

August 1988

ASSISTED HOUSING

Overview of Problems at the Longwood Cooperative in Cleveland, Ohio



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**Resources, Community, and
Economic Development Division**

B-231980

August 23, 1988

The Honorable John Glenn
The Honorable Howard M. Metzenbaum
United States Senate

The Honorable Louis Stokes
House of Representatives

In an August 6, 1987, letter you asked that we review the events surrounding the failure and foreclosure of the Longwood Cooperative, a low-income housing project in Cleveland, Ohio. Your letter raised concerns regarding how Longwood was permitted to deteriorate while at the same time receiving millions of dollars in federal subsidies. In response to your letter and subsequent agreements with your offices, we are providing detailed information on (1) the history of Longwood's financial and management problems, particularly during the period from July 1975 through July 1986 when the project was known as the Longwood Cooperative; (2) why it took nearly 4 years for the Department of Housing and Urban Development (HUD) to gain possession of Longwood after foreclosure proceedings were initiated in 1982; and (3) HUD's efforts to revitalize the project through its resale and rehabilitation.

In summary, we found that Longwood had a continuous history of financial and management problems and that conditions grew worse after it was converted to a nonprofit cooperative in 1975. In April 1977 Versatile Property Systems, Incorporated, headed by a former chairman of the Cooperative's Board of Trustees, took over the management of the project. However, Versatile's performance in operating and maintaining the project was less than adequate, and the project's financial situation did not improve despite the influx of millions of dollars in federal assistance. This situation led to the filing of a foreclosure action by the U.S. Attorney on behalf of HUD in August 1982. During the foreclosure period the presiding chairman of the Board of Trustees and one of the primary maintenance contractors were convicted of criminal wrongdoing involving project activities. Primarily because of a 33-month period during which the court took no action on the foreclosure case, 4 years passed before HUD was able to gain control of the project. When HUD took over in July 1986, the project was in deplorable physical condition. HUD sold the project in August 1987 under the condition that the new owner rehabilitate it within a 2-year period. Rehabilitation costs are expected to exceed \$12 million. As of May 1988 approximately 85

percent of the rehabilitation work had been completed. To ensure that the project continues to serve low-income tenants, HUD is providing Section 8 subsidies to all 820 project units for a 15-year period.¹ HUD and the owner may in the future mutually agree to extend the subsidy period.

History of Longwood's Problems

Longwood, a multifamily housing project originally containing 828 units, has experienced financial problems since it first began operations in the late 1950s. These problems eventually led to the conversion of the project on July 1, 1975, into a nonprofit entity known as the Longwood Cooperative. At that time the Cooperative assumed responsibility for the \$8.4 million mortgage held by the HUD. The establishment of the cooperative was based on a feasibility study conducted at HUD's request. It was envisioned that cooperative ownership would build the resident support and participation needed to bring about a sound and economically viable project. However, despite the payment of over \$10 million in federal rent subsidies from October 1976 through July 1986, and several mortgage modification agreements that ultimately reduced the project's mortgage payment to equal only property taxes, the financial problems persisted.

A private management company, TechniCo-op, managed the Cooperative from July 1975 through April 1977. In April 1977 Longwood's Board of Trustees—the project's governing body elected by Cooperative members—hired Versatile Property Systems, Incorporated, to replace TechniCo-op as the managing agent. Versatile's owner and president was formerly the chairman of Longwood's board—a position which he relinquished in order to manage the project.

TechniCo-op cautioned HUD regarding potential problems with Versatile; however, HUD told us that it could not have prevented the management company change. Within a year of Versatile's taking control, indications of problems began to arise. For example, in an April 27, 1978, memorandum the acting director of HUD's Cleveland office noted that Longwood's general maintenance operations were deficient and that the physical condition of the project was generally poor. A subsequent inspection in March 1979 showed that the project remained in poor condition and in need of extensive repairs. Finally, in reviewing Longwood's 1981 financial records, HUD's Office of Inspector General (OIG) found significant

¹This program, established under Section 8, U.S. Housing Act of 1937 (42 U.S.C. 1437f), aids low-income families in obtaining decent, safe, sanitary housing in private accommodations. Low-income families in the program generally pay 30 percent of their income for rent, while HUD pays landlords the difference between the 30 percent and the unit's rent (not to exceed the fair market rent).

problems with Longwood's system of internal controls over receipts, disbursements, and procurements. These persistent problems led HUD to request the U.S. Attorney to foreclose on the project.

On August 24, 1982, the U.S. Attorney filed a foreclosure complaint with the U.S. District Court for the Northern District of Ohio. It took almost 4 years, however, from the time the U.S. Attorney filed the foreclosure complaint until HUD actually gained possession of the project in July 1986. During the foreclosure period the project's physical condition continued to decline and serious questions were raised concerning Versatile's management and use of almost \$5 million in federal subsidies that were paid during this period (see app. I).

Court's Inaction Delayed HUD in Gaining Possession of Longwood

Our review of records obtained from the U.S. Attorney's Office in Cleveland shows that for 33 months the federal district court took no action in regard to the foreclosure. During this period two judges were assigned to Longwood; however, heavy case work loads, caseload priorities, and the semi-retired status of one of the judges all contributed to the lengthy foreclosure period. The U.S. Attorney's office was aware of the desirability of foreclosing quickly, but we were told that it had no control over how quickly the assigned judge proceeded with the case. The Assistant U.S. Attorney who handled the case told us that tactics used by Longwood's attorney to delay HUD from taking possession of the project also contributed to the lengthy foreclosure period. HUD records show that HUD was particularly concerned over the impact the foreclosure delay was having on the use of federal subsidies, the physical condition of the project, and the tenants' well-being. HUD officials told us that other than prodding the U.S. Attorney's office, HUD could do little to speed up the process.

HUD's OIG did, however, criticize HUD's oversight of the project during the foreclosure process. Specifically, the OIG found that HUD did not (1) conduct required annual on-site inspections, (2) ensure that project deficiencies were corrected, and (3) obtain sufficient information to consider withholding Section 8 rental assistance subsidies. HUD officials responsible for overseeing the project advised us that the required inspections were not made because the project was in foreclosure and HUD expected to gain control at any time. We were also told that HUD was well aware of the project's deficiencies but recognized that Versatile was unwilling to comply with HUD requirements. Given that the project was already in foreclosure, HUD decided not to withhold Section 8 payments because it anticipated that such action would result in the eviction of many of the

tenants and would lead to further deterioration and decline in the value of the project.

