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**REPORT TO THE SUBCOMMITTEE
ON INVESTIGATIONS AND OVERSIGHT
HOUSE COMMITTEE ON PUBLIC WORKS**

Review Of The
Harambee Hotel Project,
Washington, D.C. B-174121

Economic Development Administration
Department of Commerce

**BY THE COMPTROLLER GENERAL
OF THE UNITED STATES**

904270

AUG. 16, 1972



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-174121

G/R
Dear Mr. Chairman:

1
2 This is our report on the Harambee Hotel project, Washington, D.C. The hotel is to be constructed at Georgia Avenue and Bryant Street NW. The Economic Development Administration, Department of Commerce, has approved Federal financing of \$7.7 million for the construction and furnishing of the project. Our review was made pursuant to your request of September 8, 1971. *571*
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We have not obtained written comments from the Federal or non-Federal organizations on the matters discussed in the report, and this should be considered in the use made of the contents of this report. We plan to make no further distribution of this report unless copies are specifically requested, and then we shall make distribution only after your agreement has been obtained or public announcement has been made by you concerning the contents of this report.

We trust that the information in this report will be of assistance to you.

Sincerely yours,

Comptroller General
of the United States

The Honorable James C. Wright, Jr.
Chairman, Subcommittee on
Investigations and Oversight
Committee on Public Works
House of Representatives

H 201

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ABBREVIATIONS

BCI	Beneficial Construction Incorporated
EDA	Economic Development Administration
FHA	Federal Housing Administration
GAO	General Accounting Office
PIC	Peoples Involvement Corporation
SBA	Small Business Administration

COMPTROLLER GENERAL'S REPORT TO
THE SUBCOMMITTEE ON
INVESTIGATIONS AND OVERSIGHT

THE HARAMBEE HOTEL PROJECT
WASHINGTON, D.C.
Economic Development Administration
Department of Commerce B-174121

D I G E S T

WHY THE REVIEW WAS MADE

1 On June 7, 1971, the Economic Development Administration (EDA), Department of Commerce, awarded a \$3.6 million grant and a \$3.6 million loan to the Peoples Involvement Corporation for the construction of the Harambee Hotel in Washington, D.C. The grant and loan were made under the public works and development facilities program. The Peoples Involvement Corporation, a nonprofit community development corporation, is composed of community residents organized to revitalize the inner-city area. 371

2 On the same date EDA awarded a \$455,000 business development loan to Murph's Hotel Corporation--a minority-owned, profitmaking corporation--to finance 65 percent of the cost of furnishing the hotel. Murph's Hotel Corporation is to lease the hotel from the Peoples Involvement Corporation. EDA also provided technical assistance funds totaling about \$64,000 for the development of the project.

The Chairman of the Subcommittee on Investigations and Oversight, House Committee on Public Works, requested that the General Accounting Office (GAO) determine whether it was appropriate, under the law, for EDA to award the Peoples Involvement Corporation a public works and development facilities grant for the Harambee Hotel project and whether the Peoples Involvement Corporation appeared to possess the necessary management capability to carry out the project successfully.

FINDINGS AND CONCLUSIONS

Use of public works and
development facilities funds

EDA generally provides public works and development facilities funds for projects which provide public facilities and services needed to attract private enterprise to a community. EDA generally assists commercial businesses, such as the Harambee Hotel, under its business development loan program rather than under its public works and development facilities grant and loan program.

The Harambee Hotel project, however, is eligible as a development facility project under the Public Works and Economic Development Act of 1965, as amended. The act provided EDA with the flexibility to fund projects which have the potential to promote the economic development of an area. Also the Peoples Involvement Corporation--a nonprofit community development

AUG. 16, 1972

corporation--is eligible to receive public works and development facilities assistance. (See pp. 5, 8, and 13.)

The Harambee Hotel project is to be a 168-room hotel with restaurant facilities, retail businesses, and a public parking garage. An EDA official informed GAO that EDA had funded the Harambee Hotel project because it should stimulate the establishment of other businesses in the community. (See p. 16.)

Management capabilities of the
Peoples Involvement Corporation
and Murph's Hotel Corporation

EDA required that the Peoples Involvement Corporation properly manage the construction of the hotel. The corporation is to be responsible for design of the hotel, contracting, subcontracting, and rezoning. After the hotel is completed, the corporation is to manage the parking garage and lease the hotel to Murph's Hotel Corporation.

These responsibilities are to be administered by three of the Peoples Involvement Corporation's employees, none of whom have had any training or experience in hotel design, construction, or management. (See pp. 18 to 20.)

In view of the Peoples Involvement Corporation's inexperience, EDA contracted with a professional hotel consultant to assist the corporation with the design of the hotel. According to EDA, EDA can protect its investment in the hotel by hiring consultants to assist the corporation and by closely monitoring the corporation's administration of the project. (See p. 20.)

EDA required that the hotel be operated by a financially responsible and experienced lessee. Murph's Hotel Corporation's management of the Harambee Hotel will consist of a board of directors and a manager for day-to-day operations. Mr. Edward Murphy is to be the manager and is also to assist the Peoples Involvement Corporation in the design of the hotel. Mr. Murphy has had over 20 years' experience as an owner and operator of restaurants and supper clubs. Mr. Murphy informed GAO, however, that he had not had any experience or training in hotel management. EDA has contracted with a consultant to assist Mr. Murphy with the hotel project. (See pp. 18, 24, and 25.)

