

OFFICE OF THE CITY CONTROLLER



**HOUSTON HOUSING FINANCE CORPORATION
FINANCIAL ANALYSIS OF
THE FOURTH WARD REDEVELOPMENT PROJECT**

Sylvia R. Garcia, City Controller

Judy Gray Johnson, Chief Deputy City Controller

Steve Schoonover, City Auditor

Report No. 00-35



OFFICE OF THE CITY CONTROLLER
CITY OF HOUSTON
TEXAS

SYLVIA R. GARCIA

September 24, 2001

The Honorable Lee P. Brown, Mayor
City of Houston, Texas

SUBJECT: Houston Housing Finance Corporation
Financial Analysis of the Fourth Ward Redevelopment Project (Report No. 00-35)

Dear Mayor Brown:

In accordance with the City's contract with Deloitte & Touche LLP (Deloitte), Deloitte has completed a Financial Analysis of the Fourth Ward Redevelopment Project (Report No. 00-35). The objectives of the analysis included ascertaining the current status of the Project properties; determining the plans, if any, regarding redevelopment of the properties; inquiring of the organizational structure of the various entities and their subsidiaries associated with this Project, and identifying the status of option agreements between the Community Development Corporations and Hou-Tex Redevelopment Authority.

The report, attached for your review, includes several conclusions and recommendations related to the Project. Draft copies of the matters contained in the report were provided to the Houston Housing Finance Corporation (HHFC) and the Housing and Community Development Department (HCDD) officials for review. The views of responsible officials as to actions being taken are appended to the report as Exhibit I.

We appreciate the cooperation extended to the Deloitte auditors by HHFC and HCDD personnel during the course of the work.

Respectfully submitted,


Sylvia R. Garcia
City Controller

xc: City Council Members
Albert Haines, Chief Administrative Officer
Gerard Tollett, Chief of Staff, Mayor's Office
Margie Bingham, Director, Housing and Community Development Department
Philip Scheps, Director, Finance and Administration Department
J. Art Morales, President, Houston Housing Finance Corporation

901 BAGBY, 8TH FLOOR • P.O. BOX 1562 • HOUSTON, TEXAS 77251-1562
PHONE: 713-247-1440 • FAX: 713-247-3181
e-mail: ctrsrg@ctr.ci.houston.tx.us

May 18, 2001

The Honorable Sylvia R. Garcia
City Controller
City of Houston
901 Bagby, 8th Floor
Houston, Texas 77002

Dear Controller Garcia:

Deloitte & Touche LLP is pleased to present our final report on the Financial Analysis of the Fourth Ward Redevelopment Project. The objectives for the financial analysis were as follows:

- Phase I
 - Ascertain the current legal status/ownership of the Project properties
 - Ascertain the plans, if any regarding redevelopment of the Project properties
 - Inquire of Houston Housing Finance Corporation's authority to create subsidiaries
 - Inquire of the organizational structure of selected entities, their subsidiaries and the consulting firms associated with the Project and the nature of the relationships.
- Phase II
 - Obtain accounting records, checkbook registers, general ledger, and supporting documentation of Houston Renaissance, Inc. (HRI), Houston Housing Finance Corporations and Hou-Tex relating to the Fourth Ward Redevelopment.
 - Sample payments made to selected vendors and obtain a description of services provided by selected individuals, firms, vendors, suppliers, contractors, etc. Also, investigate services, deliverables, and payments (including rates) for these selections.
 - Identify the status of option agreements between the Community Development Corporations and Hou-Tex
 - Inquire as to the sources of funding for the loans made by HHFC to HRI
 - Sample agreements or contracts related to the funding for the loans and inquire if all the requirements, if any, were met.
 - Compare the loans and the entity's loan policies to determine agreement with those policies.
 - Obtain the Non-Profit Organizations Act and communicate any report violations with the Act (this procedure does not include specific testing for compliance with the Act)

We performed the following activities and work steps in order to conduct the Financial Analysis of the Fourth Ward Redevelopment Project.

- Obtained accounting records, checkbook registers, general ledger, and supporting documentation of HRI, Hou-Tex and Houston Housing Finance Corporation (HHFC) relating to Fourth Ward Redevelopment

The Honorable Sylvia R. Garcia

May 18, 2001

Page 2

- Sampled payments made to selected vendors and obtain a description of services provided by selected individuals, firms vendors, suppliers, contractors
- Sampled real estate transactions related to the properties purchased by HRI and perform the following:
 - Determined who received commissions, if any, on the sale of properties
 - Identified when properties were acquired
 - Reviewed closing documents for property that has been sold by HRI, Hou-Tex or HHFC in the Fourth Ward and review the nature of the closing costs
- Identified the status of the option agreements between the Community Development Corporations (CDC's) and Hou-Tex
- Inquired as to the sources of funding for the loans made by HHFC to HRI
- Obtained the Non-Profit Organizations Act

This report is a matter of public record and its distribution is not limited; however, this report is intended solely for the use of city management and City Council and should not be used for any other purposes. The City's external auditors and regulators may be provided with a copy of this report in connection with filling their respective responsibilities.

Thank you for the opportunity to conduct this financial analysis. We look forward to working with the City of Houston on future projects.