Also, during the foreclosure period the Federal Bureau of Investigation (FBI) looked into possible criminal activity involving the use of project funds. Its investigation resulted in the conviction of the presiding chairman of Longwood's Board of Trustees for (1) defrauding the government of \$10,000 for a never-performed feasibility study that was to have been done by a local architect and (2) obstructing justice by encouraging a construction contractor to lie in regard to the study. The investigation also resulted in the conviction of a Longwood maintenance contractor for conspiracy to defraud the government and for making false statements to HUD regarding work he supposedly performed at Longwood. (See app. II.)

Present Status of Longwood

On August 31, 1987, HUD sold Longwood to L.A. Limited Partnership for \$4.2 million. As part of the sales agreement, HUD made a commitment to provide Section 8 subsidies for 15 years to all of the project's housing units. This assistance is valued at \$4.3 million per year, or about \$64.6 million over the 15-year period. Under the terms of the sale, the buyer agreed to rehabilitate 820 of the project's 828 units. HUD estimated that it would cost about \$12 million to complete the work. The other eight units were to be demolished because of structural problems. The rehabilitation work was scheduled to be completed by September 30, 1989, but will likely be completed much sooner. As of May 15, 1988, approximately 85 percent of the rehabilitation work had been completed. (See app. III.)

Observations

Two significant events—the hiring of Versatile Property Systems, Inc., and the unreasonably long foreclosure period—played major roles in the physical deterioration of Longwood after it became a cooperative. HUD records show that Versatile was ineffective in operating and maintaining the project and was unresponsive in addressing identified deficiencies and in complying with HUD requirements. Moreover, the 33-month period when the case languished in the courts resulted in further project deterioration and extended the period during which HUD lost control over how federal rent subsidies were spent.

Whether HUD should have pursued foreclosure action before 1982 is debatable. Foreclosure action should be initiated when it is evident that a project cannot continue to operate under existing conditions and it is

no longer in HUD's or the tenants' best interest for HUD to continue to support its operation. In retrospect, it would have been in HUD's interest to foreclose earlier. However, because the decision as to when to foreclose is judgmental and must be based on information available at the time, we believe it is not appropriate for us to question the timing of HUD's decision. Likewise, the withholding of Section 8 subsidies during the foreclosure period was a judgmental decision. After considering the potential impact on the project and its residents, HUD elected not to withhold Section 8 payments. We believe that whatever decision HUD made would likely have had negative consequences and we did not find one course of action to be clearly preferable to the other.

Our review was conducted between October 1987 and May 1988 at HUD headquarters and HUD's Cleveland field office. We reviewed records on the Cooperative maintained at these locations and at the project. The financial records at the project were incomplete and in disarray; consequently, we were unable to evaluate the Cooperative's expenditures or their appropriateness. Also, because of the lack of records, GAO had to rely to a large extent on testimonial evidence to reconstruct events that occurred over an 11-year period beginning in July 1975.

We discussed Longwood's managerial and financial problems with HUD officials familiar with the project's history. We discussed problems relating to the lengthy foreclosure process with the U.S. Attorney for the Northern District of Ohio, the Chief of the Civil Division for that office, and the Assistant U.S. Attorney who handled the foreclosure case. We also spoke with a law clerk for one of the federal judges assigned to the case. In addition, we met with a representative of the FBI to discuss criminal investigations of Longwood's operations. We met with several tenants to discuss their concerns regarding mismanagement at Longwood. Our review was performed in accordance with generally accepted auditing standards.

As agreed with your offices, we did not obtain official agency comments but instead discussed the information contained in the report with HUD and Department of Justice officials and incorporated their comments where appropriate. As also arranged with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 14 days from the date of this letter. At that time we will send copies to the Secretary of Housing and Urban Development and

other interested parties and make copies available to others upon request.

John H. Luke

John H. Luke
Associate Director

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Abbreviations

FBI	Federal Bureau of Investigation
GAO	General Accounting Office
HUD	Department of Housing and Urban Development
OIG	Office of Inspector General
RCED	Resources, Community, and Economic Development Division

History of Longwood's Financial and Management Problems

Throughout its 30-year history the Longwood housing project has faced severe financial and management problems that resulted in the project's physical deterioration, poor living conditions for its tenants, and the questionable use of federal subsidies. During the first 18 years of operation, various attempts were made to make Longwood into a viable project, including a number of mortgage work-out agreements that substantially reduced the monthly mortgage payments. A change was also made in the project's ownership in the hope that the project's financial condition and management would improve. Unfortunately, these actions proved unsuccessful. In 1975 the project, burdened with heavy debt and the possibility of foreclosure, was converted to a low-income cooperative.

During the next 7 years (1975-82), the project's physical and financial condition continued to deteriorate despite the Department of Housing and Urban Development's (HUD) efforts to help by providing Section 8 rental assistance subsidies,¹ which exceeded \$5 million during the period. Eventually, HUD had no choice but to begin taking the steps necessary to foreclose on the project. On August 24, 1982, the U.S. Attorney for the Northern District of Ohio filed a foreclosure action in the U.S. district court on behalf of HUD and asked that HUD be granted immediate possession of the project during the foreclosure process.

The court, however, did not grant HUD possession of the project until July 1986, almost 4 years from the date the foreclosure action was filed. This lapse in time was primarily attributable to a 33-month period during which the court did not act on the case—a situation over which neither the U.S. Attorney nor HUD had control.

During the foreclosure process, HUD provided the project another \$5 million in subsidies while the project's physical condition worsened. Allegations of mismanagement were widespread, and two individuals directly associated with the project were convicted of defrauding HUD.

¹This program, established under Section 8, U.S. Housing Act of 1937 (42 U.S.C. 1437f), aids low-income families in obtaining decent, safe, sanitary housing and private accommodations. Low-income families in the program generally pay 30 percent of their income for rent, while HUD pays landlords the difference between the 30 percent and the unit's rent (not to exceed the fair market rent).

