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**MEMORANDUM NO.**  
2004-CH-1804

September 16, 2004

**MEMORANDUM FOR:** Howard Goldman, Director of Minneapolis Multifamily  
Housing Hub, 5KHMLA  
Margarita Maisonet, Director of Departmental Enforcement  
Center, CV

*Thomas M. Towers*

**FROM:** Tom Towers, Acting Regional Inspector General for Audit, 5AGA

**SUBJECT:** Legacy Management and Development Corporation  
Multifamily Equity Skimming  
Edina, Minnesota

### **INTRODUCTION**

We reviewed the books and records of Legacy Management and Development Corporation. We performed the review to determine whether Legacy Management used Projects' funds in compliance with the Regulatory Agreements and HUD's requirements. Legacy Management inappropriately used \$305,038 from or six Projects under its management. Legacy Management charged two Projects for an Occupancy Specialist's salary while charging six Projects an occupancy service fee for the same services. For maintenance charges, Legacy Management used rates for skilled labor (to be consistent with local industry charges) even though the work performed required unskilled labor. In other instances, charges for work were ineligible because the employees responsible for doing the work were absent. Also, Legacy Management used a general description to describe maintenance services to save time instead of itemizing each service provided. The \$305,038 in inappropriate payments occurred while most Projects were in a non-surplus cash position, and consequently, was no longer available for the operation and repair of the Projects.

### **BACKGROUND**

Legacy Management and Development Corporation managed six Projects that included Como by the Lake, Archer Heights Minnetonka, Legacy Village, Yorktown Continental, Archer Heights Maplewood, and York Manor. The owner of Legacy Management also owned

Legacy Maintenance, which provided maintenance services for the six Projects. In addition, the owner had an ownership interest (identity of interest) in Legacy Village, Archer Heights Minnetonka, Archer Heights Maplewood, and York Manor.

### **METHODOLOGY AND SCOPE**

Our review covered the period between January 1, 1996 and June 30, 2000. The review period was extended as necessary. We interviewed HUD's staff, Legacy Management and Development employees, and Legacy's maintenance employees. We reviewed the Projects' files including general ledgers, check stubs, invoices, Regulatory Agreements, and audited financial statements for Fiscal Years 1997 to 1999. We also reviewed HUD Handbook 4370.2 REV-1 CHG-1, 24 CFR Part 24, Title 12 of the United States Code Section 1735f-15, and Title 31 of the United States Code Section 3801.

### **RESULTS OF REVIEW**

Legacy Management made inappropriate payments totaling \$305,038 when most Projects under its management were in a non-surplus cash position. The inappropriate payments included \$70,239 in double-billings, \$34,412 in over-charges, \$2,778 for work claimed while employees were absent, and \$197,609 in charges for maintenance tasks that were not itemized.

**Double-Billing for Occupancy Services.** Legacy Management and Development Corporation improperly disbursed \$70,239 in Projects' funds by charging an occupancy service fee to six Projects, while also charging two of the Projects for the salary of its Occupancy Specialist. During 1996 through 1998, Legacy Management charged \$34,701 and \$35,538 in salary expenses to Archer Heights Minnetonka and Archer Heights Maplewood Projects, respectively. At the same time, Legacy Management charged a total of \$52,123 in occupancy service fees for all six Projects. Legacy Management's Vice-President said the Specialist's salary was charged to the two Projects because the Specialist periodically filled in for the Project Manager. According to HUD Handbook 4370.2 REV 1 CHG 1, charging for personnel who oversee or supervise project operations should not be charged to the project as these salaries are paid from the management fees. Because Legacy Management improperly disbursed \$70,239 of the Projects' funds, fewer funds were available for the operation and repair of the Projects.

Of the \$70,239 that was double-billed, \$52,483 occurred when the affected Projects were in a non-surplus cash condition. Archer Heights Minnetonka was in a non-surplus cash position in 1997 and 1998, and Archer Heights Maplewood was in a non-surplus cash position in 1996.

**Improper Maintenance Charges.** Legacy Management and Development Corporation improperly disbursed Project funds by charging Projects more than the amount ordinarily paid on the open market for unskilled services. Legacy Management improperly disbursed \$34,412 for unskilled services (from January 30, 1996 to June 30, 2000). Legacy Management considered the maintenance charges to be consistent with local industry charges.

