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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

COMMUNITY AND ECONOMIC
DEVELOPMENT DIVISION

16 AUG 1982

B-208620

The Honorable William Proxmire
Ranking Minority Member
Committee on Appropriations
United States Senate



119257

Dear Senator Proxmire:

Subject: Negotiated Sales of HUD-Owned Multifamily Housing
Projects (GAO/CED-82-117)

In line with your May 17, 1982, request, we analyzed the Department of Housing and Urban Development's (HUD's) negotiated sales of HUD-owned multifamily projects during the period October 1, 1976, through April 30, 1982. You posed the following questions:

- What regulations, policies, and procedures govern negotiated sales of HUD-owned multifamily projects, and how often has this sales method been used?
- Have the regulations, policies, and procedures always been followed, and what types of purchasers have acquired projects through the negotiated sales method?

In summary, we found that Section 203 of the Housing and Community Development Amendments of 1978, as amended, authorizes the Secretary of HUD to dispose of a HUD-owned multifamily project on a negotiated, competitive bid, or other basis on such terms as the Secretary deems appropriate, considering the low- and moderate-income character of the project. Current HUD regulations governing negotiated sales are contained in the Code of Federal Regulations, 24 CFR 290, October 1, 1979. (See enc. I.) The regulations prescribe the types of projects and purchasers for which negotiated sales are permitted. The regulations, however, allow the Assistant Secretary for Housing-Federal Housing Commissioner to waive any requirements for "good cause."

Additional policies and procedures pertaining to negotiated sales are contained in three internal HUD memorandums which have not been codified. (See enc. I.) The most recent of these internal HUD memorandums, dated May 7, 1982, states that use of the negotiated sales method will be expanded in the future. For example, although only 18 sales were negotiated in fiscal year 1981 and 5 sales in

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fiscal year 1982 through April 30, 1982, 30 were under consideration as of July 1982. In total, HUD headquarters records show that 184 sales, or about 31 percent, of 582 total sales, were negotiated between October 1, 1976, and April 30, 1982.

Our review of 145 of the 184 negotiated sales HUD made during the period October 1, 1976, through April 30, 1982, showed that there had been no violations of Federal regulations prescribing the types of projects and purchasers for which negotiated sales were permitted. Of the 145 sales we reviewed, 122 sales (84 percent) were to agencies of Federal, State, and local governments and 12 sales to nongovernmental entities such as nonprofit and limited dividend corporations--all permitted under existing regulations. The remaining 11 sales, 9 involving formerly unsubsidized projects and 2 involving subsidized projects, were sold to profit-making organizations, tenant cooperatives, and nonprofit corporations--all involving waivers of the regulations, which were granted by the Assistant Secretary for Housing-Federal Housing Commissioner.

Fifteen of the 122 sales to governmental entities were subsequently passed through to nongovernmental, profit and nonprofit entities, a matter that is not covered in the regulations nor in HUD policies and procedures. Other important matters--including when in the negotiation process waivers should be obtained, whether attempts must always be made to competitively bid sales prior to entering into negotiations, and how tax shelter advantages should be valued in negotiated sales with private, profit-motivated entities--also are not covered in the regulations nor in HUD policies and procedures.

In this regard, a July 19, 1982, report by HUD's Inspector General concerning two proposed negotiated sales of HUD-owned multifamily properties discusses many examples concerning the lack of specificity in applicable regulations, policies, and procedures. (See enc. II.) The Inspector General recommended, among other things, that specific guidelines be developed for negotiated sales of HUD-owned projects (1) addressing the need to systematically determine the property value prior to entering into negotiations, (2) establishing the capability within HUD to perform tax analyses and determine anticipated tax benefits in computing property values, (3) establishing the types of sales terms that can be granted and conditions which would merit offering such terms, (4) requiring advertisement of the conditions of sale prior to any negotiation with a proposed buyer, and (5) establishing procedures to provide reasonable assurance that the objectives of internal control over the negotiating process are accomplished and documented. The Department, although expressing disagreement with many of the findings and conclusions of the Inspector General's draft report, has not officially responded regarding what, if any, specific actions it plans to take to address the final report recommendations.