As part of its agreement with EDA for the \$455,000 business development loan, Murph's Hotel Corporation is to borrow \$440,000 from private sources and provide an equity investment of \$225,000. EDA may have to guarantee a \$300,000 loan and the corporation may be about \$72,000 short of its equity requirements. Mr. Murphy informed EDA that the corporation will be able to meet the equity requirements through the sale of stock after hotel construction begins. (See pp. 24 and 25.)

As of June 1972 Mr. Murphy was operating Ed Murphy's Supper Club. Mr. Murphy financed the club with the aid of two \$15,000 Small Business Administration (SBA) loans. A financial statement of the supper club indicated a net loss of \$6,700 for the period January through June 1971.

Mr. Murphy informed GAO that the club had a loss in 1971 because he was too busy with negotiations with EDA and the Peoples Involvement Corporation for the hotel project to oversee the club's operations. (See p. 26.)

Mr. Murphy has been delinquent three times on his SBA loans since 1964 when the first loan was disbursed. The third delinquency occurred shortly before the Harambee Hotel project was approved. In March 1972 Murph's Hotel Corporation made the delinquent interest and principal payments to SBA totaling \$3,234. SBA granted a moratorium on the loan payments through June 1972. The outstanding balance of the two loans as of June 1972 was \$19,654. (See p. 26.)

In view of problems experienced by the Peoples Involvement Corporation and by Mr. Murphy in previous federally financed projects, and the inherent difficulty of establishing a successful development facility in a ghetto, GAO believes that the Harambee Hotel project is an extremely high-risk enterprise. EDA recognizes the high risk associated with the project but believes that the project's potential for stimulating the economic development of the area outweighs the risks. (See p. 28.)

CHAPTER 1

INTRODUCTION

On June 7, 1971, the Economic Development Administration (EDA), Department of Commerce, awarded a \$3.6 million public works and development facilities grant and a \$3.6 million public works and development facilities loan to Peoples Involvement Corporation (PIC) for construction of the Harambee Hotel to be located in Washington, D.C. PIC is a nonprofit Washington community development corporation composed of community residents organized to develop and revitalize the innercity through the delivery of social services, community mobilization, and opportunities enhancement.

The hotel is to contain 168 rooms, banquet and/or conference space for 700 persons, restaurant and lounge facilities for 175 persons, coffee shop for 75 persons, space at lobby level for four to six retail operations, and a parking garage for 325 cars. EDA estimates that construction of the hotel will begin in July 1973.

The hotel, except for the parking garage, is to be leased by Murph's Hotel Corporation--a minority-owned, profit-making corporation established for the purpose of operating the hotel. EDA also awarded a \$455,000 business development loan to the corporation on June 7, 1971, to finance 65 percent of the cost of furnishing the hotel.

EDA technical assistance funds, totaling about \$64,000, were used to determine the feasibility of the project, to assist PIC in preparing its public works application, and to obtain assessments and appraisals of the property for the hotel.

The hotel is to be located at Georgia Avenue and Bryant Street, NW., Washington, adjacent to Howard University and Freedman's Hospital. EDA anticipates that the prime market for the black-oriented hotel will be created by Howard University and black organizations and individuals, many of whom now use Washington's downtown first-class hotel facilities.

In a letter dated September 8, 1971, the Chairman of the Subcommittee on Investigations and Oversight, House Committee on Public Works, requested us to determine whether it was appropriate, under the Public Works and Economic Development Act of 1965, as amended (42 U.S.C. 3121), for EDA to award PIC a grant for the Harambee Hotel project and whether PIC appeared to possess the necessary management capability to carry out the project successfully.

We reviewed records and interviewed officials of EDA, the Office of Economic Opportunity, the Department of Housing and Urban Development, and the Small Business Administration (SBA). We interviewed also officials of PIC and Mr. Edward Murphy, president of Murph's Hotel Corporation. Our work was performed at the agencies' headquarters in Washington.

CHAPTER 2

USE OF PUBLIC WORKS AND DEVELOPMENT FACILITIES FUNDS

FOR THE HARAMBEE HOTEL PROJECT

PURPOSE OF EDA ASSISTANCE

The purpose of the Public Works and Economic Development Act of 1965, as amended, is to help the Nation's depressed areas build diversified, viable local economies primarily by creating jobs for the unemployed and raising the income and capabilities of the underemployed.

Federal financial assistance is available to designated redevelopment areas--generally areas having substantial unemployment, population losses, or low median family incomes. EDA, under the act, designated Washington eligible for assistance in May 1968.

To accomplish its objective the act authorized programs to provide (1) public works and development facilities grants and loans for improving public works, development facilities, and public services of a locality as an inducement for private enterprise to locate in the area, (2) business development loans, to encourage the establishment or expansion of businesses to take advantage of the public improvements, and guarantees of loans by private lenders to such businesses for working capital, and (3) technical assistance to areas to help find meaningful solutions to industry and resource problems.

Public works and development facilities grants and loans are available for the acquisition or development of land and improvements for public works, public service, or development facility usage. The funded projects, directly or indirectly, must (1) tend to improve opportunities for the successful establishment or expansion of industrial or commercial plants or facilities, (2) otherwise assist in the creation of additional long-term employment opportunities, or (3) primarily benefit the long-term unemployed and members of low-income families or otherwise substantially further the objectives of the Economic Opportunity Act of 1964 (42 U.S.C. 2701).

