Issue Date
October 22, 2008
Audit Report Number
2009-FW-1001

TO: Jesse Westover
Acting Director, Office of Public Housing, 6FPH

James E. Slater
Director, Community Planning and Development Division, 6FD

FROM: Gerald R. Kirkland
Regional Inspector General for Audit, Fort Worth Region, 6AGA

SUBJECT: The Fort Smith Housing Authority Made Inappropriate Guarantees, Did Not Follow Procurement Requirements, and Spent Program Funds on Questionable Activities

HIGHLIGHTS

What We Audited and Why

We audited the Fort Smith Housing Authority (Authority) in response to a request from the U. S. Department of Housing and Urban Development's (HUD) Office of Public Housing. The objectives were to determine whether the Authority and its instrumentality, North Pointe Limited Partnership (Partnership), spent HUD-provided funds in compliance with HUD's rules and regulations for costs related to North Pointe Development (the development), including relocation activities, and whether they complied with federal procurement regulations.

What We Found

Between November 2006 and April 2007, the Authority and its instrumentality improperly encumbered Authority assets. Also, the Authority and its instrumentality did not comply with federal procurement regulations for three

procurements. Further, between October 2006 and January 2008, the Authority inappropriately spent HUD program funds on activities that did not benefit those programs.

What We Recommend

We recommend that HUD require the Authority to

- Obtain the release of any encumbered assets and require the Authority to ensure that it will no longer encumber assets,
- Support or repay $400,000 to its HOME Investment Partnerships Program and more than $94,000 to its Community Development Block Grant program,
- Support or repay more than $30,000[1] to its capital fund grants or HUD, as appropriate, for questionable costs,
- Ensure that it procures goods and services as required,
- Support or repay more than $9,700 to its Section 8 project reserve account, as appropriate, for unsupported expenses,
- Implement written procedures and controls to prevent the use of capital fund (low-rent) grants for unauthorized costs, and
- Implement written procedures and controls to ensure that its instrumentalities comply with federal procurement regulations.

For each 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 audit.

Auditee's Response

We provided the draft report to the Authority and HUD on September 19, 2008, with comments due October 8, 2008. We held an exit conference with the Authority on September 26, 2008. The Authority provided a written response on October 7, 2008, and generally disagreed with the findings. We have included the complete text of the Authority's response, along with our evaluation of that response, in appendix B of this report. Due to the volume, we did not include the attachments included in the Authority's response. These are available for inspection upon request.

[1] The Authority has repaid $4,440 of this amount.

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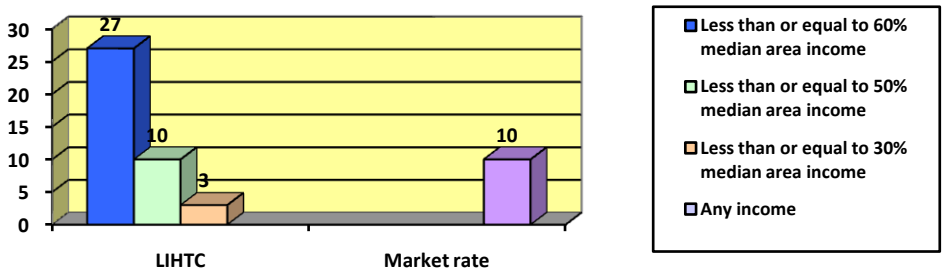
BACKGROUND AND OBJECTIVES

In 1940, the Housing Authority of the City of Fort Smith, Arkansas, was created under Arkansas law to administer public housing programs under the United States Housing Act of 1937 (the Act). It later changed its name to Fort Smith Housing Authority (Authority). A five-member board of commissioners appointed by the mayor of the City of Fort Smith (City) governs the Authority with an executive director managing the day-to-day operations. The Authority also participates in other U. S. Department of Housing and Urban Development (HUD) programs.

In 1995, the Authority entered into an annual contributions contract with HUD for the funding of its public housing programs. HUD provided nearly $1 million in annual contributions and subsidies for its two public housing facilities (448 units), Ragon Homes and Nelson Hall Homes.

In 2005, the Authority planned to demolish and replace Ragon Homes with mixed financed developments. By August 2008, it had relocated Ragon Homes' tenants in preparation for the demolition. North Pointe Development (the development) in Fort Smith, Arkansas, was the first phase of the Authority's master plan to replace Ragon Homes. The development consisted of 40 low-income housing tax credit (LIHTC) units and 10 market rate units, which were not public housing units.



Private investors substantially own the development.[2] On January 17, 2006, the Authority created North Pointe, Inc. (company), to serve as general partner in the development. The Authority was the company's sole shareholder. Two of the Authority's board members, its executive director, and its director of finance served within the company. On February 7, 2006, the company established North Pointe Limited Partnership (Partnership) to finance, construct, own and operate the development. As an instrumentality of the Authority, the Partnership was required to comply with the Authority's annual contributions contract.

The audit objectives were to determine whether the Authority and its instrumentality, the Partnership, spent HUD-provided funds in compliance with HUD's rules and regulations for costs related to the development, including relocation activities, and whether they complied with federal procurement regulations.

[2] Alliant Credit Facility, the limited partner of North Pointe Limited Partnership since April 1, 2007, owned 99.99 percent interest. The company, as general partner, owned the remaining interest.

RESULTS OF AUDIT

Finding 1: The Authority Inappropriately Placed Its Public Housing Assets at Risk and Could Not Support Three Procurements

In violation of requirements, the Authority inappropriately encumbered its assets, spent HUD funds for other than reasonable and necessary program costs, and could not support that it provided free and open competition for three procurements. As a result, it placed more than $2.2 million of its public housing assets at risk and spent more than $426,000 for unsupported costs. Further, the Authority cannot ensure that it received the best price for more than $4.2 million that it spent for goods and services. This condition occurred because the Authority misunderstood federal regulations related to instrumentalities and did not follow its procurement policies.

The Authority Placed Its Public Housing Assets at Risk

Between November 2006 and April 2007, Authority management violated its annual contributions contract by encumbering assets when it inappropriately entered into agreements that guaranteed the Partnership's repayment of two loans and its' performance as general partner. The violations occurred because Authority officials did not believe that they encumbered the Authority's assets or violated requirements. The Authority did not have sufficient unrestricted reserves to cover the bank loans in the event of default. Therefore, Authority management put public housing assets at risk. While the agreements favored the investors, the loans were paid; thus, the loan guarantees were no longer active. However, the Authority also inappropriately guaranteed the company's performance as general partner. This guarantee will remain active until all of the activities of the partnership agreement are completed. The Authority did not inform HUD of the guarantees as required.[3]

The Authority Guaranteed Two Bank Loans

On November 28, 2006, the Authority guaranteed a $75,000 loan for the Partnership. The Authority granted its irrevocable and unconditional full faith and credit as a primary obligor for the complete performance of the Partnership's obligations under the loan. Further, on April 3, 2007, the Authority unconditionally guaranteed the full and prompt payment of a $1.9 million construction loan. The loan guarantees were unsecured and did not identify specific Authority assets as collateral. As the following excerpt shows, the Authority could have been responsible for the loan payments if the Partnership had defaulted on the loans.

