Audit Related Memorandum
98-NY-112-0802

December 18, 1997

MEMORANDUM FOR: Nicolas P. Retsinas, Assistant Secretary for
Housing-Federal Housing Commissioner, H

FROM: Alexander C. Malloy, District Inspector General for Audit, 2AGA

SUBJECT: Riverside South Apartments Project No. 012-32269

As you are aware, the Office of Inspector General (OIG) in a previous Audit Related Memorandum[1] questioned an application for mortgage insurance pertaining to Riverside South Apartments. In that Memorandum, we explained that because of local community and congressional interest, the OIG evaluated a $356 million application for mortgage insurance. The mortgage proceeds were to be used to build Riverside South Apartments, a development located on the Upper West Side of New York City, New York. Our conclusion was that FHA should not insure the proposed $356 million mortgage for three reasons, which are provided in the attached Audit Related Memorandum. Subsequent to issuing that memorandum, the Mortgagee withdrew that application and submitted a revised one in August 1997, which shows a drastic reduction in the project's size and mortgage amount. Nonetheless, our evaluation of the revised application resulted in the same concerns that we raised in our previous Audit Related Memorandum.

According to the revised application, the Mortgagee reduced the request for mortgage insurance from $356 million to $180 million. The Mortgagee originally requested that FHA insure a loan to build a project consisting of four buildings containing 1,663 residential units, of which 333 would have been available for low income families. In the revised application, the project will consist of two buildings containing 853 units, of which 171 units will be available for low income families. In the original application, 65 percent of the site consisted of a park and pier (58 percent pertained to the park while 7 percent pertained to the pier). In the revised application, the pier was dropped, but the park remained and still represents 58 percent of the site. During the review of the original application, we estimated that the value of the park and pier represented one-fourth of the

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[1] Audit Related Memorandum, dated February 21, 1997, Riverside South Apartments is an appendix to this Audit Related Memorandum.

mortgage. Likewise, during our review of the revised application, we estimate that the value of the park represents almost one-fourth of the mortgage.

As previously described, the scope of the project was simply cut in half. Therefore, the same three reasons that we provided in our previous Audit Related Memorandum, as to why FHA should not insure the $356 million mortgage, also pertain to the $180 million request. Consequently, we do not believe that FHA should bear the risk of insuring the revised request for mortgage insurance for three reasons. First, for each million dollars of insuring authority only one unit of low income housing will be built[2]; second, almost one-fourth of the security of the mortgage (park) will eventually be given to the City of New York; and third, as we explained in our previous Audit Related Memorandum, we question whether Congress intended for FHA to insure a mortgage that includes the value of a park.

The major issue is the park. It is important to note that the Developer plans to develop approximately 21 acres of the former Penn Central rail yard into a park along the Upper West Side of New York City, New York as part of a grand plan to construct buildings containing 5,700 housing units. If the FHA approves the revised application for mortgage insurance, which includes the value of approximately four acres of the park, the precedent will be set for the Developer to submit other applications with other parts of the park to the FHA in a piecemeal manner. In short, it is possible that FHA could end up insuring the value of a substantial part of the park.

During our evaluation of the revised application, we noted that representatives of the Mortgagee are discussing different strategies with HUD officials in the New York City Field Office regarding the conveyance of the park to the City of New York. The primary issue is whether the park should be conveyed to the City immediately after it is developed and the buildings constructed, or at some later date. It is our position that regardless of when the park is conveyed to the City of New York, considering the size of this mortgage, it would be a significant drain on the FHA insurance fund, if a mortgage default occurred that results in a mortgage assignment to HUD. Furthermore, if the Developer is resolute in its intention to donate the park to the City, then we question why the Developer does not merely make the donation outside of the insured mortgage transaction.

In our previous Audit Related Memorandum, we explained how FHA's procedures allowed developers to obtain high amounts of insuring authority, and we made appropriate recommendations to request that a limit be placed on the value of site not attributable items, such as a park, that can be included in the amount of insured mortgages. As you are aware, the OIG and FHA are at an impasse as to the resolution of these recommendations; therefore, we requested that the Deputy Secretary review the matter.

In this Audit Related Memorandum, we are recommending that the FHA seek a legal opinion to determine if Congress intended for the FHA to insure mortgages that include the value of a park as an allowable amenity when it passed Section 220

[2] The average cost of each of the 853 units amounts to approximately $211,020 per unit.

of the National Housing Act. If the legal opinion provides that a park is not an allowable amenity, the FHA should not approve the revised application.

Within 60 days please give us a status report on: (1) the corrective action taken; (2) the proposed corrective action taken and the date to be completed; or (3) why action is considered unnecessary. Also, please furnish us copies of any correspondence or directives issued because of this review.

Should you have any questions, please call me or William H. Rooney, Assistant District Inspector General for Audit, at 212-264-8000, extension 3976.

Attachment 1

Distribution

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