT UNITS

As stated on page 14, one of the reasons for the HUD insuring office's initial rejection of HDC's proposal for the purchase and rehabilitation of the Clifton Terrace Apartments was that the proposed unit composition provided for too many efficiency and one-bedroom units--about 32 percent of the total units--and therefore did not meet the needs of families in the neighborhood. Also, the HUD insuring office's survey in September 1967 disclosed a high rate of vacancies in efficiency and one-bedroom apartments in the neighborhood.

From the standpoint of potential vacancies of efficiency and one-bedroom units in the Clifton Terrace project and related loss of rentals, a measure of relief was provided by reducing the number of these units from 92 to 81 and by HDC's obtaining the National Capitol Housing Authority agreement to lease 50 of the one-bedroom apartments for low-rent public housing. Since up to 57 units in the project are covered by a rent-supplement contract, as many as 107 of the 285 dwelling units in the project may be subject to double Federal subsidies--that provided under the BMIR program and that provided under either the leased-housing or the rent-supplement program.

CONCLUSIONS

HUD's decision to approve the Clifton Terrace project for insurance of a mortgage loan of about \$4.4 million under the BMIR program, which is designed to provide housing assistance for families of low- to moderate-incomes (having annual incomes ranging from less than \$6,600 for a one-person household to \$12,200 for a family of seven persons or more in D.C. as of the close of our review), was not, in our opinion, supported by an adequate financial analysis. Although HUD policy provides that reasonable risks be assumed to achieve what it considers to be important social objectives, the record does not clearly show that HUD had determined what the economic risks were. Also, the basis for some of the decisions made by HUD regarding approval of the project for mortgage loan insurance appeared questionable.

In our opinion, HUD headquarter officials should not have approved the Clifton Terrace project without the benefit of a fair market value appraisal of the project. It is possible that the acquisition price of \$1.4 million, which was 40 percent higher than the fair market value indicated by a HUD insuring office appraisal, could have been significantly reduced had all parties to the negotiations, including HUD headquarter officials, been aware of the appraisal.

Under HUD's procedures, the amount of the proceeds of a HUD-insured mortgage loan that is provided for the purchase of property to be rehabilitated may not, of itself, represent a reasonable purchase price. We believe that an appraisal should be made of the fair market value of such property and be used by HUD to preclude an owner from making an unwarranted profit on the sale of property. That HUD's procedures are inadequate is demonstrated by the values assigned to the Clifton Terrace project by HUD officials that ranged from \$850,000 to the \$1.4 million, as finally approved.

In determining the maximum amount of the mortgage loan to be insured, HUD did not, in our opinion, make a reasonable estimate of the cost of rehabilitating the Clifton Terrace Apartments. HUD's estimate, which was developed on the basis of the cost of new construction, gave no consideration to the increased costs which should have been expected to result from contracting with newly established general contractor and subcontractors and from employing and training unskilled or semiskilled workers on the project. Furthermore, contrary to HUD's regulations in effect at the time of the estimate, no provision was included in the rehabilitation cost estimate for a contingency reserve.

HUD's evaluation of the economic feasibility of the proposed mortgage loan for the project was based on estimated annual expenses for operating the project that would permit approval of an insured mortgage loan of \$4.4 million. This estimate, in our opinion, was not representative of

the expenses which, on the basis of the information available to HUD, could have been reasonably expected to be incurred in operating the project.

Rents approved by HUD for the project appeared to be somewhat high to serve the optimum number of low- and moderate-income families. Also, the approved rents may have to be increased if actual operating expenses are higher than those used in HUD's evaluation of the project's feasibility.

Whether the project eventually will prove to be economically feasible is uncertain; however, the chances for its meeting its financial obligations have been enhanced by HDC's leasing agreement with the National Capital Housing Authority, the rent-supplement contract with HUD, and the possibility of a greater Federal subsidization of the mortgage loan under the section 236 program.

RECOMMENDATIONS

We recommend that the Secretary of HUD require, as a matter of policy, that a fair market value appraisal be made and used in determining the amount to be included in the insured mortgage loan for the purchase of property to be rehabilitated.