[3] Annual contributions contract, part A, section 7.

Excerpt from the $1.9 million loan guarantee

> 2. Guaranty of Payment. For value received and in consideration of any loan or other financial accommodation heretofore, now or hereafter at any time made or granted to Borrower by Lender, the undersigned ("Guarantor") hereby unconditionally guarantees the full and prompt payment when due, whether by acceleration or otherwise, and at all times thereafter, of all obligations of Borrower to Lender under the Loan Documents, howsoever created, arising or evidenced, whether direct or indirect, absolute or contingent, or now or hereafter existing, or due or to become due (all such obligations of Borrower being hereinafter collectively called the "Obligations"), and Guarantor further agrees to (a) pay all expenses and attorneys' fees, including the allocated cost of in-house counsel, paid or incurred by Lender in endeavoring to collect the Obligations, or any part thereof, and in enforcing this Guaranty; and (b) cooperate with Borrower in Borrower's performance of Borrower's covenants and agreements.

The Authority Guaranteed the Partnership's Performance

To induce the limited partner to invest in the Partnership, the Authority entered into an agreement with the limited partner on April 1, 2007. The Authority guaranteed the Partnership's/general partner's performance to the investors for almost every contingency including loss of tax credits, funding of development and operating deficits, and other general partner obligations set forth in the partnership agreements. The Authority also guaranteed that it would make a capital contribution to pay any unpaid portion of the $335,872 development fee. Further, it waived its right to defend enforcement of the agreements and agreed to pay the investors' legal costs for enforcing the agreements against it.

The Partnership Did Not Properly Procure a $4.2 Million Construction Contract

The Partnership did not follow federal procurement regulations when it entered into the $4.2 million contract with ERC Construction Group, LLC (ERC), for construction of the development. Although it was subject to federal procurement regulations, the Authority wrongly believed that it did not need to follow the regulations because the Partnership was a private entity. As a result, the Partnership appeared to sole source the contract and did not adequately protect HUD's interest. The Partnership generally used federal funds to pay for the $4.2 million construction contract. It used $400,000 in HOME funds, a $1.9 million construction loan guaranteed by the Authority, and about $1.9 million in tax credit equity.

The Partnership, as an instrumentality of the Authority, did not procure the contract with full and open competition as required by HUD.[4] In accordance with requirements, the Partnership solicited bids and rejected all of the bidders as permitted.[5] However, in violation of procurement requirements, the Partnership

[4] 24 CFR (*Code of Federal Regulations*) 85.36(c).
[5] 24 CFR 85.36(d)(2).

then separately negotiated and contracted with ERC, which had not submitted a bid.

Additionally, the Partnership did not require ERC to obtain a performance and payment bond for 100 percent of the contract amount as required by HUD.[6] Federal regulations required the Partnership to get a 100 percent performance and payment bond from the contractor unless HUD had determined that its interests were adequately protected. HUD did not waive the bond requirement. The Partnership initially required the bidders to certify that they could get the required performance and payment bond, but when it contracted with ERC, it did not require a performance and payment bond for 100 percent of the more than $4.2 million contract. Instead, ERC provided a $630,000 irrevocable letter of credit, slightly less than 15 percent of the contract amount.

The Authority Did Not Properly Procure Legal and Architectural Services

The Authority provided no evidence that it prepared independent cost estimates and solicited quotes for the architectural and legal services before selecting the service providers as required by its own procurement policy and HUD requirements.[7] As a result, it could not support that $26,048 capital funds that it spent on legal and architectural services from November 2005 through December 2006 was reasonable and necessary for its public housing program.

In its fiscal year 2005 audit report, dated June 28, 2006, the independent auditor reported that the Authority had not followed its procurement policy. The audit report disclosed that the Authority agreed to review all services provided and contracts and ensure that it complied with its procurement procedures in the future. The independent auditor cleared the finding during the fiscal year 2006 audit.

Following the 2005 financial audit, the Authority did not review the procurement of legal services to determine whether it complied with procurement procedures. The Authority continued to use the attorney throughout this audit period. When questioned about the legal services, the Authority could not support that it followed procurement requirements, although it entered into another contract with the attorney on May 7, 2008.

Further, the Authority spent up to $7,368 of its capital funds for its instrumentality's legal costs that were not approved by HUD as public housing activities. The legal services included various research regarding the limited partnership, such as reviewing articles and certificate and code provisions,

[6] 24 CFR 85.36(h).
[7] HUD Handbook 7460.8, REV-2.

reviewing and revising by-laws, reviewing the HOME agreement and letter of intent, correspondence with and letters to the limited partner, and research regarding CDBG funds. The $7,368 is included in the $26,048 in improper procurements noted above.

Recommendations

We recommend that the Acting Director, Office of Public Housing, require the Authority to

1A. Obtain the release of any encumbered assets and implement procedures to ensure that it will no longer encumber assets.

1B. Support or reimburse $26,048 from nonfederal funds to its capital fund grants or HUD, as appropriate,[8] for unsupported procurement activities and costs.

1C. Ensure that it procures goods and services as required by its own procurement policy and HUD procurement requirements.

We recommend that the Director, Office of Community Planning and Development, require the Authority to

1D. Support or reimburse the HOME program $400,000 from nonfederal funds for unsupported procurement activities.

1E. Implement written procedures and controls to ensure that its instrumentalities comply with federal procurement regulations.

[8] 42 USC (*United States Code*) 1437(g).

Finding 2 The Authority Spent More Than $108,000 on Questionable Costs

The Authority spent more than $108,000 for ineligible and unsupported costs. It spent more than $104,000 in CDBG and Section 8 funds to purchase land for planned housing developments. However, the land was not zoned for housing, and the City did not approve rezoning. Further, the Authority spent more than $4,000 in low-rent funds on costs not included in its public housing plan because it misclassified the costs. As a result, the funds were not available to fund other activities for the intended program beneficiaries.

The Authority Spent $104,198 for Land That Could Not Be Used for Housing Purposes

In October 2006, the Authority purchased land for $104,198, using $94,430 in CDBG funds and $9,768 in pre-2003 Section 8 administrative fee reserves. Authority officials planned to use the land for housing purposes as required by federal regulations.[9] However, the zoning laws did not permit it. Further, the City's planning commission did not approve a rezoning of the property so that the Authority could use it as planned. If the Authority cannot use the land for housing purposes as required by federal regulations, it should return the $104,198 to the CDBG and Section 8 programs.

The Authority Inappropriately Spent $4,440 in Low-Rent Funds

In violation of its annual contributions contract, the Authority inappropriately spent $4,440 in capital funds on mixed finance activities without HUD approval. Apparently, Authority officials misclassified the costs. The misclassification of funds reduced the funds available for the Authority's public housing program.

Specifically, from August 2007 through January 2008, the Authority spent $4,440 for credit checks of individuals who were not public housing tenants. Following discussions with the Authority's executive director, the Authority repaid $4,440 to its capital fund grants.

[9] 24 CFR Parts 982 and 570.

