



U.S. Department of Housing and Urban Development

District Office of the Inspector General
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February 10, 1997

Audit-Related Memorandum
97-AT-203-1805

MEMORANDUM FOR: Reba G. Cook, Director, Multifamily Housing Division, 4GHM

FROM: Nancy H. Cooper
District Inspector General for Audit-Southeast/Caribbean, 4AGA

SUBJECT: Survey of Holiday Apartments/Midland Management Company

We have completed a limited survey of Holiday Apartments and Midland Management Company, its management agent. This survey was part of OIG's assistance to the U.S. Attorney in Mississippi to identify possible equity skimming in HUD-insured Mississippi multifamily developments. We presented our findings to the U.S. Attorney, who did not pursue these equity skimming aspects due to owner repayment of the unauthorized distributions.

Our survey results, however, need resolution by HUD for the two findings presented in the attachment. Within 60 days please furnish us, for the four controlled recommendations, a status report on: (1) corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is not considered necessary. Also, please furnish us copies of any related correspondence or directives.

Should there be any questions, please call me (404/331-3369) or Auditor Maxie Walls (205/290 - 7630).

Attachments

- 1 - Survey Results
- 2 - Distribution

BACKGROUND

Holiday Apartments is a 221(d)(3) project in Natchez, Mississippi. The property was built in the 1940's as military barracks. In 1973, it was converted to civilian housing. The property has 121 units, all of which are Section 8. There are 20 two-story buildings.

HUD's August 9, 1995 physical inspection showed \$205,473 in estimated repair costs. The project was current on mortgage payments, as of May 1996.

Midland Management Company is the management agent for 22 HUD properties, including Holiday Apartments. The management agent is a division of The Molpus Company, with corporate headquarters in Philadelphia, Mississippi. Of the 22 projects, 19 are in Mississippi with 3 in Alabama. The General Partner for Holiday Apartments is The Molpus Company; the estate of Herman Wilson is a Limited Partner.

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We made our on-site survey during April and May 1996. Details follow on our work, and needed HUD actions.

FINDING 1 - MANAGEMENT AGENT MADE UNAUTHORIZED DISTRIBUTIONS

The management agent made distributions totaling \$145,840 of project funds which, in our opinion, were not evidenced as necessary for reasonable operating and maintenance expenses of the same project. The Regulatory Agreements state in part that owners shall not, without prior HUD approval, dispose of any personal property of the project, including rents, or pay out any funds, including repayment of owner advances, (except surplus cash) except for reasonable operating expenses and necessary repairs. Also, owner shall not make any distributions of assets or income except from project surplus cash. Contrary to the requirements, the management agent made distributions involving advance repayments (\$105,956), overpaid management fees (\$13,312), and unresolved Central Payables Account balances (\$26,572). Another \$116,670 was paid from the Central Payables Account but not advanced to the account by four projects.

Advance Repayments

During 1994 through March 1996, the management agent made these repayments of advances:

<u>Project Name</u>	<u>Project #</u>	<u>Amount</u>	
Selma Square Apartments	062-44061	\$ 17,000	(1994)
		64,057	(1995)
Holiday Apartments	065-35073	10,000	
Colonial Place Apartments	065-35148	2,011	
Moorhead Manor Apartments	065-35334	1,000	
Ferndale Apartments	065-44044	6,888	
Ridgewood Apartments	065-44057	<u>5,000</u>	
		<u>\$ 105,956</u>	

The management agent/owners believed they had a "gentleman's agreement" with HUD whereby they were permitted to recoup advances. This unwritten agreement occurred in the 1980's. Nevertheless, the repayments of owner advances were unallowable due to the projects being in a non-surplus cash position either at the time of, or after the repayment(s). The Certified Public Accountant (CPA) for the developments had been citing the management agent/owners for this type of payment for several years. The CPA also cited the management agent for making distributions prior to the surplus cash computation.

Management Fees

The management agent had not refunded these overpaid management fees:

<u>Project Name</u>	<u>Project #</u>	<u>Amount</u>
Chanticleer Apartments	062-44056	\$ 4,172
Selma Square Apartments	062-44061	1,087
Terrace Gardens Apartments	065-44017	3,310
Village Apartments	065-44050	1,571
Ridgewood Apartments	065-44057	<u>3,172</u>
		<u>\$ 13,312</u>

The CPA reported overpayments in 1994 for Chanticleer Apartments (\$4,172) Terrace Garden s Apartments (\$2,409) and Ridgewood Apartments (\$3,172). Per the CPA's 1995 audits, th e management agent had not repaid these amounts. In addition, the management agent overpai d management fees for Selma Square Apartments (\$1,087) and Village Apartments (\$1,571) and had the overpayment increase to \$3,310 for Terrace Gardens Apartments. As of the March 1996, th e management agent had not repaid these overpayments.

