Telephone: (913) 551-5870 http://www.hud.gov/oig/oigindex.html Fax: (913) 551-5877

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

May 28, 1999

Audit Related Memorandum
99-KC-211-1802

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

FROM: Roger E. Niesen, District Inspector General for Audit, 7AGA

SUBJECT: Plaza Square Apartments
St. Louis, Missouri

We completed our review of Plaza Square Apartments, a HUD-insured, 925-unit apartment complex. We performed the review at your request. Our objective was to determine if the Project Owner complied with terms of the Regulatory Agreement.

We concluded that the Project Owner did not comply with the Regulatory Agreement. We identified two significant violations of Plaza Square's Regulatory Agreement. The violations included payments of approximately $1.35 million made from the Project's operating account to the Owner and/or affiliated companies of the Owner while the Project's mortgage was in default or the Project was in a non-surplus cash position. The payments were to repay advances, which the Owner made to the Project when the Project was not generating enough receipts to cover operating expenses and debt service. However, repayment of advances is not permitted by the Regulatory Agreement except when the Project is in a surplus cash position. Also, the Owner did not fund approximately $149,000 in security deposits as required by the Regulatory Agreement.

To resolve the issues we identified, in April 1999, the Owner modified and restructured the HUD-insured mortgage loan by investing capital of more than $2.4 million from non-Project sources. Approximately $1.5 million was used to bring delinquent principle and interest current; and approximately $900,000 was put into escrow accounts under HUD's control. The Owner also fully funded the security deposits in a separate account.

We believe the actions the Owner has taken to modify the loan, invest capital from non-Project sources, and put funds in HUD controlled escrow accounts satisfactorily resolves the problems we identified. This report does not contain any recommendations.

BACKGROUND

HUD insured Plaza Square Apartments pursuant to Section 221 (d) (4) of the National Housing Act. Final endorsement on the $27,476,200 mortgage was effective December 29, 1997. The Owner had financial difficulties making the mortgage payments from the outset. On September 1, 1998 the mortgage went into default and continued in default through April 1999.

On April 20, 1999, the Owner (Plaza Square Partners, L.L.C., a Missouri limited liability company) and the mortgagee (GMAC Commercial Mortgage Corporation) restructured the mortgage. The primary change was the reduction of the interest rate from 8.25 percent to 6.95 percent, resulting in a reduction in the debt service requirements. The restructured loan agreement included bringing current the delinquent principal and interest payments, the basic escrow accounts (mortgage insurance premium, real estate taxes, hazard insurance, and replacement reserves); the establishment of a rehabilitation escrow account; the establishment of an operating deficit escrow account; and the payoff of all accounts payable over 30 days old.

REVIEW RESULTS

The Owner executed a Regulatory Agreement with HUD on July 30, 1996. The Regulatory Agreement details controls over the insured Project's management.

During our review, we identified two areas where the Project was not managed according to the terms of the Regulatory Agreement. First, the Owner improperly used $1.35 million of Project funds to repay advances from the management company and other affiliated entities. Second, the Owner did not fully fund the Project's security deposits. The security deposits were deficient by approximately $149,000.

The Owner used Project funds totaling $1,356,505 in violation of HUD's guidelines. The improper payments were made primarily to the identity-of-interest management agent (Comprehensive Management Services, Inc.) and to affiliated entities (Fox Valley Ice Arena; Parcfront; Taylor Place; and Four Towers) while the mortgage was in default or in a negative surplus cash position. The Owner said the disbursements were meant to repay advances made by the management agent and the affiliated entities to cover deficits relating to operating expenses and debt service. However, HUD's requirements do not allow the repayment of advances when the Project is in a non-surplus cash position or in default.

Plaza Square also did not have its security deposit liability account fully funded as required by the Regulatory Agreement. During most of the audit period, the Owner maintained the security deposits in the operating account. However, the operating account became overdrawn and the security deposits were depleted and used for other than their intended purpose. As a result, tenant security deposits of $148,955 were not properly held in reserve.

