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MEMORANDUM NO.
2004-CH-1803

August 9, 2004

MEMORANDUM FOR: Preston A. Pace, Jr., Director of Columbus Multifamily Housing
Hub, 5EHMLA
Margarita Maisonet, Director of Departmental Enforcement
Center, CV

FROM: Heath Wolfe, Regional Inspector General for Audit, 5AGA

SUBJECT: Somerset Point Nursing Home
Multifamily Equity Skimming
Shaker Heights, Ohio

INTRODUCTION

We reviewed the books and records of Somerset Point Nursing Home (Project) to determine whether the owner/management agent used the Project's funds in compliance with the Regulatory Agreement between HUD and the Somerset Point Limited Partnership and HUD's requirements. The Somerset Point Limited Partnership and/or Associated Motor Inns, the Somerset Point Nursing Home's identity of interest management agent, inappropriately used \$329,255 of Project funds when the Nursing Home was in a non-surplus cash position and/or had defaulted on its FHA-insured mortgage.

BACKGROUND

The Somerset Point Nursing Home is a combination of a 50-bed skilled nursing facility and a 90 unit assisted living facility in Shaker Heights, Ohio. The Project was insured under Section 232 of the National Housing Act, and the Regulatory Agreement was executed on June 1, 1994. The Project's owner is Somerset Point Limited Partnership, of which SOMSOL, Inc. is the General Partner. The president of SOMSOL, Inc. is also the president of Associated Motor Inns. The Project defaulted on its FHA-insured mortgage in November 2002.

METHODOLOGY AND SCOPE

Our review covered the period between September 1, 2001 and August 31, 2003. The review period was extended as necessary. We interviewed HUD's staff, State of Ohio officials, and employees of the: Project; Somerset Point Limited Partnership; General Partner; current and former management companies; Independent Public Accountant; and the Project's mortgage company. We reviewed the Project's files including: general ledgers; canceled checks; invoices; Regulatory Agreement; and Audited Financial Statements for Fiscal Years 2000 to 2002. We also reviewed: HUD Handbooks 4370.1 REV-2, 4370.2 REV-1, and 4381.5 REV-2; 24 CFR Parts 24 and 232; Title 12 of the United States Code Sections 1715z-4a, 1715z-19, and 1735f-15; and Section 1303.32 of the Ohio Revised Code.

RESULTS OF REVIEW

The Somerset Point Limited Partnership and/or Associated Motor Inns inappropriately used \$329,255 of Project funds between December 1998 and October 2003. The inappropriate expenses included: \$160,227 to repay advances made by SOMSOL, Inc.; \$93,591 in excessive management fees paid to Associated Motor Inns; and \$75,437 in legal fees unrelated to the Project's operations. We provided Associated Motor Inns, the Somerset Point Limited Partnership, and HUD's staff a schedule of the inappropriate expenses. The Project was in a non-surplus cash position and/or had defaulted on its FHA-insured mortgage when the funds were used. As a result, Project funds were not used efficiently and effectively, and fewer funds were available for the Project's normal operation and debt service.

Federal Requirements

The Regulatory Agreement, between HUD and the Somerset Point Limited Partnership, paragraph 6(e), states that the Owners may not, without prior written approval of HUD: assign, transfer, dispose of, or encumber any personal property of the Project, including rents, or pay out any funds, other than from surplus cash, except for reasonable operating expenses and necessary repairs; make or receive and retain any distribution of assets or any income of the Project except surplus cash; and incur any liability other than for current operating expenses.

Paragraph 13(g) of the Project's Regulatory Agreement defines distribution as any withdrawal or taking of cash or any assets of the Project, excluding payments for reasonable expenses incident to the operation and maintenance of the Project.

HUD Handbook 4370.2 REV-1, Chapter 2-6(E), requires that all disbursement be used to make mortgage payments and required deposits, pay reasonable expenses necessary for the operations and maintenance of the project, and pay distributions of surplus cash.

