OFFICE OF AUDIT
REGION 7
KANSAS CITY, KS

The Temtor
St. Louis, MO

Section 220 Multifamily Insurance Program

2013-KC-1003

AUGUST 8, 2013

U.S. DEPARTMENT OF
HOUSING AND URBAN DEVELOPMENT
OFFICE OF INSPECTOR GENERAL

Issue Date: August 8, 2013

Audit Report Number: 2013-KC-1003

TO: Timothy J. Ferlin, Supervisory Project Manager, St. Louis Program Center, 7EHMLAX

Craig T. Clemmensen, Director of Departmental Enforcement Center, CACB

//**signed**//

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

SUBJECT: The Temtor Disbursed Project Funds for Ineligible and Unsupported Expenses

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of disbursements made by The Temtor.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8L, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at http://www.hudoig.gov.

If you have any questions or comments about this report, please do not hesitate to call me at 913-551-5870.

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August 8, 2013

The Temtor Disbursed Project Funds for Ineligible and Unsupported Expenses

Highlights

Audit Report 2013-KC-1003

What We Audited and Why

We selected The Temtor in St. Louis, MO, for audit because the project quickly defaulted on its mortgage and requested a partial payment of claim. The project reached final endorsement on January 30, 2012, and failed to make timely mortgage payments beginning March 1, 2012. Our audit objective was to determine whether Temtor's project funds were used for ineligible expenses.

What We Recommend

We recommend that the Director of HUD's St. Louis Office of Multifamily Housing Programs require the project owners to return $401,705 in ineligible disbursements to the project operating account and provide support for $316,883 disbursed for unsupported costs or return the funds to the project operating account.

Additionally, we recommend that the Departmental Enforcement Center pursue appropriate administrative sanctions against the individuals involved, to include suspension, debarment, or limited denial of participation.

What We Found

The Temtor used project funds for ineligible and unsupported expenses. This misuse included payments of developer fees, unsecured loans, and excessive funds to the management agent. In addition, Temtor transferred funds out of its tenant security deposit reserve account and submitted incorrect accounting reports that concealed the transfers.

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BACKGROUND AND OBJECTIVE

Steins Broadway Management and Rothschild Development collaborated to manage the renovation of the former Coca-Cola syrup plant, also known as The Temtor. The project also included a redevelopment of nine scattered sites located in the South Carondelet neighborhood of St. Louis, MO. The project consists of 109 residential units and 9 commercial units.

To finance the construction, The Temtor project received approximately $14.4 million from a U.S. Department of Housing and Urban Development (HUD)-insured mortgage. HUD authorized the mortgage based on Section 220 of the National Housing Act (12 U.S.C. (United States Code) 1715k). Regulations are in 24 CFR (Code of Federal Regulations) Part 200 and 24 CFR 220.1. This program provides funding for good quality rental housing in urban areas that have been targeted for overall revitalization. The project also received approval for State and Federal historic tax credits, Brownfield tax credits, and tax-incremental financing.

The project owners formed a limited liability company, 8000 Michigan, LLC, to administer project development and operations. The company selected Steins Broadway Management Company to perform the management duties. Temtor received initial endorsement on April 1, 2010, and final endorsement on January 30, 2012. Following final endorsement, the project began missing mortgage payments in March 2012. By December 2012, the project reported $748,517 payable to the HUD-insured mortgage holder.

HUD’s control over the borrower is exercised by a regulatory agreement, form FHA-2466, signed at initial closing. The agreement outlines terms and conditions for the HUD-insured mortgage, such as what expenses could be paid with project funds.

Our audit objective was to determine whether the project funds were used for ineligible expenses.

RESULTS OF AUDIT

Finding 1: The Temtor Disbursed More Than $700,000 in Ineligible and Unsupported Payments From Its Project Accounts

Temtor used project funds for ineligible and unsupported expenses. This condition occurred because Temtor chose to use project funds to benefit the project owners rather than making the mortgage payment. As a result, the more than $700,000 used to make improper payments was no longer available to make mortgage payments, contributing to the project's default.

Ineligible and Unsupported Disbursements

Temtor used project funds for ineligible and unsupported expenses. These expenses included payments of developer fees, unsecured loans, and excessive funds to the management agent.

Paid Developer Fees

Temtor paid $282,000 in developer fees with project funds. These fees were development expenses, not operating expenses. The regulatory agreement required that project funds pay only for reasonable operating expenses and necessary repairs. Owners could use surplus cash to pay other expenses.

The operating agreement also restricted the payment of developer fees. The agreement required payment of the bridge loans before payment of the developer fees with development funds. The Temtor used project funds to pay developer fees without paying the bridge loans in their entirety. While The Temtor could have paid developer fees with surplus cash, the project did not generate surplus cash during our audit period.

Paid Unsecured Loans

Temtor paid more than $69,000 on unsecured development or construction loans with project funds. These loans were development expenses, not project operating expenses.

Paid Excessive Funds to Management Agent

Temtor paid more than $50,000 to the management agent above the amount allowed by the project owner's-management agent certification. The additional amounts included payments for accounting services, project management, office supplies, equipment lease, computer maintenance, phone and Internet services, and residential screening. These were either management agent expenses that should have been covered by the approved management fee or not related to The Temtor project.

Made Unsupported Payments

Temtor made more than $316,000 in payments from project accounts without being able to provide invoices and other documentation to demonstrate that these payments were allowable. The payments included transfers to other accounts owned by the management group, cash withdrawals, and direct payments to third parties.

Benefit to the Owners

Temtor chose to use project funds to benefit the project owners rather than making the mortgage payment. The improper payments benefited the project owners since they also owned the development and management companies that received many of the payments. In addition, the loan repayments relieved personal obligations of the ownership group.

More than $700,000 Improperly Disbursed

More than $700,000 used to make improper payments was no longer available to make mortgage payments, contributing to the project's default. The improper payments included ineligible payments of $401,705 and unsupported payments of $316,883. Details are included in appendix C.

Disbursement Type	Amounts	
Developer Fees	$ 282,000	
Unsecured Loans	$ 69,418	
Excessive Funds to Mgmt Agent	$ 50,287	
Ineligible Payments - Sub-total		$ 401,705
Unsupported Payments		$ 316,883
Improper Payments - Total		$ 718,588

The project reported $748,517 payable to the holder of the HUD-insured mortgage at the end of our audit period.

Conclusion

Temtor did not have adequate policies and procedures in place to ensure that disbursements were only for eligible project expenses. However, this report contains no related recommendations because after our audit period, Temtor changed management agents and the mortgage was assigned to HUD.

The project regulatory and operating agreements established that members of the ownership group were individually liable to HUD if they received project funds that they were not entitled to retain. The agreements further state the members agree to be liable for their own acts and deeds, or acts and deeds of others which they have authorized, in violation of the provisions of the HUD regulatory agreement. HUD should require that the project owners return the improper payments to the project operating account.

Recommendations

We recommend that the Director of HUD's St. Louis Office of Multifamily Housing Programs require the project owners to

1A. Return the $401,705 in ineligible disbursements to the project operating account.

1B. Support the $316,883 disbursed for unsupported costs or return the funds to the project operating account.

RESULTS OF AUDIT

Finding 2: The Temtor Diverted Tenant Security Deposits

Temtor transferred funds out of its tenant security deposit reserve account and submitted incorrect accounting reports that concealed the transfers. This condition occurred because Temtor chose to use the security deposits for project expenses rather than following the HUD requirement to maintain the deposits apart from all other funds of the project. As a result, HUD was not able to effectively monitor the condition of the project, and the tenants were at risk of not being able to recover their deposits.

Security Deposits Used for Operating Expenses

Transferred Funds

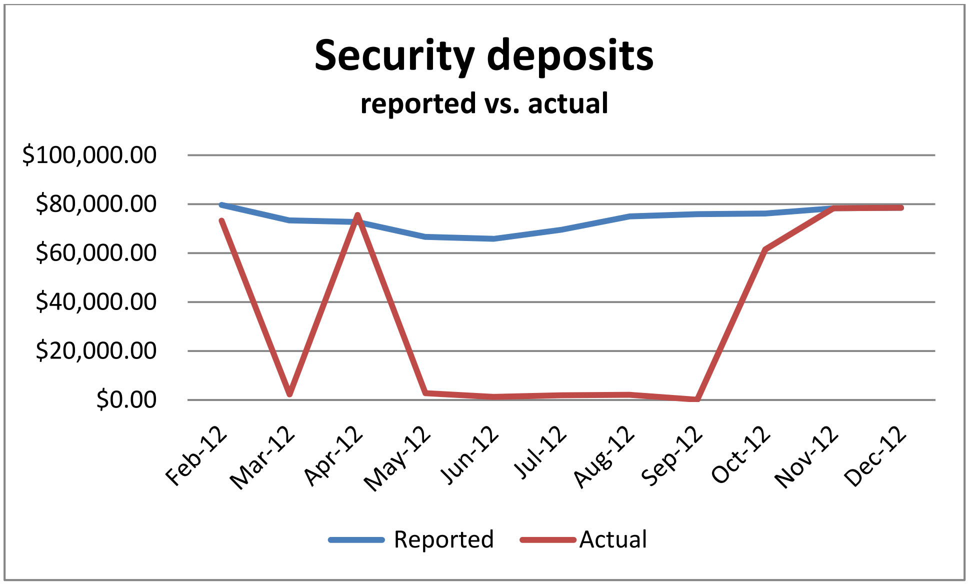
In March 2012, Temtor transferred $70,000 from its security deposit account to its operating account. Temtor returned $70,000 to its security deposit account from its operating account in April 2012. In May 2012, it transferred $73,000 from its security deposit account to its operating account. These transfers supported two mortgage payments of $78,419 each from the operating accounts to the holder of the HUD-insured mortgage. From March to September 2012, Temtor made multiple smaller transfers from its security deposit account to various other accounts.