Longwood's Financial Problems Began Before Formation of the Longwood Cooperative

Longwood is a multifamily housing project that was constructed over a several-year period in the late 1950s and early 1960s. The 828-unit project comprises 78 buildings located on over 25 acres of land near downtown Cleveland. HUD records show that Longwood was built as an urban renewal project in an area that for years had been economically depressed and slum ridden. Five of the six mortgages that financed the construction of the project were insured by the Federal Housing Administration through Section 220 insurance that was designed for projects constructed in urban renewal areas.

During its first 8 years of operation, the project experienced continual financial problems. According to HUD records, in January 1963 an attempt was made to resolve this situation. Under the sponsorship of the Cleveland Development Foundation, a branch of the Cleveland Chamber of Commerce, the project's six outstanding mortgages were consolidated under a newly created, nonprofit entity known as the Longwood Housing Corporation. The new \$8.4 million mortgage was insured by HUD under Section 221 (d)(3) of the National Housing Act, which enabled the nonprofit entity to obtain a 3-1/8 percent mortgage interest rate. Under the Section 221 (d)(3) program, public agencies and nonprofit, limited-dividend, or cooperative organizations are eligible for mortgage insurance to help finance rental or cooperative multifamily housing for low- and moderate-income families.

Longwood's nonprofit status and low interest rate mortgage did not resolve its problems, however. The project continued to experience financial difficulties even after a series of mortgage modification agreements, extending from September 1963 through April 1971, reduced the amount of money Longwood was required to pay on its mortgage each month. According to HUD, increasing operating costs, the inability to collect adequate rents, incompetent management, depleted replacement reserves, and the inability of the project to secure additional funds from its sponsor—the Cleveland Development Foundation—contributed to the failure of the Longwood Housing Corporation to become solvent even with the mortgage modification agreements. Consequently, in September 1971 HUD paid the holder of Longwood's mortgage—the Government National Mortgage Association—the outstanding mortgage balance and the mortgage was transferred to HUD.

HUD records show that following assignment of the mortgage to HUD, the original sponsoring organization, the Cleveland Development Foundation, removed itself from involvement in the project by resigning from the Longwood Housing Corporation's Board of Trustees. Subsequently, a

new Board of Trustees, under the name Longwood Housing Association, Inc., assumed control of the project, and HUD hired TechniCo-op, Inc., in 1971 to determine the feasibility of converting Longwood into a cooperative.

A cooperative is a housing project that is owned and operated by its members who live in the project. A member does not directly own his and/or her dwelling unit but rather owns a membership certificate in the cooperative. Membership carries with it the exclusive right to occupy a dwelling unit in the project. The cooperative approach is designed to instill pride of ownership in the resident owners that results in a deeper interest in maintaining the property. Also, the cost to operate a cooperative is reduced because the owner's profit is eliminated and cooperative members often perform some of the maintenance on their dwelling units.

In January 1972, on the basis of the feasibility study, the Longwood Housing Association presented to HUD a long-range plan for converting the project into a cooperative. Before approving the plan, however, HUD required that \$500,000 in physical improvements be made. To provide funds for the rehabilitation work and to allow time for the project to meet conversion requirements, HUD agreed to modify the mortgage payments. TechniCo-op was hired to manage the project and provide the training needed to bring about a successful cooperative. According to a December 11, 1974, letter to HUD, the Longwood Housing Association believed that cooperative ownership was the only practical way to build the support and participation needed to bring about a sound and economically viable project. The Longwood Housing Association formally transferred the project assets, subject to the existing mortgage, to the Longwood Cooperative in July 1975. At that time HUD extended the mortgage term by 10 years and agreed to defer mortgage principal payments for 1 year.

Financial and Management Conditions Worsened After Longwood Became a Cooperative

Following the transfer of the mortgage, the project continued to experience financial difficulties, and HUD was forced to agree to another series of mortgage modification agreements. However, increasing operating costs and the need to make repairs out of operating funds—because the project had no replacement reserve funds—caused the Cooperative to continue in default under the terms of the modification agreements.

TechniCo-op continued to manage the project until April 30, 1977, when Versatile Property Systems, Incorporated, assumed this responsibility.

Versatile was headed by the chairman of the Longwood Cooperative Board of Trustees. The Board of Trustees hired the chairman's company to manage Longwood and the chairman resigned to run the project. HUD's Cleveland field office and Office of Inspector General (OIG) identified serious problems with Versatile's management. These problems, together with the project's continuing financial difficulties, led HUD to request the U.S. Attorney to begin foreclosure proceedings.

Attempts to Improve Longwood's Financial Condition Were Unsuccessful

According to information in HUD files, during the closing months of the Cooperative's first year of operations, vacancies were growing and accounts payable over 30 days due were getting out of hand. Consequently, Longwood appealed to HUD for further financial assistance. HUD responded by agreeing to continue deferring the mortgage principal payments until July 1977. Moreover, to provide the project with additional operating funds, the Board of Trustees authorized, and HUD approved, a 22 percent rent increase for all project units.

In September 1976 HUD authorized \$587,259 in annual Section 8 subsidies for 480 of Longwood's 828 units. The Section 8 assistance, in addition to providing the project with increased income, also helped (1) residents who qualified under Section 8 guidelines to pay lower rent and (2) fill the vacancies with new tenants who qualified for Section 8 assistance. Also, HUD modified the mortgage agreement again in November 1977 to allow the Cooperative to make mortgage payments equal to property taxes only. Even with these actions, conditions did not improve.

Throughout 1978 the project's financial condition remained unstable. In February 1979 HUD advised Longwood that it had approved 273 additional units of Section 8 assistance. However, a March 26, 1979, HUD inspection report revealed that the project was in poor physical condition and in need of extensive repairs to restore it to a well-maintained condition. Out of 33 major inspection items, 19 were in need of immediate attention. Because of the significance of the problems, many of the units did not meet Section 8 standards, and consequently the Section 8 subsidies for the 273 units were withheld. Some of the problems cited as needing immediate attention were

- leaking roofs;
- damaged walls, floors, windows and doors;
- insect infestation;
- inoperable and deteriorated furnaces and boilers; and

**Appendix I
History of Longwood's Financial and
Management Problems**

- leaking and missing hot water tanks.

