



## **Housing Authority of the City of Meridian, MS**

### **Single Family Loan Program**



Issue Date: August 25, 2014

Audit Report Number: 2014-AT-1009

TO: Kathleen Zadareky, Deputy Assistant Secretary for Single Family Housing, HU  
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//signed//

FROM: Nikita N. Irons, Regional Inspector General for Audit, Atlanta Region, 4AGA

SUBJECT: The Housing Authority of the City of Meridian Did Not Adequately Maintain Its FHA-Insured Rental Apartments

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of the Housing Authority of the City of Meridian's acquisition and management of its Queen City rental apartments.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at <http://www.hudoig.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at 404-331-3369.



August 25, 2014

## The Housing Authority of the City of Meridian Did Not Adequately Maintain Its FHA-Insured Rental Apartments

# Highlights

Audit Report 2014-AT-1009

### What We Audited and Why

We reviewed the Housing Authority of the City of Meridian's Queen City apartments at the request of the U.S. Department of Housing and Urban Development's (HUD) Single Family Office of Asset Management. Our objectives were to determine whether the Authority acquired, financed, and managed the purchase of the apartments in accordance with applicable regulations and determine the cause of the Queen City apartments' Federal Housing Administration (FHA) loan defaults.

### What We Recommend

The audit identified a deficiency which did not comply with a requirement in the deeds of trust which is an agreement between the originating lender and the Authority. Specifically, the audit identified that the Authority did not adequately maintain the physical condition of Queen City rental apartments which was required by the deeds of trust for each property. However, the deficiency only violated a covenant provided in the agreement and did not violate any HUD Federal regulations; therefore, no recommendations were made in the report.

### What We Found

The Authority acquired and financed Queen City rental apartments in accordance with HUD's Federal regulations by executing 26 FHA-insured mortgages for the purpose of renting the apartments to low- and moderate-income families. However, the Authority did not properly manage and operate the apartments. Specifically, the Authority did not adequately plan for its maintenance. This condition occurred because the Authority's maintenance plan did not adequately consider the costs of upkeep and the Authority did not have a contingency plan in place to address the physical condition of the apartments in the event of declining rental income. As a result, the Authority exposed the FHA insurance fund to unnecessary risk and a potential loss of more than \$608,000.

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## BACKGROUND AND OBJECTIVES

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The Housing Authority of the City of Meridian is a public corporation organized under the laws of the State of Mississippi, and its primary mission is to provide low-income housing for qualified individuals. To accomplish this purpose, the City appoints a governing board, and the board designates its own management. The board has governance responsibilities for all housing activities within Meridian, MS. The Authority was incorporated in 1939 and provides decent, safe, and affordable housing opportunities to more than 3,000 residents in Meridian, MS. It administers 1,215 public housing units and 215 housing choice vouchers and manages 89 mixed-income apartments. The U.S. Department of Housing and Urban Development's (HUD) field office in Jackson, MS, has the responsibility for overseeing the Authority.

The Authority purchased 87 privately owned apartment units, known as the Queen City rental apartments, from HUD's Property Disposition Branch in Jackson, MS on multiple dates in 1987 and 1988 with 26 different Federal Housing Administration (FHA) loan transactions totaling more than \$1.7 million. HUD's Loan Management Branch is responsible for all decisions concerning formerly coinsured mortgages and properties under its jurisdiction. The Loan Management Branch keeps the Property Disposition Branch informed of the current status of all potential acquisitions and mortgagee-in-possession actions. HUD's Property Disposition Branch manages and sells all acquired properties and is responsible for the management of those projects which HUD owns. During the time of the loan transactions, the Loan Management Branches and the Property Disposition Branches operated at multiple offices across the country and reported to the Office of Asset Management. However, in 1996 the Office of Asset Management consolidated the operations of both of the branches and formed what is currently known as the Property Disposition Branch which now operates with only two field offices in Ft. Worth, TX and Atlanta, GA.

Queen City consists of 26 properties, comprised of multiple duplexes, triplexes, and quadplexes, totaling 87 units located within 1 zip code area of Meridian. The Authority manages and operates the apartments. However, all of Queen City operations are accounted for separately and are independent with respect to the Authority's annual contributions contract with HUD. The Authority and HUD did not enter into any contract agreements regarding Queen City beyond the FHA loan requirements.