A member of the ownership group deposited $75,000 into the security deposit account in October 2012. Additional deposits made from the project's rental account brought the balance of the security deposit account back to the reported level in November 2012.

HUD Handbook 4370.2, REV-1, CHG-1, Financial Operations and Accounting Procedures for Insured Multifamily Projects, requires that all security deposits be segregated from other project funds and used only for refunds to tenants and payment of appropriate expenses incurred by the tenant.

Incorrect Reports

Temtor submitted incorrect accounting reports to HUD. It certified the security deposit account balances in the project's monthly accounting reports. Between February and December 2012, Temtor overstated the security deposits in 8 of 11 months. The average amount of overstatement was $54,631. This overstatement effectively concealed the diversion of funds from HUD.



Shortages Covered by Owners

The management agent stated that the project did not have adequate funds to cover operating expenses. He was also aware that using security deposits for operating expenses was not allowed. However, Temtor chose to use tenant security deposits as it preferred rather than following HUD requirements.

Financial Risk

HUD was not able to effectively monitor the condition of the project. The December 2012 project report indicated $748,517 in overdue payments on the HUD-insured mortgage. If the Temtor had accurately reported the use of security deposit funds to pay the mortgage, HUD would have been better able to take prompt corrective action.

The security deposit account was not properly funded, placing the tenants at risk of losing their deposits if the project failed.

Conclusion

The Temtor placed tenant security deposits into its project operating account and filed inaccurate reports concealing the diversion. Because improper payments were made from project accounts during the audit period (see finding 1), these transfers increased the project's ability to make the improper payments. HUD can impose various administrative sanctions against individuals who have acted improperly to protect the public interest. These sanctions include suspension, debarment, and limited denial of participation.

Recommendation

We recommend that the Director of HUD’s Departmental Enforcement Center

2A. Pursue appropriate administrative sanctions for both findings against the individuals involved, to include suspension, debarment, or limited denial of participation.

SCOPE AND METHODOLOGY

To accomplish our objective, we

- Interviewed HUD and project management,
- Reviewed Federal regulations and HUD handbooks,
- Reviewed independent public accountant reports,
- Reviewed the project operating and regulatory agreements,
- Reviewed the closing documents, and
- Reviewed project bank statements and supporting documentation.

We reviewed monthly financial reports that were submitted to HUD by Steins Broadway Management Company. The company reported disbursements totaling approximately $4.8 million during our audit period. We selected for review payees that were paid more than $25,000 during the audit period. By targeting the payees that received the largest disbursements, our sample included 94.8 percent of the reported funds that were disbursed during our audit period. We compared the invoices and payment documentation provided by the auditee to the selected disbursements. We looked for support that the expenses were properly assigned to the project.

We identified additional disbursements from the project accounts that were not disclosed in the monthly financial reports; thus, we included an additional sample in our review. We obtained the project operating and rental accounts' monthly bank statements and supporting documentation. Unreported payments totaling approximately $1 million were made from the project operating or rental accounts during our audit period. We excluded payments that were less than $1,000 and transfer payments between the project's rental and operating accounts. By targeting the payees that received the largest disbursements, our sample included 98.9 percent of the unreported funds that were paid during our audit period.

We performed audit work from January through June 2013. We conducted audit fieldwork at The Temtor, 8125 Michigan Avenue, St. Louis, MO. Our review generally covered the period February 1 through December 31, 2012.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

INTERNAL CONTROLS

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objective:

- Policies and procedures to ensure proper oversight of project disbursements.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- The Temtor did not have adequate policies and procedures in place to ensure that disbursements were only for eligible project expenses.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/	Unsupported 2/
1A	$401,705	
1B		$316,883

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.

2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

8000 Michigan LLC
393 North Euclid – Suite 300
St. Louis, MO 63108
314-361-7117

June 27, 2013

Mr. Ronald J. Hosking
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
400 State Avenue, Suite 501
Kansas City, KS 66101

Dear Mr. Hosking:

This letter is provided in response to your letter dated June 13, 2013 regarding the discussion draft that reported on your audit of The Temtor project's disbursements.

In the draft report you state that "(t)he Temtor used project funds for ineligible and unsupported expenses." We categorically disagree with that assertion.

Comment 1

Your findings indicate that the project paid developer fees, repaid unsecured loans and owner advances and made excess management fee payments totaling $435,090.49 and had unsupported payments totaling $596,569.36. You indicate that "(t)he Temtor used project funds" to make these payments. This assertion results from your conclusion that our having deposited some receipts and having made some disbursements associated with the project into and out of a bank account that was separate from the bank account used to handle day-to-day operating receipts and disbursements was improper. This assertion also appears to be based on your conclusion that receipts from the sale of the various state income tax credits and contributions by the federal historic tax credit investor were "project funds" even though the Security Agreement for the loan and the UCC filed as collateral for the loan state that the HUD-insured loan collateral "specifically excludes" 8000 Michigan LLC's "interests and rights" in those receipts.

Comment 2

HUD Handbook 4370.2, REV-1, Section 2-3, from which you included excerpts with your draft report, states that '(i)n establishing a financial accounting system, auditing problems can be avoided by keeping operating funds separate from other project funds." We believe that we have complied with this requirement by using one account for operating purposes and one for other project purposes. We do not agree that using funds from sources that are not part of the HUD-insured loan collateral are subject to the same limitations as funds provided from rents and other project related receipts.

Comment 3

The Regulatory Agreement, dated April 1, 2010, between HUD and 8000 Michigan LLC states that the "(p)roject includes the mortgaged property and all its assets of whatsoever nature" and that the "(m)ortgaged (p)roperty includes all property, real, personal or mixed, covered by the mortgage or mortgages securing the note and endorsed for insurance or held by the Secretary." Since the various state income tax credits and contributions by the federal historic tax credit investor are specifically excluded from the mortgaged property they should be excluded in the use of the term "project" within your report.

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While we have operated under this interpretation since we started this project, we recently provided the applicable documents to our attorneys at Husch Blackwell to have them review this situation and give us their conclusions. A copy of a letter dated June 26, 2013 from Stacey Grote at Husch Blackwell is attached and agrees with our position.

The Temtor's annual financial statements were audited for two years by an independent CPA firm which reported on compliance with specific HUD requirements and, in neither year, did the auditors note a problem with our use of funds from these two accounts. The assertion is made in your report that "Temtor chose to use project funds to benefit the project owners rather than making the mortgage payment," however, the independent CPA firm reported in footnote number 5 to the certified financial statements for the year ended December 31, 2012 (the period of your review) that "(f)or the year ended December 31, 2012, no distributions to partners were made." They further reported in footnote number 5 to the certified financial statements for the year ended December 31, 2011 that "(f)or the period from July 1, 2011 through December 31, 2011, no distributions to partners were made." Copies of these footnotes to the financial statements are attached.

With regard to compliance, the auditor's report on compliance pointed out that "(m)anagement is responsible for compliance with the requirements of laws, regulations, contracts and grants applicable to its HUD programs" and that it was the auditor's responsibility "to express an opinion on compliance for each of 8000 Michigan LLC's major HUD programs based on our audit of the compliance requirements referred to above." The auditor's "Opinion on Each Major HUD Program" for 2012 states "(i)n our opinion, 8000 Michigan LLC complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on its major HUD program for the year ended December 31,2012." We have attached a copy of that report.

Comment 4

We also reported monthly for over two years to the local HUD office which oversaw the Temtor project. This reporting was done on HUD forms which showed operating, construction and other expenses and payments being paid from all bank accounts. This form states that the information on the form "is used by HUD to assess the need for remedial actions to correct project deficiencies." At no time did the local HUD office or anyone else who may have reviewed these reports point out any need for remedial action with regard to payments from our bank accounts.

In addition, in connection with our efforts to complete a Partial Payment Claim, the local HUD office performed its own on-site audit of our records and did not find fault with our handling of payments from the bank accounts.

Comment 5

The funds from state income tax credits and our federal historic tax credit investor (which according to the forecasted sources and uses of funds statements submitted to HUD for the construction phase of the project totaled more than $10 million) were specifically excluded from the collateral on the HUD-insured loan. There was no requirement that the receipt of these funds be put into project operating accounts and these funds, to the extent they were not needed to repay the bridge loans, were available for construction and other project needs. As a result, we were free to use these funds for any purpose and we elected to use them to support the project.

We have attached a copy of the Buyer's Final Settlement Statement from the title company dated 4/1/2010 which shows all of the funds charged and credited to our account for this loan. This statement reflects that in addition to the $14,427,800 HUD-insured loan there was an additional $10,923,256 of funds that came from bridge loans and from the $288,556 of funds we were required to deposit because of the change order situation described elsewhere. These additional funds were used to pay all of the required construction costs, fees and other project costs

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specified to be paid at closing. Once the state tax credits were received and sold, the difference between the bridge loan and the sale amount of the credits was available to cover the costs like those you have questioned.

