



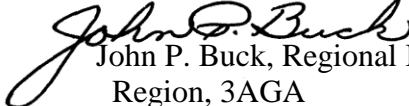
U.S. Department of Housing and Urban Development
Wanamaker Building, Suite 1005
100 Penn Square East
Philadelphia, PA 19107-3380

Regional Inspector General for Audit

Audit Memorandum
Number 2009-PH-0801

June 19, 2009

MEMORANDUM FOR: Carol J. Galante, Deputy Assistant Secretary for Multifamily Housing Programs, HT

FROM: 
John P. Buck, Regional Inspector General for Audit, Philadelphia Region, 3AGA

SUBJECT: Corrective Action Verification Review
Upfront Grant for Ridgecrest Heights Apartments
CEMI-Ridgecrest, Inc.
Washington, DC
Audit Memorandum 98-AO-219-1804

INTRODUCTION

We completed a corrective action verification review on the subject audit memorandum as a result of allegations made in a December 2008 Washington Post news article. Among other things, the article alleged that a developer, H.R. Crawford, former president of CEMI-Ridgecrest, Inc. (grantee), failed to repay the U.S. Department of Housing and Urban Development (HUD) proceeds gained from the sale of townhomes located at Ridgecrest Heights Apartments as required by the upfront grant agreement. Since we had previously made a recommendation addressing this matter in a prior audit (Audit Memorandum 98-AO-219-1804; September 24, 1998) we determined it was necessary to evaluate whether HUD had adequately implemented the recommendation. As such, the objective of this corrective action verification review was to determine if HUD ensured the repayment of excess proceeds from the sale of townhomes located at Ridgecrest Heights Apartments. We plan to review other allegations discussed in the news article on future audits as appropriate.

METHODOLOGY AND SCOPE

In performing our review, we reviewed HUD program files, related correspondence, and documentation pertaining to the upfront grant agreement, the audit memorandum and HUD's management decision and applicable follow-up actions. We interviewed HUD's Director of Asset Management and her staff, responsible officials from the Philadelphia Office of Multifamily Housing Programs, the Atlanta Office of Multifamily Housing, the District of Columbia's Office of Community Planning and Development, and HUD's Office of Public

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Affairs. The previous audit memorandum included six recommendations. Due to the specific allegation in the news article, we focused this corrective action verification review on one recommendation. This recommendation was for HUD to establish and monitor a mechanism to ensure the repayment to HUD of approximately \$10 million from the sale of the townhomes. Our review covered the period November 1996 through January 2004.

BACKGROUND

Upfront Grant for Ridgecrest Heights Apartments

Ridgecrest Heights Apartments (also known as Walter E. Washington Estates) was a 331 unit apartment complex located at 800-843 Bellevue Street, S.E., Washington, DC, that was acquired by HUD through a foreclosure sale in October 1995. The Ridgecrest Heights Tenants Cooperative Association, representing over 51 percent of the tenants who wanted to redevelop the property, consulted with Mr. H.R. Crawford, a developer and property manager and President of Crawford Edgewood Managers, Inc., (CEMI) to propose a plan to acquire the apartments and redevelop the site into new townhomes. In September 1996 HUD sold the property for \$1 to CEMI and the Ridgecrest Heights Tenants Cooperative Association with the agreement that both groups form a joint nonprofit corporation named CEMI-Ridgecrest, Inc., to facilitate the redevelopment effort. In addition, tenants who decided not to participate in purchasing a townhome were provided Section 8 vouchers or certificates and were relocated. Mr. Crawford also arranged with the District of Columbia Housing Finance Agency for a 5-year tax relief for families who purchase units in the new development and to provide housing purchasing assistance.

In conjunction with the property sale, the HUD District of Columbia Office approved an upfront grant for \$24.5 million to fund the Ridgecrest redevelopment. The upfront grant agreement was signed in November 1996. The grant included requirements for the construction of a job skills training center and day care facility, the renovation of a community center, and the demolition and redevelopment of the property into 141 townhomes for mixed income families. In addition, the grant specified that 30 units would be available for qualifying low-income families returning to purchase the new Ridgecrest development townhomes. The grant agreement also provided that a housing trust fund be established in the amount of \$1.9 million to assist the new homeowners association in the operation of the Ridgecrest development for a period of 10 years. The trust fund was to be created from the proceeds of the initial townhome sales. After the trust fund corpus was established, the proceeds from the townhome sales were to be repaid to HUD. The trust fund also was to revert to HUD after the 10-year period expired.