States or their political subdivisions, Indian tribes, and private or public nonprofit organizations are eligible to receive public works and development facilities assistance. Grants are available for all eligible public works, public service, and development facilities projects. Loans, however, may be made only if the funds are not otherwise available on reasonable terms from private lenders or from other Federal agencies. The loans are made at a rate of interest not less than a rate determined by the Secretary of the Treasury for a term up to 40 years.

Business development loans and working-capital guarantees, unlike public works and development facilities grants and loans, are available to private businesses. The loans are authorized to help start or expand businesses that will provide new jobs and new income in distressed areas. The project for which financial assistance is sought must be reasonably calculated to provide more than a temporary alleviation of unemployment within a redevelopment area.

Business development loans may be made up to 65 percent of the cost of a project for a term of 25 years, provided that funds are not available on reasonable terms from private lenders or from other Federal agencies. Working-capital guarantees may be made up to 90 percent of the outstanding unpaid balance of a working-capital loan from a private lender. Generally the term of the working-capital loan is limited to 5 years. Guarantees for working-capital loans are available only when the loans are not otherwise available from private lenders.

EDA may provide technical assistance which includes (1) identifying, planning, and programming economic development projects, (2) management and operational assistance, (3) preliminary design planning and feasibility studies of development facilities, and (4) demonstration programs of special methods of economic development. Technical assistance may be provided by EDA's staff or consultants or under grants to eligible applicants. Repayment of technical assistance funds may be required when a project is expected to result in substantial benefit to a particular company for which the project is undertaken.

FINANCING OF HARAMBEE HOTEL

The Harambee Hotel project was initiated in 1968 by Mr. Murphy who planned to build and operate the hotel complex with financial assistance from EDA's business development loan program.

EDA requires that applications for financial assistance for projects costing \$1 million or more be accompanied by feasibility studies made by qualified consultants. In September 1968 Mr. Murphy applied to EDA for technical assistance funds of \$15,000 to meet the cost of a study to determine the feasibility of the Harambee Hotel project. In November 1968 EDA agreed to provide the technical assistance and contracted with a national consulting firm to make the study.

In June 1970 EDA contracted for a second study to update and supplement the data collected by the first. The second study cost \$2,425. The studies showed a demand for a quality hotel to serve Washington's black community and indicated that with professional management the Harambee Hotel project was financially feasible.

In September 1969 Murph's Hotel Corporation was chartered in Washington to build and operate the hotel. In December 1970 Mr. Murphy, as president and majority stockholder of the corporation, submitted an application to EDA for a \$3.5 million business development loan to finance 65 percent of the estimated cost of \$5.4 million to build and furnish the hotel. The application showed that:

--20 percent, or \$1.1 million of the total cost, would be borrowed from private sources.

--The hotel corporation, as required by the Public Works and Economic Development Act of 1965, would provide a non-Federal investment of 15 percent, or \$810,000, and as required by EDA would provide working capital of \$340,000 (\$40,000 to be an equity investment and \$300,000 to be borrowed from private sources.

--The loans of \$4.9 million could be repaid from the project's estimated annual sales of \$3.2 million.

EDA noted, however, that the estimated sales shown in the application were higher than industry averages for hotel/motel businesses cited in trade journals and shown in the two feasibility studies. EDA's records indicated that, if the estimated annual sales were realized, the corporation could meet its loan obligations but that the realization of the estimated sales was dependent upon the wholehearted support of the black community. EDA decided that the financing of the project had to be restructured to enhance the corporation's ability to meet its loan obligations.

EDA considered reducing the corporation's loan obligations either by redesigning the hotel to make it less costly or by having another organization own and finance the garage with public works and development facilities funds. EDA's records indicated, however, that the cost could not be reduced without substantial redesign of the hotel. An EDA official informed us that the hotel had to be a luxury hotel in order to be effective as a development facility and, therefore, it should not be redesigned. Mr. Murphy informed us that the hotel had to be first class to compete with the major hotels and motels used by blacks.

EDA restructured the planned financing of the hotel by eliminating the financing of the garage from the business development loan and thereby reduced the loans by \$1 million. EDA's records indicated that realization of annual sales of \$1.8 million as estimated by one of the consultants was more realistic than the \$3.2 million used in the project application. According to EDA the estimated sales of \$1.8 million would enable the corporation to meet its debt payments but not all the depreciation expenses of the hotel. For example, in its sixth year of operation, the corporation would be \$70,000 short of meeting the depreciation expenses of the hotel.

EDA concluded that the estimated sales were not adequate to insure successful financial operation of the hotel and did not approve the application for a business development loan. EDA's records indicated, however, that the hotel could have a significant impact on stimulating the economic development of the ghetto area and could be funded under the public works and development facilities program as a development facility if a local nonprofit corporation constructed the hotel.

In March 1971 Mr. Murphy proposed to the PIC Board of Directors that PIC, a nonprofit organization eligible to receive public works and development facilities assistance, apply for a public works and development facilities grant and loan to assist in financing the construction of the hotel and that the hotel be leased to Murph's Hotel Corporation. Subsequently, the board passed a resolution authorizing PIC's executive director to execute and file an application with EDA for a public works and development facilities grant and loan.