Comment 6

You state in your letter that the "regulatory agreement required that project funds pay only for reasonable operating expenses and necessary repairs." The actual wording of the Regulatory Agreement (section 9 (g)) states "all rents and other receipts of the project shall be deposited in the name of the project in a financial institution…" and that "(s)uch funds shall be withdrawn only in accordance with the provisions of this Agreement for expenses of the project" and permitted distributions of surplus cash. We believe there is a difference between the meanings of the terms "reasonable operating expenses and necessary repairs" and "expenses of the project." We have attached a copy of section 9 (g) of the regulatory agreement.

Comment 7

We have complied with the provisions of section 9 (g) since all operating rents and other operating receipts of the project were deposited in an account that was only used for operating expenses. Where we seem to differ is in the use of the funds that were deposited in a separate account from sources that were not part of the collateral on the HUD-insured loan. If we were to treat all of these additional receipts as funds that could only be used for "operating expenses and necessary repairs", as we noted above, we would not have had any funds available to pay all of the project fund requirements which were in excess of the HUD-insured loan. It is very clear that all funds were used for "expenses of the project."

In particular, you have questioned the following:

Comment 8

1. In your analysis of the allegedly "ineligible disbursements" you state that the $282,000 of developer fees "were development expenses, not operating expenses." The developer fees paid in February 2012 (totaling $61,000) were paid with proceeds from the sale of the state historic tax credits which were not required to repay the bridge loan. The developer fees paid in April 2012 (totaling $221,000) were paid from excess funds the project received from our federal historic tax credit investor. The $282,000 of developer fee payments was necessary for us to comply with the state historic tax credit requirements. These requirements state that the developer must pay at least 10% of the developer fees on the project upfront and only 90% can be accrued over a period of six years.

   We have attached a copy of a portion of the Missouri Department of Economic Development Handbook dealing with the requirements for the payment of developer fees which states "(a)ccural (sic) of up to 90% of developer fees will be considered for eligibility for HTC credits" which necessitates that 10% be paid before the credits are issued. After these payments were made, they were returned to the project accounts and used for project purposes and none of these fees were retained by the developer or anyone associated with the ownership of this project.

   With regard to these developer fees, the forecasted statement of sources and uses of funds for the project dated 10/22/09 (which was submitted to HUD prior to approval of the loan) showed over $1.4 million of non-deferred developer fees being paid from sources other than the HUD-insured loan. It is clear that these payments were anticipated and required by the state, were to be repaid with funds other than from the HUD-insured loan and were put back into the project and not distributed to the developer. A copy of the forecasted statement of sources and uses of funds referred to above, which covers all of the 8000 Michigan properties, is attached.

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In your letter you also point out that "(t)he operating agreement also restricted the payment of developer fees. The agreement required payment of bridge loans before payment of the developer fees with development funds." Although this may correctly reiterate what the operating agreement states, we would point out that the operating agreement is between the members of the LLC and we are not aware of any requirement in the loan documentation to allow others to make assessments of our compliance with that agreement. Even with that provision, no one could reasonably expect we would not comply with state requirements regarding the state historic tax credits. Also, it is worth noting, as further explained later, that the reason the project had unpaid bridge loans outstanding was because of the significant delays in closing and cash drains which resulted from the decisions made by the then-director of the St. Louis HUD office and caused the project's interest reserves and other reserves to be depleted to zero.

Comment 9

Comment 10

2. You state that the Temtor made $69,418 of payments on "unsecured development or construction loans with project funds." You further state that "(t)hese loans were development expenses, not project operating expenses." It was never our intention to treat these expenditures as "operating expenses" but rather they were made in support of the construction of the project. These were payments made from the funds deposited in the separate account from tax credit proceeds or from our federal historic tax credit investor and were used, as you state, for "development or construction" purposes.

Comment 11

You have questioned a $25,376 payment on 2/3/2012. As we explain later in this letter, the Temtor project was drained of all of its available cash and required to inject additional cash into the project based on actions taken by the former director of the St. Louis HUD office. Because of this, we were forced to accept a $250,000 advance from one of our partners to pay the general contractor for the removal of an underground storage tank for which we had been granted but did not receive a $224,624 state grant for such removal costs. Even after it was determined by our environmental consultants and the State of Missouri that the storage tank did not need to be removed (and has not been removed), the former director of the St. Louis HUD office demanded that we pay the contractor for a removal which never happened.

Since the tank was not removed, we did not qualify for the grant so we had to pay this $224,624 to the contractor for this removal out of our own funds. The $25,376 paid to the Carpenter's on 2/3/2012 that you have questioned as an ineligible cost represents our refund of the difference between the $250,000 which was advanced from our partner and the $224,624 that we were actually required to pay. The $2,042 payment on 8/17/2012 and the $1,000 payment on 10/10/2012 represent interest payments on the outstanding $224,624 advance.

We have attached an e-mail dated January 30, 2012 from Ben Simms to Juli Laramie and others at the Carpenter's Union stating "(w)hat are the wiring instructions for a partial payment of the $250,000 note payable? We will be sending $25,376 later this week. This is $250,000 - $224,624."

Comment 12

The $21,000 payment on 2/3/2012 and the $20,000 payment on 4/26/2012 were repayments of bridge loans made in January 2012 prior to the HUD-insured loan closing to allow the project to be completed since all other available funds had been drained through change orders (which we explain later.) The $20,000 payment repaid a $20,000 advance from Perry Steinhandler, one of the 8000 Michigan LLC members, on 1/13/2012 as reflected on the attached US Bank statement for January 2012. The excess funds from state historic credits arose because we were able to obtain bridge loans on those

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credits at a portion of their sale value and therefore the balance of the proceeds were not required to repay the bridge loan. The $21,000 payment in February 2012 was repaid from excess state historic credits which were received in February 2012 and the $20,000 repayment in April 2012 was repaid from proceeds from our historic tax credit partner. Again, neither of these payments was made with any operating funds nor from any collateral pledged as security on the HUD-insured loan.

Comment 13

3. With regard to the repayment of $33,385.53 of owner advances which you state were repaid "with project funds", you have questioned $21,545.42 of legal fee payments that you state are "owner advances" because they were made by reimbursing Steins Broadway Management. We would first point out that Steins Broadway Management is not now and has never been an owner of the project but was the property manager which was approved by HUD and was operating under a HUD-approved management agreement. This $21,545.42 represents money advanced by the former property manager to pay property legal expenses until such time as the property revenues allowed for those expenses to be reimbursed. We continue to see nothing wrong with a property manager paying bills for which the property is responsible and then being reimbursed. This certainly happens frequently in the thousand other units we manage.

The individual legal bills were supplied to the auditors but, as you state, the auditors "did not analyze the detailed legal invoices to determine how much of each one related to The Temtor project." Therefore, it is impossible to determine any specific legal bill you are questioning.

You have also questioned $11,840.11 as "ineligible repayment of owner advances" which you state was reported in the monthly financial reports for August, October and November 2012. You state this money was "transferred to Steins Broadway Management Company" during those months. Again, we would point out that Steins Broadway Management Company is the property manager and not an owner. These expenditures were incorrectly titled by our accountant as owner related on the front page of these reports. These funds, as you state, were paid to the former property manager, Steins Broadway Management, as repayment of expenses previously paid by the manager on behalf of the property.

Comment 14

The $4,848.67 in August 2012 was repayment of operating expenses that were paid by the property manager in May 2012 but were not requested for reimbursement in May because of a personnel change in the property manager's accounting office. It was subsequently noticed by the new accountant, and reimbursement was requested. These expenses are fully presented in the August 2012 report to HUD under the caption "invoice for May bills." The information we provided earlier showed this amount paid $562.01 for phone service, $395.43 for water service, $798.50 for trash, $709.29 for maintenance supplies, $453.40 for janitorial service, $555.00 for a contractor, $642.60 for lawn care and $732.44 for property insurance.

The $3,395.53 in October 2012 and the $3,595.91 in November 2012 were also repaid to the former property manager, Steins Broadway Management, and the former property manager has explained that these payments were also reimbursement for expenses paid by that entity.

Comment 15

4. Finally, as part of the alleged "ineligible" costs, you site $50,286.96 of "excess management fees." Of this amount, you state that of the $20,611.45 in office administration fees for the months from June through December 2012, "$9,244 in office

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Comment 15

administration fees was ineligible overhead expenses or not related to Temtor project." You have not provided any detail as to what comprises the $9,244 you allege was not eligible so it is impossible for us to refute the specific costs that you are questioning. However, we would point out that the schedule of forecasted net operating income showing projected annual income and expenses, which was submitted to and approved by HUD prior to closing of the loan, included a line item of $21,800 in annual "Administrative" expenses without specifically enumerating how these expenses were to be spent. So the amount spent in 2012 is not greatly out of line with projected administrative expenses. A copy of the Schedule of Forecasted Net Operating Income dated 10/22/09 is attached.

