



U.S. Department of Housing and Urban Development
Southwest District Office of Inspector General
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November 24, 2000

01-FW-111-0801

MEMORANDUM FOR: Dane Narode
Deputy Chief Counsel, Administrative Proceedings Branch
Legal Division, VALA

SIGNED

FROM: William W. Nixon
Acting District Inspector General for Audit, 6AGA

SUBJECT: Request for Investigation of the Rainbow Village Project
in Houston, Texas for a Possible Program Fraud Civil Remedies Act Filing

At the request of HUD's Counsel, we performed a limited review of the Rainbow Village Section 202 project to determine whether a Program Fraud Civil Remedies Act (PFCRA) filing was merited. To perform the review, we reviewed information provided by you and the project files. We also interviewed appropriate HUD staff. Based on our work and HUD's inaction, we do not believe that a PFCRA filing is appropriate. We do not believe that debarment is an appropriate action either. Instead, HUD should take administrative action to prevent any future payments to entities with prohibited conflicts of interest. In addition, HUD Counsel must determine whether HUD's inaction on information in its possession negatively affects its ability to recover previous payments to entities with conflicts of interest. Further, HUD should provide notice to the three individuals and their related conflict-of-interest entities that they will not be able to participate in any future phases of the project because of their conflicts. Finally, HUD must adjust the remaining amount of the developer's fee to ensure that the amount paid at final closing does not exceed the 8 percent regulatory cap.

Background

Rainbow Village is a HUD-funded Section 202 Elderly multifamily housing property located in Houston, Texas. The project sponsors were awarded a fund reservation pursuant to the 202 Loan Program in 1996. The sponsor's application identified Mr. Daniel Nip as a consultant on the project. The sponsor then created the ownership entity, Houston Chinese Senior Estates, and named Mr. Nip as the Owner's President. Mr. Thomas Lord, an Officer of the management company is also Vice President of the ownership entity. Finally, one attorney of the legal counsel for the ownership entity had a conflict of interest with ownership Board Member Ms. Antonia Day.

Findings

In its request, Counsel stated that it appeared that Mr. Nip, Mr. Lord, and Ms. Day may have made false statements/certifications in order to obtain HUD contracts and funding. In our opinion, the issue is not clear-cut. As discussed in more detail below, HUD had documents in its possession prior to the project's initial closing that identified the three individuals and their conflict-of-interest relationships. HUD should have canceled the fund reservation based on the conflicts that existed. Yet, HUD took no action at the initial closing. HUD did not question the conflicts until the project entered the final closing stage.

Daniel Nip's Conflict of Interest

Since he served both as President of the Owner and Consultant, Mr. Nip has a prohibited conflict-of-interest relationship. HUD's Section 202 regulations prohibit Officers and Board Members of either the Sponsor or Owner from having a financial interest in any contract with the Owner or in any firm, which has a contract with the Owner. The prohibition period is for as long as the individual is on the Board and for a period of 3 years following resignation or final closing, whichever comes later.¹ However, HUD had or should have had knowledge of Mr. Nip's prohibited relationship. In January 1997, Mr. Nip submitted two HUD-2530 *Previous Participation Certificates*. One certificate showed him as President of the Owner. The other identified him as the consultant. For consultants, the burden is upon HUD staff to review the HUD-2530's to determine if conflicts of interest or identities of interest exist.² HUD apparently reviewed and approved these documents in April 1997 based on information stamped on them. Yet, HUD did not inform Mr. Nip that a conflict existed nor did it take any action to cancel the fund reservation.

Counsel is arguing that the two conflict-of-interest statements prepared by Mr. Nip are a civil fraud. The two statements, which do not disclose his conflict as President and Consultant, were prepared and submitted to HUD on March 18, 1997, after the HUD-2530 statements. If these were the only documents in the file, there would be a better civil case. However, in June 1997, Mr. Nip submitted a notarized *Identity of Interest and Disclosure Certification*. Although it is not a HUD form, the certification plainly discloses that Mr. Nip is both Consultant for and President of the Owner. Again, HUD did not question the conflict even though it had all of these documents when initial closing was held in September 1997.

Thomas Lord's Conflict of Interest

In a scenario similar to Mr. Nip's, Mr. Lord also has a prohibited conflict-of-interest relationship. Mr. Lord is Vice President of the Owner and an Officer of the Managing Agent. Again, HUD either was aware of or should have been aware of this conflict before initial closing. In January 1997, Mr. Lord submitted his HUD-2530 *Previous Participation Certificate*, on which he clearly disclosed that he was both an Owner Board Member and Officer of the Managing Agent. Based on a review stamp, HUD reviewed this form and does not appear to have

¹ 24 CFR Part 891. 130(a)(1)

² HUD Notice 96-102, Section III, Paragraph E.6.(d)

questioned this obvious conflict of interest. HUD should have canceled the fund reservation at this time. Like Mr. Nip, Mr. Lord also prepared a March 1997 conflict-of-interest statement that did not disclose the conflict. However, Mr. Lord prepared a June 1997 notarized *Identity of Interest and Disclosure Certification* that plainly shows him as both Vice President and a representative of the Managing Agent. HUD apparently did not question this conflict even though it was readily apparent at the time of initial closing in September 1997.

