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MEMORANDUM NO.
2010-CH-1809

August 3, 2010

MEMORANDUM FOR: Scott M. Hunley, Director of Columbus Multifamily Housing, 5EHM

FROM: Heath Wolfe, Regional Inspector General for Audit, 5AGA

SUBJECT: Columbus Properties Limited Partnership
Property Renovations
Columbus, OH

INTRODUCTION

In response to a request from Congresswoman Mary Jo Kilroy, we conducted a review of the allegations that Columbus Properties Limited Partnership (Columbus Properties) did not renovate six apartment complexes in Ohio for which it obtained U.S. Department of Housing and Urban Development (HUD)-insured mortgages. Congresswoman Kilroy asked for a review based on local newspaper articles that alleged waste and abuse stemming from HUD's Section 221(d)(4) program. The program insures mortgage loans for multifamily properties owned by profit-motivated entities. The newspaper articles alleged that Columbus Properties obtained Federal Housing Administration (FHA) mortgages totaling $26.6 million in 1997 to purchase and renovate the six apartment complexes but did not perform the renovations. Congresswoman Kilroy asked us to provide answers to five specific questions.

Our objectives were to determine whether HUD followed its standard operating procedures for monitoring the inspection of renovation activities designed to ensure compliance with the specifications and to address the questions outlined in the congressional request. We concluded that HUD followed its procedures to monitor the renovation of the six projects. We also addressed the congresswoman's questions in the Results of Review section.

We provided our discussion draft memorandum report to the Director of HUD's Columbus Office of Multifamily Housing during the review. We asked HUD to provide written comments on our discussion draft memorandum report by July 8, 2010. HUD advised via an electronic message, dated July 12, 2010, that the discussion draft memorandum report was accurate.

BACKGROUND

The program. Authorized under the National Housing Act, as amended, Section 221, Public Law 86-372, 12 U.S.C. (United States Code) 1715(1), the Section 221(d)(4) program insures mortgage loans to facilitate the purchase or rehabilitation of multifamily rental housing. Participants in the Section 221(d)(4) program must apply for FHA-insured multifamily financing with an FHA-approved lender. HUD, through FHA, insures lenders against loss on mortgage defaults.

The purpose of the Section 221(d)(4) program is to assist private industry in providing comfortable and attractive rental accommodations for moderate-income families that have been displaced from urban renewal areas or as a result of governmental action or a major disaster as determined by the President.

The Section 221(d)(4) program is used by profit-motivated borrowers or sponsors. The program allows for long-term mortgages (up to 40 years) that can be financed with Government National Mortgage Association mortgage-backed securities. Profit-motivated borrowers or sponsors using Section 221(d)(4) can receive a maximum mortgage of 90 percent of the HUD/FHA replacement estimate. A Section 221(d)(4) loan is secured by a pledge of the property as collateral. The loan is nonrecourse, meaning that the borrower is not personally liable if the borrower defaults on the loan.

The approval process. HUD currently uses multifamily accelerated processing (MAP) almost exclusively to process Section 221(d)(4) loans. The sponsor works with the MAP-approved lender, which submits required exhibits for the preapplication stage. HUD reviews the lender's exhibits and will either invite the lender to apply for a firm commitment for mortgage insurance or decline to consider the application further. If HUD determines that the exhibits are acceptable, the lender then submits the firm commitment application, including a full underwriting package, to HUD's local multifamily housing office for review. The application is reviewed to determine whether the proposed loan is an acceptable risk. Considerations include market need, zoning, architectural merits, capabilities of the borrower, availability of community resources, etc. If the proposed project meets program requirements, the local multifamily housing office issues a commitment to the lender for mortgage insurance.

At the time the Columbus Properties complexes were insured, loans were processed by HUD's field office staff under traditional application processing. The sponsor has a preapplication conference with the local HUD multifamily housing office to determine preliminary feasibility of the project. The sponsor must then submit a site appraisal and market analysis (SAMA) application (for new construction projects) or feasibility application (for substantial rehabilitation projects). Following HUD's issuance of a SAMA or feasibility letter, the sponsor submits a firm commitment application through a HUD-approved lender for processing. If the proposed project meets program requirements, the local multifamily housing office issues a commitment to the lender for mortgage insurance.

The six Columbus complexes. HUD's Columbus Office of Multifamily Housing used the traditional application processing for the six complexes' loans for Columbus Properties. On

November 6, 1996, HUD held an initial conference with the lender, Armstrong Mortgage Company, for the six complexes (Chatterton Club, Gahanna Commons, Greenbriar/Greenleaf, Monticello, The Savoy, and Thurber Square). Based on the information Armstrong Mortgage Company provided, on November 15, 1996, HUD invited Armstrong Mortgage Company to submit a separate firm application for Section 221(d)(4) mortgage insurance for the six complexes. Columbus Properties was also required to submit information on historic rents and occupancy along with rent rolls for each unit. HUD's Columbus Office of Multifamily Housing also asked the complexes' architect to work with its staff architect to prepare the work write-ups or specifications.

HUD's Columbus Office of Multifamily Housing issued a firm commitment on August 15, 1997, an initial endorsement on August 28, 1997, and a final endorsement on January 18, 2000, after the property renovations were complete.

Columbus Properties received mortgages totaling more than $26.6 million for the six complexes with more than $8.1 million in rehabilitation costs. None of six complexes was subsidized directly by HUD. The following table summarizes the mortgage amounts and rehabilitation costs for each complex.