Although we are not making any recommendations at this time, the second phase of the work that you requested on May 17, 1982, will examine in detail the adequacy of HUD's regulations, policies, and procedures for both negotiated and competitively bid sales of HUD-owned multifamily properties as well as the basis for the prices HUD receives, the adequacy of financing arrangements, and the adequacy of HUD's sales advertising procedures. We will then determine to what extent and how HUD regulations, policies, and procedures should be strengthened and whether HUD actions based on its Inspector General's recommendations have been adequate.

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In conducting our work, we reviewed applicable laws, regulations, policies, and procedures relating to negotiated sales of HUD-owned multifamily properties and interviewed HUD headquarters and field office officials. We reviewed HUD headquarters records for the period October 1, 1976, through April 30, 1982, and identified 184 negotiated sales of HUD-owned multifamily properties. We then requested the HUD field offices to verify the accuracy and/or provide additional information on the 184 sales identified from headquarters records. We obtained information from 38 of the 41 field offices on 145 of the completed sales. Remaining HUD field offices did not respond to our request in time to include the other sales in our report. We concentrated our review on HUD's compliance with Federal regulations governing its authority to conduct negotiated sales because this was a matter that could be readily determined. Because of the need to provide this information quickly, we did not examine in detail the adequacy of the regulations, review HUD's compliance with other requirements in its regulations, policies, and procedures, or independently verify the accuracy and/or completeness of the information obtained from HUD's files or provided by HUD field office officials. These determinations require greater indepth analysis, which we plan to perform in the second phase of our review.

As arranged with your office, we plan to send a copy of this report, per their requests, to Congressman Henry B. Gonzalez, Chairman, House Subcommittee on Housing and Community Development, Committee on Banking, Finance and Urban Affairs, and Senators Donald W. Riegle, Jr., and Christopher J. Dodd, members of the Senate Committee on Banking, Housing and Urban Affairs, 24 hours after its issuance. Unless its contents are released earlier, we plan no further distribution of this report until 5 days from its issue date. At that time we will send copies to the Secretary of

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Housing and Urban Development and make copies available to other interested parties.

Sincerely yours,

A handwritten signature in cursive script that reads "Henry Eschwege". The signature is written in black ink and is positioned above the typed name.

Henry Eschwege
Director

Enclosures - 2

REGULATIONS, POLICIES, AND PROCEDURESGOVERNING NEGOTIATED SALES

Section 203 of the Housing and Community Development Amendments of 1978, as amended, states that the purpose of HUD's property management and disposition program shall be to manage and dispose of projects in a manner which will protect the financial interests of the Federal Government and be less costly to the Federal Government than other reasonable alternatives. It further states that the Secretary is authorized to dispose of a HUD-owned multifamily housing project on a negotiated, competitive bid, or other basis, on such terms as the Secretary deems appropriate considering the low- and moderate-income character of the project.

The current Code of Federal Regulations (CFR) governing the methods of sale of HUD-owned multifamily properties was issued as 24 CFR 290--Management and Disposition of HUD-Owned Multifamily Housing Projects--on October 1, 1979, and prescribes the basic policies which govern multifamily project dispositions. Section 290.53 of the regulations states that disposition shall be through a publicly advertised competitive offering or a negotiated sale. Specifically concerning negotiated sales for both formerly unsubsidized and subsidized projects, Section 290.53(c) states that HUD may negotiate the sale of any project to an agency of the Federal, State, or local government. Section 290.53(c)(2) provides for other circumstances under which sales of formerly subsidized projects can also be negotiated. It states that such sales may be made when:

- "(i) The purchaser is a nonprofit cooperative corporation formed by the present or prospective tenants for the purpose of holding title to the project;
- (ii) The purchaser is a nonprofit or limited dividend entity and it is determined by HUD to be the best source of ownership in the locality capable of the successful long-term operation of the project in a way which is responsive to all the HUD requirements for operation of the project;
- (iii) The project is to be converted to homeownership and individual condominium or homeownership units are to be sold; or
- (iv) The purchaser is a nonprofit consumer cooperative corporation with successful experience in the operation of nonprofit housing."

HUD's initial regulations concerning disposition of multifamily projects were issued on January 27, 1977, and were basically the same as those now in existence except that the prior regulations:

- did not allow the sale of formerly subsidized projects through negotiation to limited dividend entities, as the current regulations do, and
- allowed the sale of formerly unsubsidized projects to be made through negotiation to nonprofit cooperative organizations, or conversion to individual condominium units and individual homes.