Very Truly,

Deloitte & Touche LLP

FINANCIAL ANALYSIS OF THE FOURTH WARD REDEVELOPMENT PROJECT

Organizational Units

The Houston Housing Finance Corporation (HHFC) is a Texas public nonprofit corporation that was incorporated on December 6, 1979 by the City of Houston, in accordance with the Texas Housing Finance Corporations Act. The City Council of Houston, upon recommendation of the Mayor, appoints or removes members of the Board of Directors of HHFC. HHFC is a component unit of the City of Houston making it a legally separate entity for which the City of Houston is primarily accountable.

HHFC provides a means to finance the cost of residential ownership and development that will provide affordable housing that is decent, safe and sanitary for residents of the City of Houston.

Houston Renaissance, Inc. (HRI) is also a Texas nonprofit corporation that was created in 1994. After its creation, HRI began acquiring property to implement the plan developed for the Fourth Ward to encourage home ownership and the development of affordable housing.

HRI transferred the title to all land and improvements owned by HRI as of April 23, 1999 to Hou-Tex Redevelopment Authority, a new nonprofit corporation formed by HHFC on March 10, 1999. Hou-Tex was created to promote, develop, encourage and maintain housing, employment, commerce and economic development in the City of Houston. Hou-Tex also assumed certain liabilities related to the notes payable to HHFC at that time.

HHFC and Hou-Tex Board's of Directors are not affiliated with HRI. **Appendix A** includes the most currently available listing of Board members for HHFC, Hou-Tex, and HRI.

Appendix B includes a listing of properties purchased with loans from HHFC to HRI. **Appendix C** includes a Fourth Ward Land Status Map as of July 13, 2000.

Sources and Uses of Funds

For purposes of this report, financial sources and uses are limited to information obtained from a review of financial statements, limited detailed transaction testing, and interviews with HHFC management. In addition, sources and uses of funds are limited to those that are relevant to the Fourth Ward Redevelopment Project up to, and including events that occurred subsequent to the effective date of that agreement and prior to July 30, 2000.

Deloitte & Touche did not conduct an audit of the financial records of any entity referenced in this report.

In October 1996, the City approved the Fourth Ward Redevelopment Agreement (Agreement). The Agreement authorized a grant of \$3,420,113 from the City of Houston to HRI. According to HRI's audited financial statements for the year ending December 31, 1997, these funds were used to pay debt obligations used to purchase land in the Fourth Ward area.

Houston Renaissance, Inc.

For the fiscal year ending December 31, 1996, HRI received only \$177,824 from local government entities and corporate donors. HRI ended that year having incurred an operating loss of (\$114,229) with a cash balance at the end of the year of \$74,568. HRI had no recorded land assets at December 31, 1996.

According to the audited financial statements for the fiscal year ending December 31, 1997, HRI revenue generating sources included:

- The City of Houston granted HRI \$3,420,113 that was used by HRI to pay off loans on land previously purchased in the Fourth Ward area
- HRI received rent income of \$89,703 in 1997
- Total revenues in 1997 were \$3,534,816

Table 1 presents a summary of HRI's sources and uses of funds for fiscal years ending December 31, 1996 and 1997.

Table 1
Summary of HRI Sources and Uses of Funds
1996 & 1997

Description	December 31, 1996	December 31, 1997
Beginning Fund Balance	(\$3,369)	(\$117,598)
Local Government Grants ⁽¹⁾	100,000	3,420,113
Other Sources	77,824	114,703
Property Development Costs	(33,828)	(206,664)
Management & General	(237,153)	(232,308)
Rental Property	0	(92,964)
Fundraising	(19,286)	(36,000)
Other Uses	(1,786)	(23,695)
Ending Fund Balance	(\$117,598)	\$2,825,587
Operating Profit (Loss)	(\$114,229)	\$2,943,185

Source: HRI Audited Financial Statements

⁽¹⁾1996 grant from HHFC and 1997 grant from City of Houston

Related Party Transactions – HRI's 1996 and 1997 audited financial statements reported that \$204,000 and \$104,000, respectively, was paid to a real estate development firm owned by an individual that served on HRI's Board of Directors through February 1996. Legal fees of \$52,109 in 1997 and \$15,104 in 1996 were paid to a law firm with whom a board member was affiliated. In 1996, HRI borrowed \$36,056 from a bank whose owner was a board member through March 1997.

Our review of HHFC and Hou-Tex financial statements did not reveal any related party transactions.

Conclusion

Contractual relationships of this type, especially where public funds are involved, can give the perception of “insider” preference. We recommend that recipients of City funds be evaluated and monitored more closely to avoid even the perception of such preferences in the future. In addition, accountability of vendors for performance and contract compliance should be improved in similar relations where City funds have been expended. No other conclusions are expressed or implied in regards to these business transactions.

HRI capitalized land, buildings, improvements and related acquisition/development costs valued at \$6,202,429 during 1997. HHFC funded approximately \$6.6 million in short-term loans in 1997 to support the redevelopment of the Fourth Ward area. According to HHFC’s general counsel, these loans were funded from HHFC’s General Fund and a \$4 million FNMA non-recourse revolving loan. This loan was paid in full by July 27, 2000 according to HHFC’s general counsel.

HRI’s cash flow statements reflect the uses of cash for the purposes of paying off loans used to acquire land in the Fourth Ward area. **Table 2** illustrates the changes in cash flow relevant to how the City’s \$3.4 million grant was used.

