Little Rock Housing Authority, Little Rock, AR

Rental Assistance Demonstration Program

Office of Audit, Region 6
Fort Worth, TX

Audit Report Number: 2019-FW-1001
April 23, 2019

To: Anthony S. Landecker, Acting Director, Public and Indian Housing, Little Rock, AR, Field Office, 6FPH

//signed//

From: Kilah S. White, Regional Inspector General for Audit, 6AGA

Subject: The Little Rock Housing Authority, Little Rock, AR, Did Not Fully Meet Rental Assistance Demonstration Program Requirements

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 Little Rock Housing Authority's Rental Assistance Demonstration Program.

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 website. 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 817-978-9309.

Audit Report Number: 2019-FW-1001
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The Little Rock Housing Authority, Little Rock, AR, Did Not Fully Meet Rental Assistance Demonstration Program Requirements

Highlights

What We Audited and Why

We audited the Little Rock Housing Authority's Rental Assistance Demonstration Program (RAD program). We initiated this assignment due to the U.S. Department of Housing and Urban Development's (HUD) Little Rock Office of Public and Indian Housing (PIH) field office's concern about the amount of funds that the Authority had spent on RAD program predevelopment costs. HUD designated the Authority as "troubled" mainly due to its transition under its RAD program. Our objective was to determine whether the Authority administered its RAD program in accordance with regulations.

What We Found

The Authority did not ensure that its RAD program fully met requirements. Specifically, it did not (1) ensure timely completion of its conversions, (2) properly account for predevelopment costs as required, and (3) resolve a potential conflict of interest. This condition occurred because the Authority's executive management did not exercise effective oversight of the program. In addition, the Authority's executive management and board members did not communicate effectively. Further, the Authority did not have effective procedures to ensure that costs were properly supported and allocated. As a result, revisions and postponements of its RAD program conversion plans adversely affected rehabilitation costs by requiring the same or similar tasks to be amended, updated, or reworked multiple times. Further, the delays resulted in reduced occupancy in anticipation of rehabilitation of units and hindered the Authority's ability to provide decent, safe, and sanitary housing to current and prospective tenants.

What We Recommend

We recommend that the Little Rock, AR, Acting PIH Director require the Authority to (1) develop and implement an achievable plan to close its remaining projects and complete its RAD program conversions; (2) Support or repay $1,925,814 in predevelopment costs to its program from nonfederal funds; (3) design and implement financial controls to ensure that predevelopment costs are properly accounted for and eligible, thereby putting $829,544 to better use; (4) develop and implement procedures to identify, report, and resolve conflict-of-interest and ethics concerns; and (5) design and implement adequate control systems to ensure that the executive management team provides oversight of its RAD program.

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Background and Objective

The Little Rock Housing Authority is a public entity formed in 1941 to provide federally subsidized housing and housing assistance to low-income persons and families within the city of Little Rock. It is the fourth oldest and largest public housing agency in Arkansas. A five-person board of commissioners governs the Authority, and an executive director oversees operations. The executive director resigned on November 8, 2018. The board appointed the director of administrative services to serve as interim director.

Congress authorized the U.S. Department of Housing and Urban Development's (HUD) Rental Assistance Demonstration Program (RAD program) in fiscal year 2012 to preserve and improve public housing properties and address a then $26 billion nationwide backlog of deferred maintenance. Under the RAD program, public housing agencies convert their public housing properties to long-term, project-based Section 8 properties. The agency may choose to convert individual units or convert all units as a group. New and returning tenants use project-based vouchers as their rental subsidy with little or no change in rent.

On October 18, 2013, the Authority's board approved a portfolio-wide RAD program application for submission to HUD. On February 26, 2015, HUD notified the Authority that it had awarded a commitment to enter into a housing assistance payments contract (CHAP)[1] for 9 projects with 787 public housing units. Three projects required no significant rehabilitation and administratively converted to RAD during 2017 and 2018. The remaining six projects required an estimated $96 million for rehabilitation. See the table below.

