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COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION

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RELEASED

JULY 30, 1981

The Honorable Mary Rose Oakar
House of Representatives



116236

Dear Ms. Oakar:

Subject: Inquiry into the Status of a Proposal To Construct 16 Single-Family Detached Homes for the Cuyahoga Metropolitan Housing Authority in Cleveland, Ohio (CED-81-147)

In accordance with your May 7, 1981, request and subsequent agreements with you, we inquired into the status of a proposal submitted by The Dillon Company to construct 16 single-family detached homes for rental to lower income persons for the Cuyahoga Metropolitan Housing Authority (CMHA) in Cleveland, Ohio. The proposed construction is sponsored by the Department of Housing and Urban Development (HUD) under its low-rent housing program. As agreed, our inquiry centered on the status of the proposal, actions that must be taken before the proposal is approved by HUD, and costs proposed by the developer to construct the units. Also, as discussed with you, the Inspector General of HUD agreed on June 10, 1981, to make a management review of CMHA's operations.

On June 24, 1981, we briefed you on the results of our inquiry. This letter summarizes the information provided to you at that time.

--The proposed project is in the early development stage and must go through a lengthy HUD review process before costs are finalized. This process, which may take several months, can result in the price going either up or down. Before HUD tentatively approves the project, it will have to determine whether (1) The Dillon Company's proposal is responsive to CMHA's invitation for proposals, (2) the site looks suitable, and (3) preliminary costs appear reasonable. Final approval would be given after final plans are prepared and agreement on a final price is reached among the developer, CMHA, and HUD. On June 24, 1981, CMHA forwarded the developer's proposal to HUD for preliminary approval.

--While the invitation for proposals for this project called for three-bedroom duplexes and rowhouses and

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four-bedroom semidetached or single-family detached homes, the proposal accepted by CMHA is only for three-bedroom, single-family detached units. As part of the preliminary approval process, HUD is required to evaluate whether the developer's proposal is responsive to CMHA's invitation for proposals.

--Because detailed plans on The Dillon Company's proposal will not be available until later in the development stage, a firm conclusion on the reasonableness of the project's preliminary costs (\$70,277 for each unit) cannot be made at this time. The dwelling construction costs proposed by the developer (including unit construction costs of \$41,000 but excluding other costs such as land) are within HUD's cost limits for Cleveland. However, the cost estimates made by a local appraiser for a city of Cleveland councilman averaged about \$12,000 a home less than the \$70,277 proposed by the developer. The difference is mostly estimates for land costs and "other" costs which include profit, overhead, and financing costs. For example, the developer's option to purchase land calls for an average price of \$13,500 a lot whereas the appraiser estimated the lots are worth \$7,920 to \$9,240 each depending on size.

OBJECTIVES, SCOPE, AND METHODOLOGY

The purpose of this review was to examine the status of a proposal to construct 16 single-family detached homes for rental to lower income persons for CMHA. Specifically we gathered and analyzed information on the

- status of The Dillon Company's proposal to construct the units,
- actions that must be taken before the proposal is approved by HUD, and
- preliminary costs proposed by The Dillon Company to construct the units.

We made our review at CMHA's headquarters and HUD's office in Cleveland, Ohio. We reviewed project files and interviewed CMHA and HUD officials. We also contacted the person who appraised the proposed project for a Cleveland city councilman. We visited the proposed site of the units and toured the surrounding neighborhood.

Because the proposed project is in the early development stage and detailed plans are not yet available, we did not make a detailed cost analysis of the reasonableness of The Dillon Company's proposal or contact officials of The Dillon Company.

BACKGROUND

Pursuant to the United States Housing Act of 1937, as amended, HUD sponsors a low-rent housing program (42 U.S.C. 1437b) whereby decent, safe, and sanitary rental housing units are made available to low-income families that cannot afford standard private housing. The program is administered at the local level by public housing agencies. The housing agencies plan, acquire, and manage the low-rent housing projects, subject to applicable laws and contractual relationships with HUD and the local government.

HUD is responsible for administering the Federal Government's participation in the program and for protecting the Government's financial interest. HUD assists the housing agencies by (1) making loans for developing new housing projects, (2) making annual contributions to housing agencies for paying the principal and interest on bonds and notes sold by housing agencies to obtain funds for developing the projects, and (3) paying operating subsidies to housing agencies.

