

In the Matter of:

AUGUST LENHART,

: HUDBCA NO. 98-B-108-D5
Docket No. 98-8051-DB(LDP)

Respondent

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FINDINGS OF FACT AND RECOMMENDED DECISION

Statement of Jurisdiction

On May 11, 1998, this Board received and docketed the request of August Lenhart (Respondent) for a hearing on a Limited Denial of Participation (LDP) imposed upon him by the United States Department of Housing and Urban Development (HUD or Department). The administrative judges of the HUD Board of Contract Appeals are authorized to serve as hearing officers and to issue findings of fact and a recommended decision upon the request of a respondent upon whom an LDP has been imposed. 24 C.F.R. §24.105, 24.314(b) (2), and 24.713(b).

Statement of the Case

By letter dated March 24, 1998, Lenhart was notified that an LDP had been imposed upon him by the HUD Director of the Connecticut Multifamily Program Center. The LDP denied Lenhart's participation in HUD's mortgage insurance program and Section 8 programs throughout the jurisdiction of the Connecticut State Office, including the entire state of Connecticut, for a period of one year. Lenhart was given the option to request an informal conference pursuant to 24 C.F.R. §24.712 or to request a formal hearing and bypass the informal conference.

An informal LDP conference was held on April 15, 1998. By letter dated April 20, 1998, the Director of the Connecticut Multifamily Program Center informed Lenhart that the decision to impose the LDP was affirmed with the modification that the LDP would not affect Lenhart's ability to receive extensions of his current Section 8 contract on another apartment complex owned by Lenhart in Waterbury, Connecticut (the Inner City Apartments). Lenhart timely requested a formal hearing pursuant to 24 C.F.R. Parts 24 and 26.

HUD cites to the following provisions of the United States Code of Federal Regulations as the legal bases for the LDP. 24 C.F.R. §24.705(a) (4) [Failure to honor contractual obligations or to proceed in accordance with contract specifications or HUD regulations]; 24 C.F.R. §705(a) (8) [Commission of an offense listed in §24.305]; 24 C.F.R. §24.305(b) (1) [A willful failure to

perform in accordance with the terms of one or more public agreements or transactions]; and 24 C.F.R. §24.305(d) [Any other cause of so serious or compelling a nature that it affects the present responsibility of a person]. The LDP makes reference to alleged physical deficiencies at the property and to Lenhart's mortgage default.

The hearing in this matter was held in Hartford, Connecticut on June 25, 1998. The following findings of fact and recommended decision are based upon the official administrative record (AR) sworn testimony and exhibits admitted as evidence given at the hearing, as well as the briefs submitted of the parties.

Findings of Fact

1. During all relevant times, August Lenhart was the owner of the Willow Street Apartments (Willow Street), located in New Britain, Connecticut. (Tr. 168). From 1985 until 1994, Lenhart had a Section 8 project-based contract with HUD for Willow Street. (Tr. 172). Under its Section 8 program, HUD provides both Section 8 portable vouchers as well as project-based Section 8 contracts for particular properties. A section 8 portable voucher or certificate transfers with the tenant. A project-based Section 8 contract ties the Section 8 subsidy directly to the property, so that anyone who meets certain income and other Section 8 requirements may move into the building and receive the Section 8 subsidy, i.e., the tenant pays 30 percent of their income for rent and HUD pays the rest. (Tr. 58, 159-160). Based upon Lenhart's testimony, which I find credible on this point, both Section 8 programs (individual voucher and project-based) have historically had long waiting lists of persons wanting to become tenants. (Tr. 169-170).

2. During the period of time in which Willow Street had a Section 8 project-based contract with HUD, the vacancy rate at Willow Street was 1%, a relatively low vacancy rate, since 7% is considered to be an average vacancy rate. (Tr. 172, 56)

3. Lenhart's Section 8 project-based contract with HUD expired in October 1994. (Tr. 89). Thereafter, Lenhart was approved for the refinancing of Willow Street via a HUD non-recourse mortgage. (Tr. 94-97, 172). A HUD non-recourse mortgage is one in which in the event of a default the Government will not seek reimbursement of any deficiencies from the borrower, personally, assuming the absence of fraud. (Tr. 96-97). In October, 1994, when Lenhart refinanced the property and obtained a HUD-insured, non-recourse mortgage, he executed a regulatory agreement with regard to the Willow Street property. (Govt. Exh. 1). Pursuant to the terms of the Regulatory Agreement between the property owner and HUD, the mortgage, and the mortgage note, Lenhart was required to make monthly payments of principal and interest. (Govt. Exhs. 1, 2 and 3). At the time that Lenhart refinanced with HUD, he was specifically informed that HUD would not give him another project-based Section 8 contract. (Tr. 99).