To what extent these conditions were addressed by project management is unclear from our review of available records. However, in September 1979 HUD did authorize Section 8 subsidies for the additional 273 units, which brought the total number of subsidized units up to 753 and the authorized subsidy amount to over \$97,000 per month, or about \$1,166,000 per year. As shown in table I.1, HUD paid the Longwood Cooperative over \$5 million in rental assistance subsidies from October 1976 through August 1982—when the U.S. Attorney filed for foreclosure. In spite of these subsidies, however, the project never overcame its financial problems.

Table I.1: Section 8 Subsidies Paid Through August 1982

Calendar year	Section 8 subsidy amount
1976 (Oct. through Dec.)	\$95,844
1977	568,104
1978	546,204
1979	607,855
1980	1,184,869
1981	1,304,978
1982 (through August)	863,612
Total	\$5,171,466

**Longwood Cooperative
Poorly Managed**

When the management of Longwood was transferred from TechniCo-op to Versatile at the end of April 1977, TechniCo-op was of the opinion that the project was moving toward financial stability. TechniCo-op maintained that, except for the mortgage, payments were up to date and repairs on over 150 units had just recently been completed. However, when TechniCo-op left, it was concerned about whether the cooperative would have the management needed to be successful.

In a May 6, 1977, letter, TechniCo-op advised HUD of the potential for problems with the Cooperative's new management. It pointed out that during the last 6 months of TechniCo-op's management, the Cooperative's Board of Trustees had begun to take steps that had a detrimental impact on the viability of the project. The board's chairman was the owner and president of Versatile. TechniCo-op said that the board had, among other things,

- solicited and signed contracts for unbudgeted and unnecessary work,

- terminated all maintenance personnel and hired contractors selected by the board to perform the work, and
- required that the chairman of Longwood's Board of Trustees authorize all bills and sign all checks.

TechniCo-op told HUD that the board increased the cleaning contract by \$19,000 and signed unnecessary contracts worth \$39,000 for furnace repairs and a property appraisal. It also said that maintenance costs had increased by assigning all maintenance work to private contractors. However, in spite of these developments, TechniCo-op stated that there were no bills more than 30 days past due except for the mortgage interest payments to HUD and bills from a hardware store that the board was holding for purposes of negotiating a discount settlement.

TechniCo-op advised HUD that Longwood's tight budget needed daily monitoring by someone skilled in management and dedicated to the long-term best interest of the community. It pointed out that the board decided to take over the day-to-day operations without proper preparation and expressed doubt as to whether Longwood had the competent, professional management it needed.

The Director of the Housing Management Division at HUD's Cleveland office told us that HUD could not have prevented Versatile from taking over the management of the Cooperative. He said that the Cooperative as owner of the project had the right to designate whomever it wanted to manage the project. We were told that Versatile met HUD's requirements for management of such a project and was doing a satisfactory job in managing another housing project in Cleveland. The director said that there was no supportable reason at that time to doubt Versatile's ability to operate the project.

In an April 27, 1978, memorandum the acting director of the Cleveland office indicated that Versatile was having problems in managing the project. The acting director pointed out that the project was in poor condition and indicated that general maintenance operations were deficient. A physical inspection of the project that HUD conducted about a year later found that management was still not maintaining the project in a satisfactory condition. The March 29, 1979, inspection report pointed out that the project was in poor physical condition. Inadequate response to repair requests and unsatisfactory repair work were cited in the report as evidence of a poor maintenance program.

A June 13, 1979, letter, from the HUD Cleveland office to the chairman of the Board of Trustees for Longwood, concerning the operating budget Longwood submitted to HUD for review in February 1979, also indicated that HUD was having significant problems with the Cooperative's management. The letter stated that the budget was inadequate and unacceptable and pointed out a number of areas where prompt responses were required to achieve economic viability, including a reduction in the project's 18 percent vacancy rate. HUD told the chairman that a competent on-site manager and an assistant must be employed to turn the project around. The letter also stated that the cleaning and maintenance contracts should be cancelled immediately and an in-house staff employed to meet most of the needs of the cooperative.

Although a September 1980 HUD management review gave Longwood's overall management a satisfactory rating, project maintenance and security were rated below average. In addition, the report pointed out that the project's high vacancy rate was one of the core problems of the project that caused a continual drain on operating capital. The report states that the vacancy problem was the result of (1) the project's inability to generate adequate capital to make the extensive repairs needed for some units to be habitable and (2) poor security and maintenance problems that discouraged tenants from moving into the project.

Because of concern over questionable management practices, HUD's Cleveland field office in January 1982 requested HUD's OIG to examine the books and records pertaining to Longwood's operations. The purpose of the examination was to determine (1) Longwood's compliance with pertinent HUD policies, rules, and regulations and (2) whether disbursements and receipts were properly accounted for and used for intended purposes. The resulting report, which covered calendar year 1981, cited significant problems with Longwood's accounting system and system of internal controls over receipts, disbursements, and procurements. The OIG found that \$153,128 was paid to maintenance contractors without adequate supporting documentation and that about \$3,000 was paid for heating units that were not installed and painting not done. In addition, the OIG said that in 1981 the Cooperative paid over \$785,000 to seven maintenance contractors without obtaining competitive bids or developing specifications for any of the work, and had executed a contract with only one of the contractors.

In commenting on the OIG report, Versatile's president stated that no bills were paid without his approval and maintained that all work paid for had been performed. He told the OIG that the heating units mentioned

in the report had been installed and the painting work done but that the invoices reflected incorrect addresses. The president agreed, however, that his payment system needed to be tightened and said that steps had been taken to do so. In regard to not using formal contracts, the president said that they were not used because if HUD followed through with its threatened foreclosure action, Longwood might be subject to breach of contract suits. The president further stated that Versatile did not seek competitive bids for services because in 1975 the contractors had set reasonable prices which had only been moderately increased each year. The OIG believed that Versatile's justification was invalid. The OIG stated that breach of contract suits can be prevented by conventional termination clauses included in contracts and that Versatile could provide no support for the reasonableness of the 1975 price rates and subsequent increases.