Audit Memorandum 98-AO-219-1804

The objective of Audit Memorandum 98-AO-219-1804 was to determine whether HUD followed established guidelines in awarding a \$24.5 million upfront grant to a non-profit organization, CEMI-Ridgecrest, Inc. In this prior memorandum we concluded that HUD had not established a mechanism to create and monitor the trust fund, had not established repayment procedures after the trust fund period was completed, and had not established procedures for the remittance of the townhome sales proceeds. The audit memorandum also noted that HUD needed to be more

involved in the monitoring of this process to ensure the viability and financial commitments of the project were met. The audit memorandum recommended that HUD establish and monitor a mechanism to ensure the repayment to HUD of approximately \$10 million from the sale of the townhomes. The \$10 million estimate was derived from the grantees' initial sources and uses of funds budget.

Prior Audit Closed Out

In a memorandum dated July 19, 2000, requesting close-out of Audit Memorandum 98-AO-219-1804, HUD stated that the revised amount available to repay HUD was between \$500,000 and \$1 million. The reason the grantee cited for the reduction in the estimated repayment amount was that an anticipated grant in the amount of \$3.6 million from the District of Columbia Development Zone Administration never materialized, and it incurred significant unanticipated development costs. HUD stated that the ultimate figure to be returned to HUD would not be known until the remaining units were completed and an audit completed by a certified public accountant would clearly state all audit findings and exceptions.

HUD stated in its audit closeout memorandum that the grantee had been submitting quarterly reports to the Atlanta Multifamily Property Disposition Center and the District of Columbia HUD Office which showed (1) sales proceeds from the sale of the townhouse units, (2) funds transferred to the trust account, (3) all costs incurred by construction phase, and (4) the balance in the sales account. As such, HUD proposed that quarterly reports, coupled with an audit by a certified public accountant would satisfy the recommendation and that the finding should be closed out. Based on these proposed monitoring procedures, we agreed to close out the audit recommendation on November 22, 2000.

Certified Public Accountant's Report Submitted to HUD

HUD did in fact receive the required certified public accountant's report in May 2004. Based on the figures in the report which showed final project costs and sources of funds, we calculated that at least \$780,326 is due to HUD, subject to additional verification¹:

Final Project Costs (A)	\$39,158,266
Sources of Funds	
1996 Upfront Grant Agreement	\$24,590,561
Sales Proceeds	\$15,135,960
Net Incidental Rental Income	\$212,071
Total Sources of Funds (B)	\$39,938,592
Excess Proceeds Due to HUD (B-A)	\$780,326

RESULTS OF REVIEW

HUD failed to adequately follow the procedures it agreed to in its close-out memorandum with the Office of Inspector General. Since HUD did not ensure the grantee submitted required

¹ See Appendix C – Independent Auditor's Schedule of Costs which shows final project costs, sales proceeds, and net incidental rental income.

quarterly reports to ensure repayment of sales proceeds we used the schedule of costs contained in the certified public accountant's report and estimated a preliminary amount of excess sales proceeds due to HUD to be \$780,326. However, HUD needs to verify the amount of sales proceeds and determine whether any funds remain in the project's trust fund, and then ensure those funds are returned to HUD as required by the grant agreement.

Required Quarterly Reports Were Not Always Submitted to HUD

HUD did not ensure the grantee submitted all quarterly reports as it agreed in its memorandum to the Office of Inspector General requesting close-out of the audit recommendation. We found that over a three-year period (1999 to 2001), HUD received only five quarterly reports. The reports were needed for HUD monitoring to show (1) the sales proceeds from the sale of the townhouse units, (2) funds transferred to the trust account, (3) all costs incurred in the construction phase, and (4) the balance in the sales account. Construction at Ridgecrest Heights Apartments, consisting of 141 townhomes, was completed on December 20, 2001. HUD did not receive any quarterly reports after April 3, 2001. Since these reports were needed for the 42 townhomes under construction as of April 3, 2001, HUD did not ensure that the grantee repaid all sales proceeds as required in the grant agreement. Additionally, three of the five quarterly reports that were submitted to HUD failed to show the construction costs incurred.