You note that the office administration fees included reimbursements for "office supplies, equipment lease, computer maintenance, phone and Internet services and residential screening." We submit that all of these types of expenses are typical in a real estate rental and support office that maintains leasing and accounting records on computers and utilizes social Internet media as its primary advertising outlet and also continues to use the telephone and copiers on a day-to-day basis in support of its work. We would note that the attached projected annual operating expenses included $9,810 for "Advertising" which is over and above the administrative expense projection so in total we had projected $31,610 per year of the type of expense you are questioning.

We would also point out that, in the start-up of an administrative office to handle rental and administration of 109 residential units and almost 40,000 square feet of commercial space, much of the administrative costs are incurred up-front as the office is equipped and stocked. That was the case for the early part of 2012 for the Temtor rental office.

Comment 16

As part of the $50,286.96, you also question $27,517.90 (five payments of $5,503.58) which you claim were "extra project management fees" since they exceeded the amount provided for in the property management agreement with Steins Broadway Management. As we have pointed out on numerous occasions, there is a distinct group of property management services on a project like this and you excerpted the management agreement with Steins Broadway Management which lays out the specific property management services that were to be provided. Such property management services include rental services, administration and normal day-to-day oversight and control of the property. We have explained to your auditors that these five payments were not for normal day-to-day functions but were for two special projects distinct from the day-to-day property management. These projects included management of the build-out of the remaining commercial space and work in the accumulation of data and preparation of the PPC. We have attached recent e-mails from Ashley West, the financial analyst who helped prepare the PPC, and Jonathon Spencer, the project manager who oversaw the construction of parts of the commercial build-out, explaining what they did and how much time they spent during the period for which 8000 Michigan reimbursed half of their compensation. We are providing these e-mails because there was no contemporaneous documentation prepared while these services were being performed.

Comment 17

The construction management was most economically done using a Steins Broadway manager because the project had been drained of funds (as we explain in more detail later in this letter) by the demands made by the former Director of the St. Louis HUD office. The PPC was required because the project could not proceed as planned due to a severe lack of reserve funds resulting from these same demands. These five payments covered half-time services of the two individuals for five months and were required to

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assure the commercial build-out was properly completed and tenants could occupy the space and in the hopes of overcoming the drain of funds by restructuring the debt.

Comment 18

Next, you questioned a $10,000 payment on 11/8/2012 transferred to the property management company's bank account to be paid for accounting services. Upon review, it appears that the $10,000 was transferred to the former property management company, Steins Broadway Management, which failed to remit the funds to the accounting firm. While this admittedly reflects poor control over this one transaction, it is not an indication of an excess management fee. It is simply an accounting fee for 2012 which remains unpaid and will now be paid to the accountants by former the property management company. However, your statement regarding this $10,000 that the "project instead paid the audit fee directly on February 14, 2013" is incorrect.

The check on 2/14/2013 for $10,000 and an earlier check on 12/10/2012 for $10,000 were paid and applied to the auditor's invoice #40048 for $20,000 issued on 2/28/2013. These payments still left an unpaid balance of $17,950 for 2012 services as reflected on Invoice #41524. This is the balance to which the $10,000 from the former management company will be applied. Accordingly, both the check on 2/14/2013 and the November check (which will now come from the former property management company) were both being paid toward outstanding 2012 accounting fees for the project. The February check was paid in addition to and not in lieu of the November check. We have attached copies of an Accounts Receivable Ledger for the 8000 Michigan LLC account provided by the accountants which shows these transactions. We have also attached a copy of Invoice #41524 showing that there remains a balance of $17,950 for the 2012 work including the $10,000 to be paid by the former property manager.

Comment 19

You also state that $3,525 was paid "for services not related to project operations." You have not supplied any details on this but we agree that there is a difference of $3,525 between our payment of $42,165 on April 20, 2012 and two of the invoices (#31717 and #34760 as reflected on the attached Accounts Receivable Ledger) which totaled $38,640. We had believed that this additional amount was for services to 8000 Michigan Manager and 8000 Michigan Developer both entities which are related to this project. We recently requested that the accounts to whom this amount was paid provide us with detail on the payment. As per the attached e-mail dated June 27, 2013 from Ben Hurwitz at the accounting firm, the $3,525 consisted of payments of $1,550 for 8000 Manager, $1,000 for 8000 Developer and $975 for 8000 TIF. As stated above, the first two entities are directly related to the project and the payments are proper. However, 8000 TIF is only peripherally related to the project and we have requested that the former property manager refund this amount to the project. We have attached a copy of the e-mail from the accounting firm.

Your final finding in this area is that "Temtor made more than $596,000 in payments from project accounts without being able to provide invoices and other documentation to demonstrate that these payments were allowable." The following is a restatement of the explanations that were provided to your auditors:

Comment 20

1. The two largest payments in this amount, $234,551.75 on 2/2/2012 and $234,601.75 on 2/3/2012, resulted from a bridge loan by one of the partners in the project. The explanation for these payments is fairly simple. As we have noted above and explain in more detail below, when we approached the final closing on 1/31/2012, the project was short on funds because all of the reserves and contingencies had been paid to the general contractor, because we had to inject $224,624 into the project to pay for the

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Comment 20

removal of a petroleum tank that had not been removed and because we were continuing to pay large interest payments due to significant delays in the project completion.

We were required, based on the decisions by Mr. Hester prior to the closing, to have funded a $234,451.75 shortfall on the loan closing statement before the project could close. One of our associates on the project, the Carpenters' Union, agreed to advance us sufficient funds to cover the shortfall but they were limited in their ability to do this until after the project had formally closed. Accordingly, one of the partners in the project agreed to bridge the necessary funds prior to the closing and to be reimbursed from the funds provided by the Carpenters' Union.

That partner, Mr. Jim Baumstark, initiated a wire transfer of $234,451.75 from his wife's Fidelity Investment account to advance the necessary funds on January 30, 2012 to fund the short-term bridge loan. 8000 Michigan LLC attempted to repay this advance plus $100 in fees to Mr. Baumstark on 2/2/2012 but the original wire from that date was returned. This first transfer is reflected as going in and out of the account. On the following day 2/3/2012 the wire was resubmitted for the advance amount plus $150 (including $50 of fees for an additional day) by the bank and cleared.

We have attached copies of the January and February 2012 statements for Bridget Baumstark's (Mr. Baumstark's wife) Fidelity Investment account showing $234,451.75 being transferred from the account on 1/30/2012 and $234,601.75 being returned in February. We have also attached an e-mail dated 2/3/2012 from Mattie Vogler, who was the accountant for the property manager at the time, informing Mr. Baumstark that "the wire I requested yesterday was returned" ("yesterday" meaning 2/2/2012). The e-mail further states "I will have to go to the bank and request this in person today" ("today" meaning 2/3/2012).

Comment 21

The Carpenter's Union funds arrived at the title company shortly after the closing. Accordingly, the advance by the partner was returned to him plus a small $50/day fee that was charged for the transfer. None of these funds came from the property and were merely refunds of short-term bridge loans necessitated by the requirement to pay to remove a tank which had not been removed.

We have attached a string of e-mails dated January 11, 2012. The first between Ben Simms and Jim Baumstark (who paid in the amounts needed to bridge the Carpenter's funds) and others discussing the need for a one day bridge loan of $234,451.75. Mr. Baumstark agreed to make that bridge loan. The second e-mail in this string is between Ben Simms and several members of the Berkadia group and P. Roark Patton who was representing the Carpenter's Union in this transaction. This e-mail discusses each of the debits in the final endorsement closing statement and includes a discussion of the $224,624 being paid to EM Harris for "the tanks they never dug up and we didn't get the grant." This e-mail concludes with the statement "I also understand that we will need to bring the $234,451.75 into the closing, then the Title Company can reimburse us the fee as soon as all documents are signed." Mr. Baumstark's loan was repaid on 2/3/2012 in the amount of $234,601.75 (including $150 of fees for the wire transfer.)

We have also enclosed a copy of the payee list from the Final Endorsement Closing Statement which shows the $224,624 being paid for remediation and those funds coming from 8000 Michigan LLC. We have also attached an e-mail dated 1/30/12 from Ben Simms to Chris Souka at Berkadia stating that "Patton" (Carpenters fund manager) has initiated his wire, which cannot be applied to the closing. Our partner, Jim Baumstark

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initiated his wire as of this AM. At this point, it is up to bank(s) whether funds arrive before 2 PM." This e-mail confirms the transfer of funds described above as well.

Comment 22

2. You have also questioned $75,077.16 of payments which result from your analysis in Note F of the "payments and tax credit deposits made to operating accounts." That analysis shows that you accounted for $4,695,416.40 of payments and only $4,620,339.24 of deposits resulting in what you conclude to be $75,077.16 of "unsupported expense." The problem with that analysis is that, because your team started their analysis of the project as of 2/1/2012 (after closing of the loan), you missed two deposits in January 2012 for $429,496.32 and $643,964.46 which also contributed to the funds that were used to make the $4,695,419.40 of payments that you noted above as well as to make other payments. We have attached the January bank statement from Excel Bank for 8000 Manager LLC (manager for SMMM, LLC which owned the credits as the state historic investor for the project) showing these two wire transfers coming in on 1/20/2012 and 1/30/2012. Also attached are copies of the checks transferring the funds from 8000 Manager LLC to 8000 Michigan LLC as a capital contribution.

   If these deposits had been included in your analysis, the result would have been that instead of a $75,077.16 shortfall there would have been a $998,383.62 excess. Again, all of these funds arose from sources that are not included in the security for the project loan and not from operating funds of the property.