Little Rock Housing Authority RAD program status

Public housing project	Project RAD status	Units	Rehabilitation estimate
Madison Heights I	Closing postponed to 3rd quarter 2019	59	$20,627,610
Fred Parris Towers	Rehabilitation began 4th quarter 2018	250	19,478,850
Madison Heights II	Closing postponed to 3rd quarter 2019	38	17,004,603
Jesse Powell Towers	Rehabilitation began 4th quarter 2018	168	14,077,547
Cumberland Towers	Rehabilitation began 4th quarter 2018	178	13,777,019
Homes at Granite Mountain	Closing postponed to 3rd quarter 2019	40	11,017,435
Cumberland Manor	Administrative RAD conversion 2017	17	175,000
Metropolitan Village	Administrative RAD conversion 2017	17	175,000
Madison Heights III	Administrative RAD conversion 2018	20	175,000
Totals		**787**	**96,508,064**

[1] Issuance of a CHAP evidences a conditional commitment provided to the Authority for units selected for RAD conversion.

The Authority contracted with two companies to function as RAD program development partners for project rehabilitation. The RAD program development partners were to obtain outside financing, to include debt funding and tax credits, and perform rehabilitation execution, to include architectural and engineering services, appraisals, market studies, contracting to subcontractors, meeting legal requirements, serving as the general contractor during rehabilitation, and managing the projects for an estimated 5 years after completion. The Little Rock Office of Public and Indian Housing (PIH) Director had expressed concerns about the amount of predevelopment costs incurred by the Authority.[2]

Our objective was to determine whether the Authority administered its RAD program in accordance with regulations.

[2] HUD designated the Authority as "troubled" mainly due to its transition under its RAD program. Classification as troubled indicates a Public Housing Assessment System (PHAS) score of less than 60 on a 100-point scale. The PHAS is the system that HUD uses to assess a public housing agency's performance in managing its low-rent public housing programs.

Results of Audit

Finding: The Authority Did Not Fully Meet RAD Program Requirements

The Authority did not ensure that its RAD program fully met requirements. Specifically, it did not (1) ensure timely completion of its conversions, (2) properly account for predevelopment costs as required, and (3) resolve a potential conflict of interest. This condition occurred because the Authority did not have controls to adequately plan, implement, or manage its RAD program. In addition, the Authority's executive management and board members did not communicate effectively. Further, the Authority did not have effective procedures to ensure that predevelopment costs were properly supported and allocated. As a result, it did not support $1.9 million or ensure that another $829,000 would be properly accounted for, allocated, and supported. Revisions and postponements of its RAD program conversion plans adversely affected rehabilitation costs by requiring the same or similar tasks to be amended, updated, or reworked multiple times. Further, the delays resulted in reduced occupancy in anticipation of rehabilitation of units and hindered the Authority's ability to provide decent, safe, and sanitary housing to current and prospective tenants.

The Authority Had Significant Delays

Due to repeated program delays and postponements resulting from financing changes, the Authority had not made significant progress on its RAD program conversion projects since they were approved in February 2015. According to HUD, the average time required to complete a RAD program conversion is approximately 14 months. The Authority had materially exceeded this timeframe. Since February 2015, the Authority had converted three projects that did not require significant rehabilitation and were subject to administrative conversion. These projects took between 2 and 3 years to convert. The remaining six projects, with estimated rehabilitation costs of $96 million, were not complete. For three of the six projects, rehabilitation began in late 2018. For the remaining three projects, the Authority postponed closing until the third quarter of 2019. The delays appeared to have been the result of the Authority not effectively planning, implementing, and managing its RAD program conversion. Because of the delays, the Authority may need to duplicate previously completed work, such as its relocation plan, environmental review, or capital needs assessment, due to changes and updated information. The delay adversely affected rehabilitation costs; occupancy rates; and the Authority's ability to provide decent, safe, and sanitary housing to its tenants.

The Authority Did Not Account for RAD Program Predevelopment Costs by CHAP

The Authority incurred substantial predevelopment costs[3] but did not account for these costs on a CHAP basis as required.[4] Additionally, it did not perform adequate procedures to ensure the eligibility of predevelopment costs.