The loans were originated by Bailey Mortgage Company. The loans were refinanced by Regions Mortgage in March 1999. In September 2013, the Authority stopped making the mortgage payments for each of the loans. On January 9, 2014, the mayor of Meridian wrote a letter to HUD on behalf of the Authority, which requested total forgiveness of the mortgage debt due to Queen City's insufficient cash flow and poor physical conditions. On April 30, 2014, HUD's Neighborhood Watch system showed that the total unpaid principal balance for the properties totaled more than \$1.25 million. A recent as-is appraisal for the apartments estimated the property's value at more than \$1.1 million. There were no secondary lien debts on the properties.

Our objectives were to determine whether the Authority acquired, financed, and managed the purchase of the project in accordance with applicable regulations and determine the cause of the Queen City apartments' FHA loan defaults.

## RESULTS OF AUDIT

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### Finding: The Authority Did Not Adequately Maintain Its Queen City Rental Apartments

The Authority acquired and financed Queen City rental apartments in accordance with HUD's Federal regulations by executing 26 FHA-insured mortgages for the purpose of renting the apartments to low- and moderate-income families. However, the Authority did not adequately maintain the physical condition of its Queen City rental apartments. This condition occurred because the Authority's maintenance plan did not adequately consider the cost of upkeep and the Authority did not have a contingency plan in place to address the physical condition of the apartments in the event of declining rental income. As a result, the Authority exposed the FHA insurance fund to unnecessary risk and a potential loss of more than \$608,000.

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#### **Apartments' Physical Condition Not Adequately Maintained**

The Authority acquired and financed Queen City rental apartments in accordance with HUD's Federal regulations by executing 26 FHA-insured mortgages for the purpose of renting the apartments to low- and moderate-income families, which is consistent with its mission. Specifically, we determined that there was no HUD FHA requirement which would preclude the Authority from acquiring and financing Queen City rental apartments with FHA mortgages. The audit also identified that the use of Single Family FHA loans for financing was allowable because each loan did not exceed the statutory limit of four families. Queen City operations are accounted for separately and are independent with respect to the Authority's annual contributions contract with HUD, and the project is not a part of the Authority's project-based housing portfolio, which receives Section 8 housing assistance payments.

However, the Authority did not properly manage and operate the apartments. Specifically, it did not comply with the deed of trust<sup>1</sup> for each property and did not adequately plan for project maintenance. The Authority's Modernization Coordinator stated that approximately 70 percent of the units were dilapidated and uninhabitable due to structural, quality, systems, and safety conditions (see appendix B).

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<sup>1</sup> The deed of trust is an agreement between the originating lender and the Authority. For each loan, a deed of trust, under the jurisdiction of the State of Mississippi, was used as the instrument for financing. The deed of trust contained several covenants, including an agreement that the Authority would not commit, permit, or suffer waste,

impairment, or deterioration of the properties or any part thereof.

We conducted site visits to each of the apartment buildings and identified that only one building with seven units was occupied by tenants. This apartment building was the only one for which the mortgage loans were current. Authority officials stated that the units were in better condition because they were constructed with sounder materials. A 2002 physical needs assessment conducted for the occupied apartments showed that the physical needs for the 7 units were less extensive than for the other 80 units.

A June 1996 physical needs assessment estimated that the total cost to rebuild the 87 units was more than \$1.8 million. The Authority refinanced each of the 26 loans associated with the project in March 1999, and the total refinance amount was more than \$1.6 million. Then in March 2002, an independent physical needs assessment estimated that the cost of the physical needs was more than \$3.8 million. It also concluded that the properties were constructed with marginal standards, cheap materials, and questionable workmanship. Authority officials also stated that the high vacancy rate was due to the poor condition of the properties, which was caused primarily by poor workmanship and cheap materials used during the original construction of the properties. Queen City had a vacancy rate of more than 80 percent<sup>2</sup>. Authority officials stated that the condition of the properties negatively affected its ability to rely on rental income from housing choice vouchers from the neighboring Mississippi Regional Housing Authority 5 because some of the units were unable to pass housing quality standards inspections. Recently, in October 2012, a physical needs assessment estimated that the rebuilding construction costs would be more than \$3.6 million, and a rehabilitation as-is appraisal estimated the Queen City's value at about \$1.2 million, or approximately one-third of the cost of construction.