Recommendations

We recommend that the Acting Director, Office of Public Housing, require the Authority to

2A. Reimburse its capital fund grants or HUD, as appropriate, $4,440 from nonfederal funds for ineligible expenses (the Authority has already repaid $4,440 to its capital fund grants).

2B. Support or reimburse $9,768 from nonfederal funds to the pre-2003 Section 8 project reserve account, as appropriate, for unsupported expenses.

2C. Implement written procedures and strengthen controls to prevent the use of low-rent funds for unauthorized costs.

We recommend that the Director, Office of Community Planning and Development, require the Authority to

2D. Support or reimburse the CDBG program $94,430 from nonfederal funds for land not used for CDBG purposes.

SCOPE AND METHODOLOGY

Based upon the initial results, we modified the objectives. The initial objectives were to determine whether the Authority complied with HUD's procurement regulations and whether it spent funds provided by HUD in accordance with HUD's rules and regulations for the period October 1, 2005, through September 30, 2007. We modified the objectives to focus on procurement and costs related to the relocation and its instrumentality's development activities. To accomplish the objectives, we expanded the audit period through January 31, 2008. We performed audit fieldwork at the Authority's administrative office in Fort Smith, Arkansas, and our office in Oklahoma City, Oklahoma.

To accomplish the objectives, we performed the following steps:

- Reviewed the Authority's financial records, policies, and procedures.
- Reviewed the Authority's audited financial statements, annual contributions contract, and annual performance plans.
- Reviewed loan and guarantee agreements related to the development.
- Reviewed relevant federal regulations and other criteria.
- Conducted interviews with HUD officials, Authority officials, and other individuals involved in development activities.
- Toured Ragon Homes and the development on February 12, 2008.
- Reviewed the $4.2 million construction contract for the development.
- Reviewed all of the Authority's payments for apparent development and relocation activities not paid to the developer, which totaled $401,290.

For the period October 1, 2005, through January 31, 2008, we reviewed the development agreement for the development. Using a nonstatistical method, we reviewed two of 15 payments from low-rent funds to the developer for relocation costs. The $18,257 in selected payments represented 9 percent of the $199,314 charged under the agreement. We reviewed the two samples to determine whether the developer had records to support costs charged for the development services. We compared the developer's records to the invoices. The developer had records to support all of the charges for the two invoices. Since we found no discrepancies, we did not test the remaining $181,057.

For the period October 1, 2005, through January 31, 2008, we reviewed $331,140 (12 percent) of $2,825,852 in payments from the Authority's CDBG, HOME, and low-rent funds to determine whether the Authority complied with its procurement policy and HUD's procurement requirements. The population did not include payments for the development or relocation activities. We used a nonstatistical sample to review the payments. For the sample of 20 payments, we selected five of the seven vendors with the top total payments and reviewed the largest payment to each vendor. For 13 of the remaining 15 samples, we selected payments that exceeded $5,000 each. We also reviewed the contracts for accounting and legal services. The

conclusions reached relate only to the sample items tested and cannot be projected to the entire population.

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

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

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

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

- Safeguarding resources – Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weaknesses

Based on our review, we believe the following items are significant weaknesses:

- Compliance with laws and regulations – Authority management violated the Authority's annual contributions contract with HUD when it inappropriately encumbered the Authority's assets, spent funds on nonprogram activities, and required tenants to waive their right to relocation assistance. Further, the

Authority and its instrumentality, the Partnership, did not comply with procurement regulations.

- Safeguarding resources – Authority management inappropriately encumbered public housing assets by guaranteeing payment of loans needed to fund private development activities. Further, management exposed the Authority to large contingent liabilities when it inappropriately guaranteed the Partnership's performance regarding the development activity.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/	Unsupported 2/
1B		$ 26,048
1D		400,000
2A	$4,440	
2B		9,768
2D		94,430
Totals	$4,440	$530,246

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local policies or regulations.

2/ 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 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.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

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October 7, 2008

Mr. Gerald Kirkland
Regional Inspector General for Audit
US Department of Housing & Urban Development
Office of Inspector General, Region VI
819 Taylor Street, Suite 13A09
Fort Worth, Texas 76102

RE: Fort Smith Housing Authority Response
Audit Report No. 2009-FW-100X
DRAFT – Audit Report

Dear Mr. Kirkland,

I am writing to comment on the draft findings and recommendations of the Office of Inspector General under Audit Report Number 2009-FW-100X. Under separate headings, as contained in this letter, we will address the three findings of the Office of Inspector General (the "OIG") as contained in said draft audit report.

Comment 1
Comment 2

THE AUTHORITY DID NOT PLACE ITS PUBLIC HOUSING ASSETS AT RISK NOR IS THE PROCUREMENT OF THE CONSTRUCTION CONTRACT REFERENCED BY THE OIG INAPPROPRIATE.

The OIG alleges that (1) the Housing Authority of the City of Fort Smith (the "Authority") placed its public housing at risk by improperly encumbering assets as a result of guaranteeing two bank loans and guaranteeing the performance of the general partner of North Pointe Limited Partnership, an Arkansas Limited Partnership (the "Partnership") in connection with the development of North Pointe Project (a low income housing tax credit development); (2) the Partnership, "as an instrumentality of the Authority," did not follow federal procurement regulations, and (3) the Authority did not properly procure legal and architectural services.

Comment 1
Comment 2

In response to the allegations, the Authority states that (1) it did not improperly encumber assets through the guarantees; (2) the Partnership is not an instrumentality of the Authority, and therefore the Partnership was not required to follow federal procurement regulations; but that even if the Partnership is deemed to be an instrumentality or affiliate of the Authority, federal procurement regulations were

followed in connection with the procurement of the construction contract; and (3) while the Authority did not properly procure legal and architectural services in all respects, it has made arrangements for repayment and has instituted controls to ensure such activities do not again occur.

I. THE AUTHORITY DID NOT PLACE PUBIC HOUSING ASSETS AT RISK

Allegations of OIG

The OIG alleges that the Authority encumbered assets when it "inappropriately" entered into agreements guaranteeing the Partnership's repayment of two loans and the performance of the Partnership's general partner: North Pointe, Inc. The three guaranty agreements at issue are as follows:

- That certain Guaranty dated April 3, 2007, whereby the Authority guaranteed a $1,900,000 construction loan from Stearns Bank National Association to the Partnership;
- That certain Guaranty dated November 28, 2006, whereby the Authority guaranteed a loan in the amount of $75,000 from Alliant Capital, Ltd. to the Partnership (collectively with 1 above, the "Loan Guarantees"); and
- That certain Guaranty dated April 1, 2007, whereby the Authority guaranteed the prompt and complete performance of certain obligations of North Pointe, Inc., an Arkansas corporation, under the Amended and Restated North Pointe Limited Partnership Agreement, in connection with the development of North Pointe (the "Partnership Guaranty").