Another provision of HUD's current regulations allows the the Assistant Secretary for Housing-Federal Housing Commissioner to waive any part of HUD's disposition regulations for "good cause." Specifically, Section 290.7 states:

"Upon completion of a determination and finding of good cause by the Assistant Secretary for Housing-Federal Housing Commissioner or his or her designee, HUD may waive any provision of this Part in any particular case subject only to statutory limitations. Each waiver shall be in writing and supported by documentation of the facts and reasons which formed the basis for the waiver."

The purpose of this amendment, which was added in October 1977, was to correct an inconsistency between the rules and the current handbooks and was permitted in the interest of program flexibility. The regulations do not specify at what time waivers should be obtained.

In addition to these regulations there are three other memorandums of significance in terms of current HUD policies and procedures for negotiation.

In a memorandum dated April 3, 1981, the Acting Deputy Assistant Secretary for Housing-Federal Housing Commissioner reiterated that Part 290 regulations permit negotiated sales to agencies of the Federal, State, or local government; cooperatives; and nonprofit or limited dividend entities that are determined by HUD "to be the best source of ownership in the locality capable of the successful long-term operation of the project in a way which is responsive to all the HUD requirements for operation of the project." The memorandum outlined categories of circumstances for which negotiated sales of HUD-owned multifamily projects would be permitted. They are, if (1) a publicly advertised bid produced no acceptable offer and HUD determines that no acceptable offer can be received through another public offering, (2) the sale would be to a public housing authority or other Federal, State, or local government agency, and (3) the sale would be to present tenants for conversion to a cooperative.

In a followup memorandum dated March 22, 1982, the Associate General Deputy Assistant Secretary for Field Operations reiterated and expanded on the previously referred to memorandum. Specifically, it was stated that any negotiated sale requires a strong justification that shows the sale is in the best interest of the Government and is the best deal the Government can receive.

Although we realize the April 3, 1981, and March 22, 1982, memorandums do not have the force and effect of the regulations, they indicate the general procedures HUD wanted to follow until recently in disposing of HUD-owned properties--primarily through competitive bids. However, on May 7, 1982, the Deputy Federal Housing Commissioner wrote to all HUD field offices a memorandum which stated that in order for HUD to dispose of its inventory of HUD-owned properties quickly, to achieve the best financial return for the Government, and to attract the best owners and managers, HUD needs to adopt new policies toward marketing these properties and promoting transfers of physical assets. The memorandum focuses on three areas--disseminating information and educating potential buyers, using the real estate brokerage community, and using new selling techniques.

Regarding negotiated sales, the memorandum states that HUD's traditional method of selling properties has been to advertise the property for a stated minimum price, accept sealed bids, and sell the property to the highest bidder who meets the minimum price. The memorandum states that this sales approach has not succeeded in obtaining the best buyers and the best price for the property. It says that HUD must consider new selling techniques, including negotiated sales. It further states that HUD must expand its ability to negotiate sales and use this method when it will achieve the best financial interests for the Government and protect the project. It cautions, however, that any negotiated sale must be in accordance with current regulations, including the requirement for a waiver signed by the Assistant Secretary for Housing-Federal Housing Commissioner, if needed.



U.S. Department of Housing and Urban Development

Office of Audit
Washington, D.C.

**Office of
Inspector
General**

(SUMMARY)

REPORT ON INTERNAL AUDIT

TWO PROPOSED NEGOTIATED SALES OF
HUD-OWNED MULTIFAMILY PROJECTS

82-TS-113-0010

July 19, 1982



Issue Date
July 19, 1982
Audit Case Number
82-TS-113-0010

TO: Philip Abrams, General Deputy Assistant Secretary for Housing-
Deputy Federal Housing Commissioner, HD

FROM: *Donald E. Kirkendall*
Donald E. Kirkendall, Assistant Inspector General for Audit, ZA

SUBJECT: Internal Audit - Two Proposed Negotiated Sales of HUD-Owned
Multifamily Projects

INTRODUCTION

We reviewed the proposed negotiated sale of seven HUD-owned projects (see Background) to the First American Housing Preservation Corporation (FAHPC) and the proposed sale of one HUD-owned project, Easthill Park Apartments, to the California Real Estate Management Corporation (CREMC). Our review was performed because of complaints alleging improprieties in the proposed sales. The proposed sale to FAHPC was negotiated through the New York Regional Office and the proposed sale to CREMC was negotiated through the Denver Regional Office.

