



US Department of Housing and Urban Development

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April 16, 1996

96-FW-219-1801

MEMORANDUM FOR: Elsie Whitson, Director, Multifamily Housing Division, 6FHM

FROM: D. Michael Beard, District Inspector General for Audit, 6AGA

SUBJECT: Ginny's Vineyard Apartments
Little Rock, Arkansas
FHA Project No. 082-35257-PM

Under our Operation Safe Home Program, we completed a review of the records of Ginny's Vineyard Apartments, Little Rock, Arkansas. Our objective was to determine whether the owners or managers had engaged in equity skimming in violation of equity skimming statutes. Specifically, our objectives were to identify:

1. Improper cash distributions to owners (all distributions were improper since the property has defaulted and is in a negative surplus cash position for the audit period);
2. Improper payments to identity-of-interest firms; and
3. Unreported cash belonging to the property or unreported rental, vending, and laundry income.

The review covered property income and expenditures from January 1991 through August 1995. However, we extended the period to include a cursory review of expenditures from August 1988 forward because we needed to ensure that washers and dryers being rented to tenants by the owner did not belong to the project. The project was collecting rent on the washers and dryers and paying the owner. HUD permitted this when HUD approved an amendment to the Regulatory Agreement on September 19, 1985. The review included an examination of the project's bank accounts, accounting records, and supporting invoices and vouchers. We also interviewed the owner, management agent, and HUD personnel.

Within 60 days, please provide us, for each recommendation cited in the report, a status on: (1) the 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 correspondence issued related to the report.

Summary

The owners violated the Regulatory Agreement and equity skimming statutes by making unauthorized owner distributions, totaling \$272,000, after defaulting on the HUD-insured mortgage on October 1, 1988. The owner made the payments to himself during the period January 1989 through July 1990. The payments were for repayment of the owner's bank loans and reimbursement of owner advances. After the HUD Field Office staff received the financial audit report in November 1989, they told the owner of the Regulatory Agreement violation and to refund the payments. Field Office correspondence shows HUD personnel had requested the owner to repay the project up until November 1990. We found no correspondence referencing this matter after this date. The owner never refunded the payments, apparently, because the loan servicer did not follow up sufficiently to assure repayment or that HUD took the appropriate sanctions against the owner.

Equity Skimming statutes provide that the Secretary can request the Attorney General to bring legal action against persons who violate the Regulatory Agreement and statutes up to 6 years after the date the Secretary discovers the violation.

Since the statute of limitations has expired, we are not recommending pursuit of the matter under these statutes. But we are recommending you consult with the appropriate legal counsel to ascertain whether any other actions can be taken against the owner and to review your Field Office procedures to ensure such violations do not occur again without appropriate action being taken by HUD.

Background

Ginny's Vineyard Apartments is a 154-unit apartment complex located at 13200 Chenal Parkway, Little Rock, Arkansas. Simmons First National Bank of Pine Bluff was the mortgagee and trustee for the Arkansas Development Finance Authority. The mortgage was originated August 15, 1985, for \$4,248,100 under Section 221(d)(4) of the National Housing Act. Ginny's Vineyard Limited Partnership owns the project. Guy A. Pardew, Jr. is the general partner and 98 percent owner. The project is managed by Southern Management Corporation, an identity-of-interest management agent. The owners defaulted on the HUD insured loan on October 1, 1988. On April 19, 1989, the mortgagee assigned the mortgage to HUD. On August 1, 1995, the delinquency was \$1,006,684. On September 19, 1995, HUD sold the loan as part of a pool of 211 nonperforming unsubsidized multifamily mortgage loans.

Finding - Unauthorized Distributions Made to Owners

The owner violated the Regulatory Agreement and equity skimming statutes by making unauthorized owner distributions, totaling \$272,000, after defaulting on the HUD-insured mortgage on October 1, 1988. The owner made the payments to himself during the period January 1989 through July 1990. The payments were for repayment of the owner's bank loans and reimbursement of owner advances. After the HUD Field Office staff received the financial audit report in November 1989, they told the owner of the Regulatory Agreement violation and to refund the payments. Apparently, because the loan servicer did not follow up sufficiently to assure repayment, the owner never refunded the payments.

The Regulatory Agreement provides under paragraph 13(g) that "distribution" means any withdrawal or taking of cash or any assets of the project, including the segregation of cash or assets for subsequent withdrawal within the limitations of paragraph 6(e), and excluding payment for reasonable expenses incident to the operation and maintenance of the project.

Paragraph 6(e) says that the owner shall not without the approval of the Secretary make or receive or retain any distribution of assets or any income of any kind of the project except surplus cash.

Paragraph 12 of the Regulatory Agreement states that as security for the owners' obligations, the owners assign the rights to rents, profits, income, and charges of whatsoever sort which they may receive or be entitled to receive from the operation of the project. Until default, permission is granted for the owners to collect and retain rents, profits, income, and charges under provisions of the Regulatory Agreement, but upon default, such permission is terminated.

