U.S. Department of Housing and Urban Development
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November 2, 2004 **2005-FW-1801**

MEMORANDUM FOR: Ray H. Carson
Director, Multifamily Program Center, 6AHMA

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

SUBJECT: Audit of Highland Meadows Apartments
Federal Housing Administration 112-11106
Dallas, Texas

INTRODUCTION

We performed an audit survey at Highland Meadows Apartments. Based upon the results of the survey, we determined there was not a need to perform further audit work. During our survey, we concluded the following reportable conditions. The owner:

- Paid $68,000 to an unapproved identity-of-interest management company;
- Took $45,000 in distributions when the property was not in good repair and in a non-surplus cash position;
- Paid $10,556 to other identity-of-interest entities;
- Paid $870 in ineligible expenses; and
- Maintained the property in poor condition.

In accordance with HUD Handbook 2000.06 REV-3, within 60 days, please furnish this office, for each recommendation in this report, a status on: (1) corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is not considered necessary. Additional status reports are required at 90 days and 120 days after report issuance for any recommendation without a management decision. Also, please furnish us copies of any correspondence or directives issued related to the audit.

Please call William W. Nixon, Assistant Regional Inspector General, at (817) 978-9309 if you or your staff has any questions.

METHODOLOGY AND SCOPE

Our audit survey objectives were to determine the owner's performance relating to:

- Appropriate use of project funds.
- Maintaining the property in a satisfactory physical condition in accordance with the Department of Housing and Urban Development's (HUD) Uniform Physical Condition Standards.

To achieve our objectives, we:

- Reviewed the regulatory agreement and other applicable requirements;
- Reviewed HUD files and reports;
- Reviewed financial and other documents obtained from the owner;
- Interviewed HUD and Highland Meadows' staff; and
- Inspected units to confirm whether deficiencies had been corrected and to document current condition of the units.

Although our scope was to include April 2001 through June 2004, the owner only provided documentation from April 2001 through November 2003. We performed our fieldwork from June 2004 through August 2004. We did not complete all audit procedures or completely answer the audit objectives since we decided not to continue the audit.

Criteria

The regulatory agreement and HUD regulations required the owner to:

- Receive distributions if he was in compliance with all the provisions of the regulatory agreement, including the requirement that the project be in good repair and condition;[1]

- Not enter into an agreement to pay, pay, or become obligated to pay management fees to the proposed agent because HUD did not approve the agent;[2]

- Pay from the management fee for services that are not front-line activities except for centralized accounting and computer services;[3] and

- Obtain prior approval of HUD to assign, transfer, dispose of, or encumber any personal property of the project, including the rents, or pay out any funds except from surplus cash, for reasonable operating expenses and necessary repairs.[4]

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[1] 4370.2, Financial Operations and Accounting Procedures for Insured Properties, Section 2-10 F.
[2] 4381.5, Management Documents, Agents and Fees, 2.16.a. (2).
[3] 4381.5, Management Documents, Agents, and Fees, 6.39.a.
[4] Regulatory agreement 6. (b).

BACKGROUND

The owner, Tracy Ishino, purchased Highland Meadows in April 2001. Highland Meadows is a 106-unit apartment complex located on the east side of Dallas, Texas. HUD insures the mortgage under the National Housing Act.[5] As of March 2004, the outstanding balance of the mortgage totaled $1.4 million. The owner did not provided HUD with any financial information since purchasing the property in 2001.

Additionally, HUD's Real Estate Assessment Center (REAC) scored the property lower than the acceptable 60 points in 2 of the last 3 years.

Year	Score
2001	52
2002	44
2003	82

In March 2004, a HUD Management Review gave the property an overall rating of unsatisfactory.

In August 2004, HUD, at the request of the owner, paid the electric and water bills totaling approximately $45,000 in lieu of the utilities being turned off. HUD is foreclosing on Highland Meadows.

RESULTS OF REVIEW

In total the owner paid $124,426 in ineligible distributions and expenditures. Specifically, the owner using Highland Meadows funds:

- Paid $68,000 to his identity-of-interest management company;
- Took $45,000 in distributions;
- Paid $10,556 to identity-of-interest entities; and
- Paid $870 in ineligible expenses.