According to requirements, the Authority could have spent a total of $900,000, $100,000 per CHAP, on predevelopment conversion costs without HUD approval.[5] However, HUD's Little Rock PIH field office approved the Authority to spend more than $2.7 million on predevelopment costs. As of July 2018, the Authority had spent more than $1.9 million in predevelopment costs. While the Authority had approval to exceed the predevelopment cost cap of $100,000 per CHAP, it did not account for these predevelopment expenses by CHAP as required.[6] This condition occurred because the Authority did not believe it was required to maintain CHAP-based records.

Additionally, the Authority did not have effective procedures to ensure the validity, completeness, authorization, accuracy, classification, accounting, or proper period of costs. Standard business practice required the Authority to document its review to obtain appropriateness of costs for goods received or services provided. Government internal control standards[7] also require adequate internal control systems and procedures regarding costs.[8] By not properly accounting for and allocating the predevelopment costs or having effective procedures to support the costs, the Authority did not support $1.9 million or have adequate controls to ensure that another $829,000 would be properly accounted for, allocated, and supported.

The Authority Had an Unresolved Conflict-of-Interest – Ethics Issue

Members of the Authority's board of commissioners questioned a matter involving the contract selection of a company to serve as a RAD program construction manager. A senior manager of the contracted company was married to an Authority employee. The Authority's management disagreed with the board because the company in question was on the board-approved list of construction managers. Management stated that this matter had been resolved but provided no documentation supporting the resolution. Management further explained that this issue dealt with ownership conflicts; however, the documentation provided by the board showed the

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[3] Predevelopment costs are costs incurred before approval of a financing plan, such as architectural and engineering fees, lender application fees, bond and tax credit consultants, appraisals, market studies, and legal fees.

[4] PIH Notice 2012-32, REV-3

[5] PIH Notice 2012-32, REV-3, section I, paragraph 1.5

[6] PIH Notice 2012-32, REV-3

[7] U.S. Government Accountability Office, Standards for Internal Control in the Federal Government (September 2014)

[8] State, local, and quasi-governmental entities, as well as not-for-profit organizations, may use these standards as a framework for an internal control system.

relationship issue.[9] According to section 19 of the annual contributions contract,[10] the Authority was prohibited from entering into a contract with an entity employing the spouse of an Authority employee. This condition occurred because the Authority had not established procedures to document the identification and resolution of potential conflicts of interest. The Authority was required to have procedures to ensure that no conflicts of interest, whether actual or in appearance, existed and have procedures to resolve such issues.

The Authority's Executive Financial Management Did Not Provide Financial Oversight of the RAD Program

The Authority's executive financial management did not exercise financial oversight of the Authority's RAD program, including

- serving only as a conduit for information and data to and from recipients,
- not working with procurement or expenditures,
- not opining on RAD program information,
- not having access to the RAD Program Resource Desk,
- receiving RAD program financial information only for "situational awareness," and
- deferring all rehabilitation activities to the RAD program consultants.

The lack of executive financial management involvement left the Authority without the finance-specific expertise needed for evaluation of these complex transactions. While the Authority had turned over the finance and management of the properties to developers, it remained accountable to HUD, the board, and its residents for the management and accounting activities of the program. According to its current plan, the Authority would assume the duties and responsibilities of management and operations at stabilization, estimated at 5 years after completion of the conversion. The Authority's assumption of duties and responsibilities for projects subject to RAD program conversion requires planning, preparation, and oversight.

The Board and Executive Management Did Not Communicate Effectively

The board and executive management did not communicate effectively regarding the RAD program conversion. For instance, the board approved an incorrect reimbursement percentage for predevelopment costs and the master development agreement with one of the Authority's selected RAD program development partners in November 2016. Specifically, the agreement required that the development partner and the Authority share the burden of the predevelopment costs at 50 percent each. However, the board approved the Authority to fund 75 percent and the development partner to fund 25 percent of the predevelopment costs. Authority executive management did not correct the error until it passed a board resolution in October 2018. This lack of communication could result in incorrect reimbursement amounts between the Authority

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[9] As an attachment to its response (see Appendix B), the Authority provided a December 20, 2018, board resolution accepting the contractual arrangement with the firm in question. Its response and board resolution was sufficient to address this specific example.

[10] The annual contributions contract is a written contract between HUD and the Authority. Under the contract, HUD agrees to make payments to the public housing agency over a specified term for housing assistance and for administrative fees up to a specified maximum. The agency agrees to administer the program in accordance with HUD regulations and requirements.

and the RAD program development partner. For the Authority's RAD program to be successful, the board and executive management must work together to ensure that contracts and resolutions are accurate.