HUD uses several different methods to provide housing to public housing agencies. Under one method--the turnkey program--the housing agency invites private developers to submit proposals, selects the best proposal, and agrees to purchase the project on completion.

The turnkey program provides a public housing agency with flexibility in selecting new housing projects from among proposals submitted. The housing agency can select various portions of a proposal according to its needs, such as whether the project fits into its concept of scattered-site housing or is located where the housing agency wants to place housing in the community. For example, in May 1972 CMHA was directed by a court order and three subsequent modifications not to place and construct public housing in black neighborhoods of Cleveland. Consequently, CMHA selects proposals which appear compatible with its objectives and the court order.

HUD reserved 260 turnkey family housing units in 1978 for CMHA. Following advertisements, a rejection, and readvertisement and HUD approval of some units, CMHA readvertised for 160 units in January 1981. CMHA recommended approval of only portions of the two bids received from two developers. One proposal selected was for 16 single-family detached homes to be built at West 59th Street and Ridgeview Avenue by The Dillon Company at a cost of \$70,277 each. The other proposal selected was for 119 units of duplexes, rowhouses, and single-family detached homes. The proposed price remains firm for a period of 150 or 180 days, depending on the type of contract to be issued, from the time the developer submits a proposal. The Dillon Company submitted its proposal to CMHA on February 23, 1981.

PROPOSAL MUST GO THROUGH HUD REVIEW PROCESS
BEFORE PROJECT IS FINALLY APPROVED

Before CMHA can award a contract, the proposed project must be reviewed and approved by HUD. HUD's Cleveland office multi-family housing representative estimated that this process takes about 5 months if there are no problems. CMHA submitted the proposal to HUD on June 24, 1981, for preliminary approval. According to this official, the following review procedures normally apply in a turnkey proposal.

First 30 days

The proposal is forwarded to the Northeast Ohio Areawide Coordinating Agency and the city of Cleveland for review and comment. At the same time, HUD makes a preliminary review to determine if the proposal is reasonable. It determines whether:

- The proposal is responsive to the invitation for proposals. If it is not, the project could be rejected. If the local HUD office is not sure, it forwards the proposal to its Washington, D.C., headquarters, which could add another 30 days to the review time.
- The land site appears suitable.
- The proposed price for housing construction and equipment is within 110 percent of HUD's preestablished prototype cost for the area.
- Preliminary costs and drawings appear reasonable.

HUD's approval at this point is preliminary and final costs are not yet established. However, if HUD approves the proposal at this stage, the project is relatively certain of final HUD approval, subject to agreement on price.

Next 60 days

HUD, CMHA, and the developer meet to discuss final processing requirements and the developer prepares final plans.

Next 30-60 days

After HUD receives final project plans from the developer, it makes a detailed cost analysis of construction costs, which cannot exceed 110 percent of HUD's prototype cost limit for the area. HUD also appraises the land and will not approve a price more than the appraised value. All other costs are evaluated against HUD's past experience with comparable costs on other projects.

If the review process extends beyond the 150- or 180-day price freeze period, and it appears likely that will happen on this project, the developer can increase the price. HUD evaluates the price increase, allowing an adjustment factor for inflation. HUD, CMHA, and the developer negotiate the final price. Once agreement is reached, CMHA executes a contract of sale with the developer.

According to a HUD Cleveland office multifamily housing representative, the Cleveland office has not approved a single-family detached home proposal as expensive as \$70,000 per unit to date.

RESPONSIVENESS OF PROPOSAL

HUD must determine whether The Dillon Company's proposal was responsive to CMHA's invitation for proposals. HUD instructions state that "a proposal shall be determined unresponsive if * * * the proposal deviates from requirements stated in the Developer's Packet." ^{1/} These instructions further state that "unresponsive proposals shall not be considered for further evaluation or selection."

The CMHA advertisement for the 160 units called for 50 three-bedroom rowhouses, 100 three-bedroom duplexes, and 10 four-bedroom semidetached or single-family detached homes. The proposal CMHA accepted was for 16 three-bedroom, single-family detached homes. HUD's Cleveland office multifamily housing representative advised us that this proposal may be a deviation from the invitation for proposals and may require the approval of HUD headquarters officials.