Table 2
HRI Cash Flows Related to Land Acquisitions
1997

Description	1997
Beginning Cash Balance – January 1, 1997	\$74,568
Cash Grants from Government and Corporate Entities	3,445,113
Rent Income	89,703
Cash Proceeds from Notes Payable	380,340
Net Cash Outflow for Operations/Financing Activities	(425,631)
Purchase of Land	(44,263)
Purchase of Fixed Assets	(20,465)
Repayments of Notes Payable	(3,456,169)
Ending Cash Balance – December 31, 1997	\$43,196

Source: HRI Audited Financial Statements for Fiscal Years ending December 31, 1996 and 1997.

HRI financial statements for 1998 and 1999 were not compiled or audited. HHFC and Hou-Tex did have audited financial statements with unqualified opinions. In the financial statements of HHFC for fiscal years ending December 31, 1998 and 1999, and in the financial statements of Hou-Tex for the fiscal year ending December 31, 1999, we noted the following:

- At the end of 1998, HRI owed HHFC \$5,471,772 in notes payable secured by first liens on tracts of land in the Fourth Ward
- In March 1999, Hou-Tex was formed as a nonprofit corporation by HHFC
- In April 1999, title to all land owned by HRI in the Fourth Ward, and the related liability, were transferred to Hou-Tex
- At the end of 1999, Hou-Tex owed HHFC \$6,586,874 including debt assumed from HRI, an additional \$1.5 million loan from HHFC to pay project development

expenses and a \$1.2 million loan for the purpose of acquiring additional land in the Fourth Ward area

HRI Annual Financial Statements

HRI's financial reports for 1998 and 1999 were not compiled or audited despite over \$5.4 MM in loans outstanding to HHFC.

Conclusion

We recommend that recipients of City funds be required to complete financial reports on an annual basis.

In addition, HHFC should require debtors to present annual financial statements during debt periods.

As part of the financial report, uses of public funds should be detailed according to governmental accounting procedures. The financial reports should be provided to the City on an annual basis as completed.

Houston Housing Finance Corporation

Based on a review of the financial statements for HRI, HHFC, and Hou-Tex, we noted several activities referred to that are relevant to this report. Significant decisions by HHFC management and its board relevant to the Fourth Ward Redevelopment Project include the following:

- In September 1996, HHFC authorized loaning money to HRI for the acquisition of Fourth Ward properties
- On February 14, 1997, HHFC passed a resolution authorizing the officers of HHFC to enter into guaranty agreements with financial institutions to assist the financing of the redevelopment and preservation efforts in the Fourth Ward
- On March 5, 1999 a resolution was passed by the HHFC Board authorizing the approval of the conveyance of properties by HRI to Hou-Tex
- The transfer was made subject to the notes payable by HRI to HHFC and secured by liens on HRI land in the Fourth Ward

Review of 20 Real Estate Transactions

We reviewed twenty real estate transactions where HRI purchased property in the Fourth Ward. Of the twenty sales that were reviewed:

- Six closed in March 1997
- Four closed in April 1997
- Three closed in May 1997
- Five closed in June 1997
- One closed in July 1997
- One closed in August 1997

Proration Date/Property Tax Costs at Closing – The proration date is a mutually agreed upon date between the buyer (HRI in this case) and the seller at which time property tax payment calculations are determined at closing.

In fifteen of the twenty transactions tested, the proration date for property taxes was December 20, 1996 even though the sales were not closed for several months later. The seller paid property taxes for 1996 (through December 20) in January of 1997. The proration calculation then determined the amount of taxes related to the period of December 21, 1996 through December 31, 1996 that is the responsibility of the buyer (period subsequent to the proration date that is paid to the seller). That amount should be added to the amount to be paid by the buyer and received by the seller at closing.

However, the proration calculations in the closing statements that we examined were for the entire period of December 21, 1996 through the closing date. Since the 1997 property taxes were not paid until January 1998 (when HRI is listed as the owner), the seller had not paid any amounts for 1997 taxes and therefore was not entitled to any reimbursement for taxes paid.

One reason that a seller may have already paid taxes is if that seller was required to make escrow payments to a lender in conjunction with an outstanding mortgage, however, none of the selected properties were shown on the settlement statements to be encumbered by mortgage liens.

Conclusion

In a typical residential property sales transaction, the seller is not reimbursed for cost they have not incurred. In the 20 sales transactions that we examined, 15 sellers were reimbursed for property taxes owed for the period January 1, 1997 through the closing date. No evidence that these taxes were actually paid by the seller was noted in the transaction files we reviewed.

Closing costs should be carefully reviewed and verified to avoid overpaying closing costs in the future.

Title Insurance – In all 20 of the residential property sales transactions we reviewed, we noticed the buyer paid for the title policy.

Conclusion

In typical residential property sales, title insurance policies are either paid by the seller or shared by both the buyer and seller (since it is additional representation that the seller is in a position to transfer title to the buyer). However, it is not uncommon in assemblage transactions such as these to see a purchaser quote a net price for the property and cover all of the closing costs.

In future property purchases, we recommend the rationale for agreeing to pay non-standard costs at closing should be documented and maintained in the property files.

Property Appraisals – In all 20 of the residential property sales transactions we reviewed, we did not see any fees related to property appraisals. HHFC management represented to us that property appraisals were not required as a condition of loaning funds to acquire property in the Fourth Ward area.

Conclusion

In a typical residential property sales transaction that involves a loan from a third party (in this case HHFC) an appraisal of the property is required by the lender to ensure that the value of the home or

property being purchased is sufficient to cover the loan in the event that it will be foreclosed. There were no appraisals performed on any of the twenty selections.