Conclusion

The Authority did not ensure that its RAD program fully met requirements. Predevelopment costs of $1,925,814 were unsupported with $829,544 to be put to better use after institution of adequate controls. This condition occurred because the Authority's executive management did not exercise effective oversight of its RAD program and did not have effective controls to achieve its RAD program conversion. As a result, revisions and postponements of its RAD program conversion plans adversely affected rehabilitation costs by requiring the same or similar tasks to be amended, updated, or reworked multiple times. Further, the delays resulted in reduced occupancy in anticipation of rehabilitation of individual units and hindered the Authority's ability to provide decent, safe, and sanitary housing to current and prospective tenants.

Recommendations

We recommend that the Little Rock Acting PIH Director require the Authority to

1A. Develop and implement an achievable plan to close the remaining projects and complete its RAD program conversions.

1B. Support or repay $1,925,814 in predevelopment costs to its program from nonfederal funds.[11]

1C. Design and implement financial controls to ensure that $829,544 in remaining predevelopment costs is properly accounted for and supported.

1D. Develop and implement procedures to identify, report, and resolve conflict-of-interest and ethics concerns.

1E. Design and implement adequate control systems to ensure that the executive management team provides oversight of its RAD program.

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[11] The total amount of funds spent in recommendation 1B, $1,925,814, and the remaining amount in recommendation 1C, $829,544, equal the total amount of approved predevelopment costs, $2,755,358.

Scope and Methodology

We performed our audit work from August 2018 through March 2019 at HUD's Little Rock PIH field office, on site at the Authority, and in the HUD Office of Inspector General's (OIG) Oklahoma City, OK, offices. Our review period was from January 2015 through July 2018.

To accomplish our audit objective, we

- Reviewed relevant Federal laws and regulations.
- Interviewed HUD staff members to obtain their input regarding the Authority's oversight of the RAD program and any related concerns.
- Conducted a site visit to the Authority and interviewed selected board members and senior Authority management personnel to
  - determine their knowledge and understanding of the RAD program and
  - obtain their insight into the strengths and weaknesses of the RAD program.
- Reviewed Authority records and documents, including
  - minutes of the board of commissioners;
  - master development agreements with the RAD program development partners and development services agreements with RAD program consultants;
  - predevelopment costs and expenditures; and
  - administrative records, to include relocation agreements, environmental reviews, occupancy requirements, tenant contract rents, and capital needs assessments.
- Interviewed the HUD Office of General Counsel staff in Little Rock to discuss RAD program legal issues and personnel from the HUD Affordable Housing Transaction Division and the HUD Office of Recapitalization to acquire an understanding of RAD program financial issues.
- Obtained and reviewed supporting financial files posted to the RAD Program Resource Desk for analysis and evaluation of Authority submissions.

Sample Selection

The Authority divided its six unconverted projects into two groups of three and assigned each group its own RAD program development partner. We selected one project from each group, Fred Parris Towers and Madison Heights I, based upon the highest number of units and highest estimated rehabilitation costs within their respective groups. The two sample items selected contained 309 units, or 39 percent of 787 RAD program units, and more than $40.1 million, or 42 percent of the estimated $96 million in RAD program rehabilitation costs, respectively. Our results apply only to the sampled items and cannot be projected to the universe. The Authority postponed its RAD program conversion closing for Madison Heights I until after we had completed our review. However, the sample was adequate to provide sufficient evidence to meet our objective. Because of the Little Rock PIH field office's concern regarding predevelopment costs, we reviewed the entire amount approved, $2,755,358, for the nine projects in the RAD program for reasonableness and eligibility of costs.

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). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Internal Controls

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.

Relevant Internal Controls

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

- Program operations – Policies and procedures that management has implemented to ensure that the RAD program meets its objectives.
- Validity and reliability of data – Policies and procedures that management has implemented to ensure that valid and reliable data are obtained, maintained, and fairly disclosed.
- Compliance with laws and regulations – Policies and procedures that management has implemented to ensure that resource use is consistent with laws and regulations.