4. From 1994, when Respondent's Section 8 project-based contract ended, through 1996, Lenhart continued to pay his mortgage in a timely fashion. (Tr. 173). However, Lenhart missed his first mortgage payment on April 1, 1997 and was in default as of May 1, 1997. (Tr. 6, 50)

5. Prior to Lenhart's default that year, HUD had submitted to Lenhart the results of a December 9, 1996 physical inspection report issued with regard to Willow Street. (AR, Tabs A-B). The transmittal letter dated March 19, 1997, which forwarded the physical inspection report, stated that the overall physical condition and maintenance policies and practices at Willow Street had been rated

below average and warned that Respondent was required to submit a correction plan by April 18, 1997. (AR, Tab A). However, the actual contents of the physical inspection report were, somewhat contradictory since, although in most instances the report did rate the overall physical condition, maintenance policies, and practices as below average (AR, Tab B at 5,6,8-10), in one instance the rating was satisfactory (AR, Tab B at 7) and the report's "Summary of Staff Skills & Quality of Maintenance" stated: "[i]t appears that the general maintenance of Willow Apartments is certainly adequate. While the neighborhood situation is obviously very difficult, it would seem that more effort need be directed at securing the site for the residents in order for the on going improvements to take hold." (AR, Tab B at 13).

6. By letter dated April 18, 1997, HUD wrote to Respondent memorializing an April 16, 1997 meeting between HUD representatives and Respondent in which Respondent was warned to keep his mortgage current. (AR, Tab C). In that letter, HUD also acknowledged that the drug problem in the New Britain area had worsened in 1996 and that while solutions offered by Respondent would help, additional measures would be necessary. Based upon this correspondence, upon the testimony of Suzanne Baran (HUD's Director of Multi-Family Housing Programs Center in Hartford, Connecticut), and Respondent's testimony on this point, I find that beginning in 1996 through early 1997, there was a surge in criminal activity associated with drug dealers and gangs in certain areas of New Britain. (Tr. 113-114, 173)

7. By letter dated April 23, 1997, Respondent wrote to HUD concerning the problems outlined in the physical inspection report and setting forth a plan to address the problems cited in the report. (AR, Tab D). HUD responded to the Lenhart letter by correspondence dated May 1, 1997, stating that: (1) Lenhart had not specified cost and funding sources for solutions set forth in his April 23rd letter; and (2) Lenhart had not specifically addressed recommendations discussed in the April 16th meeting for physical improvements to deter drug dealers.

8. The results of a HUD management review of Respondent's property were transmitted to Respondent. The review concluded that Respondent's management of Willow Street was unsatisfactory. HUD mandated that Respondent submit a correction plan by June 23, 1997. (AR, Tabs F-G)

9. Subsequently, correspondence between HUD and Respondent reflected disagreement between the parties with respect to: (1) the state of the exterior physical conditions at Willow Street; and (2) appropriate approaches to deal with the drug trafficking on and around Respondent's property. (AR, Tabs H-I). While Respondent took numerous and various actions in an effort to improve and maintain his property as well as to combat the drug problems, HUD asserted that his property was maintained at a substandard level. HUD also tried to convince Respondent that he should adopt different and/or additional approaches to dealing with the drug problems. (Tr. 47-48, 52-53, 72-78, 103-104, 173-176, 180-185). Both parties, however, were in agreement that the drug dealers and drug trafficking were serious barriers to Respondent's ability to attract tenants to Willow Street and consequently, to Respondent's ability to pay his mortgage. (AR, Tabs H-I); (Tr. 56, 103-104, 211).

10. By 1997 and throughout that year, the vacancy rate at Willow Street had climbed to 21%. (Tr. 56). Respondent had another Section 8 project-based contract with HUD which subsidized an apartment complex in Waterbury, Connecticut which never suffered from the same high vacancy rates as Willow Street. However, that property was located in an area not known for being

crime-ridden, and it was physically set up differently from Willow Street. (Tr. 112). Likewise, the apartment complex across the street from Willow Street, Talcott Gardens, which was not owned by Respondent, did not suffer from a high vacancy rate, but rather maintained a waiting list. (Tr. 124). Even though Talcott Gardens was substantially better maintained than Willow Street, drug dealers still loitered in front of Talcott Gardens, as they did at Willow Street. Talcott Gardens also had a Section 8 project-based contract with HUD. (Tr. 155).

11. On August 19, 1997, HUD sent formal notice to Respondent that he was in violation of his contractual obligations under the Regulatory Agreement he had executed with HUD, wherein Respondent was obligated to maintain the mortgaged premises in good repair and condition and to render prompt payment on the mortgage. The letter pointed out that Respondent had been in default since May 1, 1997. HUD directed Respondent to restore the physical property and to cure the mortgage default by September 19, 1997. (AR, Tab J).

12. By letter dated September 8, 1997, Lenhart responded to HUD, acknowledging that he was in default. Lenhart stated that his default was caused by the low occupancy and made reference to the termination of his Section 8 project-based contract and to the high crime rate problems at Willow Street. (AR, Tab K).

