



U.S. Department of Housing and Urban Development
Region 6, Office of Inspector General
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November 18, 2002

2003-FW-1801

MEMORANDUM FOR: Raynold Richardson
Director, Multifamily Housing Program Center, 6EHM

/SIGNED/

FROM: D. Michael Beard
Regional Inspector General for Audit, 6AGA

SUBJECT: Wood Hollow Place Apartments
Project Number 114-11183
Texas City, Texas

INTRODUCTION

We completed a review of Wood Hollow Place Apartments. The objective of our review was to determine whether expenditures and disbursements complied with the terms and conditions of the Regulatory Agreement and other HUD requirements.

METHODOLOGY AND SCOPE

Our review covered Wood Hollow Place Apartments' operations from December 9, 1999, through August 31, 2001. We expanded the scope of our review for one transaction to May 1999. To accomplish our objective, we:

- Reviewed the Regulatory Agreement and HUD's Handbook requirements;
- Examined the project's financial records and supporting documentation; and
- Interviewed HUD staff and the management agent and his staff.

We performed the fieldwork between October 2001 and January 2002. We conducted additional work in August 2002.

BACKGROUND

Wood Hollow Place Apartments, FHA Project 114-11183, was an 80-unit apartment complex located in Texas City, Texas. Wood Hollow Partners, Ltd., a Texas limited partnership, owned the project. As of October 1999, the partnership consisted of:

Community Housing Fund 1992-V	Limited Partner
Leslie A. Harlander	Special Limited Partner
Wood Hollow General Corporation ¹	General Partner

The partnership agreement called for Kingwood Equities, Inc.² to manage the project. Thus, Kingwood Equities, Inc. was the management agent. Mr. Stephen C. Helm was the president of Wood Hollow General Corporation, as well as Kingwood Equities, Inc.

HUD originally insured the mortgage of Wood Hollow Place Apartments under Section 221(d)(4) of the National Housing Act. However, the partnership refinanced the mortgage under Section 223(f) of the National Housing Act and signed a Regulatory Agreement with HUD on December 9, 1999. The partnership received \$285,245 in excess funds from the mortgage refinancing. The partnership was allowed to retain excess refinancing proceeds, but it deposited the excess in the project's operating account. The management agent depleted the excess funds by January 25, 2000. On that date, all of the project's banks accounts had a cumulative negative cash balance of \$476.

Although the management agent has been chronically delinquent in paying the mortgage, the project was not in default. However, the project was in a non-surplus cash position for our entire review period.

RESULTS OF REVIEW

Because the project experienced cash flow problems, the management agent did not follow the Regulatory Agreement and other HUD regulations. As a result, the management agent: (1) improperly paid advances, loans and other fees totaling \$223,373 and (2) paid \$27,684 in ineligible and \$7,500 in unsupported expenses. In addition, the management agent improperly used tenant security deposits funds to fund project operations. These improper payments weakened the project's financial condition and put the project at risk of default.

Criteria

As a condition of receiving mortgage insurance, owners must sign a Regulatory Agreement with HUD. Provisions in the Regulatory agreement specify that expenditures must be reasonable and

¹ Kingwood Equities, Inc. was the general partner from the partnership's inception to October 20, 1999. Kingwood Equities, Inc. assigned its partnership interest to Wood Hollow General Corp on October 20, 1999.

² Kingwood Equities, Inc. also does business as Helm Interests and The Helm Companies.

necessary to the project and limit the circumstances and manner under which the owner may take cash out of the project. Specifically, owners cannot make or receive any distribution of assets or income of any kind except surplus cash.³ The Regulatory Agreement also requires that the owner maintain a separate account for security deposits which at all times equals or exceeds the project's tenant security deposit obligations. The owner may contract with a management agent to operate and maintain the project. Nevertheless, the owner remains responsible for proper management of the project and compliance with the Regulatory Agreement.

Management agent improperly paid advances, loans, and other fees totaling \$223,373

Even though the owners and the management agent made loans, advances and contributions to the project totaling \$483,416, the project did not have surplus cash available during our review. The Regulatory Agreement and HUD's Handbooks prohibited repayments of loans and advances and distributions when a project was in a non-surplus cash position. In addition, HUD regulations required that fees for providing tax and other financial advice to the partners can only be paid from surplus cash. However, the management agent paid \$223,373 in advances, loans and other fees. The payments negatively impacted the project's precarious financial condition. HUD should require that these funds be repaid to the project. The following table summarizes the improper payments:

Payees	Description	Amount
Owners	Distribution	\$137,900
Management Agent	Repayments	\$58,703
Community Housing Fund	Investor Service Fees	\$5,000
Kingwood Equities, Inc	Developer Note ⁴	\$21,770
Total		\$223,373

Management agent paid \$27,684 in ineligible fees and expenses

The Regulatory Agreement and HUD's Handbooks prohibited owners from paying expenses that are not necessary and reasonable operating expenses of the project. Yet, the management agent paid itself \$19,456 in ineligible incentive fees and duplicate payroll expenses. In addition, the project paid \$8,228 in late charges and non-sufficient funds fees. The project would not have incurred and paid these fees if the management agent properly managed the property.