Comment 23

3. You questioned $5,763.70 of administrative expenses which you say "were not properly supported" but for which you provided no detail as to which specific expenses you are referring. Absent any specifics, we can't tell what we are looking for or whether you are questioning the propriety of the support we provided or are saying there was no support. Again, however, we point out that these expenses are part of $20,611.45 of total administrative expenses for the period against budgeted administrative expenses of $21,800 for the year.

   If we accepted your conclusion that this $5,763.70 is not supported and that the previously discussed $9,244.06 is ineligible, that would leave $5,603.69 of "acceptable" administrative costs, about $933 per month and about 25% of the annual budget expended for six months of a budget year when the office was in a start-up mode. These are very low amounts to have been spent on administration of a property of this size and complexity.

Comment 24

4. Finally, you have questioned $46,575 consisting of 16 individual payments which you claim are "unsupported." We looked at the largest one of these, a payment for $10,000 on 4/4/2012. This payment represented the reimbursement of part of a $14,000 cash advance to the management company by one of the partners that was used to pay project expenses. We have not, but can, look at the other fifteen payments but we have been told by the former property management company that these are all simply reimbursements for project expenses paid.

Comment 25

As your second finding, you note that starting in April 2012 "Temtor transferred funds out of its tenant security deposit reserve account and submitted incorrect accounting reports that concealed the transfers." While it is mentioned in the details of your finding, we believe it is important to note that all of the security deposit amounts transferred out were reimbursed in April 2012 and again in October 2012 and that tenant deposits from thereon remained fully funded in a separate bank account. We do not dispute the fact that the former property manager, Steins Broadway Management, inappropriately and without authorization from the company or the

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knowledge of the managing member, used security deposits on an interim basis to fund operations until an additional contribution by a part of the ownership group could be arranged.

Comment 25

We do, however, believe that for full disclosure this report should at least refer to the reason, as we explained to the auditors on numerous occasions, why this project was so underfunded, lacked reserves to meet the early cash requirements of the project and required the continual scramble for funds to try to keep the project afloat.

What we explained to the auditors was that parts of the project were placed in service beginning on June 3, 2011. However, prior to final closing on the HUD-insured loan in January 2012, we ran into significant problems with our general contractor, EM Harris, and the head of the local office HUD office, Mr. Charles Hester. Prior to the closing, Mr. Hester demanded that we pay the contractor for hundreds of thousands of dollars of change requests that had previously been denied by our architects and ourselves and also denied change orders that we presented to reduce the contract amount. Mr. Hester stated to us that, if we wanted an occupancy permit for the project, we would agree to approve all of the contractor's change requests thus using up all of the budgeted reserves and contingency funds and most of the funds needed to complete the commercial portion of the project.

There were numerous improperly denied change requests but we have provided a few examples. First, our contract called for the contractor to tuck-point the building to prevent outside water from entering the building – a normal renovation project requirement. After the contractor's tuck-pointing subcontractor completed its work, a rain storm hit the area and there were numerous places where the building had significant leaks. We requested that the contractor fix those leaks as part of the initial contract requirements. In response, the contractor submitted an $80,000+ change request which was denied by us and our architects since the work was part of the original contract.

As another example, the first change order for the project changed the painting requirements for the building. The original construction contract with EM Harris, the architectural plans and specification book all provided that 100% of the interior walls and ceilings of the Temtor building were to be sandblasted. In its contract with its subcontractor for the remediation work (which was to have included this sandblasting) EM Harris failed to recognize that the subcontractor had not provided for this sandblasting and that to add this to the subcontractor's work would cost approximately an additional $400,000. When this was brought to our attention, we acquiesced and agreed to change order number one (which did not change the project cost) which removed the sandblasting requirement and instead stated "(a)ll existing walls, columns and ceilings are to be scraped of loose paint, prepped for patching, and painted."

Despite our willingness to change the scope to a less preferred approach, EM Harris chose not to paint large portions of the commercial space as required by the change order. The architect's memorandum on May 3, 2011 stated that 42,760 square feet of commercial space was not painted. The cost of completing this painting (almost $32,000) after EM Harris was replaced just added to the financial uncertainty at the start of the project.

As another example, many of the payments you have questioned relate to payments we made to Excel Bank and others to cover interest on bridge loans for tax credits. We were unfortunately required to pay this interest for a significantly longer period than the original estimate. These extended payments occurred because EM Harris did not complete the individual buildings in accordance with the construction time schedule provided in the construction contract and therefore we could not receive the state historic tax credits which are only issued after the construction is completed. As is typical in these types of construction contracts, terms were

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Comment 25

included in the construction contract which provided for liquidated damages in the event the contractor was late in delivering the project and would have offset much or all of the additional interest we were forced to pay on the bridge loans.

On this project, the liquidated damages (which are contractually binding and do not have to be litigated) would have totaled more than $100,000. These liquidated damages should have resulted in a reduction of the contract price at the end of the construction period.

Finally, as perhaps the most egregious example, early in the project there was an old petroleum storage tank located under the parking lot of the plant that presented a potential environmental risk. We obtained a $224,624 grant from the State of Missouri PSTIF fund to pay for removal of the storage tank and, for purposes of our HUD loan application, the grant was treated as a source of funds for the project and the removal cost as part of the contractor's project cost.

In May 2012, it was determined by our environmental consultant and the Missouri State Department of Natural Resources that, rather than remove the tank, the planned resurfacing of the parking lot would sufficiently encapsulate the tank and remove any environmental problems. A copy of the May 26, 2010 "No Further Remedial Action Letter" from the State of Missouri Department of Natural Resources is attached.

Accordingly, the outside grant was not required and a change order was submitted on September 8, 2010 removing the grant funds as a source and the $261,912 cost of removal as a project cost which included $37,288 of profit and fees that would have been paid to our general contractor if the tank had actually been removed. This downward change request was submitted to the local HUD office and at that point we were told by Mr. Hester that, even though it was certain the tank would not be removed, it would not be approved at that time and that all change orders would be reviewed later. A copy of the Owner Change Proposal prepared by EM Harris for this amount is attached.

The change orders described above, along with all of the other of the contractor's denied change orders, were resubmitted to HUD by the general contractor just prior to final closing of the loan. The petroleum tank change order and request for liquidated damages were also offered by us as necessary changes. At a pre-closing conference, we were told by Mr. Hester that he was approving all of change orders that we and our architects had previously denied, thus using up all of the contingency reserves in the project, and that he was not approving our downward change requests for the storage tank or liquidated damages. He then stated unequivocally that he would not approve the loan closing and we would not get an occupancy permit unless we agreed. With no other alternatives, we acquiesced.

We were therefore required to pay the contractor the full cost plus $37,288 of contractor profit for the removal of a tank which then remained and still remains in the ground. We were then told to come up with funds to pay the contractor out-of-pocket to cover that cost since the grant was never received. We were also required to pay all of the continuing interest and other costs that arose because of construction delays despite the liquidated damages provision in the contract.

After a long period of our disputing this conclusion, Mr. Hester told our representatives that if we wanted to close the loan and get an occupancy permit we would approve the previously denied change orders and withdraw our change orders. We were paying large interest payments on the construction loan (7 ½%) and bridge loans on various credits and could not afford to continue those payments since the delays in getting the permanent loan approved had used up our interest reserves.

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We also had lease reservations for residential and commercial spaces that needed to be fulfilled. Because of these factors and under duress, we relented, infused $288,566 of our own money and signed off on the closing. But this left the project with no reserve funds with which to complete the build-out of commercial space, carry the early operating period deficits during lease-up and the ramp-up of commercial rents under the commercial leases. The commercial leases required significant early rent concessions to attract tenants in the midst of the severe recession.

Accordingly, the project was unable to meet all of its obligations including payment of the HUD-insured loan.

Comment 26

As you are probably aware, Mr. Hester is no longer with the HUD office because, as reported in the April 18, 2012 St. Louis Post Dispatch, Mr. Hester was indicted by a federal grand jury of bribery in connection with another HUD financing in which he overruled local staff on the refinancing. As reported in stltoday.com on June 26, 2013, Mr. Hester "pleaded guilty Sept. 11 to one count of conspiracy to provide and accept an illegal gratuity." The stltoday.com story further explains that Hester accepted money to "facilitate the refinancing as well as the release of construction funds" on a HUD-subsidized project. A copy of the story is attached.

Comment 27

Additionally, in your report you found a "significant deficiency" in the project's system of internal controls. You state "(t)he Temtor did not have adequate policies and procedures in place to ensure that disbursements were only for eligible project expenses." As noted above, we do not agree with the assessment that there were ineligible expenses so we disagree with this conclusion.

Comment 28

Finally, in the first paragraph of your Finding 1, you state that "(a)s a result, the more than $1 million used to make improper payments was no longer available to make mortgage payments, contributing to the project's default. We have attached an e-mail from Ben Simms to the members of 8000 Michigan LLC dated 3/30/2012 discussing his telephone conversation that day with John Kearney at Berkadia in Pennsylvania during which they discussed the problems the project was having due to the slow ramp up of commercial leases and to the delay in the receipt and lower amount of TIF payments from the City of St. Louis which needed to be factored into the underwriting. Although the TIF payments are not part of the collateral for the HUD-insured loan, it had been our intention to at that time to voluntarily use these payments to support project operations. We have also attached a letter from Tony Perez, Sr. VP at Berkadia, dated April 10, 2012 discussing "a possible restructuring of the Loan."