We recommend also that the Secretary of HUD emphasize to the HUD insuring offices the need to:

- Develop, in conjunction with a project sponsor and his architect and contractor, comprehensive work write-ups for a rehabilitation project that would provide a reasonable basis for estimating the rehabilitation costs.
- Give full recognition in the rehabilitation cost estimates to any secondary objectives of the project.
- Provide an adequate contingency reserve in the estimates of rehabilitation costs, particularly where the

scope of work is not well defined and the contractor is newly established.

--Use the most current cost data available to estimate project operating expenses, and adjust these estimates to give full recognition to forecasts of price trends.

CHAPTER 4

QUALITY AND PROGRESS OF THE

REHABILITATION WORK

QUALITY OF WORK

In general, the allegations made regarding the rehabilitation work were that the contractor had not adhered to the original plans and specifications, that inferior materials had been used, and that the quality of the workmanship had been substandard.

In May 1970, we discussed the quality of the rehabilitation work with various representatives of the D.C. Bureau of Licenses and Inspections, including those responsible for inspecting and approving the plumbing, electrical, and general construction work and the new heating system. We were told that the work inspected and approved by the D.C. representatives complied with the building plans as approved by the District and conformed with applicable building code and zoning code requirements. In addition, we were told that the quality of the rehabilitation work was at least average, that the mechanical and electrical workmanship was very good, and that the materials used were standard or better.

Representatives of the firm of architects employed by HDC and the firms of consulting engineers (structural, mechanical, and electrical) employed by the architect confirmed the opinion of the D.C. representatives and stated that their inspections had shown that the rehabilitation work met HUD's Minimum Property Standards.

According to HUD's investigation, as discussed in chapter 2, the contractor had met either the original specifications or the changes in specifications required by HDC and approved by HUD's insuring office and the quality of the work performed and accepted was at least average for this type of work. Also, it was HUD's opinion that rehabilitation often required broader and more flexible specifications than those for new construction, that the real standards

that must be met were those of safety and serviceability, and that these standards were unquestionably being met in the Clifton Terrace project.

The following major allegations had been made by a private citizen regarding the quality of the rehabilitation work at the project.

1. The contractor repaired the roofs, instead of replacing them as required by the specifications.
2. The old plastered ceilings were not removed prior to installing dropped ceilings, although their removal was required by the specifications.
3. The floors were being repaired in the cheapest and least professional manner, and the repairs were not in accordance with the specifications. Also, workmen's debris and garbage had been thrown in the space beneath the floors and thereby invited rats and other vermin.
4. The partitions were not anchored to the concrete slabs, as required by the specifications and the D.C. building code, but were placed on top of the old wooden floors, which presented a potential fire hazard.

Our comments on each of the above items are presented in the following sections.

Roofs

There was much confusion regarding the roofing specifications. The general contractor and HUD's insuring office interpreted the specifications to mean a repaired roof, but the architect and HDC interpreted them to mean a new roof. Also, the investigative report prepared by HUD's Office of Standards stated that the original specifications clearly required that the old roof be removed and that a new one be installed, but the report prepared by HUD's insuring office stated that the specifications were not clear as to the architect's intent.

We discussed the original roofing specifications with a representative of the firm of architects and were advised that, in his opinion, the specifications required that the old roof be removed and a new one installed. Following are excerpts of pertinent sections of the original roofing specifications.

"7A REPLACEMENT OF BUILT-UP ROOFING AND FLASHING

"7A.01 SCOPE OF WORK

- a. This Contractor shall furnish all materials, trucking, tools and other equipment, and perform all necessary labor for the removal and disposal of existing built-up roofing materials and insulation, and the installation of new roofing materials complete with bituminous base flashing, special base sheets, edge strips, cants, etc., where the integrity of the roofing materials is interrupted by roof drains, plumbing vents, building components and others." (Underscoring supplied.)

* * * * *

"7A.03 APPLICATION

a. Vapor Barrier

- (1) Prime deck with asphalt primer where all existing roofing material has been removed and concrete deck is exposed.
- (2) Apply a heavy coat of steep asphalt or pitch over entire roof and, while hot, embed one ply of Barrett Vaporbar." (Underscoring supplied.)