We recommend that all future lending transactions include appraisals of the underlying property to ascertain the sufficiency of the underlying collateral.

Review of Real Estate Sale Transactions by Hou-Tex – We reviewed each of the three real estate sale transactions made by Hou-Tex in the Fourth Ward. There were two sales of property to the Housing Authority of the City of Houston. The first was on August 13, 1999 and the second was on October 8, 1999. The third sale was to Bayou Lodging Group, LLC on November 3, 1999.

There were no commissions paid on any of these sales. The property taxes were prorated in the usual manner, where the seller paid for the estimated property taxes related to the time that they owned the property in 1999. Each of the closing statements indicated the repayment of the first mortgages held by HHFC.

The closing statement for the sale to the Housing Authority of the City of Houston on August 13, 1999 indicated the payment of \$1,385 for 1998 property taxes that were previously unpaid by HRI. Hou-Tex paid the taxes and has implemented internal procedures to monitor tax issues relevant to property sales and acquisitions. Hou-Tex and HHFC currently operate under a tax-exempt status.

Conclusion

We recommend that Hou-Tex continue to monitor its property portfolio and maintain its tax-exempt status.

Option Agreements

Hou-Tex entered into option agreements with four CDCs in the Fourth Ward for the purchase of property in June 1999. The CDCs involved in the option agreements include:

- Fourth Ward Community Development Coalition
- Antioch Project Reach, Inc.
- Miracle of Hope, Inc.
- Uplift Fourth Ward, Inc.

The option agreements had a take down schedule that would be triggered by the passage of the “street ordinance” by the City Council. The ordinance was passed December 15, 1999. None of the CDCs met the requirements of the initial option agreements. The option agreements were renegotiated with revised take down schedules. **Table 3** shows revised critical dates and the minimum amount of land each CDC is to take down per their Option Agreements.

Table 3
Critical Dates and Minimum Amount of Land
Take Down Per Option Agreements

Community Development Corporations	Square Footage				
	Total Option 100%	07/31/00 5% Total	10/30/00 10% Total	04/31/01 30% Total	08/30/01 100% Total
Fourth Ward Community Development Coalition	100,000	5,000	10,000	30,000	100,000
Antioch Project Reach, Inc.	153,500	7,675	15,350	46,050	153,500
Miracle of Hope, Incorporated	82,500	4,125	8,250	24,750	82,500
Uplift Fourth Ward, Inc.	60,000	3,000	6,000	18,000	60,000
Totals	396,000	19,800	39,600	118,800	396,000

Source: Hou-Tex Redevelopment Authority

Status of Option Agreements between the Community Development Corporations (CDCs) – The HHFC Executive Director has been working closely with the CDCs to take down the land according to the option agreements. The CDCs were required to take down five percent of the land by March 31, 2000. HHFC and the CDCs renegotiated the option agreements to revise the take down schedule. A formal ground breaking for the affordable homes in the Fourth Ward area occurred July 31, 2000.

According to Hou-Tex, as of February 1, 2001, Antioch Project Reach had purchased approximately 130,000 square feet of its land options. Antioch received a grant from the Houston Endowment, which allowed them to take the options down more quickly. Antioch has one house that is under construction.

The Fourth Ward CDC had purchased approximately 5,000 square feet as of late July 2000. Miracle of Hope met the requirements for 7/31/00; however, they have only purchased an additional 2,500 square feet. Miracle of Hope has completed one house with the homebuyer occupying the home. A second house is in progress. Uplift Fourth Ward, Inc. purchased 5,000 square feet in July 2000, 2,500 square feet in October 2000, and 5,000 square feet in November 2000. Throughout the Fourth Ward district construction loans have been closed on 12 homes with homebuyers in place and four homes are under construction or constructed.

Conclusion

HHFC and the CDCs have renegotiated the option agreements to revise the take down schedule. HHFC has continued to work with the CDCs to accomplish the overall goal of the revised take down schedule.

Professional Services Contracts

HRI and HHFC hired several individuals and firms to provide specific and on-going consulting services to the organization. Many of these consultants were paid on a project basis while others were paid a monthly retainer. We reviewed contracts, vouched payments to vendors, and reviewed board minutes to ascertain evidence that consulting services were received and reported to the board as indicated by contracts, payments and board minutes.

Review of Contracts with Consultants – Based on our review of HHFC payment records, contracts and board minutes from 1996 to February 2000, we found evidence that one consultant may not have complied with the contract terms requiring written monthly reports to the Board. HHFC management and general counsel represented to Deloitte & Touche that the consultant in question did make oral reports to the board and did recall several written handouts being provided to the board.

Conclusion

We recommend vendor performance monitoring and contract requirement compliance procedures be implemented in the future.

However, nothing came to our attention that would lead us to believe payments were made for services not rendered.

HHFC, HRI and Hou-Tex Financial Transactions

The scope of this engagement included obtaining the accounting records, checkbooks, general ledger, and supporting documentation of HHFC, HRI and Hou-Tex related to the Fourth Ward Redevelopment project. With the assistance of City Controller personnel, we sampled 130 payments made to selected vendors, individuals, firms, suppliers and contractors from HHFC, HRI and Hou-Tex for the period from 1997 through 1999. Each tested payment had adequate documentation to support the transactions except for two immaterial HRI transactions. HHFC and Hou-Tex tested transactions were properly authorized and documented.