Since the owner did not submit the required financial statements, no computation of surplus cash was performed. Based upon our attempt to calculate surplus cash for 2001 and 2002, we concluded the project was not in a surplus cash position, regardless of whether the units met housing quality standards. This occurred because the owner ignored or disregarded the regulatory agreement[6] and HUD's requirements.

5 Federal Housing Administration Number 112-11106 insured under Section 223(f).
6 Paragraph 6(e).

The Owner Paid His Company $68,000.

Highland Meadows ineligibly paid $68,000 in management fees to an identity-of-interest company from April 2001 to May 2004.[7] HUD could not approve the identity-of-interest company, Pacific Coast Management, as the management agent because the owner failed to submit required financial information to HUD. Because HUD never approved the management agent, we consider the expenses ineligible.

The Owner Took $45,000 in Highland Meadows Funds.

Violating the regulatory agreement, the owner took $45,000 in distributions from May 2001[8] through September 2002. Because the owner did not provide financial information, we calculated Highland Meadows' surplus cash as of the end of 2001 and 2002 based upon the best available information. Our calculations showed that Highland Meadows was in a non-surplus cash position both years. The regulatory agreement states owners shall not without prior written approval of the Secretary make or receive and retain any distribution of assets or any income of any kind except from surplus cash.

Listing of Distributions to the Owner

Date	Distribution Amount
5/25/2001	$ 5,000.00
5/2/2002	15,000.00
7/25/2002	15,000.00
9/25/2002	10,000.00
Total	**$ 45,000.00**

The Owner Used $10,556 in Highland Meadows Funds to Identity-of-Interest Entities.

According to documentation, Highland Meadows repaid $10,556 to related entities for gas bills and payroll costs. The regulatory agreement required the owner obtain approval prior to encumbering funds.

The Owner Paid $870 in Ineligible Expenses.

Further, the owner paid $870 from April 2001 to February 2003 for ineligible activities such as:

- Owner travel expenses to visit the property;
- A Christmas party;

7 The $68,000 does not represent costs of paying front-line employees because front-line employee's expenses are an allowable expense for the property.

8 One month after purchasing the property.

- A pager used by owner; and
- Legal fees incurred by the owner.

The regulatory agreement required the owner to use funds for reasonable operating expenses and necessary repairs. The above expenses do not meet those criteria.

Property in Poor Physical Condition.

The owner maintained the property in poor condition. Of the 540 deficiencies noted during the REAC and HUD Multifamily Management Reviews conducted from 2001 through 2004, the owner did not correct 216 or 40 percent of the deficiencies. Some of the same deficiencies reported to the owner as needing repair in the 2001 REAC review were reported again in 2004 HUD Multifamily Management Review. We conducted an on-site observation of individual units on July 29, 2004. We observed:

- Chipped sinks and tubs;
- Inoperable ground fault plugs;
- Leaking faucets;
- Missing or inoperable smoke detectors;
- Inoperable garbage disposals, range vent hoods, and stove burners; and
- Infestation of roaches.

An example of an occupied unit's bathroom.

The management agent told HUD during the 2004 Management Review that there was no money for repairs. Therefore, the owner performed no preventive maintenance and only performed emergency repairs. The apartment manager made the same statement when we asked in June

2004. This is a violation of the regulatory agreement,[9] which states that owners shall maintain the mortgaged premises in good repair and condition.

The Owner's Involvement in Another HUD Project, High Oak Terrace.

In January 1999**,** the owner purchased High Oak Terrace located in Arlington, Texas. In February 2004, the owner abandoned this property after he had stopped paying utility bills in December 2003 while market rate tenants still resided at the property.

RECOMMENDATIONS

We recommend HUD's Director, Multifamily Program Center in Fort Worth:

1A. Seek reimbursement from the owner for the $124,426 in ineligible disbursements and payments.

We recommend HUD's Director, Departmental Enforcement Center:

1B. Impose sanctions against the owner as appropriate, including debarment and civil and/or criminal money penalties.

[9] Paragraph 7.