* * * * *

"7A.05 BOND

Upon completion of Roofing Work, the Contractor shall furnish the Owner with the maximum Surety Maintenance Bond available for the roofing repair and felt and metal flashings and connections to gravel stops." (Underscoring supplied.)

A roofing subcontractor submitted a bid to the general contractor in March 1969 on the basis of the subcontractor's interpretation--which agreed with the architect's--of the above specifications. The subcontractor told us, however, that he had been informed by representatives of the general contractor that the roof was to be repaired rather than replaced. Because of the apparent disagreement between the architect and the general contractor as to what was to be done to the roof, the HUD inspector assigned to the project requested the architect to make a determination as to the intent of the roofing specifications. The architect subsequently advised the contractor that it was the clear intent of the roof specifications that the old roof be removed and a new one installed.

A meeting of representatives of HDC, the contractor, the architect, and HUD's insuring office was held in April 1969 in an attempt to resolve the differences of opinion

regarding the intent of the roof specifications. As a result of this meeting, a change order was approved by all parties in July 1969, which authorized the repair, rather than replacement, of the old roof in accordance with revised specifications to be prepared by the architect. The scope of the work to be done and the materials to be used were left to the discretion of the architect.

The revised specifications required the contractor to repair the roof by removing the gravel and asphalt topping down to the smooth-surface felt and installing four layers of felt, cemented together with asphalt, with an asphalt and gravel topping. In addition, the contractor was to furnish HDC with a 20-year unconditional maintenance-free roof bond upon completion of the rehabilitation work. At the time of our visits to the project in March and May 1970, the roof of one building had been repaired and the roof of another building was being repaired. On the basis of our observations of the repaired roofs and discussions with representatives of D.C. and the architect, it appeared that the roofing work was being done in accordance with the revised specifications.

Ceilings

On the basis of the ceiling work in process at the time we visited the project, it appeared to us that the old ceilings, except those in the corridor areas, were being removed prior to installation of the new, suspended ceilings. An official of HUD's insuring office explained that when the project had been constructed the plaster in the corridor areas was applied directly to the underside of the concrete floor slabs and was so tightly affixed that it was impractical to remove it.

We discussed this matter with HUD's insuring office construction inspector who confirmed our observations. In discussing this matter with the HUD inspector, the architect, and the general contractor's project superintendent, we were told that loose plaster had been removed and would continue to be removed prior to the installation of the new, suspended ceilings.

Floors

The plans and specifications provided no indication of the quantity of repair work the contractor was required to do on the floors. As a result, the repaired floors had to be inspected and accepted on a room-by-room basis by the architect.

In the substantially completed building, we observed that most of the floors had been repaired. In some apartment units, the floors were completely replaced with new parquet floors. We were told that this had been done when the old floors could not be repaired to the satisfaction of the architect.

On the basis of the experience gained in repairing the old floors in this building, the general contractor decided that it would be easier and less expensive to install new parquet floors, and a change order was approved providing for the complete replacement of the old floors with parquet floors in the two other buildings.

HUD's Office of Standards, in commenting on the floor repairs in its investigative report, was critical of the fact that the plans and specifications did not provide any indication of the quantity of work required by the contractor on the floors. The report concluded that:

"Our review of the plans, specifications and construction on this project confirms the necessity for instructions to our field offices on specification writing for rehabilitation. Most of our offices have little or no experience in rehab, and all should have the benefit of the experiences of problems presented by projects such as this."

As discussed in chapter 2, HUD's Office of Audit also recognized the need for HUD to issue instructions on how specifications submitted to HUD for approval should be written.

With respect to debris, the director of HUD's insuring office reported that, although the insuring office knew of no specific instances of there being workmen's debris and

garbage in the space beneath the floors, it was not unusual for workmen to leave debris in structural spaces on new work as well as on rehabilitation work. We noted no unusual instances of such debris during our visits to the project.