The sample of invoices shown in **Table 4** was selected from various source documents including a check register, a bank activity report and a partial general ledger listing. The Hou-Tex sample was taken from a check register consisting of 40 checks totaling approximately \$768,420. HHFC tested transactions were selected from a partial general ledger listing from which meaningful expenditure totals could not be determined. The HRI sample was selected from a bank activity report that listed 86 checks totaling approximately \$1,005,286. The City Controller's Office Audit staff selected the invoices to be tested for Hou-Tex.

Table 4
HHFC, HRI and Hou-Tex
Vendor Payment Selections

Entity	Number of Selections	Payee	Service	Payment Amounts Tested
Hou-Tex	8	CDI Management*	Demolition, utilities, management fees, and administrative payroll, installation of smoke detectors	\$237,570
Hou-Tex	6	Mayor, Day, Caldwell & Keeton*	Legal Service for HRI	160,682
Hou-Tex	2	Vernon Henry & Associates*	Revising and updating real estate acquisition status maps and preparing map illustrations and Balance as of 4/15/99 for HRI creditors	51,373
Hou-Tex	2	Stewart Title**	Amount due from the buyer on the closing of Fourth Ward property	57,037
Hou-Tex	1	Land Tech	Surveys for street realignments for Fourth Ward	50,201
Hou-Tex	4	Morris, Lendais, Hollrah & Snowden	Title research, reviewing files, discussions on street ordinance and transmittal of surveys, and other related legal fees	53,585
Hou-Tex	1	Hermes Reed, Architects	Balance as of 4/15/99 for HRI creditors	3,313
Hou-Tex	1	Marion Spiers, Architects*	Master plan & designs for mixed use layout, single family detached, four story apartment complex, and garden apartments for the Fourth Ward Redevelopment project	22,650
Hou-Tex	1	Hill Swift, Architects	Balance as of 4/15/99 for HRI creditors	4,156
Hou-Tex	1	Peter Doyle Associates	Balance as of 4/15/99 for HRI creditors	6,500
Hou-Tex	1	Llewelyn-Davis Sahni	Balance as of 4/15/99 for HRI creditors	15,142
Hou-Tex	1	Mir Fox & Rodriguez, P.C.*	Balance as of 4/15/99 for HRI creditors	62,430
Hou-Tex	1	Boyd & Associates*	Balance as of 4/15/99 for HRI creditors	40,000
Hou-Tex	1	Hou-Tex Redevelopment	Transfer of funds to Hou-Tex General Checking account to open reserve checking account	300,000
Hou-Tex	1	Houston Housing Finance Corp.	Reimbursement to CDI for operating expenses for the month of December	17,916
Hou-Tex	2	Carter & Burgess*	Project management and reproduction expenses, environmental due diligence studies for Freedmen's Town Historic District and Balance as of 4/15/99 for HRI creditors	7,816
HHFC	30	Doug Williams	Consulting Services rendered per his contract with HHFC	157,000

Entity	Number of Selections	Payee	Service	Payment Amounts Tested
HHFC	2	Vernon Henry and Associates	Prepare revisions to land status map and prepare computer plots of map	420
HHFC	1	Baca Landata*	GIS mapping time and plots	315
HHFC	2	Antioch Baptist Church	Reimbursement for expenses for 4 th Ward planning meeting	667
HHFC	5	Jim Box-Consultant	Monthly consulting fees related to TIFD/TIRZ creation and 4 th Ward redevelopment	35,333
HHFC	13	Norman & Norman	Professional Services provided to HHFC for 4 th Ward redevelopment	73,140
HHFC	16	Andrews & Kurth	Legal Services provided to HHFC for 4 th Ward redevelopment	384,648
HRI	12	The Boyd Group	Consulting Agreement	170,334
HRI	5	Heather Bowen Consulting	Fund Raising Consultant	16,500
HRI	1	Stull and Lee, Inc.	Architect and Planning Services	8,990
HRI	1	Landtech	Surveys of the Fourth Ward	99,635
HRI	1	Morris Lendais, Hollrah & Snowden	Legal Services	23,805
HRI	3	Laguarta & Co.	Developing Strategies of Acquisition and disposition of land in Fourth Ward	176,525
HRI	2	Mir Fox & Rodriguez	Accounting Services	16,410
HRI	1	Vernon Henry & Associates	Mapping Land Acquisition and Ownership Status, revisions ad updates to ownership maps; preparation of TIRZ application text and maps; set up spreadsheets showing status of petitions to create TIR and prepare updates as information changes	40,308
HRI	1	Carter & Burgess	Environmental Site Assessment	26,487

Source: Hou-Tex Redevelopment Authority, HHFC and HRI Financial Records

*Payer was also a payee of HRI

** Stewart Title and Laguarta & Company, which was paid through property closing statements, were also payees of HRI

Conclusion

No material issues were noted as a result of the transaction testing procedures.

Non-Profit Organizations Act – The scope of work for this project included communicating any reported violations of the Non-Profit Organization Act.

Conclusion

There were no reported violations of the Non-Profit Organization Act that came to our attention. No legal opinion regarding compliance with the Act is expressed or implied.

Transfer of Land To/From Perry Homes – In April 1999 the Hou-Tex board approved a contract with Perry Homes in which Hou-Tex agreed to sell and convey eight parcels of land containing 120,137 square feet of land in return for 115,019 of land owned by Perry Homes. Hou-Tex also received \$275,000, prior to closing costs, related to this transfer of land. Through discussions held with the Executive Director of HHFC it was noted that Hou-Tex was interested in such a transfer of land primarily to consolidate its land holdings to include only properties that fall within the Fourth Ward boundaries.