Title 12, United States Code, Section 1715z-19 provides fines and imprisonment for misuse of project income or assets when the project is in default or in a nonsurplus cash position as defined by the Regulatory Agreement. Title 12, United States Code, Section 1715z 4-a provides for double damages for unauthorized use of multifamily housing project assets and income. However, a time limitation of 6 years applies to when HUD can request legal action to be taken against the owners under this statute. This time limitation is 6 years after HUD discovers the use of funds in violation of the Regulatory Agreement.

The \$272,000 in unauthorized payments during the period January 1989 through July 1990 was for a combination of the owner's personal bank loans and reimbursement of owner advances. Citizens Bank of Jonesboro, Arkansas, combined several of the owner's loans into a \$580,000 package which consisted of loans covering subsidized cash flows until rent-up, cost over-runs of construction, and closing costs. During the forbearance period granted by the mortgagee, the project paid Cayman, Inc., a company 100 percent owned by Mr. Pardew,

\$25,000 a month from January through September 1989 for a total of \$225,000.

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The owner told us these payments were to cover his loans with Citizens Bank. The project also made payments to Cayman ranging from \$2,500 to \$5,000 a month during 1989 through part of 1990, totaling \$30,000. The owner said these were reimbursements for operating expenses he loaned the project personally. Additionally, during 1989 the project paid Ginny's Vineyard Investors' Account \$17,000. This was reimbursement to the partnership for money the partnership paid on behalf of the project. Since Guy Pardew owned 98 percent of the project, the payments were primarily payments to himself.

Based on correspondence contained in the HUD files, the HUD Field Office found out about the unauthorized payments as a result of a November 1, 1989 letter from the owner to HUD that requested HUD to recognize the interest payments on the loans as project operating expenses. HUD's response dated November 8, 1989, was that such payments from the project would be a violation of the Regulatory Agreement. In addition, HUD's letter stated that HUD staff had noticed the \$25,000 payments to Cayman on the monthly accounting reports. Also, HUD was to make a determination as to the best method to resolve the violations during HUD's review of the financial statements.

On January 3, 1990, HUD sent the owner a letter containing the results of HUD's review of the audited financial statements. One of the findings was that interest-bearing advances had been made by the general partner and repaid while the mortgage was in default. The letter stated the owner must repay the operating account for all unauthorized loans and repayment of advances. The letter further stated that the owner violated the Regulatory Agreement and if corrective action is not taken within 30 days of the date of the letter, HUD may declare a default and proceed with administrative sanctions against the owner or exercise other rights provided under the Regulatory Agreement.

On April 6, 1990, the owner provided a letter to HUD requesting HUD's official acknowledgement of the loans and to allow repayment of the loans from the project. The letter said the bank took an assignment of interest in Ginny's Vineyard and personal collateralization to secure the loans. The letter recognized the Regulatory Agreement prohibited repayment of the loans from project funds without HUD approval.

HUD's response on May 9, 1990, reiterated HUD's position and said HUD did not acknowledge the debt. The letter said that any repayments of such a debt is a serious violation of the Regulatory Agreement. HUD also issued a letter to the owner on November 2, 1990, that said HUD had noted during review of the monthly accounting reports that the owner had continued to collect \$2,500 a month for repayment of owner advances. This letter advised that if the owner did not perform obligations as agreed in the workout, HUD will terminate the workout, begin foreclosure, and consider administrative sanctions that may result in civil penalties. We could not find correspondence referencing this problem after

this date, although HUD entered into workout agreements with the owner subsequent to this time. The latest workout agreement was for the period October 1994 through September 1995.

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We attempted to determine why HUD did not proceed with sanctions and enforcement of the Regulatory Agreement. Responsible HUD personnel has changed since the violations occurred. The responsible loan servicer is no longer employed by HUD. We asked the former Director, Housing Management Division, currently employed as an Asset Manager, why HUD did not proceed with action to enforce the Regulatory Agreement. He said the loan servicer was responsible for following up on the problem and she apparently let the problem "fall through the crack."

Since the 6-year statute of limitations has expired, we will not make a referral to the U.S. Attorney's office under the Operation Safe Home Program. However, we are recommending you consult with legal counsel to determine what administrative sanctions can be taken against the owner to protect the Department should the owner attempt to do any future business with the Department. Also, we recommend you review your Field Office procedures to ensure any such future violations of Regulatory Agreements do not go unresolved.

Recommendations:

We recommend you:

1A. Consult with Counsel to determine what action you can take against the owner and to protect the Department in the future.

1B. Review current Field Office procedures to ensure you take appropriate measures to see that such violations of Regulatory Agreements and statutes do not go unresolved in the future.

Distribution

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Comptroller, 6AF

Director, Housing, 6AH

Director, Accounting, 6AAF

Director, Multifamily Housing Division, 6FHM (4)

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Assistant to the Deputy Secretary for Field Management, SC (Room 7106)

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