This condition occurred because the Authority's prior management did not adequately plan for the apartments' maintenance and upkeep. Specifically, the Authority's maintenance plan in its loan proposal significantly underestimated the cost of the upkeep, and the Authority did not have a contingency plan to address the physical conditions in the event of declining rental income.

- Inadequate maintenance budget - The Authority's loan proposal included a maintenance plan, which estimated that the maintenance costs would be approximately \$830,000 over the life of the 30-year mortgage, or nearly \$27,000 each year. However, over a 10-year period from 2003 through 2013, the Authority expended more than \$810,000 for maintenance, or approximately \$81,000 per year.

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<sup>2</sup> The vacancy rate was calculated by dividing the vacant units (65) by the available units (81). The Authority's records showed that only 81 units were available for lease when the calculation was completed. The calculation was not made based on the original 87 units because 6 of the units were taken off line and were scheduled for demolition due to structural concerns.

From 1988 through 2013, the Authority expended more than \$1.6 million, or almost double what was planned for maintenance (see table 1), from funds generated solely from rental income since acquiring the apartments.

**Table 1 - Actual maintenance expense**

<u>Year</u>	<u>Maintenance cost</u>
1988	\$ 42,047
1989	\$ 19,952
1990	\$ 37,250
1991	\$ 28,138
1992	\$ 52,797
1993	\$ 38,350
1994	\$ 41,158
1995	\$ 37,686
1996	\$ 91,973
1997	\$ 52,817
1998	\$ 70,133
1999	\$ 74,607
2000	\$ 88,669
2001	\$ 89,615
2002	\$ 63,691
2003	\$ 66,482
2004	\$ 75,416
2005	\$ 72,352
2006	\$ 62,637
2007	\$110,244
2008	\$ 67,943
2009	\$ 60,929
2010	\$ 95,760
2011	\$108,795
2012	\$ 51,315
2013	\$ 38,473
Total	\$1,639,229

- Failure to establish a contingency plan - The Authority’s loan proposal showed that it planned to rely only on the project’s rental income to pay expenses, including maintenance costs. The Authority should have created a contingency plan to address the upkeep of the physical condition of the project in the event that rental income declined.

Although, the Authority did not have a contingency plan in place, it attempted to sustain the project as a viable asset while its rental income was significantly declining. Specifically, from March 2009 to March 2014, the Authority expended more than \$700,000 of its own non-Federal funds in an attempt to maintain the properties. Authority officials provided a letter, dated May 7, 2014, which explained that the funds were originally planned for security surveillance installation and enhanced lighting upgrades throughout the Authority’s public housing portfolio. Authority officials added that they had exhausted the non-Federal funds and were no longer able to support the project without negatively affecting the Authority’s overall operations. The Authority obtained more than

\$666,000 in low-income tax credits to cover the cost of rehabilitating the project in 2013.

Unlike the Authority's project-based public housing portfolio, the Authority had not received an administrative fee from HUD's Office of Public Housing for Queen City, and it was not an asset management project. Under project-based funding, asset management projects receive funding directly from HUD, and each project has its own project expense level. The project expense level is a model-generated estimate of the cost to operate a project. A Public Housing Revitalization Specialist stated that in 2008, the Authority contacted their office to informally discuss the possibility of designating Queen City as a public housing asset management project; however, the request was declined due to the condition of the properties.

The Authority's failure to adequately plan for the maintenance of the properties resulted in its inability to rely on rental income to pay their expenses, including the mortgage, as shown in table 2. Table 2 also shows that the apartments had begun to lose rental income and had consistently operated in a negative cash flow position since 1998. As of April 30, 2014, the Authority's outstanding mortgage balances for the defaulted loans were more than \$1.2 million which exposed the FHA insurance fund to unnecessary risk and a potential loss of more than \$608,000. The potential loss was calculated by multiplying the outstanding mortgage balances for the defaulted mortgages by the FHA's insurance fund actual loss rate of 52 percent for fiscal year 2014, quarter 1. (see appendix C).