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 believe that the following item is a significant deficiency:

- The Authority did not have adequate controls to ensure compliance with requirements or adequately plan, implement, and manage its RAD program (finding).

Appendixes

Appendix A

Schedule of Questioned Costs and Funds To Be Put To Better Use

Recommendation number	Unsupported 1/	Funds to be put to better use 2/
1B	$1,925,814	
1C		$829,544
Total	**1,925,814**	**829,544**

1/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures. In this instance, unsupported funds are total predevelopment costs incurred through July 2018 that were not accounted for by CHAP or submitted in that form to PIH for approval.

2/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently in an OIG recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. In this instance, funds to be put to better use represent the remaining estimated predevelopment costs not accounted for by the Authority by CHAP or properly supported by the Authority. As discussed in the Scope and Methodology section, predevelopment costs were audited separately from the audit sampling application, and the deficiency was attributed to noncompliance with requirements by the Authority and the field office’s not requiring Authority to comply with requirements.

Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation | **Auditee Comments (attachments A through D available upon request)**

METROPOLITAN HOUSING ALLIANCE
100 South Arch Street
Little Rock, AR 72201
(501) 340-4821 / (501) 340-4845 (fax)

April 5, 2019

City of Little Rock Housing Authority d/b/a Metropolitan Housing Alliance OIG Findings - Response

Comment 1

A. Ensure timely completion of its conversion

1. The City of Little Rock Housing Authority d/b/a Metropolitan Housing Alliance "MHA" received a CHAP award for 9 projects totaling 787 units Feb. 26, 2015.

2. MHA secured its development team, Gorman and Company ("Gorman") and ITEX Development, LLC ("ITEX"), via HUD required procurement procedures May, 2016. MHA issued the Developer RFP three times before securing the team that provided the best partnership opportunity for the Authority. Not all potential developers were willing to share the developer fees with the Authority. The developer fees are an essential source of replacement funds for the revenue loss attributable to the RAD conversion.

3. From November 2017 to October, 2019, the Authority closed 6 RAD transactions totaling 650 units, or 83% of its original RAD portfolio. Three of the projects (596 units) were closed simultaneously in October 2018. These three projects involved tax-exempt-bonds, 4% LIHTC, Historical Federal and State Tax Credits, Federal Home Loan Bank Affordable Housing Program, Arkansas Development Authority "ADFA", NSP II, and HUD Capital and Replacement Housing Factor Funds.

   Construction began on the Towers November 2018 and the first tenants moved into their new units in February 2019. Projected construction completion of the three Towers is last quarter 2019.

   Residents have been maintained on site during construction as a project cost savings method. Residents are relocated by floors to vacant units created by restricting leasing starting in January 2017. The cost savings from the relocation expense outside of the buildings were retained in the capital investments. Maintaining our vulnerable residents in their familiar surroundings also reduced some of the stress of relocation. The overall vacancy incurred aided in the acceleration of the construction schedule.

   MHA has experienced delays with its RAD implementation but nothing out of the ordinary given the Authority was tracking as many as 9 transactions simultaneously. Unexpectedly the projects have been challenged by the 2018 Tax Reform Act that completely disrupted the tax credit market; RAD programmatic changes; uncooperative ownerships; hazardous site conditions; zoning modifications; new trade tariffs that escalated material costs and Board of Commissioner directives to focus labor engagements on the Little Rock market