Because of the continuing decline in the physical condition of the project and the Cooperative's continuing inability to meet its financial obligations, the HUD Cleveland office decided that it had no alternative other than to recommend to HUD headquarters that steps be taken to foreclose on the project. HUD headquarters requested the Department of Justice to proceed with the foreclosure in March 1982. Subsequently, the U.S. Attorney for the Northern District of Ohio on HUD's behalf filed for foreclosure on August 24, 1982. At that time, the U.S. Attorney asked the court to grant HUD mortgagee-in-possession, which would have allowed HUD to take immediate control of the project while foreclosure was completed. However, as discussed in appendix II, it took almost 4 years for HUD to be granted mortgagee-in-possession. Versatile continued to manage Longwood from August 1982 through July 1986—a period characterized by further project deterioration and mismanagement.

Foreclosure Period Marked by Increased Mismanagement, Criminal Investigations, and Further Project Deterioration

Between August 1982 and July 1986, conditions at Longwood substantially worsened. Both HUD management and the HUD OIG identified many significant problems with Versatile's management of Longwood. Moreover, the FBI had an ongoing criminal investigation of activities at Longwood which resulted in the convictions of the chairman of Longwood's Board of Trustees and of one of Longwood's primary maintenance contractors.

The physical condition of the project also continued to deteriorate in spite of HUD's providing almost \$5 million in Section 8 subsidies. HUD's OIG was critical of HUD's oversight of Longwood during this period and of HUD's not giving adequate consideration to withholding at least some of

the Section 8 payments. HUD officials elected to continue the Section 8 payments with the expectation that they would gain control of the project at any time. They believed that stopping the subsidy payments could hurt both the tenants and the project.

HUD and OIG Highly Critical of Versatile's Management

In an October 1983 HUD management review of Longwood's operations, Versatile was given an unsatisfactory rating. HUD's review found, among other things, that the Cooperative had no control over the time expended on repairs and billed to the project. HUD was also critical of Versatile because repairs to the housing units were performed by three contractors rather than Cooperative employees, which would have cut out the contractors' profit and enabled the Cooperative to retain control. In addition, HUD found that the Cooperative had no formal inspection schedule for occupied units. A substantial amount of deferred maintenance existed, as well as water leaks, cracked windows, deteriorated plaster, and other problems. Project grounds were also not in good condition. Lawns needed cutting, bushes were not trimmed, and the parking lots were in need of repair. Other problems contributing to Longwood's unsatisfactory rating included an out-of-control vacancy problem—139 units were vacant with 71 units uninhabitable—and Versatile's failure to submit an operating budget for HUD's review and approval.

The HUD Office of Inspector General reviewed Versatile's management of Longwood for the period January 1, 1985, through June 30, 1986. However, because of the inadequacy of the records at the project, the OIG had to limit the scope of its review. Nevertheless, the OIG found Versatile's financial and general management practices to be inadequate. Specific problems cited in the OIG report included:

- Financial records were incomplete and in disarray. According to the report, Versatile did not exercise proper care in maintaining its records. Ledgers and journals reportedly did not exist and contractor files, invoices, and cancelled checks were incomplete. Consequently, as the OIG pointed out, there was no assurance that project funds were adequately safeguarded and used only for intended purposes.
- Excessive costs were incurred for contractor services. The OIG found that Versatile paid about \$60,000 in excessive costs for waste removal, heating maintenance, and exterminating services. Additionally, the report states that Versatile did not ensure that repair work was actually

performed or that it was performed properly. For instance, a HUD engineer identified over \$4,000 in repairs that were paid for and not performed and questioned an additional \$11,000 in repairs that he was unable to determine whether the contractor actually made.

Given the severity of the findings, the OIG recommended that HUD's Cleveland office impose appropriate sanctions against Versatile. On July 30, 1987, HUD advised Versatile and its president that it was denying them participation in HUD's multifamily housing programs within the jurisdiction of the Cleveland Office for a 1-year period ending July 30, 1988.

FBI Investigated Activities at Longwood

Allegations of corruption involving various activities and individuals associated with the Longwood Cooperative and the shooting of a Cleveland city councilman, who was making inquiries concerning poor conditions at the project, led the FBI to initiate an investigation in March 1982. During the course of the investigation, Longwood's management, tenants, and various contractors who performed work at the project were interviewed, as were HUD officials. Also, selected records pertaining to Longwood's operations were subpoenaed for review.

The investigation resulted in one of the project's primary maintenance contractors pleading guilty to one count of conspiracy to defraud HUD and five counts of making false statements to HUD in regard to services allegedly performed at Longwood. In addition to the conviction of the maintenance contractor, the FBI investigation also resulted in the conviction of the presiding chairman of Longwood's Board of Trustees for defrauding HUD. The chairman, who was also an architect, was convicted of receiving \$10,000 for architectural services that were to have been performed by another architect but were not rendered. In addition, the chairman was convicted of obstructing justice by encouraging a construction contractor and two others to lie concerning the case to the FBI and to a federal grand jury probing Longwood's operations.

Project Conditions Further Decline During Foreclosure

During the foreclosure period the level of maintenance needed to prevent further project deterioration was not performed. A HUD inspection of selected units in the project, conducted as part of HUD's October 1983 management review, revealed numerous deficiencies, including damaged walls and floors, cracked windows, lack of hot water, and garbage and debris around buildings. According to our review of HUD records and discussions with HUD officials, the project significantly deteriorated up

until the time HUD gained possession in July 1986. A March 12, 1986, HUD memorandum states that Versatile was spending about \$60,000 a month on maintenance without improving the condition of the project. This memorandum pointed out that the same contractors were repeatedly paid for repairs that seemed to have no effect on improving the project.

When the U.S. District Court for the Northern District of Ohio granted HUD mortgagee-in-possession in July 1986, HUD found the project in what it described as deplorable condition. According to a HUD pre-acquisition report dated August 4, 1986, the project suffered from an "absolute neglect" of maintenance and there was no evidence that the reported repair work had been done. HUD's report states that tenants were living in boarded-up units, units without plumbing, units that if they were single-family housing would be abandoned, and units with bathtubs that were delivered but not hooked up to the drain for 7 months or with windows that would not open in buildings without air conditioning. Very few of the 78 buildings in the project had roofs that did not leak; some had 10-inch holes that had been unrepaired for 3 years. In addition, all heating systems were in need of repair.