In May 1971 EDA entered into an \$8,800 technical assistance contract with a consultant to assist PIC in developing the application for public works and development facilities assistance and in analyzing the estimated cost of the hotel project. EDA's records showed that the estimated cost was increased from \$5.7 million to \$8.3 million as a development facilities project.

A substantial part of the increased cost resulted from updating the estimated construction cost by 45 percent from 1968 to 1973, the date estimated for start of construction; increasing the cost of related supporting items, such as architect fees, legal and administrative fees, and contingencies; and enlarging the size of the parking garage and increasing the spaces from 218 to 325.

On June 7, 1971, EDA approved an award to PIC of a public works and development facilities grant of \$3.6 million and loan of \$3.6 million to finance the construction of the hotel and an award to Murph's Hotel Corporation of a business development loan of \$455,000 to finance 65 percent of the cost of furniture and fixtures for the hotel.

The planned financing of the hotel as a business development loan project and as a development facilities project is presented as follows:

Source of funds	Planned financing as a business development loan project			EDA approved financing as a development facilities project		
	Amount	Interest rate	Term	Amount	Interest rate	Term
		(Percent)	(Years)		(Percent)	(Years)
EDA loans:						
Business development	\$3,510,000	7-1/4	25 ^a	\$ 455,000	6	10 ^a
Public works and development facilities	-			<u>3,569,000</u>	5-1/2	40 ^b
Total	<u>3,510,000</u>			<u>4,024,000</u>		
Private loans:						
First mortgage	1,080,000	10	20 ^a	140,000	Prime+3	8 ^c
Working capital	<u>300,000</u>	10	5	<u>300,000</u>	10	5
Total	<u>1,380,000</u>			<u>440,000</u>		
Total loans	4,890,000			4,464,000		
Public works and development facilities grant	-			3,569,000		
Equity investment	<u>850,000</u>			<u>225,000</u>		
Total investment	<u>\$5,740,000</u>			<u>\$8,258,000</u>		

^a30-month deferment of principal payments.

^b36-month deferment of principal payments.

^c12-month deferment of principal payments.

Although the total estimated cost of the project increased by \$2.5 million, or 44 percent, the EDA grant of \$3.6 million resulted in a decrease of \$426,000 in the amount of the loans and of \$625,000 in the equity investment. The amount of the loans from private sources was decreased \$940,000, and the amount of the loans from EDA was increased \$514,000. The reduced loan obligation and the more favorable interest rate combined with the longer amortization period of the public works and development facilities loan reduced the annual loan payments by approximately \$120,000. EDA estimated that the hotel financed as a development facility project should show a profit by the third year of operation.

PROPRIETY OF USING PUBLIC WORKS AND
DEVELOPMENT FACILITIES FUNDS FOR THE
CONSTRUCTION OF HOTEL FACILITIES

EDA's public works and development facilities funds are generally awarded for projects which provide public facilities and services needed to attract private enterprise to a community. EDA usually assists commercial enterprises, such as the Harambee Hotel, under its business development loan program rather than under its public works and development facilities grant and loan program. The Harambee Hotel project, however, is eligible as a development facility project under the Public Works and Economic Development Act of 1965, as amended.

The act provides EDA with the flexibility to fund projects that EDA believes have the potential to promote the economic development of an area. The legislative history of the act cites examples of projects eligible to receive public works and development facilities financial assistance and includes not only public facility projects, such as water or sewage systems or public buildings, but also other types of development facility projects, such as industrial parks, health facilities, or recreational and tourism complexes in appropriate cases.

The legislative history of the act indicates that EDA could fund projects for facilities and services normally provided by private enterprise, such as bus and truck terminals, mass transit facilities, warehouses, industrial and commercial buildings of all kinds, telephone and telegraph facilities, radio and television stations, theaters, hotels and motels, and tourist and tourism facilities.

During hearings on House bill 6991 before the House Committee on Public Works, prior to enactment of the act, a question was raised concerning the use of public funds versus private capital for hotel and motel projects. An amendment to the bill, which would have prohibited the construction of hotels and motels in an area unless a determination was made that such additional facilities were needed, was rejected on the floor of the House of Representatives.

Section 702 of the act, however, prohibits EDA from extending financial assistance to any project that would result in an increase in the availability of services or facilities when the demand is not sufficient to employ the efficient capacity of existing competitive commercial facilities.

EDA in a study in 1970 concluded that financing of the Harambee Hotel would not be contrary to the provisions of section 702. EDA based its determination on the average hotel occupancy rate in Washington compared with the national average for the years 1965 through 1969, the average net increase in hotel rooms during the 1961 to 1969 period in Washington, and the number of visitors during the 1966 to 1969 period to the national parks located in the Washington metropolitan area.

EDA concluded that the growth of tourism to Washington could readily absorb the additional room capacity that would be provided by the Harambee Hotel without adverse effects on other Washington transient accommodations. An EDA official informed us that EDA's study did not consider the effect of the hotel's restaurant facilities on other restaurants.

Other hotel projects funded under
the public works and
development facilities program

Prior to approving the funding for the Harambee Hotel project, EDA's policy was to fund the construction of hotels and motels with public works and development facilities funds only when they were auxiliary facilities for developmental tourism complexes.