**Table 2 - Schedule of rental income and net income or loss**

<u>Fiscal yearend</u>	<u>Total net income or loss</u>	<u>Dwelling rent revenue**</u>	<u>Housing assistance revenue***</u>	<u>Total revenue</u>	<u>Total revenue percentage increase or decrease</u>
3/31/1988	\$ 77,781		*	\$229,279	
3/31/1989	\$ 46,379		*	\$269,550	18%
3/31/1990	\$ 13,656		*	\$272,307	1%
3/31/1991	\$ 26,235		*	\$270,608	-1%
3/31/1992	(\$ 23,487)		*	\$249,321	-8%
3/31/1993	\$ 28,633		*	\$278,951	12%
3/31/1994	\$ 42,775	\$136,443	\$158,521	\$294,964	6%
3/31/1995	\$ 46,905	\$133,816	\$148,432	\$282,248	-4%
3/31/1996	(\$ 4,848)	\$143,598	\$160,865	\$304,463	8%
3/31/1997	\$ 33,189	\$145,096	\$159,812	\$304,908	0%
3/31/1998	(\$ 3,430)	\$151,861	\$146,518	\$298,379	-2%
3/31/1999	(\$ 17,920)	\$164,342	\$130,872	\$295,214	-1%
3/31/2000	(\$ 31,373)	\$151,121	\$146,747	\$297,868	1%
3/31/2001	(\$ 1,699)	\$192,049	\$121,831	\$313,880	5%
3/31/2002	(\$ 18,354)	\$173,848	\$111,105	\$284,953	-9%
3/31/2003	(\$ 19,311)	\$158,768	\$134,929	\$293,697	3%
3/31/2004	(\$ 25,085)	\$139,041	\$164,490	\$303,531	3%
3/31/2005	(\$116,476)	\$145,552	\$143,706	\$289,258	-5%
3/31/2006	(\$ 12,457)	\$223,943	\$ 92,450	\$316,393	9%
3/31/2007	(\$ 26,508)	\$213,782	\$ 85,610	\$299,392	-5%
3/31/2008	(\$ 39,093)	\$178,261	\$104,599	\$282,860	-6%
3/31/2009	(\$ 48,281)	\$132,842	\$ 91,659	\$224,501	-21%
3/31/2010	(\$ 87,356)	\$144,892	\$ 76,283	\$221,175	-1%
3/31/2011	(\$121,042)	\$146,438	\$ 63,637	\$210,075	-5%
3/31/2012	(\$ 98,519)	\$120,398	\$ 36,481	\$156,879	-25%
3/31/2013	(\$110,994)	\$ 82,960	\$ 30,957	\$113,917	-27%
Total	(\$490,680)	\$3,079,051	\$2,309,504	\$6,958,571	

\* During these years, the Authority's accounting system tracked only total rent revenue, and it did not separate dwelling rent and housing assistance payment revenue.

\*\* Dwelling rent revenue was income received from market rents.

\*\*\* Housing assistance revenue was the Authority's accounting for its Housing Choice Voucher income.

### Subsequent Steps Were Taken to Revitalize Queen City

The Authority began to develop a plan to restore the distressed apartments in 2007. Specifically, the Authority's current management stated that in 2007 it issued a request for qualifications to private development firms for assistance in the restoration of the apartments' financial viability. The Authority procured the Michaels Development Company, to assist with planning and development in January 2013. The Authority and Michaels developed a plan for addressing the problems associated with the apartments' financial and physical condition. The plan involved a new first loan mortgage, supported by Section 8 rents, tax credits received in August 2013, and soft subordinate gap funding to cover the costs of acquisition and rehabilitation. We acknowledge that the Authority has taken steps to restore the apartments; however, we did not assess the adequacy of the proposed plan because it involved a significant financial component that has not been approved by HUD.

## Conclusion

The Authority acquired and financed Queen City in accordance with HUD's Federal regulations by executing 26 FHA-insured mortgages for the purpose of renting the apartments to low- and moderate-income families. However, it did not properly manage and operate the apartments. Specifically, the Authority did not adequately plan for their maintenance. Its maintenance plan significantly underestimated the cost of the project's upkeep, and it did not have a contingency plan in place to address its physical condition in the event of declining rental income. Due to the Authority's inadequate maintenance plan, the condition of the properties declined, and a portion of Queen City was uninhabitable, which caused the Authority to lose substantial rental income. Therefore, the Authority defaulted on its FHA-insured mortgages, which exposed FHA's insurance fund to an unnecessary risk and a potential loss of more than \$608,000.