Sales Proceeds Should Be Verified and Excess Proceeds Should Be Returned to HUD

As discussed above, the grant agreement required that a housing trust fund be established in the amount of \$1.9 million to assist the new homeowners association in the operation of the Ridgecrest development for a period of 10 years. The trust fund was to be created from the proceeds of the initial townhome sales. After the trust fund corpus was established, the proceeds from the townhome sales were to be repaid to HUD. The trust fund also was to revert to HUD after the 10-year period expired.²

Due to cost overruns reportedly associated with the project, the grantee requested that HUD permit it to borrow funds from a local financial institution of up to \$10 million and use the excess sales proceeds for repayment of the funds borrowed. In a letter dated November 25, 1998, the Director of Chesapeake Multifamily hub granted approval for the grantee to use \$8.5 million to repay the borrowed funds. Based on a revised development budget the grantee submitted, HUD's Director of the Atlanta Multifamily Property Disposition Center increased this amount to \$10 million of sales proceeds that the grantee could use to repay the borrowed funds (in an undated follow-on letter). In addition, the certified public accountant's report showed the grantee did in fact fund the required housing trust fund in the required amount of \$1.9 million to assist the new homeowners association in the operation of the Ridgecrest development. Therefore, at a minimum \$11.9 million (\$10 million + \$1.9 million) in sales proceeds would not be required to be returned to HUD at the end of construction. Since the sales proceeds reported by the certified public accountant were \$15.1 million we calculated that \$3.2 million (\$15.1 million minus \$11.9 million) could potentially be required to be returned to HUD. However, the certified public accountant did not give any explicit assurances with respect to the sales proceeds

² Redevelopment of the townhomes was completed in May 2003; thus the 10-year expiration date for the trust fund is May 2013.

nor did it indicate whether all of the units had been sold. The purpose of the certified public accountant's report was to account for the actual costs of development of Walter E. Washington Estates. Therefore, since all of the quarterly monitoring reports were not submitted to HUD as required, HUD should verify the amount of sales proceeds, and then ensure any excess proceeds are returned to HUD as required by the grant agreement. In addition, when the 10-year trust period ends, HUD should ensure any remaining trust funds be returned as required by the grant agreement.

RECOMMENDATION

Based on the results of our review, we will reopen and revise the recommendation from Audit Memorandum 98-AO-219-1804 as follows:

We recommend that HUD's Deputy Assistant Secretary for Multifamily Housing Programs

- verify the final amount of the sales proceeds, determine if any amounts should be returned to HUD, and ensure such amounts are repaid to HUD under the terms of the grant agreement.
- after 10 years from the date of final development has expired, determine whether any funds remain in the project's trust fund, and ensure such amounts are repaid to HUD under the terms of the grant agreement.

AUDITEE'S RESPONSE

We discussed our results with HUD officials during the review. We provided a copy of the draft memorandum to HUD on May 20, 2009, for its comments and discussed the memorandum with HUD officials at the exit conference on May 27, 2009. HUD generally agreed with our recommendation but disagreed with some aspects of this review. The complete text of HUD's response, along with our evaluation of that response, is included in appendix B of this memorandum.

For a recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the review.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/
1A	\$780,326

- 1/ Ineligible costs are costs that are questioned because of an alleged violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the expenditure of funds. The amount shown above is an estimate for tracking purposes only. Since HUD did not ensure the grantee submitted required quarterly reports to ensure repayment of sales proceeds, we used the schedule of costs contained in the certified public accountant's report and estimated amounts due to HUD. However, this calculation was based solely on available information, and may not reflect the final sales proceeds and trust funds due to HUD. Once HUD verifies this information, it can then determine the exact amount that the grantee should return.