We identified 25 hotel and motel facilities, other than the Harambee Hotel, that were funded under EDA's public works and development facilities program. In all of these projects, the hotels or motels were part of a larger tourism/recreation complex. In addition to containing lodging facilities, many of the complexes contained such features as marinas, trailer parks, golf courses, recreation buildings, and swimming facilities. The purpose of each of

the 25 projects was to increase employment opportunities as a result of a rise in tourism in the project area. All the projects were located in rural areas, including 13 on Indian reservations.

An EDA official informed us that EDA's policy of limiting public works and development facilities financial assistance to hotel and motel facilities for tourism development applied only to rural areas. According to the official, the economic development of ghetto areas present problems different from those of rural areas and therefore EDA's policies, which are concerned primarily with rural areas, cannot always be applied in ghetto areas. EDA does not have any special written policy for evaluating applications for projects in urban areas.

EDA's investment per job in the Harambee Hotel

One criterion used by EDA to measure the effectiveness of its programs is the number of jobs created by a project and its dollar investment per job. In 1970 EDA, with the aid of several consulting firms, evaluated 274 public works and development facilities projects. To allow cross-project comparisons and to eliminate the effects of seasonal employment, the evaluation converted the number of jobs created by the projects to job equivalents. The job equivalents were determined by dividing the annual salary of each job by \$6,500, the average annual manufacturing wage in 1968. The evaluation also took into account indirect employment--employment created in the service industries as a result of the direct employment of the projects. The indirect jobs created were estimated by multiplying the number of direct jobs by a factor that varied according to the population of the communities in which the projects were located.

The evaluation indicated that:

--EDA's average investment per project was \$280,000 and resulted in an average of 122 direct and indirect job equivalents. On the basis of this data, EDA's average investment per job equivalent was about \$2,290.

--For projects costing more than \$1 million, EDA had a much higher average investment per job equivalent.

--For 24 projects costing an average of over \$1 million, 148 job equivalents were created per project at an average EDA investment per job equivalent of \$6,707.

According to EDA the Harambee Hotel project will create 218 direct jobs and will employ local blacks, most of whom are presently unemployed, and the retail establishments in the hotel will create 20 additional jobs. To compare the Harambee Hotel project with EDA's evaluation, we used EDA's methods for determining the job equivalents and indirect jobs that would be created by the project. We found that the hotel would create 332 job equivalents--166 direct and 166 indirect. The resulting EDA public works and development facilities investment per job was \$21,500, or more than triple the average investment for projects costing over \$1 million. Furthermore, when the business development loan funds are added to the public works and development facilities funds, the EDA investment per job equivalent increased to \$22,870.

An EDA official informed us that the Harambee Hotel project should result in more indirect jobs than the typical development facility project because it would bring a new industry--tourism--into the ghetto area, rather than expanding an existing industry. Furthermore he stated that EDA funded the Harambee Hotel project because of its potential as a developmental facility rather than for the jobs that would be created by the hotel and that EDA believes that the hotel would act as a catalyst for the establishment of other motels, restaurants, and businesses in the ghetto area.

According to the official the hotel facility will not only allow the area to share in Washington's tourist revenues but also enhance the effectiveness of the rehabilitation efforts of the Shaw Urban Renewal and Model Cities programs for the area.

CONCLUSIONS

We believe that it was not inappropriate for EDA to award a public works and development facilities grant and loan to PIC for financing the construction of the Harambee Hotel. In our opinion, public works and development facilities grant and loan funds may be used for the construction of hotel facilities as long as the applicant is eligible to receive public works and development facilities assistance and the facilities will not result in unfair competition as described in section 702 of the EDA act.

The act provides EDA with the flexibility to fund projects that EDA considers to be potential aids to the economic development of an area. EDA funded the Harambee Hotel project because of its potential as a developmental facility and because of EDA's belief that the project will stimulate the establishment of other businesses in the area. The EDA investment per job for the Harambee Hotel project, however, is high compared with the investments for other EDA projects.

CHAPTER 3

MANAGEMENT CAPABILITIES OF PEOPLES INVOLVEMENT CORPORATION AND MURPH'S HOTEL CORPORATION

In June 1971 EDA awarded to PIC a public works and development facilities grant and loan totaling \$7.1 million for the design and construction of the Harambee Hotel project. EDA's financing agreement with PIC requires PIC to properly manage the construction of the hotel and to lease the hotel for operation by a financially responsible lessee of proven managerial experience.

After construction of the hotel is completed, PIC plans to manage the 325-space parking garage and has entered into an agreement to lease the hotel to Murph's Hotel Corporation. The agreement provides for lease payments in the amount necessary to amortize the EDA 40-year, \$3.6 million public works and development facilities loan and for the corporation to make the lease payments--\$18,830 a month--directly to EDA. The lease has a term of 40 years with options to renew for two additional 40-year periods.

PEOPLES INVOLVEMENT CORPORATION

PIC was established in 1967 as one of the 14 pilot organizations funded by the Office of Economic Opportunity to administer neighborhood, service-delivery-oriented programs with special emphasis on the operation of multiservice centers. Multiservice centers house in one building several health and welfare programs so that persons needing assistance do not have to go to several locations. The Office of Economic Opportunity designated PIC as the delegate agency for the implementation of community and economic development programs for the Special Impact Area in Washington. Special impact areas are communities or neighborhoods, defined without regard to political subdivisions or boundaries, in urban areas having especially large concentrations of low-income persons.

