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TO: Charles H. Williams, Deputy Assistant Secretary for Multifamily Housing, HT

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FROM: Ronald J. Hosking, Regional Inspector General for Audit, 8AGA

SUBJECT: HUD Appropriately Approved Evergreen's Eligibility and Exception Rents Under the Mark-to-Market Program, and Assessed the Physical Condition of the Property.

HIGHLIGHTS

What We Audited and Why

In response to a congressional request, we audited the U.S. Department of Housing and Urban Development's (HUD) Mark-to-Market Program (Program) debt restructuring of Evergreen Terrace I (Evergreen). The audit objectives were to determine whether HUD appropriately approved Evergreen's eligibility and exception rents under the Program, and assessed the physical condition of the property.

What We Found

HUD appropriately approved the project, approved exception rents for the project, and assessed the physical condition of the project.

What We Recommend

Since we found no violations of the Program, we have no recommendations for the deputy assistant secretary for multifamily housing.

Auditee's Response

We provided the discussion draft of the audit report to HUD on February 3, 2006. We received HUD's verbal agreement to the report on February 7, 2006.

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BACKGROUND AND OBJECTIVES

The Multifamily Assisted Housing Reform and Affordability Act (Act) established the Mark-to-Market Program (Program). The Program restructures multifamily properties insured by the Federal Housing Administration. Projects become eligible for the Program when their Section 8 housing assistance contracts expire. One of the Program's primary intents is to preserve low-income rental housing while reducing the long-term costs of federal rental assistance. Another primary intent is to encourage owners of eligible multifamily housing projects to restructure their U.S. Department of Housing and Urban Development (HUD)-insured mortgages. A third primary intent is to protect the interest of project owners and managers because they are partners of the federal government in meeting the affordable housing needs of the nation through the Section 8 rental housing assistance program.

The Act established a new office within HUD, the Office of Multifamily Housing Assistance Restructuring. The office later became the Office of Affordable Housing Preservation. HUD's responsibilities include being accountable for and monitoring the restructuring activities carried out by participating administrative entities (contractors). The contractors develop and recommend a restructuring plan. The restructuring plan

- Determines market rents and the availability of other low-income housing,
- Identifies the project's needed physical improvements, and,
- Identifies methods of restructuring the finances of properties if needed to make operating at comparable market rents financially feasible.

The contractor can recommend restructuring the project and if needed, exception rents (rents higher than the fair market rents). Based on this recommendation, HUD makes the final decision. One of HUD's primary concerns in restructuring a project with exception rents is ensuring tenants maintain their affordable housing without serious impact. In addition, the project's net operating income must be insufficient to support reasonable and necessary operating expenses, adequate annual deposit to the reserves for replacements, and a reasonable return to the owner.

As of October 12, 2005, HUD has restructured 1,378 properties through this program. The properties vary in size from 6 to 1,260 units. HUD estimated that less than 2 percent of local governments raised strong opposition to restructuring the projects.

Evergreen Terrace I and II are located in Joliet, Illinois. Our audit focused on Evergreen Terrace I, which consists of 241 units of housing. All Evergreen units receive Section 8 subsidies. HUD received the owner's intent to enter the Program on November 21, 2001. The owner and HUD executed the restructure commitment for Evergreen in May 2003 and again in September 2005.

The city is planning for the Evergreen Terrace I and II sites to be redeveloped into mixed-income housing. It has its own resident relocation plan and site drawings for the land.

The audit objectives were to determine whether HUD appropriately approved the eligibility and exception rents for Evergreen under the Program, and assessed the physical condition of the property.

RESULTS OF AUDIT

HUD Appropriately Approved Evergreen's Eligibility and Exception Rents Under the Mark-to-Market Program, and Assessed the Physical Condition of the Property.

HUD Appropriately Approved the Eligibility of Evergreen

HUD appropriately approved Evergreen for the Program. HUD's responsibilities include being accountable for and monitoring the restructuring activities carried out by participating administrative entities (contractors). Two separate and independent contractors reviewed Evergreen for restructuring. Both contractors followed the Program's operating procedures guide, except as stated below. Both contractors completed due diligence and proposed comprehensive restructuring plans that addressed Evergreen's financial and physical needs.