Ref to OIG Evaluation	Auditee Comments
	even though the best construction prices are not always available in LR submarket. Despite the delays, the RAD program modifications aided in raising more capital; no significant losses were experienced in tax credits, a second Federal Home Loan Bank Affordable Housing Grant application was submitted resulting in a $2 million award for Parris Towers. **4.** MHA received a CHAP for Sunset Terrace (74 units) in May 2018. Sunset was part of the 2013 RAD Portfolio Wide approval, however, was not deemed feasible because of upwards of $5 million gap funding required. Upon completing the larger portion of the RAD portfolio, MHA determined that it had the funds to bridge a substantial portion of the gap. To enhance the viability of the Sunset RAD project, MHA added Central and Stephens, a combined 13 units. A many-to-one RAD application for Central and Stephens was submitted in February 2019 with an anticipated April 2019 CHAP award. **5.** Madison Heights I & II and Homes at Granite Mountain has been delayed because of unexpected protracted negotiations with the ownership of MH I & II. HAGM as a stand-alone project erodes the economy of scale benefits generated from combining the projects. MH I & II was not able to move forward for the ADFA approval of the 4% LIHTC without proof of site control despite the option MHA retained in the transaction. As of early 2019, MHA and the ownership as entered into a PSA for purchase of the partnership with an anticipated May 2019 closing. As the terms of its MDA with ITEX, ITEX Management will assume the property management role upon exit of the current ownership and management structure. MHA with the lead of ITEX will pursue a RAD closing the second quarter 2020. In addition, ADFA has committed all of its allocation to a priority project in the state for 2019 thus not permitting any additional projects until 2020. **6.** MHA will make a decision on its final potential RAD asset, HAGM Senior, upon completing Sunset and Madison Heights I & II. Although the conversion will primarily require a Replacement Reserve Investment of upwards of $1 million, MHA has determined that other projects have a higher priority because of their physical conditions. **7.** Under the direction of the Board of Commissioners and the previous executive director, MHA's core in-house RAD team consists of the Deputy ED - Real Estate and the Procurement & Capital Funds Coordinator. **8.** We will set and acknowledge project milestones We will provide regular project milestone updates to the Board of Commissioners, HUD, and stakeholders. We will plan for problems (anticipate problems). We will alert the Board of Commissioners, HUD and stakeholders immediately when things go wrong.

Ref to OIG Evaluation

Auditee Comments

B. Properly account for predevelopment costs as required

Comment 2

1. The preliminary OIG reports alleges that MHA misappropriated $1,925,814 of predevelopment funds for the Towers and should not be permitted to spend $829,544 of predevelopment funds for Madison Heights I&II. The report further recommends that the Authority repay the $1,925, 814 of unsupported expenditures.

2. MHA Finance Director [redacted] submitted predevelopment budget approval requests to LR PIH [redacted] on December 5, 2016 and January 8, 2018 for $2.7 million ($1.9 million for Towers and $800k for MH I &II/HAGM). The field office requested MHA submit a grand total of all predevelopment budgets for all CHAPs that would exceed the $100K limit set by PHI 2012-32 Guidance, and RAD SME consultation. MHA received approvals on December 5, 2016 and January 8, 2018. From the date of the last approval provided by the LR PIH for the subject projects/CHAPs, MHA is not aware any official requests to explain prior costs, nor to discontinue using Public Housing funds for the stated uses of predevelopment. Thus, MHA was cleared to use the Public Housing funds for the subject projects/CHAPs. See **Attachment A**.

   The Towers had a combined pre-development budget of $1,992,605 (Cumberland - $603,252; Parris - $812,220 and J. Powell - $577,131) The governing MDA signed May 11, 2016 between MHA and Gorman & Company provided that MHA would pay 75% of the predevelopment cost and Gorman 25% of the predevelopment cost. As of the October 2018 closing which MHA paid $680,047.50 or thirty-one percent of the total predevelopment budget, while Gorman paid $226,682.50, eleven percent of the total predevelopment budget.as shown in the chart below, additional predevelopment fees of $391,896.78 for legal and other costs of $116,203.67 were paid by MHA. MHA received reimbursement at closing of $ 1,107,605.45. Any remaining predevelopment cost not reimbursed as part of the construction budget will result in a note to be paid by the ownership partnerships to MHA. **All expenditures of MHA Public Housing funds were eligible conversion-related uses per the RAD program including "pre-development, development, or rehabilitation costs and establishment of a capital replacement reserve or operating reserves."**

SUBJECT PROJECT/ CHAPS	LEGAL	OTHER
AR004000009	$158,806.81	$48,077.83
AR004000010	$120,413.07	$34,996.89
AR004000011	$112,676.90	$33,128.95
TOTAL	**$391,986.78**	**$116,203.67**

3. Madison Heights I & II/HAGM had combined initial predevelopment budget of $608,700; the Board approved an increase to $ 140,300 at its October 18, 2019 Board meeting. The governing MDA signed June 26, 2016 between MHA and ITEX provided that MHA would pay 50% of the predevelopment cost and Gorman 50% of the predevelopment cost.