The management agent stated that generally management fees were estimated throughout the year including miscellaneous income. Some estimates were adjusted at year-end by the CPA such a s ineligible fees on certain miscellaneous income.

Central Payables

The management agent/owners made the following ca sh advances "to" the Central Payables Account (Account) from the applicable project operating account:

<u>Project Name</u>	<u>Project #</u>	<u>Amount</u>
Chanticleer Apartments	062-44056	\$ 21,607
Holiday Apartments	065-35073	<u>4,965</u>
		<u>\$ 26,572</u>

Also, the management agent/owners made payments charged to the Account for the followin g projects when the projects did not advance sufficient monies to the Account to cover expenses:

<u>Project Name</u>	<u>Project #</u>	<u>Amount</u>
Selma Square Apartments	062-44061	\$ 90,614
South Park Manor Apartments	065-44038	3,046
Oak Ridge Manor Apartments	065-44043	13,340
Village Apartments	065-44050	<u>9,670</u>
		<u>\$ 116,670</u>

The management agent performed monthly reconciliations intended to bring the Account to a zero balance. The management agent believed that reconciliations and other records were adequate for accountability, and that the Account had efficient funds management.

The management agent, however, had not timely corrected known imbalances. For instance, the CPA's 1994 Financial Statements stated that the operating account for Chanticleer Apartments should be repaid \$15,000 which had been advanced to the Account. Actually 1995 Financial Statements showed that the \$15,000 had not been repaid, and another \$6,607 was advanced.

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The unallowable distributions involved advance repayments, overpaid management fees, and unresolved Central Payables Account balances; they deprived the projects of monies for specific project purposes. At the beginning of our site work (April 17, 1996), the management agent had not repaid the questioned distributions. However, the management agent did repay them following our exit conference.

Recommendations:

We recommend that you have your staff continue to monitor:

- 1A. Distributions, including any advance repayments, to ensure that the management agent/owners do not make distributions prior to the end of an annual or semi-annual period, or when the project would be placed in a non-surplus cash position.
- 1B. The timeliness of the management agent's/owners reimbursement for future items cited by the CPA, including overpaid management fees and imbalances in the management agent's Central Payables Account.

Finding 2 - PROJECT CONTINUED TO NEED PHYSICAL IMPROVEMENTS

While improvements were being made, the physical condition of Holiday Apartments remained below average due to many uncorrected maintenance items. Paragraph 7 of the Regulatory Agreement requires owners to maintain the mortgaged premises, accommodations and the grounds and equipment appurtenant thereto, in good repair and condition. The management agent/owners had not adequately complied with this requirement. Estimated needed repairs at Holiday for 1993 through 1995 were estimated at \$107,354, \$135,760, and \$205,473, respectively. Certain of the items cited in 1993 had also been previously cited, including needed repairs to vinyl flooring and subflooring, to stairwells, and to drywalls.

Based on our site inspections, the management agent had emphasized interior unit repair completion. During 1995, the owners made advances to Holiday, which indicates intent to upgrade the physical conditions. However, HUD's August 9, 1995 physical inspection report stated that past maintenance had been haphazard resulting in conditions where normal maintenance would not keep up with needed repairs. Based on our limited inspections, we agree.

An example of the cause for the below average conditions follows:

Inadequate preventive maintenance program

In the past, this would have been evident by the amount of deferred maintenance, particularly as illustrated by the stairwells. The poor condition of stairwells had been cited since at least 1992. In a March 22, 1993 letter to the mortgagee, the management agent stated it would complete common hall/stairways at a rate of three per month. In an August 24, 1993 letter to HUD, the management agent stated it would begin such renovations in September 1993 at the rate of two per month.

Problems still existed in 1994 based on HUD's July 26, 1994 inspection. The report stated renovation was needed in 48 hallways, staircases, etc. HUD's August 8, 1995 inspection cited the deficiency again.

The management agent has schedules in place to implement an effective preventive maintenance program, if these schedules are followed. Staff has been trained to implement the preventive maintenance program.

Recommendations:

We recommend that your staff:

- 2A. Verify that the management agent has implemented and continues its preventive maintenance program.
- 2B. Check on identified needed repairs for correction. If needed repairs have not yet been completed, HUD should consider replacement of the management agent.

DISTRIBUTION

Secretary's Representative, Southeast, 4AS
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Audit Liaison Officer, 3AFI
State Coordinator, 4GS
Director, Multifamily Housing Division, 4GHM
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Director, Housing and Community Development, Issue Area, U.S. GAO,
441 G Street, Room 2474, Washington, DC 20548 ATTN: Judy England-Joseph
Audit Liaison Officer, Office of Housing, HF (Room 5132) (3)
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President, Midland Management Company
US Attorney, Mississippi