24 CFR Part 24.110 permits HUD to take administrative sanctions against employees or recipients under HUD assistance agreements that violate HUD's requirements. 24 CFR Parts 24.300, 24.400, and 24.700 authorize the sanctions, which include debarment, suspension, or limited denial of participation, respectively. HUD may impose administrative sanctions under the following conditions:

- Failure to honor contractual obligations or to proceed in accordance with contract specifications or HUD regulations (limited denial of participation);
- Deficiencies in ongoing construction projects (limited denial of participation);
- Violation of any law, regulation, or procedure relating to the application for financial assistance, insurance, or guarantee or to the performance of obligations incurred following a grant of financial assistance or a conditional or final commitment to insure or guarantee (limited denial of participation);
- Violation of the terms of a public agreement or transaction so serious that it affects the integrity of an agency program, such as a history of failure to perform or unsatisfactory performance of one or more public agreements or transactions (debarment);
- Any other cause so serious or compelling in nature that it affects the present responsibility of a person (debarment); or
- Material violation of a statutory or regulatory provision or program requirements applicable to a public agreement or transaction, including applications for grants, financial assistance, insurance, or guarantees, or to the performance of requirements under a grant, assistance award, or conditional or final commitment to insure or guarantee (debarment).

Title 12, United States Code, Section 1715z-4a, Double Damages Remedy for Unauthorized Use of Multifamily Housing Project Assets and Income, allows the Attorney General to recover double the value of any housing project assets or income that was used in violation of the Regulatory Agreement or any applicable regulations, plus all costs relating to the actions, including but not limited to reasonable attorney and auditing fees.

Title 12, United States Code, Section 1735f-15, Civil Money Penalties Against Multifamily Mortgagors allows the Secretary to impose a civil money penalty of up to \$25,000 per violation against a mortgagor, with five or more living units and a HUD-insured mortgage. A penalty may be imposed for any knowing and material violation of the Regulatory Agreement by the mortgagor, such as paying out any funds for expenses that were not reasonable and necessary operating expenses or making distributions to owners while the project is in a non-surplus cash position.

Recommendations

We recommend that HUD’s Director of Multifamily Housing Hub, Columbus Field Office, ensure that the Somerset Point Limited Partnership and/or Associated Motor Inns:

- A. Reimburses HUD \$329,255 for the inappropriate payments cited in this audit memorandum.

We recommend that HUD’s Director of Multifamily Housing Hub, Columbus Field Office, in conjunction with HUD’s Office of Inspector General:

- B. Pursues double damages remedies if the Somerset Point Limited Partnership and/or Associated Motor Inns do not reimburse HUD for the inappropriate payments cited in this audit memorandum.

We also recommend that HUD’s Director of Departmental Enforcement Center:

- C. Pursues administrative sanctions against the Somerset Point Limited Partnership and/or Associated Motor Inns for the inappropriate payments cited in this memorandum.
- D. Imposes civil money penalties against the Somerset Point Limited Partnership and/or Associated Motor Inns for the inappropriate payments cited in this audit memorandum while the Project was in a non-surplus cash position and/or in default on its FHA-insured mortgage.

SCHEDULE OF INELIGIBLE COSTS

<u>Recommendation</u>	
<u>Number</u>	<u>Ineligible 1/</u>
A	<u>\$329,255</u>
Total	<u>\$329,255</u>

1/ Ineligible costs are costs charged to a HUD-financed or insured program or activity that the auditor believes are not allowable by law, contract, or Federal, State, or local policies or regulations.

In accordance with HUD Handbook 2000.06 REV-3, within 60 days, please provide us, for each recommendation without a management decision, 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. Additional status reports are required at 90 days and 120 days after

the report is issued for any recommendation without a management decision. Also, please furnish us copies of any correspondence or directives issued because of the audit.

If you or your staff has any questions, please contact Ronald Farrell, Assistant Regional Inspector General for Audit, at (614) 469-5737 extension 8279 or me at (312) 353-7832.