Antonia Day's Conflict of Interest

In the case of the Owner's Board Member, Antonia Day, she has a prohibited conflict of interest because her sister is one of the partners for the Owner's legal counsel: Mayor, Day, Caldwell & Keeton, L.L.P. HUD's Handbook on Section 202 Supportive Housing for the Elderly expands prohibited conflicts of interest to include contracts for services with family members of any officer, director, or authorized agent of the Sponsor or Owner.³ Ms. Day did submit a *Conflict of Interest and Disclosure Certification* on March 24, 1997. In it, Ms. Day stated that she did not have any prohibited conflicts. However, on March 12, 1997, prior to her conflict-of-interest statement, the Owner's legal counsel submitted a non-standard conflict of interest and disclosure certification that identified Ms. Day as the sister of one of the firm's partners. HUD should not have proceeded to the initial closing in September 1997 based on the conflict-of-interest information in the legal counsel's disclosure statement. However, HUD performed the initial closing and apparently did not object to this conflict of interest.

Since HUD had in its possession documents which clearly identify that these three individuals had conflicts of interest, we do not believe a good civil fraud case exists. HUD is responsible for reviewing Owner corporations, Previous Participation Certificates, and Conflict of Interest and Disclosure Certifications. Although they submitted one certification that does not disclose their conflict, both Mr. Nip and Mr. Lord openly stated their conflicts of interest to HUD, both before and after the inaccurate disclosure form was submitted in March 1997. The only individual against whom a good civil case might be made would be Ms. Day, since she did not subsequently detail her conflict. However, it can be argued that HUD should have detected the conflict from information provided by the Owner's legal counsel and thus should not have proceeded to initial closing.

Even though we are not recommending civil action, several issues remain to be resolved. One, HUD should not allow anymore payments to individuals with conflicts. HUD's Section 202 regulations clearly state the Owner should not be controlled by or under the direction of persons seeking to derive profit or gain there from.⁴ Further, officers and directors of the Owner are prohibited from having a financial interest in any contract with the owner. Thus, HUD should not compound its past errors by allowing anymore payments that are clearly prohibited. HUD should issue formal letters to the individuals detailing their conflicts and informing them that future payments will not be made to them or to entities with which they have prohibited conflicts of interest. Two, HUD Counsel needs to determine if HUD's inaction on documents in its possession prevents it from recovering funds previously paid to entities with conflicts. HUD

³ HUD Handbook 4571.3, REV-1, 1-11, Paragraph D.1.b.

⁴ 24 CFR, Part 891.205.

made the previous payments to entities that clearly had prohibited conflicts. Thus, HUD may be able to issue a demand letter to recover these ineligible payments if Counsel determines that HUD's silence does not negatively impact HUD's ability to recover the funds. Finally, HUD has provided information that indicates that another phase of Rainbow Village is under consideration. Prior to funding any other phases, HUD should provide written notice to the three individuals and their related conflict-of-interest entities that they will not be able to participate in any future phases of the Rainbow Village project because of their conflicts.

Developer's Fee Improperly Increased

While reviewing the project files, we also noted that an administrative error occurred. HUD improperly increased the developer's fee from \$373,136 to \$381,482. The Section 202 Program limits a developer's fee to 8 percent of the total replacement cost of the project. The original amount of the capital advance for this project was \$4,584,200. The amount of the developer's fee was properly computed to be \$366,736 on the capital advance agreement. However, HUD's handwritten Financial Record of Mortgage Loan Transaction⁵ prepared at the same time shows the mortgage proceeds to incorrectly be \$4,768,500 and a corresponding 8 percent fee of \$381,482. An amended capital advance prepared in January 2000 correctly shows that the mortgage increased to \$4,664,200. The 8 percent developer's fee for this amount is \$373,136. However, the Cost Certification Review sheet prepared in January 2000 for final closing incorrectly shows the mortgage amount as \$4,768,500 and an 8 percent developer's fee of \$381,482. Before final closing occurs on this project, HUD needs to take action to ensure that the total amount paid as the developer's fee does not exceed 8 percent of the total replacement cost of the project.

We recommend for the Rainbow Village Section 202 project that:

- 1A. HUD's Fort Worth Multifamily HUB Office take administrative action to prevent any future payments to entities with prohibited conflicts of interest.
- 1B. HUD's Office of Counsel should determine whether HUD's inaction on information in its possession negatively affects its ability to recover any previous payments of fees to any of the principles that have a conflict of interest with Officers or Board Members of the Owner.
- 1C. HUD's Office of Counsel should provide written notice to the three individuals and their related conflict of interest entities that they will not be able to participate in any future phases of the Rainbow Village project because of their conflicts.
- 1D. HUD's Houston Multifamily Program Center review the project files and take action to ensure that the developer's fee is limited to 8 percent of the total replacement cost of the project.

⁵ Form HUD-9245

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