

**U.S. Department of Housing and Urban Development**

**Office of the Inspector General for Audit  
Thomas P. O'Neill, Jr. Federal Building  
10 Causeway Street  
Boston, Massachusetts 02222-1092**

**New England**

**(617) 565-5259 FAX: 565-6878**

**Audit Related Memorandum**

**No: 97-BO-219-1801**

November 18, 1996

MEMORANDUM FOR: Jeanne McHallam, Director, Multifamily Housing Division,  
Massachusetts State Office, 1AHM

FROM: William D. Hartnett, District Inspector General, Office of Audit, 1AGA

SUBJECT: Equity Skimming Review  
RAP-UP IIB  
Roxbury, Massachusetts  
Project No. 023-44152

We performed a limited review of the financial operations of RAP-UP IIB to determine whether the project owner/manager violated the equity skimming statute by: (1) withdrawing project funds while in a non-surplus cash position, and (2) charging the project for expenses belonging to the owner, and not the project.

HUD and the Department of Justice developed a strategy for prosecuting cases in which private owners of FHA-insured multifamily projects have illegally diverted project resources. Misuse or diversion of project assets and income, known as "*equity skimming*", contributes to defaults on FHA-insured multifamily mortgages, results in substandard living conditions for low-income families, increases the demand on HUD for further financial assistance, and results in losses to HUD through the sale of devalued, foreclosed properties.

**BACKGROUND**

RAP-UP IIB, located in Roxbury, Massachusetts, is an insured Section 236 multifamily project with 51 units. The project was insured in May 1973. Our review covered the period January 1, 1993 to August 31, 1996.

The project is owned by Roxbury Action Program, Inc., whose general partner is Lloyd King. A management fee of six percent of rents collected is paid to HighFort Management, Inc. (management agent), an identity of interest company of the general partner.

HUD's review of the annual audited financial statements for fiscal years ended December 31, 1993 and 1994, identified advances to affiliated parties. HUD instructed the management agent to return these advances to the project. The project was never repaid.

A physical inspection conducted by the mortgagee in April 1996 rated the overall condition of the property as satisfactory. The project is rated as financially troubled by the MA State Office.

SCOPE

We reviewed the project's annual audited financial statements for fiscal years ended 1993 through 1995 and monthly accounting reports for the months January through June 1996. Indicators of potential equity skimming and expenses charged to the project which may be the responsibility of the owner, were identified.

We performed a limited on-site review and reviewed the project's books and records as of August 31, 1996. We reviewed supporting documentation relating to the indicators of equity skimming and unrelated project expenses that had been noted. We conducted interviews with the project owner and the owner's fee accountant.

We also held discussions with the HUD Massachusetts State Office, Multifamily Housing Division, Asset Management Team Leader and Asset Manager responsible for this project.

\* \* \* \* \*

Within 60 days, please provide us with 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 the review. Should your staff have any questions, please contact our office at (617) 565-5259.

CONCLUSION

The project owner withdrew project funds of \$90,684 between January 1, 1993 and August 31, 1996, while the project was in a non-surplus cash position. The project was in a non-surplus cash position, per the audited financial statements, as follows:

Year	Amount
------	--------

1993	(\$154,912)
1994	(\$161,202)
1995	(\$116,573)

The \$90,684 consisted of \$40,209 in advances to the management agent, and \$50,475 for ineligible and unsupported tenant services.

Advances to Management Agent

Project funds of \$40,209 were advanced to the management agent to cover payroll and vendor charges that are paid by the management agent on the project's behalf. The funds represent the total amount advanced in excess of actual expenses at August 31, 1996. Advances are made monthly based on unsupported estimates by the management agent, who is also the project owner. The amount of over-advancement has been increasing. The over-advanced balance at fiscal year ended December 31, 1993 was \$7,775.

These advances to the management agent are contrary to provisions of the Regulatory Agreement. Paragraph 6(b) of the project's Regulatory Agreement provides that the owners shall not "pay out any funds, other than from surplus cash, except for reasonable operating expenses and necessary repairs."

Tenant Service Expenses

Project funds of \$50,475 were charged for tenant services which are both ineligible and unsupported.

Funds of \$40,400 were paid to Highland Park Development, a State of Massachusetts subsidized project which is also owned and operated by the same individual as the subject property. The basis for these charges was not provided by the project owner; nor was information regarding when services were provided, who received the services, and who provided the services. Invoices supplied to us indicate that services were rendered in connection with a tenant services contract; however, the project owner advised that no contract exists.

Funds of \$10,075 were paid in connection with the Title VI Preservation application and appraisal. These cost are the responsibility of the project owner.

The use of project funds for the above two items is also contrary to the project's Regulatory Agreement, Paragraph 6(b).

The project owner agreed with our conclusions and showed a willingness to refund the money to the

project. Therefore, involvement of the United States Attorney's Office is not warranted at this time. However, if an acceptable agreement to recover these funds within a timely fashion cannot be reached, this case will be presented to the United States Attorney's Office, District of Massachusetts, for possible civil action.

**Recommendation**

We are recommending that your office:

- 1A. Execute an agreement with the project owner to recover the unauthorized withdrawals of project funds, and to prevent the project owner from similar unauthorized withdrawals in the future. Assessment of interest and penalty should be considered.

# Distribution

Secretary Representative, 1AS

Director, Office of Multifamily Housing Development, HMD

Assistant to the Secretary for Field Management, SC, Room 7106

Director, Housing, HF, Room 5132

Acquisition Librarian, Library, AS, Room 8141

Chief Financial Officer, F, Room 10166

Deputy Chief Financial Officer for Operations, FO, Room 10166