The objectives of the examination were to determine whether: (1) the proposed sales of the projects are in accordance with existing HUD regulations, (2) the negotiated sales of these projects will be more cost effective than sale through competitive bid, and (3) the internal controls for preventing program abuse and mismanagement are adequate when disposing of projects through negotiated sales.

The examination was conducted in the New York, Newark and Hartford Area Offices, the New York and Denver Regional Offices, and primarily at the Property Disposition Branch of the respective Area Offices. In addition, certain follow-up interviews were performed in Headquarters.

The examination was conducted from May 12, 1982, through June 18, 1982, and included a review of applicable HUD regulations and records, discussions with cognizant Regional and Area Office staff, review of appropriate Area Office reports, and analyses of disposition processing files for eight multifamily projects. The examination was made in accordance with the applicable portions of generally accepted governmental audit standards and included such auditing procedures as we considered necessary.

SUMMARY

We found that the negotiation for the proposed sales of Easthill Park Apartments, Colorado Springs, Colorado, and the seven New York area projects by HUD were undertaken without a meaningful determination of project value being made and without HUD adequately determining the degree of risk involved from possible future foreclosures. In determining values, HUD has inadequately considered the value of important benefits to be derived by the proposed purchasers such as tax advantages, possible syndication proceeds, profits from condominium conversions and advantageous sales terms. HUD is exposed to a high degree of risk because of the allocation of cash downpayments primarily to the marketable projects in the New York area sale and the high-risk mortgages established in both sales.

We recommend that specific guidelines be developed for negotiated sales of HUD-owned projects addressing the need to systematically determine the value prior to entering into negotiations, establishing the capability within HUD to perform tax analyses, establishing the types of sales terms that can be granted and conditions which would merit offering such terms, and restricting use of purchase money mortgages to an appropriate portion of the project value.

The proposed negotiated sale of Easthill Park Apartments had not been justified by the Denver Regional Office and actions taken were in violation of HUD regulations and directives issued on negotiated sales. We believe HUD was placed in this position because a change in the sales package offer was not publicly advertised for bid. The negotiation for the proposed sale of seven New York area projects was conducted without adequately demonstrating that such a sale would be in compliance with existing regulations. Such actions as public bid offerings and offerings to Federal, state, or local agencies were not properly considered.

We recommend that negotiated sales of HUD-acquired properties be accomplished within procedural guidelines to include advertisement of the conditions prior to any negotiation with a proposed buyer.

Additionally, a reexamination of existing policies and procedures and strengthening of controls over future negotiated sales are needed. The internal controls procedures for the proposed negotiated sales were not effective in protecting the interests of the Department. We believe this was because there was not an adequate separation of duties, documentation of the negotiations, and the proposed sales contained terms not normally granted in a HUD sale to a private investor and, as previously stated, were not adequately evaluated.

We recommend that procedures be established to provide reasonable assurance that the objectives of internal control are accomplished.

We also found that inadequate consideration had been given to repairs in negotiating both sales. In the sale of Easthill Park Apartments, no provisions were included in the contract to ensure the buyer would accomplish the repairs from other than project revenues nor were any provisions made for HUD monitoring of repairs. At the time of our review, the proposed purchaser of the seven projects and HUD's consultant had not jointly identified specific repairs that will be completed or the remedies HUD will have for protection of its interest.

We recommend that current prerequisites on the disposition of multifamily projects relating to repairs be reinforced through memoranda and training courses. Subjects to include would be itemization of repairs, timetables for completion, specific remedies to ensure HUD's interests are protected, specifically identifying changed conditions from time of negotiation completion to the settlement date, and supported repair estimates prepared by Area Office staff.

The final items in the report concerns various administrative problems associated with the disposition recommendations processed in the respective Area Offices. These included Area Office Disposition Committees meeting subsequent to initiation of negotiation proceedings and the utilization of lower occupancy rates than actually experienced. We recommend that procedural adherence be reemphasized during training sessions conducted on disposition proceedings and justification for deviations from existing procedures be included in the Area Manager's disposition recommendation to the Office of Multifamily Financing and Preservation.

The results of the audit were discussed with appropriate Headquarters, Regional, and Area Office officials during the audit. The results of the audit were also discussed with the General Deputy Assistant Secretary for Housing-Deputy Federal Housing Commissioner and the Executive Assistant to the Assistant Secretary for Housing at an exit conference held on June 21, 1982.