Partitions

During our visits to the project, we noted that the partitions separating the apartments had been placed on top of the wooden floors and had not been anchored to the concrete slabs, contrary to the requirements of the building code and the work specifications. We learned, however, that this method of partition anchorage had been approved by D.C. prior to installation of the partitions. The Chief of the Construction Branch in the D.C. Bureau of Licenses and Inspections indicated, in a letter on this matter, that, although the method of anchorage was technically a minor building code violation, it presented no significant fire hazard.

HUD's insuring office director stated that the interior apartment walls were being installed in accordance with the approved rehabilitation plans. He pointed out that the HUD inspector had questioned the apparent discrepancy between the rehabilitation plans and the work specifications and that this had led to an interpretation by the project architect in January 1969 that the plans should prevail. He stated that both D.C. and HUD had concurred in this decision. HUD's Office of Standards stated that no significant fire hazard was presented by the method of installation.

REHABILITATION WORK
SUBSTANTIALLY BEHIND SCHEDULE

According to HUD and HDC files, the pace of the rehabilitation work on the Clifton Terrace project has been a problem from the very beginning, and HUD does not expect the project to be completed until about 1 year after the contract completion date of August 1, 1970. Although the files show that various factors have contributed to the slow work progress, the major one appears to be the general contractor's limited experience from an organizational viewpoint.

According to the construction contract between HDC and the general contractor, work was to begin within 15 days from the contract date of August 8, 1968. HDC requested assurance from the general contractor, in the early part of June 1968, that demolition and construction would begin immediately after approval of the construction contract; however, work did not begin until September 12, 1968. No subcontracts, except those for demolition and temporary lighting, were awarded until November 1968.

HDC advised the general contractor in December 1968 that it might be necessary to notify the bonding company of the lack of progress on the project and that, at the rate of progress achieved during the first 4 months of the contract, the company was heading toward contract default. In July 1969, HDC notified the bonding company that the progress of the rehabilitation work was unsatisfactory and that HDC was requesting a meeting with the general contractor to discuss the progress of the work and the course of action to be taken to ensure satisfactory progress in the future.

Subsequently, in September 1969, the director/treasurer of Burnett-Boise Corporation, a holding company owned by Mr. Winston A. Burnett and the Boise Cascade Corporation, advised HDC that its subsidiary, the Winston A. Burnett Construction Company of New York, Inc., had been reorganized and that the Boise Cascade Corporation would assume a very significant role in its management. He assured HDC that, by virtue of Boise Cascade's role in the management of the general contractor, all efforts would be made to meet the general contractor's commitments on the Clifton Terrace project.

Because of the continued slow pace of the work and the possibility that the project would not be completed by the contract completion date, HDC requested and obtained a modification to the construction contract to provide a liquidated-damage clause. A penalty up to \$1,067 a day for failure to substantially complete the project by August 1, 1970, was agreed to by the general contractor, to cover HDC's additional costs for interest, taxes, and insurance resulting from construction delays. The general contractor also agreed to pay the amount of the fees charged by the Government National Mortgage Association to extend its loan commitment beyond August 1970.

We discussed the progress of the rehabilitation work with officials of the general contractor in May 1970 and were advised that action had already been taken by the contractor to correct the principal problems, noted on page 19, which had contributed to past delays and that the project would be completed by December 31, 1970. According to HUD records, however, the project was only 50 percent completed as of August 1970, and HUD was of the opinion that the project probably could not be completed before August 1971.

CONCLUSIONS

Our review, which included discussions with officials responsible for inspection of the work and visits to the project, disclosed no instances where the work completed and accepted was not in substantial conformance with the approved plans and specifications as amended by change orders and field order modifications by the architect. All work had been approved by the District of Columbia as meeting its building code requirements and by the HUD insuring office as meeting the objectives of the HUD Minimum Property Standards.

Although HUD regulations permit specifications for rehabilitation work to be broader and more flexible than those for new construction, we believe that the Clifton Terrace specifications should have been more explicit and detailed, because of the size of the project and the extensiveness of the proposed work. Since the buildings were gutted so that little remained but the outer shell and floor structures, it appears that the rehabilitation work was comparable in many respects to new construction and, in our opinion, could have benefited from the use of detailed specifications.