Recommended Decision

An LDP is a discretionary administrative sanction that is imposed in the best interests of the Government. 24 C.F.R. §24.700. Underlying the Government's authority not to do business with a person is the requirement that agencies only do business with "responsible" persons and entities. 24 C.F.R. §24.115. The term "responsible", as used in the context of administrative sanctions such as LDPs, debarments and suspensions, is a term of art which includes not only the ability to perform a contract satisfactorily, but the honesty and integrity of the participant. 48 Comp. Gen. 769 (1969). The test for whether a sanction is warranted is present responsibility, although lack of present responsibility may be inferred from past acts. *Schlesinger v. Gates*, 249 F.2d 111 (D.C. Cir. 1957); *Stanko Packing v. Bergland*, 489 F. Supp. 947, 949 (D.D.C. 1980). The Government bears the evidentiary burden of demonstrating, by adequate evidence, that cause for Respondent's LDP exists.

Under the terms of 24 C.F.R. §705(a)(4), a failure to honor contractual obligations or to proceed in accordance with contract specifications or HUD regulations will constitute grounds for the imposition of an LDP. Under the terms of the Regulatory Agreement, the mortgage, and the mortgage note, Lenhart was required to make timely monthly payments of principal and interest on the Willow Street property. The parties have stipulated to the fact that Respondent defaulted on the Willow Street mortgage. Respondent essentially argues that he should not be held responsible for the default because he did his best. However, it is not necessary to establish whether Lenhart's failure to pay his mortgage occurred despite his best efforts. Under the terms of 24 C.F.R. §705(a)(4), Respondent's default on the mortgage constituted adequate evidence, per se, for the imposition of the LDP. There is no requirement that HUD present further proof to support its decision to impose the LDP upon Lenhart. However, it is well established that mitigating evidence must be considered and that an administrative sanction is warranted only if it is in the best interests of the Government and the public. In addition, the imposition of an LDP by HUD is a serious sanction whose purpose is to protect the public interest and not for the purposes of punishment. 24 C.F.R. §24.115(b).

The parties extensively debated the adequacy of actions taken by Lenhart with respect to the maintenance of the physical condition of Willow Street and the control of the problems spawned by the drug traffic; this controversy goes to the heart of the matter. The Government has enumerated several items that it suggests Respondent could have undertaken to properly secure the project, and, by extension, argues that, had he done so, he could have maintained an occupancy rate low enough to keep Willow Street from going into default. The Government also criticizes Respondent for accepting his management fee while the project was in financial difficulty, a criticism that I do not find relevant. Respondent submits a long list of actions which he did employ in an attempt to sustain the financial viability of Willow Street. While the facts demonstrate that Respondent ultimately failed to do so, the picture is not one of a negligent manager or of one who is not conscientious of his obligations to his property, his tenants, or HUD.

Based upon the record viewed in its entirety, I find that the actions taken by Respondent with respect to the maintenance of Willow Street and with regard to his efforts to combat the problems generated by drug trafficking at or near his property were reasonable. While HUD suggested alternative and/or additional methods, Lenhart did, in fact, follow many of HUD's suggestions. The fact Respondent did not elect to follow all of HUD's suggestions and the fact that he was ultimately unsuccessful in fighting the tide of crime that hit New Britain in 1996 and early 1997, does not mean that his approach or efforts were unreasonable, that he is not a responsible participant in a HUD program, or that an administrative sanction is required.

Suzanne Baran, the Director of HUD's Multi-Family Housing Programs Center in Connecticut who made the determination whether to impose the LDP upon Respondent, testified that if a landlord defaulted but, in HUD's opinion, had taken all reasonable measures to avoid the default, HUD likely would not impose an LDP. (Tr. 99, 104). While HUD apparently does not view Lenhart as having attempted all conceivably reasonable efforts to avoid a default, I view his efforts, taken as a whole, as having been reasonable. There is no evidence that HUD abused its discretion to impose the LDP upon Respondent based solely upon his default pursuant to 24 C.F.R. §24.705(a)(4). However, given the fact that administrative sanctions should not be punitive and given the circumstances under which an LDP is selectively used as articulated by Baran, it would have been a more just resolution for HUD to have exercised its discretion without resort to imposing such a serious sanction given the unique circumstances of this case.

The existence of a cause for the imposition of an administrative sanction, however, does not necessarily require that the person be sanctioned. I find that Respondent has met his burden of proof in demonstrating the impact of the contravening programmatic and environmental factors which contributed substantially to the financial degradation of the Willow Street project. While I find that the imposition of the LDP is supported by adequate evidence based upon the state of default of the Willow Street mortgage, it is my recommended decision that the LDP was not warranted under the circumstances because Respondent acted in a responsible manner, amply cooperated with HUD in attempting to make Willow Street a viable project amidst conditions of societal adversity, and utilized reasonable measures to avoid default. In this case, the termination of Respondent's Section 8 project-based contract, without a concurrent sanction, was a sufficient remedy to protect the public interest.

For the reasons set forth above, I find that the LDP issued in this case is not warranted and should be terminated immediately.

David T. Anderson
Chief Administrative Judge

Date: December 4, 1998