Ref to OIG Evaluation	Auditee Comments

4. MHA maintains records of each predevelopment pay application received from its developers, legal team and other service providers. Copies of such including the supporting documentation were provided to the OIG during its site visit and/or subsequent requests.

5. MHA utilizes fund accounting and each CHAP was assigned a unique fund number enabling MHA to track all RAD costs by CHAP. Each invoice is reviewed at least three times by three different MHA staff to insure the expenses are properly supported and charged to the correct fund (CHAP). After the invoice has been processed for payment MHA's Grants Accountant reviews the invoice again insuring it has been properly supported and correctly charged to the appropriate fund (CHAP) and prepares the voucher that is submitted to HUD by the Director of Finance after a final review. Further evidence of MHA's accounting of the predevelopment costs by AMP/Project/Fund/CHAP is set forth in Attachment B that contains sample Trail Balances for each AMP/CHAP; the 2017 Financial Statement which shows the Replacement Housing Factor Funds spent by AMP—RHF funds covered the predevelopment costs; and an Excel spreadsheet showing the predevelopment costs per CHAP . MHA also reports to PIH via EPIC all expenditures for each CFP grant MHA has been awarded, this report shows total expenditures charged to each grant broken down by CHAP/AMP.

6. MHA maintains that the predevelopment expenditures were necessary and in line with multifamily development industry standards. Moreover, the expenditures were incurred to meet the requirements of the HUD RAD program, our tax credit investors, construction and permanent lenders, the National Park Service for federal historic designation and the Arkansas Development Finance Authority.

7. We will get expenditure tracking mechanisms pre-approved by HUD and voted on by resolution by the Board of Commissioners.

Comment 3

C. Resolve a potential conflict of interest

1. The potential conflict of interest presented by a MHA Board Member during the OIG interview surrounds the retention of a construction management firm to assist MHA with the construction oversight of the Towers. There was a marital relationship between one of the vendor's third-party service providers and one of MHA's site managers. The subject MHA employee had no role in the procurement and/or the selection process for this service provider. The impacted third-party vendor withdrew from the relationship upon learning of the potential conflict. The selected firm along with four (4) other firms were designated for the MHA's pool of providers for construction management. Four firms responded to the task order request from which the appointed firm was selected.

2. To resolve the matter, MHA approached the selected firm to provide clarity regarding the relationship. The firm provided ownership information establishing that the related party was not part of the ownership structure nor the senior management. Their relationship

Ref to OIG Evaluation	Auditee Comments
	was that of a third-party vendor included in the response for a service that would be provided as required. Given that the services provide by the related third-party were not part of the task order, MHA determined that there was no conflict. 3. At the request of the Board of Commissioners, MHA staff provided the gathered information related to the "potential conflict" and presented it to the Board. The Board at its monthly public meeting approved the Task Order by Resolution #6701 on December 20, 2018. The potential conflict was outlined, discussed and voted on in public in order to defeat any notion of bias. The selected firm has been providing valuable service to MHA since its engagement. The firm provides direct reports to the Board at its monthly meetings. Written reports are also provided to the Board, MHA staff and the developer's construction management team. **See Attachment C.** 4. The conflict of interest was resolved at the request of the Commission with a review of our procurement practice in the manner of how bids are prepared. At the Commission request, a complete review of the procurement process for the agency has been conducted and updated. Additional forms including the "Full Disclosure Statements" and Conflict of Interest will be incorporated in each procurement activity moving forward.
Comment 4	**D. Other – Board Response** 1. The Executive Director Weekly in addition to other numerous communications are provided to the Board of Commissioners routinely in an effort to bridge the communication gap. The weekly reports contains subject matters across the organization from RAD and Section 8 to litigation and special projects. Leading up to the closing of the Tower's RAD transaction, a specific RAD project calendar was included in the weekly. In addition, the Board Agenda often contained RAD updates and action items as required. Board members were in attendance for the RAD Construction Contractor information meetings. 2. The MHA Board of Commissioners recently recommended the creation of the following committee structures to provide higher level contacts with the Board members: Employment, Technology, Housing and Finance. 3. The cited incident of the ED informing the Board of the improper allocation of predevelopment costs was due to a drafting error in the resolution. The mistake was due to a carrier over from a previous draft of the resolution, not intentional misleading information from the ED. More importantly, the costs were paid according to the contractual provisions in the MDA, a 50/50 split of the costs. This was merely a drafting error. The error was corrected with the Board approving an amendment to the resolution on 6637 October 2018.
Comment 5	**E. Other – MHA Executive Staff Engagement**