Summary Response of Authority

The OIG's findings are based on an alleged breach of the Annual Contribution Contract ("ACC"); more specifically, Part A, Section 7 (draft Report, September 19, 2008, p. 13, foot note 3). The Authority disagrees with the finding for the following 3 reasons:

Comment 3

(1) The OIG's findings do not allege that the guarantee agreements violated any statutory regulation. Prior to June 20, 2007, HUD regulations contained no clear prohibition against public housing authorities entering into guaranty agreements (although the regulations did prohibit housing authorities from demolishing, disposing of or mortgaging real property without HUD approval). On June 20, 2007, HUD issued PIH-2007-15(HA), to establish that, in HUD's interpretation, the creation of a claim against project assets under a guaranty or indemnity agreement is restricted by the ACC. The Code of Federal Regulations ("C.F.R.") has not been amended to reflect the notice's interpretation. Further, and more importantly, PIH-2007-15(HA) was promulgated subsequent to the guarantees executed by the Housing Authority and should not be applied retroactively.

Comment 3

(2) The Authority did not "encumber" or "pledge" assets by entry into the guaranty agreement. The above guaranty agreements were not secured by any program

assets and, in the absence of an encumbrance or pledge of restricted assets, there is no breach of the ACC. Moreover, the loans with respect to the guaranty dated April 3, 2007 and the guaranty dated November 28, 2006 are paid; thus the guarantees are extinguished and no longer of any force and effect.

Comment 1

(3) The guaranty agreements created no right to reach assets protected by the ACC and federal law.

REQUEST FINDING #1: The Authority requests that HUD find in favor of the Authority that it has not encumbered its assets or otherwise inappropriately placed public housing assets at risk.

The OIG's recommendation under 1A is to require the Authority to: "Obtain the release of any encumbered assets and implement procedures to ensure that it will no longer encumber assets."

Comment 1

The Authority requests that the recommendation be modified to remove the request it obtain releases, and state instead, **"The Authority is to implement procedures to ensure its future compliance with HUD PIH 2007-15 notice's restrictions on the encumbrance of assets."** This recommendation reflects the present situation—the Authority faces no potential liability under the loan guarantees, the Authority has no ability or legal right to compel the release of the Partnership guaranty, and the limited partners have no obligation or incentive to provide a release of the Partnership guaranty. This recommendation also reflects that, prior to the June 20, 2007 issuance of HUD PIH 2007-15, there was no official guidance regarding interpretation of the ACC's anti-encumbrance provisions, and that all transactions at issue occurred prior to the promulgation of HUD PIH 2007-15.

Analysis

Comment 3

1. The Guaranty Agreements do not Violate any Statute or Regulation.

The OIG's findings do not allege that the guaranty agreements violated any statute or regulation. Prior to June 20, 2007, HUD regulations contained no clear prohibition against public housing authorities entering into guaranty agreements (although the regulations did prohibit housing authorities from demolishing, disposing of or mortgaging real property without HUD approval). On June 20, 2007, HUD issued PIH-2007-15(HA), to establish that, in HUD's interpretation, the creation of a claim against project assets under a guaranty or indemnity agreement is restricted by the ACC. "C.F.R." has not been amended to reflect the notice's interpretation. The Authority notes that all of the guaranty agreements at issue were entered into on or before April 2, 2007. HUD notice PIH-2007- 15 was issued June 20, 2007. The notice contained new language (which is absent from the ACC and C.F.R.) prohibiting certain "encumbrances" of Authority assets, including the "[p]ledge or other encumbrance of public housing project funds" and the "[c]reation of a claim against project assets, under a guaranty or indemnity

agreement[.]" The notice does not purport to be retroactive. Further, since this language is not contained in the ACC or the C.F.R. it appears that it was intended to establish HUD's interpretation of the ACC.

The Authority was without the guidance of PIH-2007-15, when it entered into the guaranty agreements in April 2007, and was without this guidance when it executed the ACC in 1995. The notice was not an amendment of the ACC, such that the Authority's *contractual* obligations under the ACC increased, and as argued above, there has been no breach of the ACC. The Authority submits that the notice has no retroactive interpretative value where it postdates both the contract (the ACC) and the guaranty agreements. To the extent that PIH-2007-15 imposes new restrictions on the encumbrance of assets, fundamental fairness demands it should be applied only prospectively.

Comment 1

2. The Authority did not Encumber or Pledge Assets.

Part A, Section 7 of the ACC provides:

> "The HA shall not demolish or dispose of any project, or portion thereof, other than in accordance with the terms of this ACC and applicable HUD requirements. With the exception of entering into dwelling leases with eligible families for dwelling leases in the projects covered by this ACC, and normal uses associated with the operation of the project(s), the HA shall not in any way encumber any such project, or portion thereof, without the prior approval of HUD. *In addition, the HA shall not pledge as collateral for a loan the assets of any project covered under this ACC.*" (Emphasis added.)

Accordingly, under Part A, Section 7 of the ACC, the Authority is forbidden to do any of the following without HUD approval: (1) Demolish any project, or portion thereof; (2) Dispose of any project, or portion thereof; (3) Encumber any project, or portion thereof; and (4) Pledge as collateral for a loan the assets of any project covered under the ACC. (We note, however, that only items 2 and 3 are specifically identified as a "substantial default" of the ACC (see ACC, Part A, Section 17), and that even a pledge of project assets as collateral for a loan is not identified as a substantial default of the ACC).

Comment 3

What constitutes a "pledge" or "encumbrance" is not defined by the ACC or by regulation. In contrast, HUD regulations do define what it means to demolish or dispose of project assets. "Demolition means the removal by razing or other means, in whole or in part, of one or more permanent buildings of a public housing development... Disposition means the conveyance or other transfer by the PHA, by sale or other transaction, of any interest in the real estate of a public housing development[.]" 24 C.F.R. § 970.5. Because none of the Authority's guaranty agreements provided for a transfer of any security interest in real estate, the agreements did not violate the ACC's prohibition against demolition or disposition of assets.

Comment 1

Likewise, the guaranty agreements are not an "encumbrance" as that term is commonly understood. An encumbrance is "[a] claim, lien, charge, or liability attached to and binding real property; *e.g.* a mortgage; judgment lien; mechanics' lien; lease; security interest; easement or right of way; accrued and unpaid taxes. If the liability relates to a particular asset, the asset is encumbered." (Black's *Law Dictionary*, p. 527 (6th ed. 1990).) Like a disposition, an encumbrance involves an interest in particular, identified real estate. In context of Part A, Section 7 of ACC, encumbrance implies an interest akin to a security interest—both demolitions and dispositions involve the modification or transfer of particular land, and the plain language of the ACC only forbids pledges which are *collateral* for a loan. The mere possibility that a guaranty agreement might someday create an obligation, which might have to be paid out of unidentified and unrestricted assets, is insufficient to rise to the level of an "encumbrance" on any project of the Authority.

Comment 4

Moreover, in its guaranty agreements, the Authority did not "pledge as collateral for a loan, the assets of any project." A "pledge" is "a bailment, pawn, or deposit of personal property to a creditor as security for some debt or engagement" or "[p]ersonal property transferred to a pledge as security for pledgor's payment of a debt or other obligation." (Black's *Law Dictionary*, p. 1153 (6th ed. 1990).)