Conclusion

Hou-Tex did not conduct an appraisal of the land that was being transferred to/from Perry Homes. The Executive Director of HHFC informed us that such an appraisal was not deemed necessary based upon their knowledge of the value of land in the area. Again, we recommend that appraisals of property accompany all property transactions, transfers, and lending agreements.

Status of Properties Purchased with the \$3.4 million City of Houston grant to the Fourth Ward for Affordable Housing

The City and HRI entered into the Fourth Ward Development Agreement, which included Land Use Restrictions, on December 5, 1997. As part of that agreement, Article VIII, 8.4 provided the following clause:

“However, upon the request of Participant and subject to the approval by the Director, the Director may execute release of Restrictive Covenants as to all or any portion of the Property, provided that, at least an equal amount of other comparable real property within the Fourth Ward which is owned by Participant and which is not already affordability-restricted is made subject to the Restrictive Covenants as provided in the Agreement.”

A Declaration of Release of Property From and Substitution of Property to Land Use Restriction Agreement was developed in conjunction with the City’s Legal Department. This agreement has been used for each of the seven land substitutions that have been enacted through September 22, 2000.

Table 5 shows the property that was purchased by the City grant and substituted with other property that did not have any restrictions:

Table 5
City of Houston Grant Funded
Property Substitutions

Property Purchased with City Grant	Acreage	Property Substituted	Acreage
August 4, 1999			
Lot 4 , Block 29	0.1148	Lot 10 Block 30	0.1148
Sub-Total	0.1148		0.1148
October 7, 1999			
Lot 1, Block 88	0.1148	Lot 10, Block 16	0.1148
Lots 1,2,3,4,5,6,7,8,9,& 10, Block 85	1.1482	Lot 4, Block 16	0.1148
Lots 1,2,3,6,7, & 8, Block 3	0.6889	Lot 4, Block 17	0.1148
		Lot 6, Block 13	0.1240
		Lot 8, Block 13	0.1148
		Lots 9 & 10, Block 13	0.2297
		Lot 1, Block 55	0.1148
		Lot 6, Block 55	0.1148
		Lot 8, Block 55	0.1148
		Lot 10, Block 55	0.1148
		Lot 3, Block 54	0.1148
		Lot 6, Block 54	0.1148
		Lot 8, Block 54	0.1148
		Lots 9 & 10, Block 57	0.2297
		Lot 5, Block 53	0.1148
Sub-Total	1.9519		1.961
December 15, 1999			
Lots 5 & 6 Block 10	0.2296	Lots 2 & 3 Block 19	0.2297
Sub-Total	0.2296		0.2297
April 13, 2000			
Lot 1, 2, & 3, Block 49	0.3414	Lot 4, Block 19	0.1148
Lot 3, Block 46	0.1148	Lot 7, Block 7	0.1148
		Lot 3, Block 18	0.1148
		Lot 7, Block 18	0.1148
Sub-Total	0.4592		0.4592
July 19, 2000			
Lots 6 & 7, Block 68	0.2181	Lot 10, Block 21	0.1148
Lots 6 & 7, Block 68	0.0791	Lot 1 & east half Lot 2, Block 21	0.1722
		Lot 3, Block 4	0.0643
Sub-Total	0.2972		0.3513
August 11, 2000			
Lot 1, Block 62	0.1148	S-1/2 of 2, and 3, 4, Block 7; Lot 8 and W 9 ' of 9, Block 40	0.3978
S 34' of lot 1, Block 64	0.0390	Lot 5 & 6, Block 47	0.2296
Lot 5, Block 84	0.1148	Lot 8, 9, & 10, Block 7	0.3445
N 1/2 of 9 and 10, Block 15	0.1148	Lot 6 & 7, Block 7	0.2296

Property Purchased with City Grant	Acres	Property Substituted	Acres
Lot 10, Block 19	0.1148	Lot 8, 9, & 10, Block 7	0.3445
Lot 6, Block 23	0.1148	E 1/2 of Lot 7 & 8, Block 8	0.1722
Lot 1, Block 24	0.0574	Lot 6, Block 11	0.1148
2 and East 3' of 3, Block 24	0.1217	Lot 10, Block 11	0.1148
West 47' of 3 and East 3' of 4, Lot 24	0.1148	Lot 2, E 1/2 of 3	0.1722
East 46.4' of s-1/2 of 9 and 2-1/2 of 10, Lot 24	0.1107	Lot 6, Block 12	0.1148
Lot 1 & 2, Block 27	0.2296	Lot 9, 10, Block 12	0.2296
East 40' of 3, Block 27	0.0919		
West 10' of 3 and East 40' of 4, Lot 27	0.1145		
5 and West 10' of 4, Lot 27, Lot 27	0.1374		
Lot 7, Block 30	0.1148		
Lot 8, Block 30	0.1148		
Lot 2 & 3, Block 63	0.2297		
Lot 4, Block 63	0.1148		
Lot 6, Block 84	0.1148		
Lot 4 & 5, Block 1	0.0896		
Lot 10, Block 2	0.1240		
Sub-Total	2.4942	Sub-Total	2.4644
September 22, 2000			
All of 1, part of 2, 11, and 12, Block 1; Lot 9 & 10, Block 4	.4897	Lot 6 & 7, Block 2	0.2379
		Lot 8, Block 2	0.1240
		Lot 10, Block 2	0.1240
Sub-Total	0.4897	Sub-Total	0.4959
Total	6.0032		6.0763

Source: Declaration of Release of Property From and Substitution of Property to Land Use Restriction Agreement
 *Lots and Blocks as recorded in the Map of the Obedience Smith Survey, A-696 Harris County, Texas

The remaining properties purchased with the City’s grant still have the required restrictions.