We point out this out because, excluding the wire to Mr. Baumstark and the returned wire amount ($234,601.75 on 2/3/2012 and $234,551.75 on 2/2/2012, respectively) and the repayment of the advance from the Carpenter's Union ($25,376 on 2/3/2012) which we have fully explained and documented above, there is only about $90,000 of amounts which you allege were "contributing to the project's default" that were made prior to the date we had already begun negotiations to restructure the loan with Berkadia. As noted above, this restructure of the loan was required because of factors, including commercial lease issues and TIF payments, which are totally unrelated to the payments you allege contributed to the project's default.

The project at that point had no operating reserves for the reasons discussed above regarding the improper change requests. These factors were explained to Berkadia in detail in March 2012 and were accepted by them as a basis on which to discuss a possible restructure of the loan as evidenced by their letter less than two weeks later.

As of 4/10/12, the loan payments were current through March 2012. It is clearly evident that, even though the project was in compliance as of that date, we had identified the future events

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Comment 28

(commercial leases and TIF payment amounts and delays) which were going to cause future problems with the loan and would require restructuring. Berkadia agreed with our assessment. Even if the $90,000 was, as you allege, "improper" (a position with which we strongly disagree), it could not have contributed to funds being "no longer available to make mortgage payments" because the loan payments were paid through March 2012.

To us, it is totally illogical to conclude that any payment from the project after 4/10/12 could have contributed to the need for a restructuring when, as of that date, the problems had been identified by ourselves and the lender and the restructuring had already begun.

In addition, in the first paragraph of Finding 1, you state "Temtor chose to use project funds to benefit the project owners rather than making the mortgage payments." To reiterate, we categorically disagree with this statement. Above we have discussed the fact that the payments you question were paid with funds from the state historic tax credits and from our federal tax credit investor which are specifically excluded by definition from the project by both the UCC filing and the Security Agreement for the HUD-insured loan. We have attached copies of those documents.

Thank you for taking time to consider this letter.

Sincerely,

8000 Michigan LLC

Milton D. Rothschild II, Managing Member

Attachments

OIG Evaluation of Auditee Comments

Comment 1 In general, the auditee disagreed with our finding that project funds were used for ineligible and unsupported expenses. The auditee claims the various project tax credits are specifically excluded from the mortgaged property and should be excluded from the project. This claim fails to recognize the difference between the mortgaged property and the project as defined by the regulatory agreement.

Mortgaged Property includes all property, real, personal, or mixed covered by the mortgage or mortgages securing the note endorsed for insurance or held by the Secretary (Regulatory Agreement, Section 13.d).

The Project includes the mortgaged property and all of its other assets of whatsoever nature or wheresoever situate, used in or owned by the business conducted on said mortgaged property, which business is providing housing and other activities as are incidental thereto (Regulatory Agreement, Section 13.e)

The various tax credits were excluded as collateral from the FHA-insured Construction loan but remain collateral for the $6 million bridge loan with Excel Bank (Loan Document Section I, Para. 1.1). Furthermore, HUD is not the lender and the relationship between the owner and HUD is governed solely by the terms of the Regulatory Agreement and cannot be modified, altered or changed by any other agreement. Under the Regulatory Agreement, all rents ***and other receipts*** of the project shall be deposited in a financial institution in the name of the project (Regulatory Agreement, Section 9.g). Such funds shall be withdrawn ***only*** in accordance with the provisions of the Agreement for expenses of the project or for distributions of surplus cash as permitted by Para. 6(e). Since the tax credit proceeds were deposited into the project bank accounts, as ***other receipts of the project, such*** funds may only be disbursed for reasonable operating expenses and necessary repairs. Moreover, such funds were pledged by the Owner to HUD as security under the Regulatory Agreement (Regulatory Agreement, Para. 12).

We recognized the various tax credits were collateral for the bridge loan and the proceeds of their sale were to be paid to the lender. Where documentation supported tax credits being used to make bridge loan payments, we did not consider the payments to be ineligible payments.

In addition, HUD form 92580, Maximum Insurable Mortgage, establishes the Mortgagors Equity Investment (tax credits) as essential to the project. HUD form 92580 documents project "Actual Costs" of $19.1 million. The form also documents a requirement of $4.7 million in Mortgagors Equity Investment in addition to the $14.4 million HUD insured loan ***to fund the project costs***. Finally, the Owners warranted that they would not execute any other agreement with provisions contradictory of, or in opposition to, the provisions of the Regulatory Agreement; and, in any event the requirements of the Regulatory Agreement are paramount and controlling as to their rights and obligations and supersede any other requirements in conflict (Regulatory Agreement, para. 15).

Comment 2 We reviewed The Temtor Rental Account and The Temtor Operating Account. In general, the rent receipts were deposited into the rental account and the project expenses were paid out of the operating account. Funds were also transferred to the management agent (Steins Broadway Management) to pay project expenses. In addition, we found tax credits were deposited into the rental account and the operating account. The documentation did not support the auditee claim that accounts were segregated. See comment 1.

Comment 3 See comment 1.

Comment 4 Our audit found false reports were filed by the auditee. In addition, payments were made from project accounts that were not disclosed on the monthly reports provided to HUD. Therefore, HUD was not able to effectively monitor the condition of the project.

We did not rely on the work of other non-HUD OIG auditors and experts to satisfy any of our audit objectives. The information obtained from these sources was used for background purposes only. Therefore we did not assess the validity of their findings.

Comment 5 See comment 1.

Comment 6 Section 6(b) of the Regulatory Agreement states, "Owners shall not without the prior written approval of the Secretary: Assign, transfer, dispose of , or encumber any personal property of the project, including rents, or pay out any funds except from surplus cash, except for reasonable operating expenses and necessary repairs."

Comment 7 The Request for Final Endorsement of Credit Instrument was signed by the Managing Member of the project on January 26, 2012. The managing member certified in this document that the construction of project is complete and all outstanding unpaid obligations were disclosed. After certification of completion, additional development costs cannot be charged to the project. Post final endorsement the only project expenses are operating expenses and necessary repairs. As noted in comment 2, the owner deposited the tax credit proceeds into the project's rental and operating accounts.

Comment 8 The excerpt from Department of Economic Development publication provided by the auditee caps the Developer Fee at 20% of the qualified rehabilitation expenditures. HUD form 92580 recognized $19,123,667 in total land and improvements for the project. To comply with the requirements of the publication, payments equal to 10% of the maximum allowable developer fee would be required. This would be ($19,123,667 * 20% * 10%) = $382,473. The excerpt from the audited financial statements provided by the auditee indicates development fees of $2,623,640 had been paid to 8000 Developer LLC, (a related party) and $17,000,000 had been earned as of December 31, 2011. These amounts greatly exceed the amount required by the Department of Economic Development. The documentation provided does not support the auditee's claim that additional payments to 8000 Developer LLC were required. In addition, we were not provided with documentation to support the auditee's claim that the developer fees were returned to the project accounts.

The restrictions regarding payment of the developer fees were included in The Temtor closing file. The Notes to Financial Statements included in the closing file stated "Unpaid developer fees of $9,162,670, do not accrue interest and, pursuant to the agreement, the fee shall be paid from development sources or net cash flow, but only after payment of all bridge loans and of excess development costs."

Comment 9 It was certified on January 30, 2012 that all required Escrow Accounts and Reserves for the Project were fully funded. Construction and development reserves would not be used for project expenses.

Comment 10 The response confirms our finding that $69,418 was paid for unsecured development or construction loans. As noted earlier, the managing member certified that the construction of the project is complete and all outstanding unpaid obligations were disclosed (see comment 7). The tax credits remain part of the project (see comment 1), and were not maintained in separate accounts (see comment 2). In addition, the Request for Final Endorsement of Credit Instrument did not list any HUD-approved notes.

Comment 11 Project construction was outside the scope of our audit. The subject of increased development costs paid to the contractor were noted and resolved prior to closing.

Comment 12 See comment 10

Comment 13 Steins Broadway Management president's identity of interest relationship with the project was disclosed and documented on the Project Owner's/Management Agent Certification. We reviewed the payments for legal fees without considering the dual role of the Management Agent and revised our report accordingly. The auditee claimed legal expenses that exceeded the documented project legal expenses by $18,102. This will be included in the reported unsupported expenses.

Comment 14 The auditee did not provide invoices or bills to support the reimbursements paid to the management agent/owner. During our audit, the management agent said he considered the reimbursements to be owner repayments for previous contributions, and could not be tied to specific expenses. The three payments totaling $11,840 will be included in the reported unsupported expenses.

Comment 15 We changed the heading in the table to read "excessive funds to management agent" to match up with the terminology in the body of the finding and to make it clear that we were not referring to the management fee itself. The $9,244 in ineligible costs included $5,452 for the lease of a copier that was not a project expense. Invoices show the copier was located at 7525 South Broadway. Steins Broadway Management, the management agent, was based at the project, 8125 Michigan Avenue. Therefore, the equipment lease was not a direct project expense.

The management company paid a total of $2,743 for phone and Internet services. We determined the phone number was registered to Steins Broadway Condominiums, LLC which is located at 7525 S. Broadway St. Steins Broadway Condominiums, LLC is a separate entity organized by the management agent.