With one exception in connection with the Guaranty given to Stearns Bank, none of the Authority's guaranty agreements contained language whereby the Authority pledged or granted a security interest in any assets. The Guaranty given to Stearns Bank dated April 3, 2007, did provide, in Paragraph 14, that the "Guarantor [Housing Authority of the City of Fort Smith] hereby grants the Lender [Stearns] a security interest in all deposits and account balances and credits of Guarantor or other sums credited by or due from the Lender to the Guarantor **in the possession of or in transit to Lender…**" (Emphasis added.) While the Stearns Bank Guaranty did have the Authority provide a security interest (i.e., a pledge) in certain assets, the security interest was limited to deposits and account balances in the possession of or in transit to Stearns Bank. The Authority had and has no deposits or account balances with Stearns Bank and thus, no rent, revenues, or income of any project covered under the ACC are subject to any pledge or security agreement in favor of Stearns Bank. Because none of the guaranty agreements at issue demolished, disposed of, encumbered or pledged as loan collateral any project assets, the Authority has not breached the ACC.

Not only is there no breach of the ACC, no assets subject to the ACC are at risk. All obligations under the Guaranty dated April 3, 2007, whereby the Authority guaranteed a $1,900,000 construction loan from Stearns Bank National Association to the Partnership, and the Guaranty dated November 28, 2006, whereby the Authority guaranteed a loan in the amount of $75,000 from Alliant Capital, Ltd. to the Partnership, have been paid. Neither guaranty involved a pledge of project assets as loan collateral, but to the extent that these guaranty agreements potentially violated the ACC (as has been interpreted under HUD's subsequent issuance of PIH-2007-1 (HA)) the issue is moot because the loans have been paid and no loss was sustained.

Comment 1

3. The Guaranty Agreements Created No Right to Reach Assets Protected by the ACC.

Finally, the Guaranty of performance of obligations under the Amended and Restated North Pointe Limited Partnership Agreement neither pledged any assets nor included any collateral for a loan. North Pointe Limited Partnership is an Arkansas Limited Partnership; the General Partner of the Partnership is North Pointe, Inc., an Arkansas corporation. It is correct that under the April 1, 2007 Partnership Guaranty, the Authority guaranteed certain obligations of the General Partner to the Partnership including payment of development deficits, operating deficits and the loss of tax credits. However, should the General Partner fail on these obligations, the Partnership could not look to any public housing assets pursuant to the ACC for payment of these obligations. Public Housing Assets pursuant to the ACC are restricted by HUD. The ACC limits the use of ACC project funds, specifies the purposes for which the funds may be withdrawn and used, and specifically provides that the funds are not fungible. (See ACC, Part A, Section 9(C).) HUD is authorized to control when and how an interest may be granted in its real property. See 42 U.S.C.A. § 1437z-2. Upon any breach of the Partnership Guaranty, the Partnership (in whose favor the guaranty runs) would have no greater right than the Authority in those funds—in other words, like the Authority, the Partnership would have no right to access the restricted project assets for purposes not specifically allowed under the ACC. Moreover, imposition of a constructive trust to ensure that the assets were used only for the public purposes to which they were dedicated would be appropriate. See, *e.g., LaFollette Medical Center v. City of LaFollette*, 115 S.W.3d 500 (Tenn. 2003) (constructive trust imposed by court to ensure assets were used for their dedicated purpose of hospital use).

The OIG Draft Report, p. 7, notes that the Authority does not have sufficient unrestricted reserves in the event of a default covered by the guaranty agreements. This may be true with respect to the Partnership Guaranty (the Loan Guarantees no longer survivesince the loans have been paid) but is ultimately irrelevant, because in the event of a default, the guarantees would have no recourse beyond the unrestricted assets of the Authority. The guarantees are sophisticated business entities presumed to know that the unrestricted assets are insufficient to cover a default. What is relevant is that the *restricted* assets are not at risk, and the OIG's findings that the project assets are at risk is incorrect.

II. THE PARTNERSHIP DID NOT IMPROPERLY PROCURE A $4.2 MILLION CONSTRUCTION CONTRACT.

Allegations of OIG

The OIG alleges that the Partnership failed to follow federal procurement regulations when it entered into a $4.2 million construction contract with ERC Construction Group, LLC (ERC). The OIG further alleges that the Partnership failed to procure the ERC with full and open competition, and that the Partnership did not require ERC to obtain a performance and payment bond for 100 percent of the contract amount

as required by federal regulations. All these findings are premised on the OIG's assertion that the Partnership was an "instrumentality" of the Authority and, as an instrumentality, required to abide by federal procurement regulations.

Summary Response of Authority

Comment 2

Without conceding that the Partnership failed to comply, or substantially comply, with procurement regulations, the Authority asserts that the Partnership is not an instrumentality of the Authority. The Authority lacks effective control over the Partnership's activities, and thus the Partnership is not an instrumentality of the Authority. Accordingly, the Authority recommends a finding that the Partnership was not required to follow federal procurement regulations, or, in the alternative, that proper procurement procedures were followed

REQUEST FINDING #1: The Authority requests that HUD find in favor of the Authority and determine (1) the Partnership is not an instrumentality of the Authority; and (2) the Partnership was not required to bid the project or obtain payment and performance bonds from ERC. Alternatively, and as set forth above, even if HUD determines that the Partnership is an Instrumentality of the Authority, the Authority requests that HUD find that no federal procurement violations occurred in securing the construction contract with ERC and the federal procurement regulations were followed.

The OIG's recommendation under 1C is to require the Authority to: "Ensure that it procures goods and services as required by its own procurement policy and HUD procurement requirements."

The Authority does not object to recommendation 1C provided the recommendation is interpreted to place no requirements on limits on the activities of the Partnership and/or other entities over which the Authority does not have effective control.

Analysis

1. The Partnership is not an Instrumentality of the Authority

Comment 5

The Authority notes that the term "instrumentality" is not defined by the C.F.R., and that the relevant procurement regulations use the terms grantee and subgrantee instead. (24 C.F.R. § 85.36.) However, under the definitions and factors set forth in PIH 2007- 15, the Partnership is not an instrumentality of the Authority, because the Authority lacks "effective control" of the Partnership.

PIH-2007- 15 contains this definition: "An 'Instrumentality' is an entity related to the PHA whose assets, operations, and management are *legally* ***and*** *effectively* controlled by the PHA, through which PHA functions or policies are implemented and that utilize public housing funds or public housing assets for the purpose of carrying out public housing development functions of the PHA." (Emphasis added.) Although the

Authority, through North Pointe, Inc. might be deemed to have legal control over the Partnership, it does not have ***effective*** control.

The Partnership was organized on February 8, 2006, and is subject to an Amended and Restated Limited Partnership Agreement dated April 1, 2007. The ownership structure is as follows:

General Partner:	North Pointe, Inc., an Arkansas corporation, .01% interest
Administrative Limited Partner:	Alliant Credit Facility ALP, LLC, .01% interest
Investor Limited Partner:	Alliant Credit Facility Limited, 99.97% interest
State Limited Partner:	Alliant Credit Facility Limited, 01% interest

The Administrative Limited Partner, the Investor Limited Partner, and the State Limited Partner are all related entities and the purpose of the Administrative Limited Partner, as set forth below, is to exercise control by way of limitation in the authority of the General Partner to contract on behalf of the Limited Partnership.