## Recommendations

The audit identified a deficiency which did not comply with a requirement in the deeds of trust which is an agreement between the originating lender and the Authority. Specifically, the audit identified that the Authority did not adequately maintain the physical condition of Queen City rental apartments which was required by the deeds of trust for each property. However, the deficiency only violated a covenant provided in the agreement and did not violate any HUD Federal regulations; therefore, no recommendations were made.

## SCOPE AND METHODOLOGY

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We performed the review from March 2014 through June 2014 at locations in Jackson and Meridian, MS, including the HUD field office, the Authority, and the project's properties. The audit generally covered the period August 1, 1987, through April 30, 2014. We adjusted the period when necessary.

To achieve the audit objective, we

- Reviewed HUD Handbook 4155.1, REV-1, paragraph 1-1(7f); HUD Handbook 4155.1, REV-5, paragraph 1-5(C) and section 3-7; 24 CFR (Code of Federal Regulations) 203.42; and other HUD program requirements.
- Reviewed the Authority's procedures and controls used to administer its Section 8 housing quality standards inspections.
- Reviewed the Authority's loan proposal to the lender for the 26 FHA loans.
- Reviewed the Authority's mortgage note and deed of trusts.
- Reviewed Queen City's FHA loan files provided by the Authority.
- Obtained origination, default, and other information from HUD's Neighborhood Watch system for loans included in the review.
- Interviewed appropriate officials and staff from the HUD Jackson office and the Authority.
- Conducted site visits at each of the 26 properties.

We conducted a 100 percent review of the 26 FHA loans that the Authority entered into for the Queen City rental apartments. The primary focus of the review focused on (1) the Authority's legal authority to acquire the property with FHA loans, (2) compliance with FHA's loan origination requirements for local government agencies, and (3) the management and operation of the apartments.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective(s). However, the review did not identify findings that would require corrective actions by the Authority. Specifically, the audit identified a deficiency that was subject to the jurisdiction of the State of Mississippi in each deed of trust. Since the Authority did not violate any Federal regulations, no recommendations were made.

# INTERNAL CONTROLS

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Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

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## Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objectives:

- Policies and procedures to reasonably ensure that the acquisition of HUD owned properties comply with HUD program requirements.
- Policies and procedures to reasonably ensure that the FHA loan financing of single family rental properties comply with HUD program requirements.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

## Significant Deficiency

Based on our review, we did not identify any significant internal control weaknesses.

# APPENDIXES

## Appendix A

### AUDITEE COMMENTS AND OIG'S EVALUATION

#### Ref to OIG Evaluation

#### Auditee Comments



**MERIDIAN HOUSING AUTHORITY**  
MERIDIAN, MISSISSIPPI 39302-0870

August 12, 2014

*Committed to Excellence*

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Nikita N. Irons, Regional Inspector General for Audit  
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Office of Audit – Region IV  
75 Spring Street, SW., Room 330  
Atlanta, GA 30303

Dear Ms. Irons:

Please consider this correspondence from the Meridian Housing Authority (“the Authority”) as the written response to your draft audit report on the status of the Queen City Rental Apartments.

It is the understanding of the Authority that written comments are to be submitted within 10 days of August 6<sup>TH</sup> which is the date of the draft report. In the event we have additional written comments as a result of the August 14<sup>th</sup> exit conference, they will be incorporated in a revised letter and resubmitted for inclusion with the final HUD-OIG report.

The purpose of the audit, as explained on page 4, was to determine whether the Authority acquired, financed and managed the purchase of the project in accordance with applicable regulations and in addition to determine the cause of the Queen City Apartment’s FHA loan defaults. We are pleased to note that the draft audit concludes that the Authority acquired and financed the Apartments in accordance with HUD regulations.

The audit further concludes that the Authority did not properly manage and operate the Apartments as it failed to adequately plan for its maintenance. Specifically, it notes that the Authority’s maintenance plan did not adequately consider the costs of upkeep and did not have a contingency plan in place to address the physical condition of the Apartments in the event of declining rental income. Recognizing on its final page, that, at worse, a covenant in the deed of trust between the lender and the Authority may have been violated, the audit, however, makes no recommendation for further action.

