

January 18, 1996
Audit Related Memorandum
96-SF-214-1803

TO: Janet Browder, Director, Multifamily Division, 9AHM

FROM: Mark J. Pierce, Senior Auditor, 9AGA

SUBJECT: DKD Property Management, Inc.
Settlement of Audit Issues
San Jose, California

Introduction

On behalf of the Department of Housing and Urban Development, the Department of Justice entered into a settlement agreement with DKD Property Management, Inc and related parties to resolve equity skimming issues raised by an OIG audit. The audit found that the management company gave the identity-of-interest developer of two insured, multifamily projects -- while the mortgage loans were in default -- \$217,190 for development cost refunds from a sanitation district. The developer paid \$239,095 to the U.S. Government to settle. \$231,922 are to be returned to the projects' operating and reserve accounts. The agreement also restricts allowable distributions from the projects for two years. Thus, HUD needs to obtain evidence that the monies are returned to the appropriate project accounts and monitor future distributions for compliance with the agreement.

Background

Gatewood Apartments (project 121-35794), Fremont-Heritage Village Apartments (121-35826), and Woodcreek Apartments (121-35818) have mortgage loans that are all insured under section 221(d)(4) of the National Housing Act. The loans went into default in March 1993. The defaults were corrected when the loans were refinanced in September 1993 with new insured mortgage loans. DKD Property Management, Inc., located in San Jose, California, oversees project operations. Identity-of-interests exist among the three projects' limited partnerships, the management company, and the projects' developer Davidson, Kavanagh & Brezzo Development Co. because of common general partners and stockholders.

In 1994 the HUD Office of Inspector General performed audit work at

DKD to identify possible misuse of assets of troubled HUD-insured projects the company manages. The work identified \$326,026 improperly distributed from Gatewood, Heritage and Woodcreek while their mortgage loans were in default. The distributions involved refunds received by the projects related to their construction and loan refinancing:

Project	Construction Refunds	Refinancing Refunds
Gatewood		\$27,943
Heritage	\$146,905	\$63,009
Woodcreek	\$70,285	\$17,884

The developer subsequently repaid the \$108,836 of refinance refunds in 1994. Only the Gatewood refinance refunds were repaid fully prior to our audit. This occurred because the public accountant performing Gatewood's 1993 annual financial statement audit reported the distributions. The public accountant performing Heritage and Woodcreek audits did not identify the violation of the regulatory agreement. Between March and November 1994, however, the developer advanced monies to Heritage equivalent to the distribution of refinancing refund. Only after we questioned the management agent on the Woodcreek distribution did the developer return that project's refinancing refund.

The agent disagreed with the audit exception on the construction refunds of \$217,190 received from a sanitation district, arguing that they were not project assets.

We distributed a draft finding on these issues to the agent and HUD's asset management branch. We considered the agent's response to the draft and, after consulting with asset management and counsel, decided to approach the Department of Justice to seek compensation under 12 U.S.C. 1715z-4a, the "double damages" statute.

The U.S. Attorney, Northern District of California, agreed to represent HUD. In consultation with HUD counsel, asset management, and OIG, the U.S. Attorney negotiated a settlement agreement covering the outstanding audit issue on the construction refunds.

Settlement Terms

Appended to this memorandum is the settlement agreement entered into November 27, 1995. The principal terms of the settlement are:

The project developer will pay the United States \$239,095. (This represents the total construction cost refunds plus imputed interest.) The government will retain \$7,173 (three percent) and return \$231,922 to be deposited to Woodcreek and Heritage project accounts as follows:

Woodcreek: Reserve fund for replacements account	\$ 6,771
Operating account	67,562

Heritage: Reserve fund for replacements account	\$ 16,374
Operating account	141,215

The funds to be returned to the operating accounts are not to be distributed in calendar years 1995 and 1996.

We understand that the developer has paid the required funds to the United States.

Recommendations

We recommend that the asset management branch:

- A. Require the management agent to provide evidence that the funds to be returned by Justice have been deposited to the appropriate project accounts.
- B. Review the 1995 and 1996 Heritage and Woodcreek audited financial statements when available to monitor compliance with the agreement to limit distributions.

Within 60 days, please furnish us a status report on the corrective action taken, the proposed corrective action and the date to be completed, or why action is not considered necessary for the first recommendation. We are not controlling the second recommendation.

If you or your staff have any questions, please contact Melissa Wong, Auditor, or Mark Pierce, Senior Auditor, on 415-436-8101.

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