North Pointe, Inc., the General Partner, is wholly owned by the Housing Authority of the City of Fort Smith. However, because the Administrative Limited Partner's consent is required for most (and certainly all significant) actions of the General Partner on behalf of the Limited Partnership Agreement, the General Partner has no independent exercise of control with respect to these matters.

Under Section 5.5 of the Amended and Restated Limited Partnership Agreement, notwithstanding any other provisions of the Agreement which provide for the authority of North Pointe, Inc., as the General Partner, to contract for and bind the Partnership, North Pointe, Inc. does not have the authority to do any of the following except with the written consent of the Administrative Limited Partner:

- Acquire any real or personal property except to the extent approved in an approved annual budget (which also requires the consent of the Administrative Limited Partner);
- Sell, lease, exchange, mortgage, pledge, or otherwise transfer any or all of the Project or any assets of the Partnership;
- Terminate the services of the accountants or management agent or amend any Project document (which would include any construction contracts);
- Make any capital improvement to the Project in excess of $25,000 (again which would include construction contracts);
- Make tax elections;
- Merge, dissolve, or windup the Partnership;
- Make any material changes in the Partnership's business;

- Enter into any amendment of the standard form of lease previously approved by the Administrative Limited Partner;
- Make changes to any insurance program;
- Institute any legal action involving a claim in excess of $50,000;
- Extend the Partnership's credit;
- Decide not to repair or rebuild any part of the Project in the case of material damage;
- Adopt any annual operating budget;
- Approve any change orders;
- Hire any employees; and
- Submit any draw requests for proceeds from the construction loan to pay the contractor.

Such significant limitations of authority demonstrate that the true party in interest is actually the Investor Limited Partner (99.97% interest), through its instrumentality, the Administrative Limited Partner. The General Partner (North Pointe, Inc.) lacks the authority to bind the Partnership in all of these material respects. Accordingly, the Authority lacks any effective control of the Partnership, and under HUD's definition, the Partnership is not an instrumentality of the Authority.

Comment 5

Since the Partnership is not an instrumentality of the Authority, the Authority was under no obligation to procure services as set forth under Part 85. The OIG has not provided the Authority with any specific citation of law stating the requirements of Part 85 would transfer to the Partnership.

Comment 6

2. The Partnership Properly Procured the Construction Contract

As set forth above, it is the position of the Authority that the Partnership is not an instrumentality of the Authority. However, even if this is not accepted by the OIG, the Partnership did properly procure the construction contract.

The OIG alleges that the Partnership sole sourced the contract and did not adequately protect HUD's Interest. The Partnership, in fact, did work with an Architect to develop plans and specifications adequate to solicit bids. The Partnership's Architect placed the project out for bid by placing ads in the local and statewide new publications, made available plans and specifications to statewide plan rooms for contractors to view, and received bids (See Exhibit #1). After a thorough review of all bids, the Partnership, at the advice of the Architect, deemed all bids non-responsive. Subsequent to deeming all bids non-responsive the Partnership entered into negotiations with ERC for purposes of arriving at a cost that would allow the project to go forward.

The OIG further alleges the Partnership generally used federal funds to pay for the $4.2 million construction contract. That it used $400,000 in HOME funds, and about $1.9 million in tax credit equity. The Authority acknowledges the use of $400,000 in HOME funds that were made available by the Arkansas Development Finance Authority (ADFA). However, it is the position of the Authority that the Partnership, not being a 501

(c)(3) non-profit entity and not being a unit of government, was not required to procure under Part 85. The Authority contacted [redacted] Manager of the HOME Program for the State of Arkansas and informed him of the OIG's concern. It was stated to us by [redacted] that ADFA does not require for-profit entities that have presented a project to ADFA with the project team in place to procure under Part 85. The Authority further believes the OIG made contact with ADFA and was given the same information.

The OIG states the Partnership did not require ERC to obtain a performance and payment bond for 100 percent of the contract amount as required by HUD. The Partnership acknowledges it did not require the payment and performance bond and waived such bond with the approval of our Equity Partner Alliant Capital who, under the terms of the Agreement retains the authority. With respect to the waiving of the performance and payment bond in the amount of 100% the Partnership provided the same opportunity to all who provided a bid. Each firm was contacted and informed of the change. **See Exhibit #2**

The Authority's position is the OIG provided no citations or regulations that allow the determination of responsibility exists.

III. THE AUTHORITY DID NOT PROPERLY PROCURE LEGAL AND ARCHITECTURAL SERVICES

The OIG has found the Authority did not prepare independent cost estimates and did not solicit quotes for architectural and legal services before selecting the service provider as required by its own procurement policy and HUD requirements.

Comment 7

THE AUTHORITY AGREES TO THE FINDING WHEREAS THE AUTHORITY DID NOT PROPERLY PROCURE SERVICES AND FURTHER AGREES TO REPAY $26,048 TO ITS CAPITAL FUND ACCOUNT

Allegations of OIG

The OIG alleges the Authority did not follow its own procurement policies as well as those rules and regulations promulgated by HUD. Further the OIG alleges the Authority spent up to $7,368 of its capital funds for legal costs that were not approved by HUD as public housing activities.

Summary Response of Authority

The Housing Authority does not dispute the finding of fact that the Authority did not follow its own procurement policies as well as those rules and regulations promulgated by HUD as it relates to procurement. The Authority believes the intent was well placed as were the expenditures. The work authorized by the Authority was to provide the Authority with as much information as possible relating to the redevelopment of the Ragon Homes public housing site. The Authority believes the costs associated with

the work scope were of excellent value from a cost basis as well as the value it provided in assisting the Authority in determining the overall scope of the redevelopment effort.

REQUEST FINDING #1: 1-B

Comment 7

The Authority agrees with the OIG, in as much, that the Authority did not follow proper procurement guidelines and regulations and therefore agrees to repay to its Capital Fund $26,048 in settlement of the finding. The Authority has issued a check #279787 in the amount of $26,048 from its pre-2003 Section 8 administrative fee reserves allowing the OIG to clear the finding.

THE AUTHORITY DID NOT SPEND $121,000 ON QUESTIONABLE COSTS

The OIG alleges the Authority purchased land for $104,198 using $94,430 in CDBG funds and $9,768 in pre-2003 Section 8 administrative fee reserves. The OIG further alleges the funds to be inappropriate because the land was not properly zoned and therefore, could not be used for its intended purpose. In addition the OIG alleges the Authority spent almost $17,000 in low-rent funds on costs not included in its public housing plan because it misclassified the costs.

I. THE AUTHORITY DISAGREES THAT THE AUTHORITY SPENT $104,198 FOR LAND THAT COULD NOT BE USED FOR HOUSING PURPOSES

Allegations of OIG

The OIG alleges the Authority purchased land for $104,198 with $94,430 in funds coming from CDBG awarded to the Authority under a competitive application submitted to the City of Fort Smith and approved by the Community Development Advisory Committee of Fort Smith and the City of Fort Smith Board of Directors. The OIG's position is the land purchased is not properly zoned for residential and therefore, the use of CDBG funds is inappropriate.