PIC's objective has been to improve the social and economic condition of its community by providing housing, education, economic development, health, welfare, and youth programs for the residents of the community. PIC's community area of Washington is bounded by 16th Street NW., Massachusetts Avenue NW. and NE., Michigan Avenue NW. and NE., and the Baltimore & Ohio Railroad tracks in the northeast section of the city.

EDA's records showed that PIC's responsibilities for construction of the Harambee Hotel were to

- instruct architect/engineer on basic workable hotel design concept;
- review architect/engineer plans and specifications in terms of desired concepts;
- subcontract for survey and soil tests;
- secure rezoning;
- review contract documents prepared by architect/engineer;
- implement Washington Plan (selected bidder list limited to contractors who agree to a joint venture with a minority contractor);
- maintain all accounting records, including construction accounts during the design and construction;
- prepare reports on the status of the project, the flow of funds, and request for disbursements; and
- expedite all phases of the project and coordinate all of its parts.

These responsibilities are to be administered by a project manager, a special assistant, and PIC's executive director. PIC is to receive \$100,000 of the EDA funds for administrative expenses--including salaries--over 3 years, the estimated maximum time required for design and construction of the hotel. PIC's executive director informed us that he

would spend 27.5 percent of his time, his special assistant would spend 50 percent of her time, and the project manager would spend 100 percent of his time on the project. The project manager informed us that neither he, nor the executive director, nor the special assistant had any training or experience in hotel design, construction, or management.

EDA's reports on the status of the project indicated that PIC lacks experience in hotel design, contracting and subcontracting, rezoning, and implementing the Washington Plan. An EDA official informed us that EDA recognized that PIC did not have the ability to manage the project but that EDA believed the hotel should be owned by an organization representing the community in which the hotel would be located.

EDA's records indicated that projects such as PIC's Harambee Hotel were needed to develop minority leadership in ghetto areas and that EDA could protect the investment of public funds in the Harambee Hotel by hiring consultants to assist PIC and by closely monitoring PIC's administration of the project.

In May 1972 EDA entered into a contract with Laventhol Krekstein Horwath & Horwath, an international hotel consulting firm, to assist PIC and Murph's Hotel Corporation with the design and preopening management of the hotel. The contract provided that the consultant would

- evaluate the market for the hotel;
- develop the preliminary and final design concepts on the basis of the recommendations of PIC, Mr. Murphy, and the architect/engineer;
- develop a preliminary financial analysis;
- review the plans and specifications;
- provide construction cost estimates and a schedule for construction;
- provide a schedule of all preopening management activities;

- design a program for development and promotion of the hotel; and
- determine the size and composition of the staff and design the recruiting and training programs.

The consultant estimated that 143 man-days would be spent on the project at a cost of \$32,900. An EDA official told us that EDA would finance the cost of these services with technical assistance funds. According to EDA's records construction of the hotel is to begin in July 1973. The consultant recommended that an experienced person be hired to monitor construction of the hotel. An EDA official informed us that the architect/engineer had recommended a person for the position and that his salary would be paid from project funds.

PIC's involvement in other projects

PIC participated in a project to rehabilitate eight row houses for low-income housing in Washington's Shaw Urban Renewal Area in 1969. PIC applied to the Federal Housing Administration (FHA) in September 1969 to guarantee a mortgage loan of \$140,000 from a private lending institution for financing the acquisition and rehabilitation of the eight row houses. According to FHA's files, PIC stated that the cost of rehabilitating the eight dwellings would be \$96,000, or an average cost of \$12,000 a dwelling unit. The project was to be completed 6 months after the start of the rehabilitation.

FHA guaranteed the mortgage loan; however, the rehabilitation costs were not to exceed \$92,364.

PIC planned to use the Beneficial Construction Incorporated (BCI)--minority-group construction firm--as the construction contractor for the rehabilitation work. PIC loaned the firm \$20,000 to provide it with an opportunity to organize, train, and compete in the construction contracting market.

BCI stated that the houses could not be rehabilitated for \$92,000 and that it would take at least \$150,000 to rehabilitate the houses as outlined in the specifications.

According to BCI, PIC indicated that an additional \$50,000 would be available to pay for the rehabilitation of the eight row houses but PIC would not guarantee, in writing, that the \$50,000 was available. As a result BIC did not enter into a contract to rehabilitate the row houses.

After BCI withdrew from participation in the project, the Mosley Construction Company, another small minority contractor, presented to PIC a bid of \$13,000 a unit to rehabilitate the eight row houses. Negotiations between FHA and the Mosley Construction Company resulted in the company's reducing its bid to \$11,545 a unit. The contract was signed on September 4, 1970, and the rehabilitation began on September 9, 1970.

After two delays the rehabilitation of the row houses stopped, and the work was about 9 percent completed as of May 1971. According to an official of the Department of Housing and Urban Development, the contractor and the project's architect could not agree on the work required by the plans and specifications. The contractor contended that the plans he had bid on were not the same as the ones filed with the District of Columbia for the work permit; the plans filed included many changes which doubled the cost of the work.