While the “no recommendations” conclusion is deeply appreciated, the Authority respectfully asserts that it did, in fact, properly manage and operate the Apartments. As documentation of this claim, we present the following facts:

- From 1987 and 1989, when the Apartments were initially acquired until September, 2013, the Authority faithfully made mortgage payments when due. As can be documented through rent rolls and housing quality standard reports during most of this period, the apartments were occupied and maintained in habitable condition. As the audit acknowledges, despite

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Comment 1

declining rental revenues, the Authority expended over \$700,000 in non-Federal funds to maintain the properties.

- In 2007, recognizing that it could not responsibly continue to subsidize operations from non-federal funds, the Authority issued a Request for Qualifications to private development partners to assist in evaluating and implementing options to restore the Apartments to financial viability. The Authority procured the Michaels Development Company, an experienced multifamily developer, to assist in this endeavor.
- The Authority and Michaels developed a sound plan for addressing problems associated with the financial health and physical condition of the Apartments. The plan entailed purchase of the Apartments and their physical rehabilitation by a limited partnership of which the Authority had an ownership interest. Acquisition and rehabilitation would be funded from a combination of a new FHA mortgage loan supported by Section 8 project based rules, tax credit equity and soft subordinate gap funding. The existing FHA loans would be repaid from these new funding sources. To further this plan, the Authority:
  - o In April 2012: responded successfully to a competitive RFP for project based vouchers issued by the Mississippi Region V Housing Authority;
  - o In May 2012: submitted an application to the Mississippi Home Corporation (MHC) for an allocation of 9% Low Income Housing Tax Credits. Tax credit applications require proof of commitments for all funding sources, including first mortgage construction and permanent debt, a commitment from an equity investor to purchase the property's tax credits, and evidence of gap funding. Unfortunately, as the program is extremely competitive, this initial application was not approved.
  - o Upon receiving notification that its initial tax credit application was denied, the Authority immediately took steps to seek mortgage relief. It required considerable effort just to determine what entities owned and serviced the mortgage loans. In October 2012, the Authority applied for but was denied a loan modification by Everhome Mortgage on the grounds the property did not meet HUD's loan modification eligibility criteria as a result of the "non-owner occupancy of the homes."
  - o In April 2013: re-applied to Mississippi Home Corporation (MHC) for low income housing tax credits. The Authority was successful in receiving a \$666,754 forward allocation of 2014 Tax Credits under the 2012 Health Care Zone Special Allocation Cycle.
  - o Unfortunately, a change in IRS regulations governing the low income housing tax credit program lowered the value of the project's tax credit allocation. The applicable tax credit rate for projects receiving 2014 allocations was reduced from 9% to a

floating rate of about 7.6%. Prior to this change, available) already committed funding sources would have readily covered the costs of acquisition (including pay-off of the existing FHA insured debt) and property rehabilitation. With the change in regulations, the project faced a funding gap. To address this funding gap, the Authority:

In May 2013: applied for HOME funds from MHC. Unfortunately, this application was unsuccessful.

In June 2013: applied for affordable housing program funds from the Federal Home Loan Bank of New York. Unfortunately, the application did not score well enough to receive funding.

July 2013: began exploring the possibility of mortgage relief. Forgiveness or subordination of the existing FHA insured debt would reduce development costs, so that new sources would once again cover proposed uses. As confirmed by Michaels' legal counsel, as well as HUD officials from the Jackson MS office, if the Apartments had been insured under FHA's multifamily programs, in all likelihood there would be mechanisms available for HUD to grant mortgage relief. However, for some odd reason (unknown to the Authority), the mortgages, although for multifamily rental units had been provided under an FHA single family program.

After over 26 years of faithfully making mortgage payments on the property, and expending more than \$700,000 of non federal funding originally planned to address escalating criminal activity, the Authority exhausted the non federal funds and could no longer support the project without negatively affecting the Authority's high performing operations.

January 2014: Meridian Mayor Percy Bland met with Former HUD Secretary, Shaun Donovan regarding Meridian's plan of action which included an FHA mortgage modification to ensure the restoration of viability of the distressed Queen City Apartments. He also indicated to Secretary Donovan that several of the property's were located within Meridian's Choice Neighborhood planning boundaries which would positively impact over 350 qualified families on Meridian's affordable housing waitlist.

March 2013: Responded to the Director Himes' request for additional information needed from the Authority regarding Queen City.