We identified one deficiency in the second restructuring plan, but it did not affect Evergreen's eligibility for the Program. While developing the second plan, the contractor did not hold the two tenant meetings required by HUD regulations. The purpose of the meetings is to ensure that key stakeholders are included in the restructuring process. The meetings allow tenants, interested members of the community, local government officials, and any other interested parties an opportunity to provide comments on the restructuring plan. The first contractor held the two tenant meetings.

HUD advised the second contractor not to hold the meetings because of the controversial nature of the restructure. Although the second contractor held no tenant meetings, key stakeholders voiced their opinions several times throughout both restructure attempts. This was done through letters, meetings, visits with HUD officials and its area members of Congress, and publicity in local newspapers. We concluded that since HUD and the contractors were aware of the stakeholders' concerns throughout the process, holding two more meetings would not have significantly affected the outcome.

HUD Appropriately Approved Exception Rents for Evergreen

HUD appropriately approved exception rents for Evergreen. Both contractors recommended that Evergreen be restructured with exception rents. HUD can approve exception rents if the loss of the project would seriously and adversely impact the tenants. For example, the displaced tenants would have serious difficulty finding comparable affordable housing.

The work of the contractors and additional work performed by HUD provided adequate evidence that the displaced tenants living at Evergreen would have serious difficulty finding comparable housing within a reasonable distance. Their market studies indicated there are fewer than 100 vacant multifamily housing units available to low-income tenants within a 15-mile radius.

HUD Appropriately Assessed the Physical Condition of Evergreen

HUD appropriately assessed the physical condition of Evergreen. Both HUD contractors hired independent contractors to perform physical condition/needs assessments. These assessments included various tasks, such as

- Site visits to the project;
- Interviews with property management personnel;
- Inquiries to the local building department, zoning department, and fire department;
- Reviews of readily available construction drawings and specifications provided by the property owner;
- Visual observations of systems components and conveyance systems; and
- Reviews of compliance with life safety/fire protection and general American Disabilities Act and Fair Housing Act requirements.

We visited Evergreen on October 31, 2005, and saw the same types of items noted in the contractors' reports. We noted that the parking lots, stairs, and elevators needed repair but were reasonably repairable. The restructuring plan addresses these items, and they would have been repaired had the process gone forward.

In addition, as of September 2, 2004, 24 units had been inspected by HUD's Real Estate Assessment Center and received a passing score of 60c*. A score of 60 and higher is passing. The 'c' means the inspector observed one or more

exigent/fire health and safety deficiencies. These call for immediate attention or remedy. The * means the inspectors found health and safety deficiencies related to smoke detectors. In May and August 2002, Evergreen received passing inspections from the city's fire department and complied with local code.

Conclusion

HUD appropriately approved the eligibility of Evergreen under the Program, approved the eligibility of exception rents, and assessed the physical condition of Evergreen. If the proposed restructuring proceeds, the rehabilitation work planned will improve the living conditions at Evergreen and bring the project in compliance with local code requirements.

SCOPE AND METHODOLOGY

We confined our audit to HUD's restructuring process for Evergreen Terrace I. Our audit covered the period November 21, 2001, through September 30, 2005.

To accomplish our objectives, we obtained and became familiar with the applicable Program requirements. We toured Evergreen. We also visited, interviewed, and obtained pertinent documentation from the following sources:

- Signet Partners Corporation (Denver, Colorado),
- Illinois Housing Development Authority (Chicago, Illinois),
- Office of Affordable Housing Preservation (the Chicago and Washington, DC, offices),
- HUD Chicago Hub,
- HUD Chicago legal counsel,
- HUD Chicago Office of Fair Housing and Equal Opportunity,
- HUD Chicago Office of Public Housing,
- HUD Chicago Office of Community Planning and Development,
- HUD Chicago deputy regional director,
- City of Joliet,
- Housing Authority of Joliet, and
- Evergreen Terrace owners and management agent.

Since our audit objectives were to determine HUD's compliance with certain procedures, we did not assess HUD's internal controls.

We performed the audit work from October 2005 to January 2006. We performed our audit in accordance with generally accepted government auditing standards.