Summary Response of Authority

While the OIG's reference is 24 C.F.R. 982 and 570, I cannot locate within the citations where it states CDBG or pre-2003 Section 8 administrative fee reserve funds cannot be used to acquire property not properly zoned for its intended use or hold property that cannot be used for its intended use. I have requested HUD-OIG [redacted] to provide the specific paragraph within 24 C.F.R. 570 which prohibits otherwise applies to our acquisition of the Williams Lane property.

Comment 8

The Authority purchased the property clearly with the intent to construct affordable housing. An **"Analysis of Affordable Housing Report" (Exhibit #3)** was

commissioned by the Authority Board of Commissioners to determine the availability of land for future development. Property information and costs of infrastructure for each parcel were presented to them for consideration, with a final recommendation as to the best suited property. The Williams Lane site was determined to be best suited site for the next phase of the Authority's development of affordable housing. The Authority proceeded forward with an application for a rezoning request to the City to have the property rezoned from Industrial I-2 to R-3 Residential Multi-family. The rezoning met with considerable opposition from the neighbors who presented a petition to the City Planning Commission requesting the property not be rezoned. Objections from neighbors are not uncommon when an application is made by a local Housing Authority to rezone property. I believe HUD has identified such action as a "Not-In-My-Backyard" syndrome (NIMBY). The Planning Commission rendered a recommendation not to rezone the property. The Authority and the City discussed the strong opposition of the residents. Ultimately a decision was made by the Authority Board of Commissioners to delay further action regarding Williams Lane and to refocus the Authority's efforts back to the Ragon Homes site.

The decision to develop a different site was in no way a decision to abandon the Williams Lane site as a potential location for affordable housing. Rather, the decision was directly related to the need to complete and submit an application to the Arkansas Development Finance Authority under the 2007 Low-Income Housing Tax Credit offering. There was not ample time to address the concerns of the neighbors and to submit a second request for rezoning prior to the due date for the 2007 round of tax credits. The Board of Commissioners remains committed to using the Willaims Lane site as its Phase III development. The Board and Executive Director decided to complete North Pointe Phase I so the Authority could showcase the completed project and units to the residents of Williams Lane prior to the resubmission of the request for rezoning. The Authority believes that with North Pointe I now complete, the residents are much more likely to accept the rezoning of Williams Lane.

On Thursday, September 25, 2008, [redacted] of the City of Fort Smith and [redacted] of HUD Little Rock CPD visited with [redacted] and me to discuss the issues raised by the OIG. Attached hereto is an e-mail **(Exhibit #4)** from [redacted] to [redacted] summarizing the discussion and findings of their tour and meeting with the Authority. The email clearly demonstrates the support of the City and the unquestionable logic for the proposed project. The I-2 parcel is an island in a sea of residential zoned property. There is every reason to support having the land rezoned to continue residential development in keeping with the surrounding properties. The City of Fort Smith has been a partner and supporter of the Authority's decision to develop the site as affordable housing. It is the intent of the Authority to meet with the residents of Williams Lane within 30 to 45 days of the date of this letter and to resubmit this year our request for rezoning of the property.

REQUEST FINDING #2: 2-B (PIH) and 2-D (CPD): The Authority requests that HUD PIH & CPD find in favor of the Authority that it has adequately supported the $9,768 and $94,430 respectively for the acquisition of land for the purpose of consolidation of

property for the development of affordable housing for persons of low to moderate income and to not be required to repay the funds.

II. THE AUTHORITY, IN PART, DID NOT INAPPROPRIATELY SPEND $16,860 IN LOW-RENT FUNDS

Allegations of OIG

The OIG alleges that the Authority inappropriately spent $16,860 in low-rent funds.

- That the Authority spent $12,420 for refrigerators and ranges for units in the development that were not public housing
- That the Authority spent $4,440 for credit checks of individuals who were not public housing tenants.

Summary Response of Authority

Comment 7

Comment 9

The Housing Authority **agrees** that the Authority inappropriately spent $4,440 in low-rent funds for costs associated with the criminal and credit checks of families not in conjunction with the relocation of families or the demolition of Ragon Homes. Following discussions with the OIG the Authority repaid the $4,440 clearing it from the Finding as stated in the OIG comments page #1 last paragraph. The Housing Authority **disagrees** with the OIG's Draft Finding that specifically sets forth; the Authority spent $12,420 for refrigerators and ranges for units in the development that were not public housing. This is not a true statement and the Authority presented evidence to support the fact it disagreed with the OIG at the exit interview held on September 26, 2008. Subsequent to the exit interview the Authority staff identified the locations of the appliances outlined in the Siano invoice #97426 **(see Exhibit #5)**. The Authority, because of the low pricing received by North Pointe Limited Partnership, decided to place an order for refrigerators and ranges to be used within the operation of the Authority's public housing units. Siano Appliance Distributors, Inc invoice #97426 represents appliances purchased and used in conjunction with Public Housing Units.

REQUEST FINDING #2: 2-A

The Housing Authority requests HUD Office of Public Housing find in favor of the Authority that it recognized its inappropriate expenditure of $4,440 and repaid said funds to the Capital Fund account and that the expenditure of $12,420 for the refrigerators and ranges were in-fact appropriate and in support of public housing units. We request of HUD and the OIG to close out and remove Finding 2-A from its final report.

III. THE AUTHORITY WILL IMPLEMENT WRITTEN PROCEDURES AND STRENGTHEN CONTROLS TO PREVENT THE USE OF LOW-RENT FUNDS FOR UNAUTHORIZED COSTS.

Summary Response of Authority

The Housing Authority shall endeavor to develop written procedures and strengthen controls to prevent the use of low-rent funds for unauthorized costs. The Authority also shall endeavor to educate key personnel regarding the duty to remain current in Low-Rent regulations.

THE AUTHORITY REQUIRED RESIDENTS TO WAIVE THEIR RIGHT TO RELOCATION ASSISTANCE

Allegations of OIG

The OIG alleges the Authority required tenants to waive their right to receive relocation benefits because it believed that it did not need to comply with federal requirements. As a result, it may have denied relocation benefits to its former tenants.

The Authority **Agrees** with the OIG's Draft Finding that the Housing Authority required 55 families to waive their right to relocation benefits, and the Authority **Disagrees** with the OIG whereas HUD required the Authority to comply with its annual contributions contract and federal regulations, and the Authority further **Disagrees** that the Authority did not set aside low-rent public housing program funds to pay relocation assistance to many of its Ragon Homes' tenants.

The Authority, through its consultant, provided relocation services in compliance with HUD regulations under 24 C.F.R. 970. Specifically, as it relates to persons that have moved into the property after the submission of the application for the demolition or disposition and, before commencing occupancy, the Authority complied with 24 C.F.R. 970.5 (i) (B) (ii) which states, in relevant part: *"The person moved into the property after the submission of the application for the demolition or disposition and, before commencing occupancy, received written notice of the project, its possible impact on the person (e.g., the person may be displaced, temporarily relocated, or suffer a rent increase) and the fact that he or she would not qualify as a "displaced person" (or for assistance under this section) as a result of the project."* See **(Exhibit #6)** 24 C.F.R. 970.5 (i)(B)(II). The Housing Authority, in compliance with the above referenced citation developed, from the sample document as provided in Handbook 1378 CHG-4 Appendix 29, (GUIDEFORM NOTICE TO PROSPECTIVE TENANT) the attached letter placing the prospective tenant on notice of their ineligibility as a displaced person. See (**Exhibit #7)** HUD's sample letter and the actual letter presented to prospective tenant. If HUD would like, the Authority can provide HUD with copies of the forms executed by each family that elected to move into Ragon Homes subsequent to the submission of application for demolition and disposition and before the tenant occupied the unit.