Ref to OIG Evaluation	Auditee Comments
	1. The MHA Senior management team is routinely if not daily engaged in the RAD implementation with oversight from the Board of Commissioners, which is also engaged in the process. Each of the members including the Executive Director, Deputy EDs, Finance Director, Procurement and Capital Fund Coordinator, Interim Regional Director, Public Housing Liaison and HCV Director are included in the working group for the RAD projects. Their roles and input vary with the stages of the projects. MHA has not held individuals in contempt when they have given in to their personal professional preferences not to participate. See **Attachment D** for a sample calendar invite for the project/CHAP working group meetings.

OIG Evaluation of Auditee Comments

Comment 1 The Authority explained the reasons for the significant delays in closing its RAD conversions. It also detailed the actions it planned to take including setting milestones, providing oversight, and notifying the Board of any delays.

We acknowledge the Authority's efforts to take corrective actions to address the finding. The Authority will need to continue working with HUD to address the report recommendations.

The response did not refute that it had significant delays. Much of the information was included in the background and finding section of the draft report. Further, the events and issues cited by the Authority seem to be routine and foreseeable events and issues experienced by all public housing agencies. The Authority's response did not address why it did not adequately plan for these foreseeable activities or that HUD had similar concerns regarding the delays. We recognize the accomplishment that the Authority has completed and returned to occupancy units in its Towers. We maintain our position.

Comment 2 The Authority stated the report alleged misappropriation of $1,925,814 in predevelopment costs paid through July 2018 and not allowing spending of $828,544 in remaining estimated predevelopment costs. The Authority further stated that the report recommends repayment of the $1,925,814. It explained its process for reviewing and approving predevelopment costs and stated that it will get expenditure tracking mechanisms approved by HUD and voted on by Board resolution.

The report did not allege misappropriation of funds, but concluded that the Authority did not properly account for predevelopment costs. The Authority did not account for its estimated predevelopment costs by CHAP when submitting its waiver request or reimbursement vouchers for costs incurred. The information provided by the Authority was insufficient to support that it accounted for predevelopment costs by CHAP. We maintain our position. The Authority needs to work with HUD to support incurred and estimated predevelopment costs by CHAP, in conformity with the expense categories detailed in its waiver request to PIH or repay non-supported costs.

To avoid any potential privacy issues, we redacted individual names from the response.

Comment 3 The Authority stated the conflict of interest was resolved, and that going forward full disclosure statements and conflict of interest would be included in all procurement activities.

The Authority's response and its submission of the December 20, 2018, board resolution accepting the contractual arrangement with the firm in question was sufficient to address the specific example. We modified the report to include this information. However, the Authority did not appropriately address this potential conflict until we raised it as a finding. Therefore, the example remained in the finding. Further, the Authority needs to work with HUD to develop and implement procedures to identify, report, and resolve conflict-of-interest and ethics concerns.

Comment 4 The Authority stated there are numerous communications provided to the board on a routine basis, and is considering the creation of various committees to increase communication with the Board. It also explained the issue regarding the misallocated developer fee costs and added that although the communication was incorrect, the actual developer fee was allocated as required.

We acknowledge the Authority's plans for improving communication with the Board. We added the dates of the original board resolution, November 2016, and the corrected board resolution, October 2018, to the finding for context. The Authority did not provide support for its assertion that it split predevelopment costs with its development partner. We maintain our position, and the Authority can work with HUD to address the report recommendations.

Comment 5 The Authority stated there was on-going senior management involvement in RAD implementation with oversight from the board.

The Authority provided copies of calendar invites; however, it did not provide documentation of any meeting agendas, attendance, actions taken or other evidence to support its representations. Authority management is accountable to HUD, the board, and its tenants and must be involved in the operations of the Authority. We maintain our position.