HHFC/Hou-Tex has released 6.0032 acres from the property restrictions and substituted these properties with 6.076 acres of property. Hou-Tex received 0.07 more acres of land than it released in the substitution transaction.

Land Acquisition with City Grant Funds – HRI began acquiring land in March 1997 with the assistance of HHFC as its lender. The City grant of \$3.4 million was actually funded in December 1997. When HRI received the grant funds in December 1997, management arbitrarily allocated the City’s grant proceeds to properties held by HRI based on the date of closing on the property. In other words, as soon as enough properties could be shown to total an amount near the amount of the grant, those properties became the properties purchased with City grant funds.

Land substitutions became necessary so that similarly restricted properties could be parceled more effectively within the Fourth Ward Redevelopment area. HHFC and Hou-Tex have

made certain assumptions in the calculation of the gain or loss being recognized on these land transactions. The assumptions will need to be reviewed for validity at the end of the seven-year term of the Agreement in order to ensure that all monies have been properly accounted for in accordance with the Agreement.

Once the redevelopment project is final, the City and HHFC will need to recalculate any gains or losses to HHFC and Hou-Tex to determine whether any monies are due to the City of Houston.

Conclusion

Given that the City Grant Funds of \$3.4 million were used to pay off notes applicable to previously acquired properties, the method for originally allocating properties to the grant proceeds appears reasonable. HRI's audited financial statements for the year ending December 31, 1997 represent that the grant was used to acquire land in the Fourth Ward area.

Status of 105 Lots in First Amendment to Fourth Ward Development Agreement –
The First Amendment to the Fourth Ward Development Agreement states:

“...with respect to an additional 105 lots in the Fourth Ward, Participant shall pass on to the home builder acquiring such lots, which shall pass on to the Homebuyer who buys such lot from the home builder the sum currently estimated at Three Thousand Seven Hundred Ninety-Eight and No/100 Dollars (\$3,798.00) to be used to reduce the purchase price or the mortgage to the Homebuyer for such unit.”

Conclusion

HHFC appears to be obligated to provide a subsidy to homebuyers of an additional 105 lots in the Fourth Ward. The Amended Agreement seems to be unclear on who is obligated to provide the additional lots for development. HHFC management did represent that they are reserving some land to sale to Houston Housing Authority that is sufficient to build between 40 and 45 homes. They do not believe they are obligated to locate and sell the additional 105 lots mentioned in the First Amendment to the Fourth Ward Development Agreement.

**Appendix A
Board of Directors**

Houston Housing Finance Corporation @ 1/24/2001

J. Art Morales, President
Charles M. Lusk, Vice President
Redick Edwards, Secretary
R. Richard Kilday, Treasurer
Margie Bingham, Directors
Harvey Clemons, Jr., Director
Zelma V. Etheredge, Director
Carlos Garcia, Director
Albert E. Magill, III, Director
Carolyn Matthews, Director
James J. Wong, Director

Hou-Tex Redevelopment Authority @ 1/19/2001

J. Art Morales, President
Charles M. Lusk, III, Vice President
Redick Edwards, Secretary
R. Richard Kilday, Treasurer
Margie Bingham, Director

Houston Renaissance Inc. @ 1/1/1999

Allen Schubert, Chairman of the Board
Frank Kelly, Vice Chairman
Cheryl Dotson, Secretary/Treasurer
Jim Lemond, At Large
Paul Bell, At Large
Beth Morian, At Large
Holcombe Crosswell
Bill Calhoun
Rev. D.Z. Cofield
Robert Dawson
Bob Fretz, Jr.
Gilbert Herrera
Gerald Womack
John Walsh, President

Appendix B
Loans to Houston Renaissance, Inc for Fourth Ward Properties

Appendix C
Fourth Ward Land Status Map
(as of July 13, 2000)

FOURTH WARD LAND STATUS MAP

ALLEN PARKWAY

Federal Reserve Bank

Allen Parkway Village

City of Houston
Public Works

City of Houston
Public Works



0 100 200 400

July 18, 2000

WEST DALLAS AVE

INTERSTATE - 45

TAFT ST.

WEST GRAY AVE

Color Key

- Structure - Occupied
- Structure - Vacant
- HOU-TEX Ownership
- Church
- Institutional / School
- Homestead
- Larry Davis - Pending Contract
- Randall Davis - Pending Contract
- Robert Rose - Pending Contract
- Camden Properties - Closed
- Housing Authority - Closed
- Housing Authority - Pending Contract
- Miracle of Hope - Pending Contract
- Antioch Project Reach - Pending Contract
- Uplift 4th Ward - Pending Contract
- 4th Ward Community Coalition - Pending Contract

