



U.S. Department of Housing and Urban Development
Great Plains Office of District Inspector General
for Audit, 7AGA
Gateway Tower II - 5th Floor
400 State Avenue
Kansas City, Kansas 66101-2406

March 2, 1999
Audit Related Memorandum
No. 99-KC-211-1801

MEMORANDUM FOR: Tommy Major, Acting Supervisory Project Manager
Multifamily Housing Program Center, 7EHM

FROM: Ronald J. Hosking, Acting District Inspector General for Audit, 7AGA

SUBJECT: Brittany Acres Apartments
Bridgeton, Missouri

INTRODUCTION

We completed our review of Brittany Acres Apartments, a HUD-insured, 300-unit apartment complex. We performed the review at your request. Our objective was to determine if the owners complied with the terms of their Regulatory Agreement.

We identified significant violations of the Brittany Acres' Regulatory Agreement. At a joint meeting with your staff, we discussed our concerns with one of the partners. He decided that refinancing the mortgage and terminating HUD insurance would be in the partnership's best interest. He later arranged refinancing and full payment of the original mortgage. The HUD insurance was terminated on September 4, 1998. The partners are not currently participating in any other HUD Programs.

We are recommending that your office take administrative action to prevent Brittany Acres' partners from future participation in HUD programs.

BACKGROUND

HUD insured Brittany Acres Apartments under its 223 (f) Co-insurance Program. Final endorsement on the original \$6,650,000 mortgage was effective July 24, 1986. The owners defaulted on their August 1, 1994 mortgage payment. The default continued through February 1995.

The partners subsequently restructured the debt and brought the mortgage current on March 1, 1995. Mark Twain Trust Company, custodian on behalf of Boatman's Bank, bought the mortgage note. In addition, Boatman's Investment Banking Department provided secondary financing with more favorable rates to pay delinquent principal and interest of \$483,317.85.

AUDIT RESULTS

Controls over the management of an insured project are contained in the Regulatory Agreement. DRG Funding Corporation, a former HUD Co-insurer, and Brittany Acres executed their Regulatory Agreement on February 8, 1984. We found that the partners committed three significant violations of the Regulatory Agreement.

In their draft audit report for the period ended December 31, 1997, Brittany Acres' Certified Public Accountant disclosed that one partner improperly diverted \$128,000 for personal benefit. Section 4. a. (1) of the Regulatory Agreement states that a partner cannot make, receive or retain distributions of cash while the project is in a negative surplus cash position. In response to the report, the partners stated: "The distributions paid to a general partner were used to commence a buyout of a limited partner..." At the time, the project was in a negative surplus cash position.

Second, the partners assigned project assets covered by the original HUD-insured mortgage without HUD's knowledge. Section 9.a. of the Regulatory Agreement prohibits conveying, assigning, transferring, encumbering, or disposing of any legal interest in the project without prior written approval of the Secretary.

This occurred during a refinancing that involved a Letter of Credit Note (\$6,368,934), a Revolving Loan Note (\$100,000) and a Term Loan Note (\$100,000). These documents, which effectively assigned project assets to the Bank, state:

"... in the event any action or proceeding is brought on this Note or the other Credit Documents to collect all or any portion of the Obligations, (i) Bank shall have recourse against the Collateral, (ii) Bank shall have recourse against the Property, and (iii) Bank shall be entitled, without limitation, to its rights and remedies under the Guaranty."

Third, the partners transferred project ownership without Secretary approval, also a violation of Section 9.a. The partners entered into an Option Agreement in February, 1995. This agreement granted the sale of the five limited partnership interests totaling 62.5% ownership to the two remaining partners. The sale price per the Option Agreement was \$437,500. The term of the option expired on February 1, 1997, but was subsequently extended to December 23, 1997. The transfer of ownership occurred when William J. Koman, Sr. and William J. Koman, Jr. completed the purchase of the limited partners' interest (62.5%).

ISSUES REQUIRING CORRECTIVE ACTION

In our draft report, we recommended the St. Louis Multifamily Housing Program Center take administrative action against William J. Koman, Sr. and William J. Koman, Jr. for violating the Regulatory Agreement. On February 24, 1999 your office placed negative comments regarding the partners into the Previous Participation System. This action will alert HUD staff to the problems identified if the partners attempt to participate in HUD programs in the future. We believe no further action is required.

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Judy England-Joseph
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- () The Honorable Fred Thompson, Chairman; Committee on Governmental Affairs; United States Senate, Washington, D. C. 20515-4305
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- () Ms. Cindy Sprunger, Subcommittee on Oversight and Investigations; Room 212, O'Neil House Office Building; Washington, D. C. 20515
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