## Comment 1

**Comment 2**

**Comment 4**

**Comment 3**

**Comment 3**

**Comment 4**

Given this set of facts, the Authority, recognized by HUD as a "High Performer", respectfully concludes that it has acted proactively and responsibly to address the physical needs of the Queen City Apartments. As outlined above, the Authority has an effective contingency plan in place to restore the distressed Queen City Apartments to financial health. That plan remains viable and sound. With a subordination of the existing mortgage loans, there are sufficient sources, in the form of a new amortizing first mortgage loan, supported by Section 8 rents, tax credit equity, and soft, subordinate gap funding to cover the costs of acquisition and rehabilitation. Funding commitments for these sources remain in place.

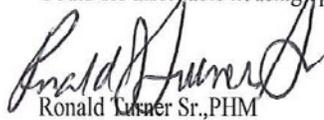
The purchase of Queen City was subject to the underwriting and approval of the HUD Single Family Loan Program at the time of the original acquisition as well as a 1999 refinancing. Although the audit is critical of the Authority for requesting approval of an existing community that a 2002 physical needs assessment indicates was constructed utilizing cheap materials and questionable workmanship, it fails to ascribe any responsibility to the FHA for underwriting and approving loans for properties with these deficiencies.

Our purpose in noting this is not to criticize the FHA, but to suggest that FHA bears some responsibility for past decisions and can now take action to redress them. Subordination of the existing FHA-insured debt will allow the Authority to address the physical condition of the Apartments, preserve much needed affordable housing stock, and provide a mechanism for repayment of the existing FHA insured debt through net annual cash flow.

However, without prompt action on HUD's part, the Authority has been warned, in writing, that MHC will rescind its tax credit allocation effective September 1, 2014.

Therefore, we respectfully request that the OIG amend its report to reflect the efforts of the Authority to address the needs of the property, which we understand, will allow the FHA to consider our reasonable request for mortgage modification.

Yours for affordable housing opportunities,



Ronald Turner Sr., PHM  
Executive Director

cc: Kathleen Zadareky, Acting Deputy Assistant Secretary, HU  
Ivery Himes, Director of Single Family Asset Management, IIU  
Sonya Lucas, Asst. Regional IG for Audit  
Booker T. Jones, IG Audit  
Jacalyn Slater, IG Audit

## OIG Evaluation Auditee Comments

**Comment 1** The Authority stated that it respectfully asserts that it did, in fact, properly manage and operate the apartments. We recognize that the Authority's current management took steps to restore the financial and physical condition of the project. However, the Authority could have potentially avoided the necessity of restoring the physical and financial condition of the apartments if prior management would have adequately planned for the maintenance of the properties when initially acquired.

The Authority stated that its response to Director Himes' request for additional information was March 2013; however the date was actually March 2014.

**Comment 2** We acknowledge that the Authority has formulated a plan to restore the project. The Authority contracted with Michaels Development Company, which assisted it with developing a plan which involved obtaining additional funding through tax credits, soft subordinate gap funding and new FHA financing. However, the fact remains that the Authority's prior management did not adequately plan for the maintenance of the project which in turn resulted in its financial distress, thereby resulting in the decision by current management to contract with the development company.

We also acknowledge that HUD designated the Authority as a high performer. However, the referenced designation is related to the Authority's operation of its Low Rent Housing Program under the Public Housing Assessment System, which was not associated with the financing, acquisition, and management of Queen City Apartments. Furthermore, a housing authority can receive this designation even though their other programs or operations are not performing well.

**Comment 3** The Authority stated that the audit failed to ascribe any responsibility to FHA for underwriting and approving loans for properties with deficiencies noted in its 2002 physical needs assessment. Our review of the Authority's records and HUD's correspondence did not indicate that the properties were uninhabitable or not structurally sound when they were acquired by the Authority. Furthermore, when the loans were underwritten in 1999, they were refinanced with a FHA streamline refinance product without an appraisal; therefore, the FHA approved underwriter would have no official knowledge of the physical condition of the properties. HUD Handbook 4155.1, section 3.C.2, provides that some streamline refinances do not require appraisals, and it also outlines the eligibility requirements for that type of product.

The Authority discussed the potential subordination of the existing FHA-insured debt. However, the circumstances surrounding the comment are outside of our scope of review, and HUD will make a determination regarding the final course of action with respect to the defaulted loans.