The management agent improperly paid itself a \$16,000 management incentive fee. The fee, which was payable from surplus cash, was an incentive payment for maintaining a high occupancy rate and effectively managing the property. Since the project did not have surplus

³ Surplus cash is any cash remaining after the payment of: (1) all sums due or currently required to be paid under the terms of any mortgage or note insured or held by the Secretary and (2) amounts required in reserve for replacement accounts. In addition, the project must have segregated cash funds for all tenant security deposits held and any special funds the project is required to maintain.

⁴ The Developer's note was for supervision and management of renovation work. The note was payable from surplus cash generated by the project.

cash or a high occupancy rate, the management agent did not earn this fee. Further, the project suffered from cash flow problems and was chronically delinquent on its mortgage. Thus, the management agent did not effectively manage it. HUD should require the management agent to repay this fee to the project.

The management agent paid itself \$3,456 twice for payroll expenses for the pay period ending May 7, 1999. The management agent reimbursed itself once in May 1999 and another time in December 1999. Such a duplicate payment is clearly ineligible and HUD should require the management agent to reimburse the project.

The management agent incurred and paid \$8,228 in late charges and non-sufficient funds fees. Late fees and bank charges might be considered a reasonable operating expense. However, the owners and management agent caused the projects cash flow problems by making unauthorized repayments and distributions. Since the project would have had sufficient funds if the distributions had not occurred, these late fees and bank charges are not reasonable and necessary costs of operating the project. HUD should require the management agent to repay these funds to the project.

Management agent paid \$7,500 in unsupported expenses

In addition to being reasonable and necessary costs of the project, HUD's regulations required that all disbursements be supported by invoices, bills, or other supporting documentation. However, the management agent paid \$7,500 to Premier Construction Company (Premier), an affiliate of Kingwood Equities, Inc, without any supporting documentation. Since Mr. Helm stated that Premier was not active and the 1999 audited financial reports did not list any outstanding accounts payable to Premier, the payment was highly irregular. HUD should require that the management agent support this expense or repay the funds to the project.

Management agent used tenant security deposits to fund project operations

According to Mr. Helm, since the project experienced cash flow problems, the management agent used tenant security deposits to fund project operations. However, tenant security deposits are not operating funds. Instead, they are a liability of the project. Further, the Regulatory agreement required that the account be fully funded and maintained separately from the project's operating funds. Yet, on average, the project owed the tenant security deposit account over \$13,000. At one point, the account had a negative balance of \$423. During most of our audit, the project did not have sufficient funds in the account to repay the all tenants their deposits. HUD should require the owner to: (1) fully fund the account and (2) stop using the deposits for project operations.

AUDITEE COMMENTS

Although we requested written comments by October 25, 2002, the management agent did not provide us with any. In addition, we called on October 28, 2002, but could not get a hold of the

management agent. The management agent, however, provided verbal comments at the exit conference.

Overall, the management agent agreed with the report. The management agent admitted improper disbursements occurred. He attributed the \$223,373 in improper disbursements to: (1) management's failure to track the amount of disbursements being made and (2) the project's failure to cash flow as expected. The management agent agreed to repay the improper disbursements. In addition, the management agreed to repay the ineligible expenses. According to the management agent, the project paid the ineligible incentive fee because he did not realize that the project did not have a high occupancy rate. He stated the ineligible duplicate payroll expense was a bookkeeping error. The management agent also agreed to research the payments to the identity-of-interest construction firm and repay the amount if he could not provide support.

We also provided HUD the draft memorandum for review and comments. HUD responded that they concurred with our findings and recommendations.

RECOMMENDATIONS

We recommend that the HUD Houston Multifamily office require the management agent and/or the partnership to:

- 1A. Immediately cease the practice of making distributions when the project is not in a surplus cash position.
- 1B. Repay the project \$223,373 for the improper distributions.
- 1C. Repay the project \$27,684 for the ineligible expenditures.
- 1C. Either provide justification and supporting documentation for the \$7,500 of unsupported expenditures or repay the projects for these costs.
- 1D. Require the management agent to fully fund tenant security deposits.
- 1E. Provide HUD for 6 months a monthly disbursement report, which includes disbursements by wire and on-line transfers, and a copy of its tenant security deposit account bank statement.

Further, we recommend the HUD Houston Multifamily office:

- 1F. Review the monthly disbursement reports to ensure that the management agent does not make any other distributions when the project is in a non-surplus cash position. In addition, HUD should review the tenant security deposit bank statement to ensure that the account is fully funded and not being used to fund project operations.

1G. Take appropriate administrative action through sanctions to protect HUD's interest if improper distributions or usage of tenant security deposits continues.

Within 60 days please provide us, for each recommendation without management decisions, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Also, please furnish us copies of any correspondence or directives issued because of this review.

Should you or your staff have any questions, please contact Theresa Carroll, Assistant District Inspector General for Audit, at (817) 978- 9309.

DISTRIBUTION

Wood Hollow Partners LTD, League City, Texas

Community Housing Fund 1992-V, L.P., Limited Partner

Leslie A. Harlander, Special Limited Partner

The Honorable Joseph Lieberman, Chairman, Committee on Government Affairs

The Honorable Fred Thompson, Ranking Member, Committee on Governmental Affairs

Sharon Pinkerton, Senior Advisor, Subcommittee on Criminal Justice, Drug Policy & Human Resources

Andy Cochran, House Committee on Financial Services

Clinton C. Jones, Senior Counsel, Committee on Financial Services

Kay Gibbs, Committee on Financial Services

Stanley Czerwinski, Director, Housing and Telecommunications Issues, U.S. GAO

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