HUD Handbook 4381.5 allows reimbursement for project related expenses such as bookkeeping and associated expenses, project checks, envelopes, postage, and air express delivery charges. From the description of the invoices, we determined that $565 was disbursed for office supplies that were not eligible project expenses.

The management company paid for residential screening services for various addresses. We matched the addresses listed in the invoice against the project rent roll and determined that only 15 of the billed units were located in Temtor buildings. The amount billed for the remaining addresses, $483, was not a project expense.

The audit reviewed the eligibility of actual expenses. We did not compare actual expenses to budgeted.

Comment 16 HUD allows for payments of special management fees if a project has special needs or problems. As documented on the Management Agents Certification, this project did not seek nor receive approval for payment of special fees. In addition, HUD Handbook 4381.5 provides that salaries for preparing budgets required by the owner or HUD and analyzing and solving project problems must be paid out of the management fee funds rather than by the project. Accordingly, the financial analyst's salary for preparing documents for the Partial Payment of Claim was not chargeable to the project. This would be an expense of the owner.

Comment 17 As noted earlier, the managing member certified the construction of the project is complete and all outstanding unpaid obligations were disclosed. After certification of completion additional development costs cannot be charged to the project (See comment 7).

Comment 18 We agree that repayment of the $10,000 would be a correct resolution of this improper payment. We removed the statement regarding direct payment to the vendor on February 14, 2013. HUD will follow up to ensure collection and closing of the recommendation.

Comment 19 8000 Michigan (The Temtor), 8000 Manager, and 8000 Developer are distinct entities. The claimed accounting and tax services for the latter two entities are not project expenses.

Comment 20 The auditee provided documents to support the $234,551.75 wire made from the project operating account on February 2, 2012 was returned. The unsupported amount included in our finding was reduced based on this information.

Comment 21 The Carpenter's Union was restricted from releasing funds to the project until the HUD loan closed. The auditee did not document receipt of the loan proceeds from the Carpenter's District Council. Therefore, we were not able to tie the payment made on February 3, 2012 to the loan proceeds.

Comment 22 The auditee provided additional documents to support the bridge loan payments made from the project operating account were funded by tax credits. The amount of unsupported payments included in our findings was reduced by $75,077.16 based on this information.

Comment 23 We compared the invoices provided by the management agent to the disbursements reported in the monthly financial reports. The total disbursements exceeded the invoices by $5,763.70. We were not provided any additional documentation to describe these payments.

Comment 24 The auditee did not provide any documentation in their response to support that these payments were made for eligible project expenses.

Comment 25 The auditee agrees the security deposits were inappropriately used to fund project operations. However, the auditee added why they believe the project was underfunded.

The following statements indicate the project was financially sound at closing. The managing member certified at closing the construction of project is complete and all outstanding unpaid obligations were disclosed (comment 7). The subject of increased development costs paid to the contractor were noted and resolved prior to closing (comment 11). It was certified on January 30, 2012 that all required Escrow Accounts and Reserves for the Project were fully funded (comment 9).

This audit reviewed operations and did not include the development phase or final closing of the project. The project reached final endorsement on January 30, 2012. Our review generally covered February 1 through December 31, 2012.

Comment 26 The auditee does not claim the charges have any connection to this project.

Comment 27 As stated in the auditee's response to the diversion of the tenant security deposits, the former management agent twice inappropriately and without authorization from the company or the knowledge of the managing member, used security deposits on an interim basis to fund operations. The members' of the ownership group responsibility for these actions is established by the regulatory and operating agreements. In these documents the members, agree to be liable for their own acts and deeds, or acts and deeds of others which they have authorized. We modified the report to state this requirement.

Comment 28 We reduced the amount of unsupported and ineligible payments based on the additional documents the auditee provided. This reduced the total amount of improper payments to $718,588.

The more than $700,000 used to make improper payments was no longer available to make mortgage payments, *contributing* to the project's default. The report does not conclude this is the sole cause of the default.

Appendix C

INELIGIBLE AND UNSUPPORTED COSTS DETAIL

			Ineligible			
Account	Date	Check #	Developer fees	Unsecured loans	Excessive funds to management agent	Unsupported
Operating	2/7/2012	EFT*	15,000.00			
Operating	2/10/2102	EFT	10,000.00			
Operating	2/15/2012	EFT	4,000.00			
Operating	2/15/2012	EFT	20,000.00			
Operating	2/17/2012	EFT	10,000.00			
Operating	2/28/2012	EFT	1,000.00			
Operating	2/29/2012	EFT	1,000.00			
Operating	4/17/2012	EFT	106,000.00			
Operating	4/18/2012	EFT	40,000.00			
Operating	4/23/2012	EFT	48,000.00			
Operating	4/24/2012	EFT	12,000.00			
Operating	4/25/2012	EFT	15,000.00			
Operating	2/3/2012	Wire		25,376.00		
Operating	8/17/2012	175		2,042.00		
Operating	10/10/2012	188		1,000.00		
Operating	2/3/2012	Wire		21,000.00		
Operating	4/26/2012	Wire		20,000.00		
See Note A	Various	See note A			9,244.06	
See Note B	6/13/2012	See Note B			5,503.58	
See Note B	7/20/2012	See Note B			5,503.58	
See Note B	8/21/2012	See Note B			5,503.58	
See Note B	9/21/2012	See Note B			5,503.58	
See Note B	10/18/2012	See Note B			5,503.58	
See Note C	4/24/2012	See Note C			3,525.00	
See Note C	11/8/2012	See Note C			10,000.00	

* EFT = electronic funds transfer

			Ineligible			
Account	Date	Check #	Developer fees	Unsecured loans	Excessive funds to management agent	Unsupported
See Note D	12/26/2012	See note D				18,102.07
See Note E	8/6/2012	See Note E				4,848.67
See Note E	10/25/2012	See Note E				3,395.53
See Note E	11/27/2012	See Note E				3,595.91
See Note A	Various	See Note A				5,763.70
See Note F	9/18/2012	See Note F				1,000.00
Rental	5/14/2012	Transfer				1,000.00
Rental	9/6/2012	Transfer				5,000.00
Rental	3/8/2012	Withdrawal				3,000.00
Rental	3/8/2012	Withdrawal				3,500.00
Rental	4/4/2012	Withdrawal				10,000.00
Rental	9/6/2012	Withdrawal				2,000.00
Operating	7/18/2012	EFT				2,550.00
Rental	9/10/2012	EFT				5,500.00
Rental	12/21/2012	EFT				1,000.00
Rental	12/24/2012	EFT				1,500.00
Operating	4/5/2012	130				3,100.00
Excel	2/28/2012	DBT CRD				2,250.00
Operating	2/3/2012	Wire				234,601.75
Operating	5/10/2012	144				1,800.00
Operating	5/11/2012	143				1,630.00
Operating	5/16/2012	146				1,745.00
	Unsupported payment total					316,882.63
	Ineligible payment totals		282,000.00	69,418.00	50,286.96	401,704.96
				Improper payment total		$ 718,587.59

Notes of Explanation

A. The management company reported a total of $20,611.45 in office administration fees for the months from June through December 2012. The office administration fees included reimbursements for the office supplies, equipment lease, computer maintenance, phone and Internet services, and residential screening; $9,244.06 in office administration fees was ineligible overhead expenses or not related to Temtor project. Additional administration fees of $5,763.70 were not properly supported.

Date	Description	Amount
06/15/12	Office administration	$ 4,418.80
07/31/12	Office administration	$ 1,544.76
08/24/12	Office administration	$ 3,160.28
11/07/12	Office admin – Sept.	$ 1,822.06
11/07/12	Office admin – Oct.	$ 3,046.91
11/07/12	Office admin – Nov.	$ 2,914.98
12/24/12	Office administration	$ 3,703.66
Total		$ 20,611.45

B. Steins Broadway Management received transfer payments for extra management activities. HUD guidance, the regulatory agreement, and the project owner's-management agent certification established criteria for project management activities. The project management services were included in Steins Broadway Management Company's standard management duties. The extra project management fees, $27,517.90, constituted ineligible expenses.

C. We determined that the $10,000 disbursement reported by the management company on November 8, 2012, was ineligible. It was ineligible since it was transferred to the management agent's bank account but not paid to the accounting company. Included with the $42,165 disbursement made on April 20, 2012, Temtor paid $3,525 for services not related to project operations.

D. We reviewed the reimbursements to the management agent for legal fees without considering the dual role of the identity of interest management agent and revised our report accordingly. The auditee claimed legal expenses that exceeded the documented project legal expenses by $18,102.07.

E. According to the monthly financial reports, three disbursements totaling $11,840 were transferred to Steins Broadway Management Company in August, October, and November 2012, notated as "invoice for May bills," "reimbursement to owner," and "owner reimbursement."

F. After the $1,500 transfer on September 18, 2012, $500 was transferred to the project operating account. Management withdrew the remaining $1,000 transferred to account 6177. The managing agent did not provide documentation supporting the eligibility of the payment.