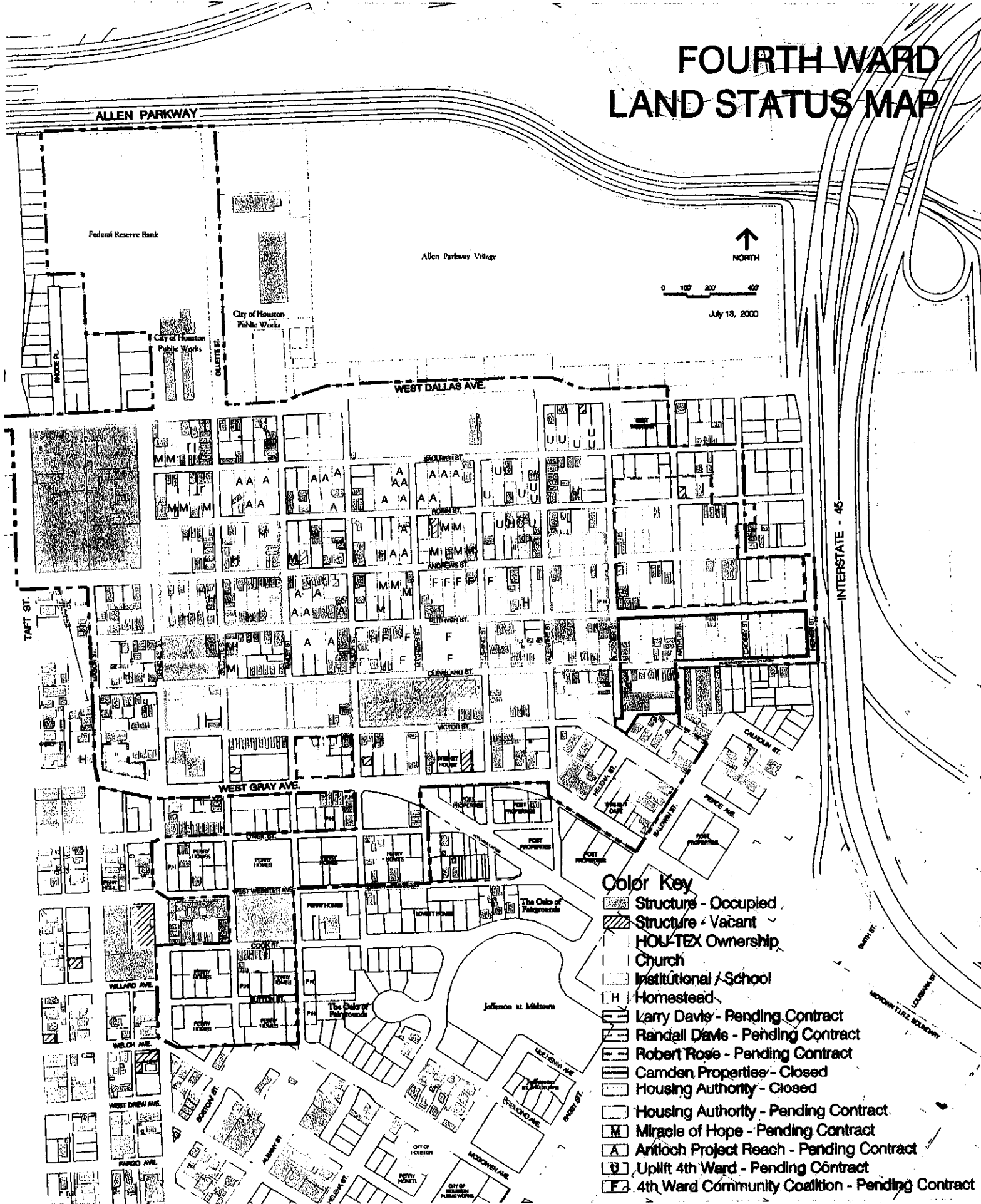


EXHIBIT 1

Houston Housing Finance Corporation

9545 KATY FREEWAY - STE. 105
HOUSTON, TEXAS 77024
Phone 713 461-2749 Fax 713 467-7598

April 11, 2001

Controller Sylvia R. Garcia
City of Houston
P. O. Box 1562
Houston, TX 77251-1562

**Re: Financial Analysis of the Fourth Ward Redevelopment Project
Final Draft - Deloitte & Touche**

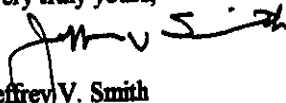
Dear Controller Garcia:

Thank you for providing us the referenced draft report. We have reviewed the conclusions and recommendations contained in the report and will consider implementation as deemed appropriate. Some of the recommendations are for practices HHFC already had in place prior to the audit.

While we generally agree with the body of the analysis, we have a somewhat different perspective on the report's conclusion regarding appraisals. Certainly, HHFC considers the valuation of collateral as a key element of our loan underwriting process. In the instance of the Fourth Ward, the negotiation of dozens of earnest money contracts arrived at the consensus sales price for a willing buyer and willing seller. This defined the market value probably better than the typical appraisal. An appraiser would have found few, if any, comparable market sales. History bears out the fact that \$5.00/sq. ft. was a reasonable estimate of market value at the time Houston Renaissance purchased the properties. Since then, there has been a dramatic rise in sales prices in the area, with some sales above \$20.00/ sq. ft.

Again, thank you for your report. We appreciated the professionalism of your staff and the Deloitte & Touche staff. We look forward to successfully completing our role in the Fourth Ward Redevelopment Project.

Very truly yours,


Jeffrey V. Smith
Executive Director

cc: J. Art Morales
President/ HHFC

*Views of Responsible
Officials*