We received a written response to our draft findings pertaining to the seven New York area projects on June 29, 1982, and to Easthill Park Apartments on July 13, 1982. These responses are shown in Appendixes I and II to this report.

The Office of Housing stated in its response that the report combines two completely separate processes (the sale of Easthill Park Apartments and the seven New York area projects) whose only commonality is that they were both negotiated property dispositions. The response also indicated that the report, through juxtaposition of unrelated facts and forced parallels, attributes the circumstances of each to the other and appears to make conclusions reached regarding one applicable to the other. Therefore, it was suggested the report be separated into two distinct audit reports. We disagree that the sale to Easthill Park Apartments and the sale of the seven New York area projects are two completely separate processes. Both concern proposed negotiated sales to profit-motivated purchasers and both proposed sales have similar problems in processing as demonstrated by the findings. The recommendations are generally

not directed at these sales but address those problems noted in the findings and corrective action which is necessary to prevent similar problems in negotiating sales in the future. Finally, when performing an audit we normally report on the activities tested collectively rather than report on an individual basis. We do not believe issuing separate reports would serve any useful purpose.

Seven New York Area Projects

The response from the Office of Housing on the proposed sale of the seven New York area projects is summarized in the auditee comments section of the findings and, where appropriate, our evaluation of these comments is provided. We have also made certain changes to the report because of the comments received. In addition to the specific comments on each of the findings, the Office of Housing made general comments which warrant clarification and, therefore, are discussed below.

The response indicated that the proposed sale of the New York projects had reached only the middle, if that far, of the process. We believe the sale was closer to the end of the process rather than in the middle for the reasons noted below. Firstly, in a letter to the attorney for FAHPC dated March 31, 1982, the Special Assistant for Multifamily Housing and Property Disposition stated that, "I have received your letters of March 16 and March 19, 1982. The Department is moving as quickly as possible with its internal paperwork so we can close the deal with FAHPC. We are hoping to close by the end of May." Secondly, the Office of General Counsel received a request on May 6, 1982, to prepare a contract of sale but stopped because additional information was needed to complete the contract. Thirdly, the President of FAHPC who was interviewed on June 9, 1982, indicated as far as he was concerned the offer from FAHPC was firm. The sale at this point in time may have regressed to the middle of the process because of the determination by the Department to request additional proposal packages from parties who have expressed an interest in purchasing any of the projects.

The Office of Housing devoted several pages of its response to the fact that it was within its authority to sell projects "as is"; that it could waive the various provisions of Part 290 of the regulations; and that the bundling approach was innovative, a demonstration project and provided justification for the proposed sale. We do not question the authority of the Office of Housing to dispose of projects "as is" and acknowledged that Part 290 regulations can be waived. We also believe the bundling concept is an innovative approach to the sale of HUD properties and that the proposed sale has some interesting aspects to it that are not generally seen in HUD sales, such as, the sharing of profits from conversion. What we do not agree with, however, is that a determination to negotiate should be made without first having demonstrated that this was the most advantageous manner of selling the projects involved.

Section 290.7 of the regulations provide that upon completion of a determination and finding of good cause by the Assistant Secretary for Housing-Federal

Housing Commissioner or his/her designee, HUD may waive any provision of this part in any particular case subject only to statutory limitations. Each waiver shall be in writing supported by documentation of the facts and reasons which formed the basis for the waiver. The only argument presented by the Office of Housing to justify granting waivers is that it is a demonstration program. At the time of our review, no explanation has been offered why the demonstration program constituted good cause for negotiating a sale.

Easthill Park Apartments

The Office of Housing indicated in its response that the Easthill Park Apartments is a study in the development of a new HUD policy for the disposition of HUD-owned properties. It is not clear in Housing's response whether or not the proposed negotiated sale was actually undertaken in connection with this study. Since specific information pertaining to the new HUD policy was not provided, we could not determine whether or not this sale conformed to the policy. We received no indication when reviewing the proposed sale that this sale was part of a demonstration program. A summary of the comments on each finding is provided in the auditee comments section of the findings, with our evaluation where appropriate.

The findings included in this report are the conclusions of the HUD Office of Inspector General, based on the auditors' testing of the operations. The findings and recommendations are subject to review and determination by your office as to corrective actions needed in accordance with procedures in HUD Handbook 2000.6 REV., on the Audits Management System.