Comment 10

REQUEST FINDING #3: 3-A.

The Authority hereby requests HUD's office of PIH and the OIG to remove, in its entirety, Finding #3 from the final Audit Report. The Authority believes it has adequately supported its actions as being in compliance with HUD regulations under 24 C.F.R. 970.5.

In closing and on behalf of the Board of Directors we want to assure the OIG and HUD that the Authority and I, as the newly appointed Executive Director, take our responsibility and stewardship of federal funds seriously and will except the criticisms as constructive and implement procedures to assure that violations of this nature no longer occur.

Respectfully Submitted:

Kenneth E. Pyle
Executive Director

Enclosures:
1. General Contractor Procurement Process
2. Letter of Credit Availability to All Contractors
3. Analysis of Affordable Housing
4. City E-mails and Maps Regarding Williams Lane
5. Siano Appliances
6. 24-CFR970.5
7. Waiver of Relocation Benefits

CC: Richard Griffin, Chairman (FSHA)
Will Nixon, OIG Fort Worth TX
Beth Howard, OIG, Oklahoma City OK
James Slater, HUD Little Rock AR (CPD)
Jesse Westover, HUD Little Rock AR (PIH)
Steve Clark, SE Clark & Assoc.
Richard Joseph, Miller, Hall & Triggs
Kathryn Stocks, Warner, Smith & Harris

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OIG Evaluation of Auditee Comments

Comment 1

We disagree with the Authority's statement that it did not encumber public housing assets in violation of its annual contributions contract. In its response, the Authority wrote that PIH (Public and Indian Housing) 2007-15 (the notice) did not apply to its guarantees because HUD issued the notice after the Authority entered into the agreements. Contrary to the Authority's opinion, HUD did not create new regulations under the notice, but clarified existing requirements. The notice was prepared to explain existing requirements regarding public housing activities, including mixed-finance development.

Even though the guarantees were unsecured, they did not include language that would prohibit the lender or limited partner from claiming a judgment against public housing assets. The Authority had obligations to pay for costs that it guaranteed under the agreements. Furthermore, the Authority waived its right to a trial by jury.

The Authority placed its public housing assets at risk. According to the $1.9 million guarantee, the lender could "receive a security interest in any property" without notifying the Authority. It could also assign or transfer all of the loan obligations without notifying the Authority. The Authority's guarantee remained in effect should the lender assign or transfer the loan obligations to another entity. Thus, the lender could assign the obligations to any entity that had in its possession the Authority's funds.

The Partnership was fortunate that the contractor completed the construction project as planned. However, had there been problems with the construction, renting the units, and the project's ability to pay its expenses, the lenders and the partnership had the Authority's guarantees they could have used against the Authority.

The Partnership guaranty will remain effective until all of the activities of the partnership agreement are completed. The Authority has guaranteed to fund development and operating deficits, loss of tax credits, and other general partner obligations set forth in the partnership agreements. The Authority will be responsible for tax credit shortfalls should the Internal Revenue Service limit or not allow the tax credits. Total tax credits over a 12-year period exceed $4 million.

Comment 2

We disagree with the Authority's assertion that the Partnership did not need to comply with federal procurement regulations at 24 CFR Part 85 because it was not the Authority's instrumentality. Federal regulations required the Partnership to comply with 24 CFR Part 85 if the Authority exercised significant functions

within the entity.[10] The Authority believes that it lacked "effective control" over the Partnership to make it an instrumentality. The Authority stated that Alliant Credit Facility had "effective control" over the Partnership. This argument is flawed in that at the time of the ERC Construction procurement, Alliant was not in the Partnership and the Authority had effective control.

DATE	DESCRIPTION
February 7, 2006	North Pointe Limited Partnership agreement signed by North Pointe, Inc. (company), the general and limited partner
October 1 and 8, 2006	Advertisement for bids for construction of North Pointe development
October 26, 2006	Bids received and reviewed; at least one, if not two, of the contractors met all the qualifications
March 20, 2007	North Pointe, Inc. entered into the construction contract with ERC Construction that did not bid on the construction
April 1, 2007	Alliant Credit Facility entered the Partnership as the limited partner; the company remained the general partner

As the timetable above clearly shows, the company was the only partner of the Partnership. As previously explained, the Authority was the company's sole shareholder. Two of the Authority's board members, its executive director, and its director of finance served within the company. Thus, the Authority controlled the company and the company controlled the Partnership. As a result, the Partnership was the Authority's instrumentality and was required to comply with federal procurement regulations.

Comment 3

The Authority's guarantees encumbered assets covered by its annual contributions contract. As stated in the finding, the Authority violated its annual contributions contract when it entered into the guarantees without informing HUD. The annual contributions contract precluded the Authority from entering into those agreements without prior HUD approval.[11]

Comment 4

This was not the issue. We agree that the Authority did not pledge its public housing assets.

Comment 5

We disagree with the Authority's assertion that the Partnership was not the Authority's instrumentality. The Authority had effective control over the

[10] 24 CFR 941.602.

[11] Annual contributions contract, part A, section 7.

Partnership because the Authority owned 100 percent of the only partner. Thus, the Partnership was the Authority's instrumentality.

Comment 6

The Partnership did not comply with federal regulations at 24 CFR Part 85. The regulations state that any arbitrary action on the part of the contracting agency is restrictive of full and open competition. The Partnership chose ERC Construction based on the following arbitrary actions that were restrictive of open competition. Violating requirements,[12] the Partnership did not support its noncompetitive procurement by determining that competition was inadequate. Upon reviewing and rejecting the bids, the Partnership rejected two qualified contractors because their bids exceeded the independent cost estimate. The Partnership should have met with the qualified bidders to discuss the differences between their bids and the cost estimate. If it determined that the cost estimate was good, it should have gone back through the request for proposal process. However, there is no evidence that the Partnership either began a new bidding process or worked with the qualified contractors to determine why their bids were higher than the estimate. Instead, the Partnership used the bids to negotiate and select a firm that did not even bid on the construction.

Comment 7

We commend the Authority for acknowledging the improper expenditures and commitment to repay its capital fund account. The Authority should work with HUD to ensure that it repays the funds to the correct program or to HUD, as appropriate.

Comment 8

The Authority stated that it intends to use the $104,198 land for affordable housing purposes, as required by federal regulations. The Authority needs to work with HUD to clear the recommendation by either successfully getting the land re-zoned or repaying the funds.

Comment 9

Based on the Authority's response, we have removed the matter from the report.

Comment 10

Based on the Authority's response and consultations with HUD, we removed the matter from the report.

[12] 24 CFR 85.36(d)(4).