**Comment 4** We acknowledge that the Authority's current management has taken steps to restore the property's physical condition and financial viability, and we adjusted the report accordingly. However, we did not assess the adequacy of the Authority's proposed plan because it involved a significant financial component that has not been approved by HUD.

## Appendix B

### PHYSICAL CONDITION OF THE VACANT PROPERTIES\*

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\*\*Property 1 – This property needs Energy Star windows, an exhaust system, hardie board siding, and roof repairs.



\*\*Property 2 – This property needs Energy Star windows and new hardie board siding.



\*\*Property 3– This property needs Energy Star windows and new hardie board siding, and the exterior stairs need to be repaired.



\*\*Property 4 – This property needs Energy Star windows, new hardie board\*\*\* siding, and new roofing shingles.

\* The pictures were taken during OIG audit site visits on May 1, 2014. The listing repairs needed was based on OIG analysis, the 2012 needs assessment and comments made by the Authority.

\*\*These properties have been boarded up due to their physical condition.

\*\*\* A hardie board is known as cement board siding and is a combination of cement and reinforcing fibers formed into 4 foot by 8 foot sheets, 1/4 to 1/2 inch thick that is typically used as a tile backing board.

## Appendix C

### SCHEDULE OF THE APARTMENTS' DEFAULTED LOANS

<u>FHA case number</u>	<u>Number of units</u>	<u>Original closing date</u>	<u>Original mortgage amount</u>	<u>Number of months delinquent</u>	<u>Outstanding balance</u>	<u>Potential loss</u>
283-0182686	4	4/26/1988	\$86,932	8	\$63,327	\$32,930
283-0182634	4	7/12/1988	\$84,129	8	\$61,287	\$31,869
283-0182590	4	9/2/1987	\$78,369	8	\$59,986	\$31,193
283-0182611	4	9/1/1987	\$84,129	8	\$59,986	\$31,193
283-0182657	4	4/28/1988	\$71,673	8	\$52,213	\$27,151
283-0183068	4	9/1/1987	\$70,739	8	\$50,978	\$26,509
283-0183074	3	9/1/1987	\$70,739	8	\$50,978	\$26,509
283-0183051	3	9/1/1987	\$68,871	8	\$49,630	\$25,808
283-0183016	3	9/2/1987	\$68,871	8	\$49,106	\$25,535
283-0182692	4	4/29/1988	\$66,587	8	\$48,432	\$25,185
283-0183045	3	9/2/1987	\$64,719	8	\$46,513	\$24,187
283-0182605	3	8/31/1987	\$65,186	8	\$46,480	\$24,170
283-0182628	3	9/2/1987	\$65,186	8	\$46,480	\$24,170
283-0182815	3	9/2/1987	\$64,719	8	\$46,147	\$23,996
283-0183008	3	9/2/1987	\$64,719	8	\$46,147	\$23,996
283-0183022	3	9/2/1987	\$64,719	8	\$46,147	\$23,996
283-0182998	3	9/2/1987	\$64,719	8	\$46,147	\$23,996
283-0182981	3	8/12/1987	\$64,719	8	\$46,147	\$23,996
283-0182939	3	9/11/1987	\$64,719	8	\$46,145	\$23,995
283-0183039	3	9/2/1987	\$64,719	8	\$46,091	\$23,967
283-0182640	3	4/12/1988	\$60,100	8	\$43,784	\$22,768
283-0182707	4	4/13/1988	\$58,698	8	\$42,687	\$22,197
283-0182742	4	7/20/1988	\$58,698	8	\$42,681	\$22,194
283-0182821	4	4/12/1988	\$57,297	0	\$41,382	\$ 0*
283-0182838	3	4/12/1988	\$53,145	0	\$38,381	\$ 0*
283-0182578	2	9/2/1987	\$47,125	8	\$33,601	\$17,473
Totals	87		\$1,734,226		\$1,250,833***	\$608,983**

\* The Authority was current on these two mortgages. The properties connected to these loans were in better condition, and tenants were living in them.

\*\* The potential loss was calculated by multiplying the outstanding mortgage balances for the defaulted mortgages by FHA's insurance fund actual loss rate of 52 percent for fiscal year 2014, quarter 1.

\*\*\*The outstanding mortgage balances above are as of April 30, 2014.