The report states that the buildings had also suffered from burst pipes, damaged water heaters, and flooded floors and units because many of the exterior doors were badly damaged or missing. Also, none of the project units had smoke detectors. The report points out that weeds and trees had been left uncut for so long that entrances to some buildings were completely obscured. HUD found that uncollected trash in out-of-the-way parking lots was piled 8-feet high, that some parking lots became 2-feet deep cesspools after each rain and would not drain for days, and that there were mailboxes for only 560 of the 828 units in the project. Subsequently HUD determined that it would cost over \$12 million to repair the project. A specific breakdown of these costs is shown in appendix III.

During the foreclosure period HUD continued to pay Section 8 subsidies to assist in the operation of the project. As table I.2 shows, HUD contributed almost \$5 million dollars from September 1982 through July 1986. When added to the subsidies paid in prior years (see p. 14), HUD's total Section 8 subsidies exceeded \$10 million.

Appendix I
History of Longwood's Financial and
Management Problems

Table I.2: Section 8 Subsidies Paid From
September 1982 Through July 1986

Calendar year	Section 8 subsidy amount
1982 (Sept. through Dec.)	\$430,339
1983	1,322,342
1984	1,305,193
1985	1,201,032
1986 (through July)	707,228
Total	\$4,966,134

HUD OIG Critical of HUD Oversight

Subsequent to Longwood's foreclosure HUD's OIG reviewed the actions that HUD's Cleveland office took in regard to the Cooperative while it was in the foreclosure process. In an August 14, 1987, memorandum to HUD's Chicago Regional Administrator, the OIG criticized HUD for not conducting the required annual on-site inspections, not ensuring that deficiencies were corrected, or not obtaining sufficient information to consider withholding Section 8 subsidies.

HUD guidelines for properties like Longwood require that they be inspected at least annually and more frequently if maintenance neglect or general project deterioration is detected. Such inspections are to be coupled with a continuing and persistent effort to obtain corrective action. The OIG found that during the 4-year foreclosure period, the only on-site review HUD made was in connection with its October 1983 management review and, although serious deficiencies were found, no follow-up was made to ensure that the problems were corrected. The OIG pointed out that its audit showed that essentially the same deficiencies existed almost 3 years later.

During the foreclosure period HUD's monitoring consisted primarily of desk reviews of Longwood's Board of Trustee minutes and monthly accounting reports detailing Longwood's receipts and disbursements. On several occasions HUD asked Longwood to provide explanations or documents regarding certain expenditures. However, as noted by the OIG, desk reviews alone are not sufficient to detect substantive problem areas.

In responding to the OIG's criticisms, HUD's Cleveland office told the OIG that on-site monitoring of Longwood was minimal because it did not have sufficient staff and that available staff could be more productively used on other projects. HUD maintained that it had provided all possible

assistance to make Longwood viable, including subsidizing units and forgoing mortgage payments, but its efforts provided no recognizable improvements. Another on-site review was planned for October 1985, but it was cancelled because HUD believed that the foreclosure was close to conclusion and conducting the review would be a waste of time since HUD would become the owner of the property.

The HUD loan servicer responsible for Longwood during the foreclosure period told us that he was responsible, on average, for monitoring about 70 projects, 10 to 15 percent of which were problem projects. The loan servicer said that he monitored Longwood's monthly accounting reports, responded to tenant and congressional inquiries, and tried to convince project management to comply with HUD rules and regulations. He said that he spent about 10 percent of his time on Longwood. The servicer also said that no annual on-site reviews were made after the October 1983 review because the project was in foreclosure and HUD kept expecting to gain control. He told us that HUD was well aware of the conditions at the project but recognized that Versatile was unwilling to make changes to comply with HUD requirements or suggestions for improvement. The loan servicer said that the only real clout that HUD has to force improvement is to threaten foreclosure and withhold subsidy payments. In the case of Longwood, he said that HUD in effect lost its ability to force corrective action when the project went into foreclosure and HUD decided not to withhold subsidy payments.

The OIG criticized HUD for not giving adequate consideration to withholding part of the Section 8 subsidy payments HUD made to the project. Although the OIG could not state with certainty that subsidy payments should have been withheld, its August 1987 memorandum points out that withholding such payments could have provided HUD with leverage in its efforts to get Longwood to improve its management. The OIG found, however, that HUD had not made the thorough on-site review and analysis needed to determine the amount of subsidy to withhold.

HUD's Cleveland office told the OIG that Section 8 subsidies were not withheld because it would have (1) adversely affected the tenants by limiting or eliminating those repairs and maintenance that were being done and (2) further worsened the condition of the project and its value. HUD maintained that even when a project is operated inefficiently, at least utility bills are paid and some repairs made.

HUD's Longwood loan servicer told us that, although HUD can withhold Section 8 subsidies, it does not always make sense to do so. He said that

**Appendix I
History of Longwood's Financial and
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even with bad management and possible improprieties, tenants at Longwood were still getting some services. He believes that not paying the subsidy would have punished the tenants and resulted in a number of them being evicted. The servicer told us, however, that after 1981 HUD did limit the subsidy payments to the rate established for the 1981 budget year. He said that this action was taken because the Cooperative did not provide the basic financial reports HUD requires to help it monitor project operations.

Court Delay Extended Foreclosure Period

At HUD's request, the U.S. Attorney filed to foreclose on Longwood on August 24, 1982. At that time the U.S. Attorney also asked the court to grant HUD mortgagee-in-possession status, which would have allowed HUD to take immediate possession and control of the project while the foreclosure was completed. However, due to circumstances that appear to have been beyond the control of HUD and the U.S. Attorney, 4 years passed before HUD gained control of the project. The primary reason for the delay is related to a 33-month period during which the court took no action in regard to the case. When HUD acquired the project at the foreclosure sale in October 1986, the outstanding mortgage balance was \$11,778,509, with \$4,629,158 delinquent. According to HUD officials the Cooperative never made a payment on the mortgage principal during the entire period it owned the project—from July 1975 to October 1986.

Table II.1 presents a chronology of significant events that occurred during the 4-year foreclosure period.

