This Preliminary Inquiry Memorandum (PIM) describes a complaint and the outcomes of limited procedures undertaken during a Preliminary Inquiry conducted by the Office of the Inspector General (OIG). Copies of this PIM along with your response, if any, will be provided to the members of the County Council and the County Executive within 10 business days of the date of this PIM.

Complaint Summary and Background:

Under Montgomery County Code §53A-4, Right of First Refusal, an owner of certain rental housing under contract for sale must offer the County, the Housing Opportunities Commission (HOC), and any tenant organization the right to buy the housing.\(^1\) The right of first refusal is exercised by accepting the offer.\(^2\)

In June of 2013, the County Department of Housing and Community Affairs (DHCA) exercised the County’s right of first refusal to purchase an apartment building in Bethesda consisting of 17-18 units. There was a pending contract between the seller and a private purchaser which indicated a sale price of $3.5 million, and DHCA contracted to buy the property at that price. DHCA then offered the property to HOC. With the agreement of HOC and the seller, in September of 2013, DHCA assigned its rights and obligations under the contract to HOC, and HOC bought the property for $3.5 million. HOC borrowed $5.2 million from the County’s Housing Initiative Fund. This included money for renovations.

OIG received an allegation that the seller and private purchaser had created a phony contract that improperly inflated the price of the property. The complainant alleged that the purpose of the contract was to induce HOC to exercise its right of first refusal, pay the

---

\(^1\) County Code §53A-4(a).
\(^2\) County Code §53A-4(d)(1).
inflated price, and thereby permit the seller and purchaser to share the profit from the sale. The complainant stated that he learned of this arrangement from someone who worked at an architecture firm in Bethesda that was involved in the sale of the property.

**Inquiry and Outcome:**

OIG staff met with HOC staff in September of 2014 and was told that it was DHCA that had exercised a right of first refusal regarding this property. HOC bought the property after DHCA offered HOC the opportunity to purchase it, along with a County loan to cover the purchase price plus renovations. HOC had no appraisals or market analysis performed when HOC decided to become the contract purchaser. HOC relied on DHCA’s decision to purchase for $3.5 million.

HOC’s *Administrative Guide for Administrators and Staff* states in the Administrative Procedures section that for acquisitions of land with structures, staff will present the Commission with two appraisals. It appears that HOC did not follow this procedure in this case. HOC does not have written policies or procedures specific to purchasing a property in the context of exercising a right of first refusal.

OIG staff met with the DHCA Director and staff in October of 2014. DHCA staff provided a copy of a financial analysis showing that the rents would be sufficient to support the operating expenses. DHCA had no appraisals for the property. The DHCA Director stated that the pending contract that had been provided to DHCA indicated the market price.

DHCA staff stated that under law, DHCA had to match the terms of the existing contract. It is the case that under County regulations, an acceptance of the offer to buy under the right of first refusal must include substantially the same terms as the owner’s offer. However, if DHCA had concluded that the price was too high, it could have chosen not to purchase.

OIG found no mention in DHCA’s files of the architecture firm the complainant referenced, although we did find that another architecture firm performed work related to this acquisition.

County Code §53A-4(c) requires the owner of the property to give the County, HOC, and any tenant organization any information that is “relevant to exercising the right of first refusal, such as architectural and engineering plans and specifications, and operating data.” County Regulation 53A.00.01.03 specifies further information to be submitted, including the latest tax assessment and a statement of income and expenses for the previous three years. It appears from the information provided by DHCA that these items were submitted to DHCA. DHCA does not have written policies or procedures for exercising a right of first refusal.

---

3 Code of Montgomery County Regulations (COMCOR) 53A.00.01.03 subsection 3.11.
In 2012, there had been a $3 million contract on the property, and DHCA did not exercise its right of first refusal at that time. That contract did not go to settlement, and we did not inquire into the reasons.

In 2013, DHCA was presented with the $3.5 million contract, and DHCA staff at first recommended against exercising the right of first refusal. DHCA staff told the OIG that at that time, they thought the property would consist of 10 townhouses, because the owner had provided information to DHCA indicating that the contract for sale was for the purpose of converting the property to 10 townhouses. The Director of DHCA asked the staff to reconsider, as the property, although approved for 10 townhouses, could remain as 17 to 18 apartment units. Because the property consisted of affordable apartments in an area with little affordable housing, staff then recommended that DHCA purchase it.

At the time of the 2012 and 2013 contracts, the property was assessed at $1,755,300, according to County Department of Finance records. The property is currently assessed at $3.5 million, according to State Department of Assessment and Taxation (SDAT) records. This increase to $3.5 million was done after the HOC purchase, and the assessment record lists the transfer to HOC. We did not ask SDAT how it developed the new value.

OIG researched public records, including criminal records, of the seller, the 2012 contract purchaser, and the 2013 contract purchaser.

**Summary and Conclusion:**

- OIG found no relationships between the seller and the purchasers in either of the two contracts and no evidence that would indicate collusion between the seller and either of the contract purchasers that would result in a bogus sale price.

- DHCA exercised its right of first refusal and contracted to purchase the property at a price that was twice the SDAT assessment, without having the property appraised.

- HOC bought the property for a price that was twice the SDAT assessment, without having the property appraised, possibly in violation of its policies and procedures for property acquisition.

- DHCA and HOC lack policies and procedures specific to exercising a right of first refusal.
DHCA and HOC appear to have complied with County law. That said, we believe DHCA and HOC need written policies and procedures for deciding to purchase property in conjunction with an exercise of the right of first refusal. These procedures may include requiring an appraisal, to guard against a fraudulently inflated price.

cc: Richard Y. Nelson, Jr., Director, Department of Housing and Community Affairs
Response to this Preliminary Inquiry Memorandum:

From Montgomery County Chief Administrative Officer:

On December 15, 2014, the office of the Chief Administrative Officer responded via email:

“Thank you for sending your Preliminary Inquiry Memorandum on DHCA/HOC Property Acquisition. We agree with your conclusion. We will develop written policies and procedures for deciding to purchase property in conjunction with an exercise of the right of first refusal. Please let me know if you have any questions or need additional information.”