COSTS PROPOSED TO CONSTRUCT THE PROJECT

Because detailed plans on The Dillon Company's proposal will not be available until later in the development stage, a firm conclusion on the reasonableness of the project's preliminary costs (\$70,277 for each unit) cannot be made at this time. However, the dwelling construction costs proposed by the developer (\$41,000 a unit) are within the cost limit established by HUD for Cleveland. On the other hand, cost estimates made by a local appraiser for a Cleveland city councilman averaged about \$12,000 a home less than the \$70,277 proposed by the developer.

^{1/}Developer packets are a set of documents prepared by housing agencies and provided to prospective developers that set forth the terms and conditions of the invitation, including the invitation for proposals.

The costs proposed by The Dillon Company for the 16-unit project follow.

	<u>Total proposed costs</u>	<u>Average cost per home</u>
Dwelling construction	\$ 656,000	\$41,000
Site	216,000	13,500
Site improvements	62,400	3,900
Architectural and engineering	15,200	950
Training	4,000	250
Other (note a)	<u>170,832</u>	<u>10,677</u>
 Total	 <u>\$1,124,432</u>	 <u>\$70,277</u>

a/Includes amounts for profit, overhead, interim financing, taxes on land during construction, and closing costs.

The allowable unit cost of HUD-subsidized housing in a given area is based on the expected costs of building a modest dwelling for low- and moderate-income people in that area. Using a standard design, HUD has estimated the cost to construct a given unit in various areas and published these unit costs--referred to as prototype costs--in the Federal Register. The cost of housing units (cost of dwelling construction and equipment) is limited to no more than 10 percent above the prototype cost established for a given area.

The proposed cost of \$41,000 a home for dwelling construction is within 110 percent of HUD's prototype costs for Cleveland, Ohio. These costs allow a price of \$39,050 1/ for a standard three-bedroom home in Cleveland.

In April 1981 a professional appraiser, who lives across the street from the proposed project, estimated for a city of Cleveland councilman that the developer's proposal included excess costs of \$334,000. After obtaining more details about the construction of the proposed homes, the appraiser revised his cost estimate upward. He increased his estimate about \$9,000 a home to allow for brick veneer, extra insulation, energy-efficient windows, thicker exterior walls, and other items that are to be included in the CMHA homes but were not included in his initial estimate.

However, the appraiser is still of the opinion that the developer's total costs are excessive by \$194,000, or about \$12,000 for each home. His revised estimates for total costs for each unit are \$57,795 to \$59,115. These estimates include \$49,875 a home for all costs excluding land and \$7,920 to \$9,240

1/HUD revised this prototype cost to \$39,200 on June 29, 1981.

a lot for land depending on lot size. The appraiser told us that these costs represent, in his opinion, the maximum cost for a fair quality home and include labor and materials, cost of interim money, sales taxes on materials, site preparation, utilities from home to lot line, plans, specifications, permits, overhead, and profit. He also told us he appraised the value of land using recent lot sales or offerings in the same or a similar residential area.

Site costs and "other" expenses account for most of the \$12,000 difference between the local appraiser's estimates and the developer's proposed costs. While the local appraiser estimated land values at between \$7,920 and \$9,240 a lot, the developer bought an option to purchase the land for \$216,000, or an average cost of \$13,500 a lot. As discussed on page 4, HUD is required to appraise the land later in the development phase and will not approve an amount for more than the appraised value. The developer's option to buy the land for \$216,000 expired July 1, 1981. However, CMHA's chief of development said developers are normally able to obtain an extension on land options but that the price may or may not change.

When land costs are eliminated from the developer's cost estimate and the local appraiser's estimates, the developer's cost per unit is \$56,777 while the appraiser's estimate is \$49,875, or a difference of about \$6,900. Much of this difference can be attributed to the developer's estimate of \$10,677 a unit for other costs.

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At your request we did not take the additional time to obtain written comments from HUD or CMHA. As arranged with your office, unless you publicly release its contents earlier, we plan no further distribution of this report until 30 days from the issue date. At that time we will send copies to the Secretary of Housing and Urban Development and the Director of the Cuyahoga Metropolitan Housing Authority and we will make copies available to other interested parties.

Sincerely yours,



Henry Eschwege
Director