A Department of Housing and Urban Development official told us that, although nonprofit sponsors usually hire a consultant to help them, PIC did not; that the rehabilitation project failed because it was not adequately financed, FHA underestimated the cost of the rehabilitation, and the contractor's bid for the work was too low; and that, for the project to be successful, PIC should have arranged to obtain additional financing of from \$50,000 to \$80,000 to meet the cost of the rehabilitation work and to hire a new contractor. PIC's executive director told us that the project was out of PIC's hands and was now the responsibility of FHA.

PIC has defaulted on its mortgage loan payments and FHA, as guarantor of the loan, must repay the private lender the \$51,202 expended by PIC for the project--\$16,299 to the Mosley Construction Company for its construction work and \$34,903 for nonconstruction costs including acquisition of the land and interest on PIC's loan. An official of the

Department of Housing and Urban Development informed us that FHA would obtain title to the property and that FHA planned to sell the eight row houses for rehabilitation, or rehabilitate the houses, or demolish the houses and sell the property.

Under an agreement with the District of Columbia Government, PIC is operating Washington's first multipurpose community center. The purpose of this center is to bring together into one neighborhood facility the health and welfare services offered within Washington. The center is temporarily located at North Capital and K Streets NW. Because of the success of this center, the Department of Housing and Urban Development and the District of Columbia Government, in January 1970, awarded to PIC \$1,730,000 for the acquisition and rehabilitation of permanent quarters for the center and the construction of a second center to be established by PIC.

Work on the first center had not begun as of June 1972. According to PIC, the District of Columbia Government was to acquire the site for the center; however, before it could complete the acquisition proceedings, Howard University acquired an option to purchase the proposed site. After considerable delay an alternative site at 2146 Georgia Avenue NW., was chosen. The plans and specifications for the center are in the process of being finalized.

The second multipurpose center will be an adjunct to the Walker-Jones Elementary School. The center will offer a child care program and welfare services. According to PIC, construction of this center began in June 1972.

MURPH'S HOTEL CORPORATION

EDA's records showed that Murph's Hotel Corporation's management of the Harambee Hotel would be made up of a board of directors and a manager for the day-to-day operations of the hotel and that the board would set policy and, through contact with the black community, would help to promote the hotel and its dining and supper club facilities. The members of the board have varied backgrounds in business, law, and general management.

EDA's records showed that Mr. Murphy, a member of the board of directors, would devote full time to the day-to-day operations of the hotel, with particular emphasis on managing and promoting the restaurant facilities. According to the EDA records, Mr. Murphy has had over 20 years' experience as an owner and operator of restaurants and supper clubs.

The agreement between Murph's Hotel Corporation and PIC for the lease of the Harambee Hotel provides that the hotel corporation is responsible for furnishing the facilities. As stated in chapter 2, EDA approved the award of a business development loan of \$455,000 to help the corporation finance the \$700,000 estimated cost of furnishing the hotel. The remainder of the cost of the furnishings is to be financed by the hotel corporation from a \$140,000 loan from the National Bank of Washington and an equity investment of \$105,000.

The EDA business development loan authorization requires the hotel corporation to have working capital of \$420,000 available for the hotel project. An EDA official informed us that \$120,000 of the working capital must represent an equity investment. The hotel corporation plans to borrow the remaining \$300,000 from a private lending institution. EDA's records indicate that EDA may have to guarantee the \$300,000 working-capital loan.

Of the total equity of \$225,000 required by EDA, \$165,000 in cash must be available when the business development loan funds are disbursed. To help Murph's Hotel Corporation meet the equity requirement, EDA has agreed to reimburse the hotel corporation \$60,475 for costs incurred in developing the Harambee Hotel project. Generally expenses incurred by an

applicant to develop a project are not considered eligible project costs by EDA. An EDA document regarding the reimbursement of these expenses stated that:

"EDA has generally not reimbursed an applicant for project development costs. In this case, however, because of the unusual nature of the project, the development process has been longer and more complex than usual. Furthermore, this project should provide practical methods of solving inner-city unemployment and poverty problems by Black development organizations and indigenous entrepreneurs. The Peoples Involvement Corporation and more particularly in this case, Murph's Hotel Corporation, the proposed lessee upon which the burden of this process has fallen, are not analogous to the usual local government applicant which has its own tax supported in-house capacities for legal, accounting, and other functions. In order to obtain these services, Murph's Hotel Corporation has paid out or owes monies that represent a major portion of equity investment for his Business Development loan. Without this work and investment, this project could not have been presented to the Agency as effectively as it was and reached the present stage at which construction can start within a year."

EDA's records indicated that, even with the reimbursement of these funds, the hotel corporation may be about \$72,000 short of its cash requirement at the time of the business development loan closing. If Murph's Hotel Corporation is unable to meet its equity requirements for the business development loan, it will not be able to lease the hotel from PIC. Mr. Murphy informed EDA that he would be able to meet the cash requirement through a sale of stock in the corporation once construction of the hotel had begun.

EDA does not have a formal set of criteria for evaluating management capabilities but considers the "track record" of applicants for business development loans. Mr. Murphy informed us that he had not had any training or experience in hotel management. EDA's records indicated that, in addition to managing the operation of the hotel, Mr. Murphy

would work with PIC in instructing the architect/engineer on the basic design of the hotel, reviewing the architect/engineer's plans and specifications in terms of the desired concepts, and expediting and coordinating all phases of the project.