Table II.1: Chronology of Actions Occurring During Foreclosure Period

Date	Description
8/24/82	At HUD's request, the U.S. Attorney filed a foreclosure complaint with the U.S. District Court for the Northern District of Ohio and asked that HUD be granted immediate mortgagee-in-possession status pending final disposition of the foreclosure complaint.
8/25/82-2/01/83	During this period various legal motions were filed by the U.S. Attorney and by Longwood's legal representative, who opposed both the foreclosure and granting HUD mortgagee-in-possession.
2/2/83	Case was reassigned to a newly appointed judge.
2/3/83-12/12/83	Ten-month period of inactivity.
12/13/83	Case reassigned to a senior judge.
12/14/83-11/12/85	The only activity occurring during this 23-month period was a 02/06/85 court appearance by the Assistant U.S. Attorney who was taking over the case. The purpose of the appearance was to inform the court of the change in the Assistant U.S. Attorney handling the case. The Assistant U.S. Attorney also used this appearance as a means to encourage the court to move on the case.
11/13/85	Magistrate filed report recommending that HUD be granted immediate mortgagee-in-possession.
11/14/85-5/26/86	Series of motions filed by Longwood's counsel objecting to the magistrate's 11/13/85 decision to grant HUD possession of the property.
5/27/86	Case reassigned to the judge who previously had the case from 02/02/83 to 12/12/83.
7/01/86	Court ordered that HUD be granted possession of Longwood.
10/28/86	HUD acquired the project at a U.S. Marshal's sale for \$10.3 million. (HUD was the only bidder on the project.)

Source: U.S. District Court docket sheet obtained from the Office of the U.S. Attorney for the Northern District of Ohio.

In discussing the length of time it took to foreclose, officials from the office of the U.S. Attorney for the Northern District of Ohio told us that no unnecessary delay in processing the foreclosure action was caused by their office. They informed us that the duration of each foreclosure depends on the circumstances surrounding the case and the speed with which the assigned judge proceeds. They said that the Department of Justice does not keep statistics indicating the average amount of time it takes to foreclose on a multifamily housing project. The Assistant U.S. Attorney who handled the Longwood case estimated that 12 to 18 months is the average time to foreclose on a multifamily project. She told us, however, that Longwood was unique because of the size of the project, the amount of money involved, and the extent to which Longwood's attorney opposed HUD's being granted mortgagee-in-possession status.

Our review of the court docket sheet for the proceedings on the Longwood foreclosure showed a 33-month period when no court action was taken in regard to the case. This period coincided with two changes in the judge assigned to hear the case. The docket shows that the initial judge assigned to the case in August 1982 was replaced by a newly appointed judge on February 2, 1983. According to the record, this judge had taken no action on the case when it was reassigned for the second time to a "senior" judge on December 13, 1983. However, other than a February 6, 1985, appearance before the court by an Assistant U.S. Attorney for the purpose of advising the court that she was taking over responsibility for the case, the docket shows no further action was taken on the case until November 13, 1985, when the magistrate's report and recommendation in regard to the request for HUD mortgagee-in-possession was filed—23 months after the case was assigned to the senior judge. The docket shows that from November 13, 1985, until foreclosure, regularly occurring activity took place on the case, including various motions filed by the Cooperative's attorney that apparently were designed to delay and prevent the foreclosure and HUD's being granted mortgagee-in-possession. Also, during this period the judge who previously had the case between February 2 and December 13, 1983, was reassigned to the case after the senior judge retired.

The Assistant U.S. Attorney who handled the foreclosure agreed that the lengthy foreclosure was due primarily to the period of time when there was no court activity on the case. She told us that the U.S. Attorney's office has no control over which judge the court assigns to a case or how quickly the assigned judge proceeds. She said she used her February 6, 1985, court appearance as a means to encourage the court to

act and also spoke to the judges' law clerks on several occasions about the case.

The law clerk for the judge who was twice assigned to the case—from February 2 to December 13, 1983, and from May 27, 1986, through foreclosure—explained to us why the judge was unable to take action on the case during the 10 months he initially had the case. When the judge was appointed to the court, over 500 cases were assigned to him, including the Longwood case. Many of the cases that were transferred from other judges in the district were old, and the judge decided to work on the oldest and most pressing cases first. Because Longwood at that time was a relatively new case—about 5 months old—the judge, on the basis of the priorities he had established, did not get to it during the initial 10 months he had the case.

During the course of our review, we were told that the senior judge who got the case after the newly appointed judge was semi-retired, worked out of his home, and carried out a great deal of his court activities through the mail. Apparently, his caseload was made up of foreclosure cases, which are often difficult and involve a considerable amount of paperwork. It appears that these circumstances had a significant impact on the amount of time it took for HUD to gain possession of the project.

HUD records show that during the foreclosure process HUD's Cleveland Office officials were very concerned about the need for HUD to gain control of Longwood as quickly as possible and frustrated by how long it was taking to complete the foreclosure. For example, in a July 18, 1983, memorandum to the Director of HUD's Office of Multifamily Financing and Preservation, concerning the need to speed up the foreclosure, the Cleveland Office manager stated that any delay in assuming control of the project would prove extremely costly to the government and would cause further project deterioration. He pointed out that the HUD OIG had reported numerous management deficiencies and that the government was providing thousand of dollars each month in subsidies while the project continued to deteriorate with little evidence of on-going maintenance.

A HUD memorandum dated over 2 years later—March 12, 1986—from the Chief of the Property Disposition Branch to the Cleveland Office manager shows HUD's continuing concern over how long it was taking to gain possession of the project. The property disposition chief suggested that HUD express its strong objection to the Justice Department over the losses the government was incurring and the need to invoke some action

to gain possession of the property to protect HUD's interest and also that of the tenants. He described Longwood as a project whose name had become synonymous with the most deplorable housing conditions and as a project that could truly be called housing of last resort. He said that not only the mortgage but many of the project's utility bills remained unpaid from month to month, while Versatile continued to collect its management fees and repeatedly paid the same contractor for repairs that seemed to have no effect. Subsequently, by letter dated March 26, 1986, HUD informed the U.S. Attorney of its concerns and requested that immediate attention be given to the matter.