Appendix B

AUDITEE'S RESPONSE AND OIG'S EVALUATION

Ref to OIG Evaluation

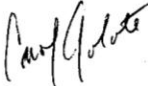
Auditee Comments



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

JUN 10 2009

MEMORANDUM FOR: John P. Buck, Regional Inspector General for Audit, Philadelphia Multifamily Hub, 3AGA

FROM:  Carol J. Galante, Deputy Assistant Secretary for Multifamily Housing Programs, HT

SUBJECT: Draft Audit Memorandum regarding the Corrective Action Verification Review of the Upfront Grant for Ridgcrest Heights Apartments, CEMI-Ridgcrest, Inc, Washington, DC, relating to Audit Memorandum 98-AO-219-1804, issued September 24, 1998

Thank you for the opportunity to discuss the above referenced draft report. The original audit memorandum to which this Corrective Action Verification Review (CAV) relates was issued in 1998 which substantially predates my involvement. Consequently, comments regarding the CAV draft were developed by the Office of Asset Management (OAM) and Multifamily field offices. I am relying on their efforts.

Comment 1

While this draft addresses issues raised at the Exit Conference held on March 27, 2009, our office still has substantive concerns which we would like addressed in the final report. They are:

- Extensive use of and reference is made to the Independent Auditors' Report and accompanying information from the audit of the Schedule of Costs pertaining to the development of the Walter E. Washington Estates, July 31, 2003. This report was provided to the Department by the president, H.R. Crawford on May 24, 2004, for use in the monitoring of the Upfront Grant for the development.

Comment 2

In this regard, we note that your estimate of potential Excess Proceeds Due to HUD of \$780,326 presented on page 3 of the draft now clearly indicates that this is an Office of Inspector General calculation. However, the estimate is still footnoted to Appendix C which is a reprint of part of the Schedule of Costs which the firm audited. It is not the "Independent Auditor's Schedule of Costs". As was discussed with you at the Exit Conference, the Department provided this document to you to assist in the CAV. This does not provide approval for inclusion in the draft report. Please remove Appendix C.

Comment 3

More importantly, the firm that was used to conduct the audit has not been consulted regarding their audit. The estimate you present is based on your understanding of the information in the Independent Auditors' Report and accompanying information.

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Consequently, it is our intention to provide a copy of the final CAV report to this firm and Mr. Crawford to afford them the opportunity to comment before an official response is provided.

Comment 4

- The CAV emphasizes that required quarterly reports were not always submitted to HUD. While this is not in dispute; the Department used other monitoring tools and applied judgment which is not discussed in your report.

For example, one such tool presented to your office for consideration while you conducted the CAV was the reliance the Department placed on the A&E firm for inspections and approval of draws establishing the validity of the actual project costs. These efforts continued until May 22, 2003, culminating in a report which also has a 5 % hold back for additional costs to address latent defects. The latent defect period expired in May 2004. Furthermore, at the time the report was presented by the A&E firm, the community building was still under construction.

We acknowledge that an Independent Auditors' Report was submitted prior to the completion of the development as originally discussed for closing out the 1998 audit resolution. Consequently, the Independent Auditors' Report which reports on the Schedule of Costs for the development for the period ending July 31, 2003, did not include these later events. However, this report was used by the Department for oversight of the grant which was complete. Using the calculated figure you provided of \$780,326, represents only a 2% variance. Such a variance in light of known ongoing construction is immaterial when forming a judgment for applying monitoring efforts.

Consequently, while the CAV recommendations ask for verification of certain information, emphasizing the lack of use of the quarterly reports without mentioning other monitoring tools and the Department's judgment on how they are used together gives a distorted picture of the extent of the Department's oversight.