We determined that the ineligible charges were for payments made to workers using a skilled labor rate for unskilled work. For example, one invoice disclosed a \$100 charge for four hours spent by a maintenance employee picking up and delivering plants.

Legacy Management also charged \$2,778 for maintenance services that the Projects did not receive during the period of January 30, 1996 to November 30, 1999. The time cards of the employees who allegedly provided the services showed the employees were absent at the time the services were performed. Legacy Management was unable to provide a reasonable explanation why these ineligible charges were made while employees were absent.

In addition, Legacy Management could not support that \$197,609 in maintenance charges were made for reasonable operating expenses or necessary repairs. Many of the work orders simply showed “work-as-assigned.” The work-as-assigned description, which was used to save time instead of itemizing each service that was provided, could not support that the charges were made for reasonable operating expenses or necessary repairs. The unsupported maintenance charges were made from January 31, 1996 to May 31, 1999. We provided schedules of improper, excessive, and inflated charges to Legacy Management and HUD’s staff. In addition, we provided a schedule of unsupported charges to Legacy Management.

Of the \$234,799 in charges made, \$157,883 was charged to properties that were in a non-surplus cash position at the time of the charge. These charges were unauthorized distributions as defined by the Regulatory Agreements. Five of the six Projects charged for improper disbursements were in a non-surplus cash position in 1997 and 1998. Three of the five projects were still in a non-surplus cash position in 1999.

### **Federal Requirements**

In consideration for HUD mortgage insurance, Project owners agree to restrictions on the use of Project funds and assets. The Regulatory Agreement restricts disbursements to payments necessary for the operation and repair of the Project. It also restricts distributions to owners based on the amount of surplus cash. The Agreement requires that payments for services, supplies, and materials do not exceed the amount ordinarily paid on the open market.

The Projects’ Regulatory Agreements state that owners may not—without prior written approval of the Federal Housing Administration’s Commissioner—assign, transfer, dispose of, or encumber any personal property of the Projects, including rents, or pay out any funds, other than from surplus cash, except for reasonable operating expenses and necessary repairs. Additionally, owners may not make, or receive and retain, any distributions of assets or any income of any kind of the Projects, except from surplus cash and except under certain conditions, including the requirements to comply with all outstanding notices for proper maintenance of the Projects.

The Projects’ Regulatory Agreements define distribution as any withdrawal or taking of cash or any assets of the Projects, excluding payments for reasonable expenses incident to the operation and maintenance of the Projects.

HUD Handbook 4370.2 REV-1 CHG-1, Financial Operations and Accounting Procedures for Insured Multifamily Projects, Section 2-6, requires all disbursements to be supported by approved invoices/bills or other supporting documentation.

In addition, HUD Handbook 4370.2 REV-1 CHG-1, Section page 4-31, states the office salaries account does not include salaries paid to occupancy, maintenance and regional supervisors who carry out the agent's responsibility for overseeing or supervising project operations and personnel. These salaries are paid from the management fee.

24 CFR Part 24.110 permits HUD to take administrative sanctions against employees or recipients under HUD assistance agreements who violate HUD's requirements. The sanctions include debarment, suspension, or limited denial of participation that are authorized by 24 CFR Parts 24.300, 24.400, or 24.700, respectively. HUD may impose administrative sanctions based upon 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 pursuant to a grant of financial assistance or pursuant to 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 as to affect 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 Mortgages, 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 project 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, Minneapolis Field Office, ensure Legacy Management and Development Corporation:

- A. Reimburses HUD \$305,038 for the inappropriate payments cited in this audit memorandum.

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

- B. Pursue a double damages remedy if Legacy Management does 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 Legacy Management for the inappropriate payments cited in this audit memorandum.
- D. Imposes civil money penalties against Legacy Management for the inappropriate payments cited in this memorandum while the Projects were in a non-surplus cash position.

**SCHEDULE OF INELIGIBLE COSTS**

<u>Recommendation</u>	
<u>Number</u>	<u>Ineligible 1/</u>
A	<u>\$305,038</u>
Total	<u>\$305,038</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 Rose Capalungan, Assistant Regional Inspector General for Audit, at (312) 353-6236 extension 2679 or me at (313) 226-6280 extension 8062.