On April 20, 1999, with the approval of the HUD-St. Louis Multifamily Housing Program Center, the Owner and the mortgagee restructured the HUD-insured mortgage loan. The ownership invested capital from non-Project sources of $2,428,790. The use of the invested capital included paying: $1,507,687 to bring the delinquent principal and interest current; $73,270 to bring the reserve for replacement account current; $650,000 to establish a rehabilitation escrow account; $174,533 to establish an operating deficit escrow account; and $23,300 to establish a corporate furniture account. HUD's approval is required to make expenditures from the rehabilitation, operating deficit, corporate furniture, and reserve for replacement accounts. In addition to the loan restructuring, the Owner contributed $150,000 and established a separate account to fund tenant security deposits. Assuming the Project will be effectively monitored by HUD, we believe the restructured loan, along with the restricted accounts, satisfactorily resolve the issues we identified.

If you or your staff have any questions, please contact me at (913) 551-5871.

DISTRIBUTION:

Deputy Secretary, SD, Room 10100
Chief of Staff, S, Room 10000
Special Assistant to the Deputy Secretary for Project Management, SD, Room 10100
Acting Assistant Secretary for Administration, S, Room 10110
Assistant Secretary for Congressional and Intergovernmental Relations, J, Room 10120
Senior Advisor to the Secretary, Office of Public Affairs, S, Room 10132
Deputy Assistant Secretary of Administrative Services/Director of Executive Secretariat, AX, Room 10139
Director of Scheduling and Advance, AL, Room 10158
Counselor to the Secretary, S, Room 10234
Deputy Chief of Staff, S, Room 10226
Deputy Chief of Staff for Operations, S, Room 10226
Deputy Chief of Staff for Programs and Policy, S, Room 10226
Director, Office of Special Actions, AK, Room 10226
Deputy Assistant Secretary for Public Affairs, W, Room 10222
Special Assistant for Inter-Faith Community Outreach, S, Room 10222
Executive Officer for Administrative Operations and Management, S, Room 10220
Senior Advisor to the Secretary for Pine Ridge Project, W, Room 10216
General Counsel, C, Room 10214
Director, Office of Federal Housing Enterprise Oversight, O, 9th Floor Mailroom
Assistant Secretary for Housing/Federal Housing Commissioner, H, Room 9100
Office of Policy Development and Research, R, Room 8100
Inspector General, G, Room 8256
Assistant Secretary for Community Planning and Development, D, Room 7100
Assistant Deputy Secretary for Field Policy and Management, SDF, Room 7108 (2)
Government National Mortgage Association, T, Room 6100
Assistant Secretary for Fair Housing and Equal Opportunity, E, Room 5100
Chief Procurement Officer, N, Room 5184
Assistant Secretary for Public and Indian Housing, P, Room 4100
Chief Information Officer, Q, Room 3152
Director, Office of Departmental Equal Employment Opportunity, U, Room 5128
Director, Office of Departmental Operations and Coordination, I, Room 2124
Chief Financial Officer, F, Room 2202
Director, Enforcement Center, V, 200 Portals Building
Director, Real Estate Assessment Center, X, 1280 Maryland Avenue, SW, Suite 800
Director, Office of Multifamily Assistance Restructuring, Y, 4000 Portals Building
Secretary's Representative, 7AS (2)
Director, Multifamily Housing Division, 7AH (2)
Audit Liaison Officer, Office of Housing, HF, Room 5132 (2)
Field Audit Liaison Officer, 6AF, (2)
Assistant Secretary for Housing, H, Room 9100
Assistant to the Deputy Secretary for Field Management, SDF, Room 7108
Deputy Chief Financial Officer for Finance, FF, Room 2202

Director Office of Budget, FO, Room 3270
Departmental Audit Liaison Officer, FM, Room 2206 (2)
Ranking Member, Committee on Governmental Affairs, 706 Hart Senate Office Building, United States Senate; Washington, DC 20510
Chairman, Committee on Governmental Affairs, 340 Dirksen Senate Office Building, United States Senate, Washington, DC 20510
Chairman, Committee on Government Reform; 2185 Rayburn Building, House of Representatives; Washington, DC 20515
Ranking Member, Committee on Government Reform, 2204 Rayburn Building, House of Representatives, Washington, DC 20515
Subcommittee on Oversight and Investigations, Room 212, O'Neil House Office Building, Washington, DC 20515
Director, Housing and Community Development Issue Area, United States General Accounting Office, 441 G Street, NW, Room 2474, Washington, DC 20548