Comment 5

- The CAV recommendation wording has improved since it was first discussed at the Exit Conference held March 27, 2009. If this remains the case for the final, a proposed management decision will be presented which will address the two parts of your recommendation as follows:
 - Our efforts to verify the sales proceeds will start with the firm that conducted the audit of the Schedule of Costs resulting in the reported estimate from the CAV of \$780,326 in questioned costs which were unsupported. We will provide the firm and Mr. Crawford a copy of your final CAV report and ask that they comment on it and specifically address your calculation. We will give the firm 45 days to complete this task. If the firm or Mr. Crawford do not refute your calculation, the Department will send a letter to Mr. Crawford requesting that the \$780,326 be repaid within 90 days of the date of the Department's letter, or that he provide acceptable proof that it is not owed; and

- A letter will be sent to the homeowners association (HOA) of the development, which has had control of the project trust funds since 2002, requesting that any unspent funds be returned to the Department. This letter will request an accounting of funds under their control which we will review. The HOA will be allowed 120 days from the date of our letter to provide a response. We will review this information and will determine if the Department is owed any funds. We expect resolution of this review considerably sooner than the legal 10 years allowed by the trust document. For purposes of tracking audit resolutions we will use May 22, 2013, which is the legal date, but we expect to close this recommendation considerably sooner than that depending on the HOA response.

If you have any questions regarding this memorandum, please contact the Office of Asset Management and arrangements will be made to address your concerns.

OIG Evaluation of Auditee Comments

- Comment 1** We discussed our draft audit memorandum and our proposed recommendations with responsible HUD officials at our exit conference held on May 27, 2009, and made adjustments to the memorandum as appropriate.
- Comment 2** The financial information contained in the certified public accountant's report was required to be submitted by the terms of the grant agreement and will not cause substantial harm to the grantee's competitive position, therefore it is not prohibited from disclosure by the Trade Secrets Act or exemption 4 of the Freedom of Information Act.
- Comment 3** As stated in the report, since HUD did not ensure the grantee submitted required quarterly reports to ensure repayment of sales proceeds, we used the schedule of costs contained in the certified public accountant's report and estimated amounts due to HUD. This calculation was based solely on available information, and may not reflect the final sales proceeds and trust funds due to HUD. Once HUD verifies this information, it can then determine the exact amount that the grantee should return.
- Comment 4** HUD has now informed us that it placed reliance on the draw request process instead of the quarterly reports as it agreed to in its memorandum to the Office of the Inspector General requesting closure of the original audit recommendation. However, HUD did not provide any documentation to support this assertion. Further, although the draw request process would in fact show costs incurred in the construction phase it would not show (1) the sales proceeds from the sale of the townhouse units, (2) funds transferred to the trust account, and (3) the balance in the sales account. As such, HUD failed to meet the intent of the original recommendation which was to ensure the repayment to HUD of the proceeds from the sale of the townhomes.
- Comment 5** We discussed our proposed recommendations with responsible HUD officials at our exit conference held on May 27, 2009, and made adjustments as appropriate. Provided HUD verifies the final sales proceeds, its proposed course of action appears to meet the intent of the recommendations.

Appendix C

INDEPENDENT AUDITOR'S SCHEDULE OF COSTS

CEMI-Ridgecrest, Inc.

SCHEDULE OF COSTS PERTAINING TO THE DEVELOPMENT
OF WALTER E. WASHINGTON ESTATES
FHA PROJECT NO.: 000-55 101

July 31, 2003

<u>FHA Line Description</u>	<u>Phase I Cost</u>	<u>Phase II Cost</u>	<u>Total Cost</u>
Construction costs	\$ 18,053,547	\$ 9,203,479	\$ 27,257,026
Engineering and surveys	117,443	64,550	181,993
Architect	1,012,838	370,823	1,383,661
Overhead fees	3,805,977	2,263,663	6,069,640
Legal and accounting	261,201	60,389	321,590
Organizational	15,000	-	15,000
Taxes and permits	264,416	19,447	283,863
Insurance	44,506	1,039	45,545
Relocation cost	208,927	-	208,927
Operating loss reserve	1,282,137	-	1,282,137
Interest expense	-	121,669	121,669
Funding of trust account	-	1,987,215	1,987,215
Total costs	<u>\$ 25,065,992</u>	<u>\$ 14,092,274</u>	39,158,266
Net incidental rental income			(212,071)
Sales proceeds from completed townhouses			<u>(15,135,960)</u>
Total costs			<u>\$ 23,810,235</u>