Appendix D

CRITERIA

Excerpts From HUD Handbook 4370.2, REV-1, CHG-1, Financial Operations and Accounting Procedures for Insured Multifamily Projects

2-3 MAINTENANCE OF BOOKS AND ACCOUNTS
C. In establishing a financial accounting system, auditing problems can be avoided by keeping operating funds separate from other project funds. Particularly when occupancy occurs prior to final closing, care must be taken to segregate construction and operating funds.
Accounting of any construction expenses shall be in accordance with HUD Handbook 4470.1, Mortgage Credit Analysis for Project Mortgage Insurance, Section 207.

2-6 REGULAR OPERATING ACCOUNT
E. All disbursements from the Regular Operating Account (including checks, wire transfers and computer generated disbursements) must be supported by approved invoices/bills or other supporting documentation. The request for project funds should only be used to make mortgage payments, make required deposits to the Reserve for Replacements, pay reasonable expenses necessary for the operation and maintenance of the project, pay distributions of surplus cash permitted and repay owner advances authorized by HUD.

2-8 SURPLUS CASH AND RESIDUAL RECEIPTS
A. Basically, surplus cash is the cash remaining after all necessary and reasonable expenses of the project have been paid or funds have been set-aside for such payment. Specifically, the regulatory agreement defines surplus cash as any cash remaining after:

1. The payment of all sums due under the terms of any mortgage, all amounts required for funded reserve accounts, and all obligations of the project, and
2. The segregation of an amount equal to the aggregate of all special funds required to be maintained by the project and the segregation of all tenant security deposits held.

2-9 SECURITY DEPOSIT ACCOUNT
A. In instances where the Regulatory Agreement allows the receipt of security deposits from project tenants, a separate bank account should be established to maintain these funds. In addition, individual states have specific regulations governing the handling of tenant security deposits and these regulations should be complied with. There shall be one Security Deposit Account per project. Funds in the single Security Deposit Account must not be commingled with any other funds, e.g., security deposit funds of other projects, operating accounts, managing agent accounts, etc. In cases where the funds in the project's Security Deposit bank account exceed the amount that may be insured by the federal government ($100,000/bank), the project may open another bank account for the excess amounts.

B. All disbursements from the Security Deposit account must be supported by approved invoices/bills or other documentation. Disbursements must be only for refunds to tenants and for payment of appropriate expenses incurred by the tenant.

2-10 DISTRIBUTIONS TO OWNERS

A. Surplus cash distributions may not be paid from borrowed funds, prior to the completion of the project or when a project is in default or under a forbearance agreement. If the owner takes distributions when the project is in default or when the project is in a non-surplus cash position, the owner is subject to criminal and/or civil penalties. (See Appendix 1 - Criminal Statutes for a listing of civil and criminal statutes). The first year's distribution may not be paid until all required cost certification submissions have been made. Distributions are earned beginning with the day following the cut-off date for cost certification. Distributions to owners are not permitted on nonprofit (NP) projects. On limited dividend (LD) or profit-motivated (PM) projects, the regulatory agreement provides that distributions can be paid without prior HUD approval only:

- if paid from surplus cash,
- if paid as of and after the end of an annual or, if specified in the regulatory agreement, semiannual fiscal period.

In effect, surplus cash generated at the end of one fiscal period is not available for distribution until the next fiscal period. Stated differently, distributions paid out early in fiscal year 1991, for example, may not exceed surplus cash available as of the end of fiscal year 1990.

2-11 REPAYMENT OF OWNER ADVANCES

A. Advances made for reasonable and necessary operating expenses may be paid from surplus cash at the end of the annual or semi-annual period. Such repayment is not considered an owner distribution. It is considered a repayment of advances. Repayment of owner advances when the project is in a nonsurplus cash position will subject the owner to criminal and civil monetary penalties. (See Appendix 1, Criminal Statutes.)

2-12 CASH MANAGEMENT CONTROLS

B. DISBURSEMENT CONTROLS

1. A request for a check must have supporting documentation (i.e., invoice itemizing amount requested with an authorized signature) in order for approval to be obtained to make the disbursement.
2. Checks must be approved by an individual authorized to approve checks.
3. The authorized check signer shall review supporting documentation before signing the check.
4. Supporting vouchers shall be marked canceled to prevent resubmission.
5. A monthly reconciliation shall be performed to ensure that all checks disbursed are accounted for (i.e., cashed, outstanding, or void).
6. Invoices should be marked “paid” and the check number and date should be posted to the invoice. Supporting vouchers shall also be marked “paid” to prevent resubmission.

Excerpts From HUD Handbook 4381.5, REV 2, The Management Agent Handbook

6.39: MANAGEMENT COSTS PAID FROM THE MANAGEMENT FEE

a. Expenses for services that are not front-line activities must be paid out of management fee funds, except for centralized accounting and computer services.

b. Salaries, fringe benefits, office expenses, fees, and contract costs for the following activities must be paid out of management fee funds. These costs include:
(1) Designing procedures/systems to keep the project running smoothly and in conformity with HUD requirements.
(2) Preparing budgets required by the owner or HUD, exclusive of rent increase requests and MIO Plans.
(3) Recruiting, hiring, and supervising project personnel.
(4) Training for project personnel that exceeds the line item budget for training expenses.
(5) Monitoring project operations by visiting the project or analyzing project performance reports.
(6) Analyzing and solving project problems.
(7) Keeping the owner abreast of project operations.
(8) Overseeing investment of project funds.
(9) Ensuring that project positions are covered during vacations, sickness, and vacancies.

Excerpts From HUD Handbook 4555.1, Section 220, Rental Housing in Urban Renewal Areas

1-7. ANNUAL FINANCIAL STATEMENTS.
Mortgagors must keep their books and accounts according to Handbook 4370.2 Financial Operations and Accounting Procedures for Insured Multifamily Projects. They must also provide annual financial reports meeting the requirements in reference (7) of the Foreword.

1-8. REGULATORY AGREEMENT.
The Secretary's control over the mortgagor is exercised by a Regulatory Agreement, Form FHA 2466, which is signed at initial closing.

Excerpts From First Amendment to the Second Amended and Restated Operating Agreement of 8000 Michigan, LLC, A Missouri Limited Liability Company
Amendment to Section 4.16. Development Fees
<u>Development Fees</u>. The Company has entered into Development Agreements with the Developer for its services in connection with each of the Company's ten historic rehabilitation projects. In accordance with such Development Agreements, the Company shall pay the Developer the respective Developer Fees (including overhead) as set forth in Schedule D. The Developer Fees with respect to each property shall each be earned in full upon substantial completion of the respective rehabilitation project, in each case as evidenced by a Certificate of Substantial Completion executed by the project architect. The Developer shall be paid such portion of the Developer Fee as is available from Development Sources or Net Cash Flow but only after payment of all Bridge Loans in their entirety and the payment of Excess Development Costs. In all events the Developer Fee shall be paid in full by December 31, 2019 and, to the extent Cash Flow and other sources are insufficient to pay such fee in full, the Managing Member shall make a Capital Contribution to the Company in the amount necessary to pay the balance of the Development Fee. (page 65)

"Article XI" HUD Requirements
g. The Members, and any assignee of a Member, agree to be liable in their individual capacities to HUD with respect to the following matters:

(1) For funds or property of the Project coming into their hands, which by the provisions of the HUD Regulatory Agreement, they are not entitled to retain;
(2) For their own acts and deeds, or acts and deeds of others which they have authorized, in violation of the provisions of the HUD Regulatory Agreement.
(3) The acts and deed of affiliates, as defined in the HUD Regulatory Agreement, which the person or entity has authorized in violation of the provisions of the HUD Regulatory Agreement; and
(4) As otherwise provided by law. (page 68)

Excerpts From the Regulatory Agreement for Multifamily Housing Projects

6. Owners shall not without the prior approval of the Secretary:
(b) Assign, transfer, dispose of, or encumber any personal property of the project, including rents, or pay out any funds except from surplus cash, except for reasonable operating expenses and necessary repairs.
(e) Make, or receive and retain, any distribution of assets or any income of any kind of the project except surplus cash and except on the following conditions:

1) All distributions shall be made only as of and after the end of a semiannual or annual fiscal period, and only as permitted by the law of the applicable jurisdiction;
2) No distribution shall be made from borrowed funds, prior to the completion of the project or when there is any default under this Agreement or under the note or mortgage;

(g) Require, as a condition of the occupancy or leasing of any unit in the project, any consideration or deposit other than the prepayment of the first month's rent plus a security deposit in an amount not in excess of one month's rent to guarantee the performance of the covenants of the lease. Any funds collected as security deposits shall be kept separate and apart from all other funds of the project in a trust account the amount of which shall at all times equal or exceed the aggregate of all outstanding obligations under said account.
9. (g) All rents and other receipts of the project shall be deposited in the name of the project in a financial institution, whose deposits are insured by an agency of the Federal Government. Such funds shall be withdrawn only in accordance with the provisions of this Agreement for expenses of the project or for distributions of surplus cash as permitted by paragraph 6(e) above. Any Owner receiving funds of the project other than by such distribution of surplus cash shall immediately deposit such funds in the project bank account and failing so to do in violation of this Agreement shall hold such funds in trust. Any Owner receiving property of the project in violation of this Agreement shall hold such funds in trust. At such time as the Owners shall have lost control and/or possession of the project, all funds held in trust shall be delivered to the mortgagee to the extent that the mortgage indebtedness has not been satisfied. (b) for their own acts and deeds or acts and deeds of others which they have authorized in violation of the provisions hereof.