EDA's reports on the status of the hotel project indicate that Mr. Murphy lacks experience in managing hotels. An EDA official informed us that a consultant had been employed by EDA to advise and assist Mr. Murphy with the design and preopening management of the hotel. (See p. 20.) EDA plans to have the same consultant assist Mr. Murphy in managing the actual operation of the hotel; however, neither the plans for the work to be performed nor the cost of the consultant services had been developed as of May 1972.

Ed Murphy's Supper Club

As of June 1972 Mr. Murphy was operating Ed Murphy's Supper Club located on the site of the proposed hotel.

Ed Murphy's Supper Club's financial statement submitted to EDA as part of Murph's Hotel Corporation's application for the business development loan indicated that the supper club had a net income of about \$28,200 for the 11-month period from January through November 1970. However, financial statements submitted to SBA indicated a net loss of \$6,700 for the 6-month period from January through June 1971. Neither EDA nor SBA had financial information for the club's December 1970 operations. Mr. Murphy informed us that his supper club experienced a loss in 1971 because he was too busy with negotiations for the hotel project to oversee its operations.

Mr. Murphy financed Ed Murphy's Supper Club with the aid of two \$15,000 loans from SBA at an interest rate of 5-1/2 percent. The loans were disbursed in December 1964 and March 1965 and were to be repaid in monthly installments of \$250 and \$177 for 6 and 10 years, respectively. Mr. Murphy became delinquent on his repayment of the second loan in October 1966 and on the first loan in December 1966. SBA's records indicated that Mr. Murphy's delinquent status was partially attributable to the costs involved in opening the club and to a fire that caused damages of \$7,500.

In November 1967, about 32 months after SBA disbursed the second loan, SBA declined a request from Mr. Murphy for a \$60,000 loan to expand the club. SBA's records indicated that the loan request was denied because Mr. Murphy was delinquent in his repayment of the two loans, that the club was grossing far less than other establishments of about the same size, and that much improvement in the existing club was required before an expansion should be contemplated. Mr. Murphy did not resume payments on the loans until January 1968.

An SBA report, dated April 23, 1970, showed that Mr. Murphy, again delinquent on both loan repayments, requested SBA to approve a 6-month deferment of the monthly installments. In his request Mr. Murphy stated that due to renovation his business volume had dropped. He indicated that, with the deferral of the loan repayments and a return to normal business, he would, at the end of 6 months, be in a position to meet his obligations to SBA. SBA approved the deferment of both loan repayments from May through October 1970.

The two loans became delinquent for the third time in May and June 1971. An unaudited financial statement of Murph's Hotel Corporation, dated October 31, 1971, showed that Mr. Murphy sold the supper club to the corporation for \$51,000 of its capital stock. Mr. Murphy, as president of the corporation, requested EDA to repay the SBA loans from the funds for the Harambee Hotel project. EDA denied this request. Mr. Murphy suggested that SBA either forget the debt or allow the hotel corporation to assume the loans with a 3-year deferment of the payments during the construction of the hotel.

In January 1972 SBA officials met with EDA officials to discuss the delinquent loans. At the meeting SBA officials stated that Mr. Murphy had shown no cooperation in trying to find a remedy for the delinquency and that, although SBA had no desire to impede the hotel project, some action had to be taken regarding the delinquent loans. EDA advised SBA that it would not disburse any of the business development loan to Murph's Hotel Corporation until Mr. Murphy had reached an agreement with SBA relating to the repayment or other settlement of the SBA loans.

SBA said that, because final resolution of the matter would probably take several months, it would grant a moratorium on loan principal repayments from February through June 1972 provided that the accrued interest and principal payments totaling \$3,234 were paid through January 1972 and that interest was kept current. Murph's Hotel Corporation paid SBA the accrued interest and principal in March 1972. The unpaid balance of the two loans as of June 1972 was \$19,654.

In April 1969 the Reconstruction and Development Corporation guaranteed a \$12,000 loan at 7-percent interest made by the United Community National Bank to Murph's, Inc., for the administrative cost of establishing Murph's Hotel Corporation and for the cost of acquiring options to purchase the land for the hotel. Subsequently the loan obligation was transferred to Murph's Hotel Corporation and the purchase options were transferred to PIC. The Reconstruction and Development Corporation is a local development corporation which guarantees loans for the initial capital needed by qualified entrepreneurs to establish or maintain businesses.

The loan was to be repaid in monthly installments of \$200 beginning in April 1970. By March 1971 no payments had been made on the loan, and the bank assigned the loan to the Reconstruction and Development Corporation. The hotel corporation paid \$1,000 to the Reconstruction and Development Corporation and signed a note for \$13,000, including accrued interest, bearing interest at 7 percent to be paid by August 1971. One month after the note was due the Reconstruction and Development Corporation's legal representative notified EDA of Murph's Hotel Corporation's delinquency. The legal representative stated that Mr. Murphy had not cooperated in any manner, shape, or form regarding the debt.

In March 1972 the Reconstruction and Development Corporation agreed to an extension, to January 26, 1974, of the maturity date of the \$13,000 loan. Murph's Hotel Corporation paid the Reconstruction and Development Corporation \$1,000 as consideration for the extension.

CONCLUSIONS

Whether PIC or Mr. Murphy has the necessary management capability to successfully manage the construction and