Longwood's Legal Status Was Not an Issue During Foreclosure

In our discussion with various Longwood tenants, they raised a question as to whether the Cooperative had taken the legal steps necessary to become a nonprofit entity in the state of Ohio. HUD officials we spoke to did not know whether or not the Cooperative had complied with Ohio requirements. Also, we did not find any information in HUD files to indicate that the legal process had been completed. A February 7, 1975, letter from TechniCo-op to HUD indicates that TechniCo-op was taking the initial steps to form the Cooperative. A realty specialist in HUD's Cleveland Office told us that he does not know if TechniCo-op completed the process.

HUD program officials and attorneys we spoke to agreed that it was HUD's responsibility to obtain satisfactory evidence that the Cooperative was properly formed. However, the HUD attorneys said that, assuming that it was not, they believed that it may have had no effect on project ownership and would not have enabled HUD to get control of the project any sooner. They said that title had apparently passed from the previous owner—the Longwood Housing Association—to the Longwood Cooperative and believed that the Cooperative, whether or not it had complied with state requirements, would in all likelihood be the legally recognized owner of the project. They also agreed that if HUD had claimed that the Longwood Cooperative was not the owner of the project, a court case to establish ownership would likely have ensued.

We discussed the question of whether the Cooperative had been properly formed with the Assistant U.S. Attorney who handled the foreclosure. She told us that she had no evidence to show that the Cooperative had not been legally formed. However, on the basis of (1) the Cooperative's efforts to keep her office from the project records, (2) project residents being treated as tenants rather than project owners, and (3) the Cooperative apparently not filing reports on its activities with the

Appendix II
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state, she had questions about whether it had. The Assistant U.S. Attorney told us that she brought this possibility up before the court but the court declined to hear arguments on this matter because of its lack of relevancy to the foreclosure issue.

Post Foreclosure—Sale and Rehabilitation

HUD sold Longwood Apartments to L.A. Limited Partnership on August 31, 1987. Under the terms of the sales agreement, the new owner paid \$4.2 million for the project and agreed to rehabilitate it within a 24-month period. As of May 1988, approximately 85 percent of the rehabilitation work had been completed. To ensure that the project continues to serve lower income tenants and is adequately maintained, HUD agreed to provide Section 8 rental assistance to all of the project units for 15 years.

New Owner to Rehabilitate the Project

According to HUD Cleveland Office officials, the new owner, a subsidiary of Associated Estates Corporation, owns other HUD-subsidized projects and has done a good job managing them. Under the terms of the sale, the purchaser is to rehabilitate 820 of the 828 units in the project within 24 months of the date of sale. HUD required that the other eight units, located in a structurally unsound building, be demolished. To ensure completion of the work, L.A. Limited Partnership was required to provide HUD four unconditional and irrevocable letters of credit totaling \$12.3 million. The letters of credit are to be released to L.A. Limited Partnership in phases as the work is completed to HUD's satisfaction. If HUD is not satisfied with the work, it has the right to draw on the letter of credit for at least 3 months after completion of the work.

The \$12.3 million letters of credit are based on HUD's estimate of the cost to repair the project at the time of its sale. Table III.1 provides a breakdown of the estimated costs.

Appendix III
Post Foreclosure—Sale and Rehabilitation

Table III.1: HUD's Estimated Rehabilitation Costs

Repair needs	Estimated costs
Concrete	\$180,000
Masonry	200,000
Metals	100,000
Rough carpentry	783,500
Finish carpentry	950,000
Waterproofing	82,000
Roofing	580,000
Sheet metal	160,000
Doors	470,000
Window	1,085,000
Drywall	670,000
Tile work	145,000
Resilient flooring	360,000
Painting/decorating	472,600
Specialties	225,000
Cabinets	431,000
Appliances	722,500
Blinds, shades and artwork	50,000
Carpets	850,000
Plumbing and hot water	1,190,000
Heat and ventilation	823,000
Electrical	600,000
Site utilities	100,000
Site improvements	220,400
Lawns and planting	150,000
General requirements	400,000
Subtotal of items	\$12,000,000
Builder's overhead	300,000
Total	\$12,300,000

According to HUD officials, L.A. Limited Partnership has made substantial progress in rehabilitating Longwood. The Chief of the Assisted Housing Management Branch in HUD's Cleveland Office told us that as of May 15, 1988, 577 of the 820 units in the project had been rehabilitated. Overall, approximately 85 percent of the rehabilitation work to the project had been done. He said that LA Limited Partnership is doing a good job in rehabilitating the project and the work is meeting HUD's housing quality standards. Although the purchaser has until September 30, 1989, to complete the work, it anticipates completing the work by October 15, 1988—11 months ahead of schedule.

To provide assurance that sufficient funds are available in the future to pay for periodic and unexpected equipment and other replacement items, L.A. Limited Partnership is required to deposit \$41,000 annually into a replacement reserves account.

All Project Units to Receive Section 8 Subsidies

In order to ensure that Longwood continues to serve lower income tenants and to help ensure that sufficient funds are available to maintain the project in accordance with Section 8 housing quality standards, HUD as a condition of sale agreed to provide Section 8 rental assistance to all 820 project units for a period of 15 years. According to the Director of the Housing Management Division the assistance amounts to \$4,304,820 a year—\$64,572,300 over the 15-year period. The assistance is to be phased in as the rehabilitation work is completed. In return the new owner agreed to continue to operate and maintain the project for the benefit of lower income tenants and to allow HUD to inspect the assisted units at least annually and at other times as may be necessary to ensure that they are maintained in a decent, safe, and sanitary condition.

In conjunction with HUD's agreeing to provide Section 8 assistance, L.A. Limited Partnership agreed also to provide HUD with audited financial statements each year. In addition, the new owner must submit other statements relating to project operations, financial condition, and occupancy as HUD may require in relation to the administration of the Section 8 assistance and the monitoring of project operations.

Major Contributors to This Report

Resources,
Community, and
Economic
Development Division,
Washington, D.C.

John H. Luke, Associate Director (202) 275-6111
Dennis W. Fricke, Group Director
Benjamin E. Worrell, Evaluator-in-Charge
Dianna G. Becerra, Typist
Vernesia J. Middleton, Typist
Molly MacLeod, Reports Analyst

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