HUD's Office of Audit and Office of Standards recognized, in their respective investigation reports, the need for HUD to issue instructions to its field offices on how rehabilitation specifications submitted to HUD for approval should be written, and the Office of Audit recommended such action. (See p. 8.) We believe that this action is warranted and should, if properly implemented, help prevent future occurrences of the type of problems encountered in the rehabilitation of the Clifton Terrace Apartments.

CHAPTER 5

SCOPE OF REVIEW

Our review, which covered activities during the period June 1967 to June 1970, was made principally at HUD headquarters, at its Washington, D.C., insuring office, at the offices of HDC and the general contractor, and at the project. We reviewed related legislation, administrative regulations, applicable project files, and HUD's investigation reports and supporting documents. We also visited the project site to observe the rehabilitation work being performed.

We obtained the views of various HUD officials knowledgeable of, and responsible for, insuring the mortgage for the Clifton Terrace project under the BMIR program and held discussions with officials of:

Housing Development Corporation--sponsor.

Winston A. Burnett Construction Company of New York, Inc.--general contractor.

McDonald, Williams & Marshall, A.I.A.--architects.

Shefferman & Bigelson Company--consulting mechanical and electrical engineers.

Wright & Mok--consulting structural engineers.

We held discussions also with the various representatives of the D.C. Government responsible for approving the project building plans and inspecting the rehabilitation work to ensure its compliance with the D.C. building code.

APPENDIX

PRESS RELEASE BY HUD
ON ITS INVESTIGATION OF THE
CLIFTON TERRACE APARTMENTS REHABILITATION PROJECT
FEBRUARY 4, 1970

The Department of Housing and Urban Development has completed an investigation of the Clifton Terrace Apartments rehabilitation project. This investigation was prompted by charges of wrongdoing and misconduct brought against HUD, the Housing Development Corporation of the District of Columbia (HDC) and the Winston A. Burnett Construction Company of New York, Inc., by Mr. George Kalavitinos.

The Clifton Terrace Apartments are located at 14th and Clifton Streets, N.W., Washington, D.C. Clifton Terrace's 285 units are being rehabilitated under the sponsorship of HDC using HUD's Section 221(d) (3) Below Market Interest Rate Program.

HUD's investigation revealed no evidence of wrongdoing or misconduct in the initial approval of the Clifton Terrace project or in the execution of the rehabilitation work by HDC or the Winston A. Burnett Company, the prime contractor.

Due to its size, location and the extent and nature of rehabilitation required, Clifton Terrace represents most all the problems which can be expected in rehabilitation projects. Under the circumstances, peculiar to large scale rehabilitation projects, work on Clifton Terrace is progressing in an acceptable manner.

Mr. Kalavitinos' charges fall under two major headings.

First, it was charged that the Clifton Terrace project was not and is not economically feasible and that HUD approval was the product of improper pressure. There is no evidence to support this charge.

Although HUD's approval was granted with full recognition that the economic feasibility of the rehabilitation project was a close question, it was determined that the project was economically feasible. In view of the benefits to the community, the experimental nature of the project, the opportunity to make use of local minority subcontractors thereby providing jobs within the community, and the presently proposed unit composition and rent structure, the Department still views the completed project as economically feasible.

There is no evidence that initial HUD approval was the product of improper pressure or was designed to secure the financial and political gain of the principals of HDC.

Mr. Kalavitinos' second major charge is that the work performed by the contractor does not meet the specifications and, in any case, is inept and inadequate. The Department finds that the contractor has met the original specifications or has met changes in specifications requested by HDC and approved by the District of Columbia FHA Insuring Office. The quality of the work performed and accepted to date is at least average for this type of work.

It should be noted in this regard that rehabilitation often requires specifications that are broader and more flexible than is the case with new construction. The real standards that must be met are those of safety and serviceability. There is no question that they have been met in this case.

The Department sees no need for further action in regard to Mr. Kalavitinos' charges. In regard to new project

applications submitted by HDC, they are being processed under regular procedures and will be dealt with on their individual merits.