Complex	Number of units	Mortgage amount	Rehabilitation cost
Chatterton Club	144	$4,203,900	$1,407,792
Gahanna Commons	128	4,907,600	1,199,580
Greenbrier/Greenleaf	181	6,478,600	1,959,901
Thurber Square	96	2,893,000	922,076
The Savoy	111	4,500,300	1,322,955
Monticello	116	3,712,700	1,337,620
Totals	776	$26,696,100	$8,149,924

On June 14, 2005, the FHA-insured loans for all six complexes were assigned to HUD following a financial default of the mortgage loans. On December 21, 2005, HUD sold the mortgage notes, resulting in more than $10.5 million in losses as detailed in the following table.

Complex	Loan balance	Sale amount	Loss
Chatterton Club	$4,016,598	$2,480,561	$1,536,037
Gahanna Commons	4,688,946	2,994,884	1,694,062
Greenbrier/Greenleaf	6,189,951	3,558,975	2,630,976
Thurber Square	2,720,058	1,859,497	860,561
The Savoy	4,252,689	2,094,820	2,157,869
Monticello	3,547,283	1,859,497	1,687,786
Totals	**$25,412,525**	**$14,848,234**	**$10,562,291**

METHODOLOGY AND SCOPE

To accomplish our objectives, we reviewed

- The National Housing Act, as amended, Section 221, Public Law 86-372, 12 U.S.C. 1715(1); applicable and pertinent HUD handbooks; and Office of Inspector General (OIG) Audit Report number 2008-BO-0001.

- HUD's files and records (maintained at HUD Columbus Office) related to the six complexes, including the approval process files and documents, the preapplication letter, the firm commitments, contractor's and borrower's cost breakdown listing all of the repair items with cost and description (work specifications), fee inspectors' trip reports, change orders, applications for advance of mortgage proceeds and certificates of payment, HUD's 2004 management review report, and the Real Estate Assessment Center's physical inspection reports between 1999 and 2005. We also reviewed the Departmental Enforcement Center's files (maintained at the Chicago Office) relating to the chronology of events and the financial analysis of the six complexes.

We interviewed HUD's staff, the two fee inspectors who certified the renovation work, and the Franklin County, OH, health inspector identified in the newspaper articles. We made site visits and conducted visual inspections of the six complexes in July 2010.

The review covered the period August 1997 through June 2005 and was expanded as determined necessary. We did not perform our review in accordance with generally accepted government auditing standards. Our scope was limited to responding to the Congresswoman's questions.

RESULTS OF REVIEW

Based on the review of the renovation documentation, specifications, trip reports, and certificates of payment, we determined that HUD appropriately monitored and ensured that Columbus Properties renovated the six complexes in accordance with the HUD-approved specifications. The fee inspectors reported that they inspected the renovations at the six complexes weekly, as evidenced by trip reports. HUD requires two site visits per month. The reports were signed by fee inspectors and included the names of attendees, which usually included a HUD official, owner's representative, architect, and the fee inspector. We also found that the application for advance of mortgage proceeds and certificates of payments were properly executed. The applications contained the work completed and the cost. The certificate for payments contained certifications by the architect, the inspector, and the contractor. The architect and the inspector certified that based on their site visit and observation, the identified work in the application was completed. We did not verify the actual cost of the renovations because the vendor invoices and the records relating to labor costs were not available for our review.

We made site visits and conducted visual inspections of the six complexes in July 2010. We also interviewed the site managers at the complexes. We found five of the six complexes were in good to excellent condition and one was in fair to poor condition. The ownership of the six complexes had changed since HUD sold the mortgage notes on December 21, 2005. Four complexes changed ownership in 2009 and two in March 2010. None of the complexes had HUD-insured mortgages. Under the new ownership, all six complexes had been substantially renovated, or were in the process of undergoing partial or substantial renovations. Since the complexes had been renovated after 1999, we were not able to determine the amount and quality

of renovations completed between 1997 and 1999. During our site visit to the Chatterton Club complex, we interviewed a tenant who had resided at the complex for 20 years. The tenant stated that she remembered that the complex was renovated approximately 12 years ago, around 1998. She also stated that she remembered this because she was required to move from one apartment to another while the contractors completed the renovations.

Congressional Request Concerns Addressed

Question 1: What are the procedures used by HUD inspectors to verify that all renovations were performed by HUD-assisted landlords, and what procedures are in place that allow HUD officials to verify the work of HUD inspectors?

The following are HUD's procedures to verify renovation work. When HUD insures a mortgage for a private owner to build or renovate a property, HUD regulations require periodic observations of construction at the project site for the purpose of protecting the interest of HUD. HUD outsources this oversight to contract fee inspectors with specialized knowledge to oversee these contractors.

The assigned fee inspectors are required to make at least two site visits per month or more frequently when warranted by problems or impending default. The field review inspections are recorded on a HUD Representative's Trip Report, Form HUD-5379, in accordance with HUD Handbook 4480.1.

According to HUD's procedures, HUD staff should visit each project site once during construction. The visits are to assess the performance of the fee inspector, compare project design and construction with conventional projects in the area, and remain current with changes in that jurisdiction. HUD staff members are to require the contract fee inspector to accompany them on the project review. For the Columbus Properties complexes, HUD's files evidenced that compliance with these procedures.

Question 2: What criminal and civil actions can the Federal Government pursue against HUD inspectors that signed off on renovations that were not performed or against recipients of HUD-assisted loans that did not fully perform the work for which the loans were authorized?

HUD inspectors are subject to personnel policies and under specific circumstances, could be subject to civil and criminal prosecution. HUD also uses fee inspectors who are under contract. Remedies would be dictated by the terms of the contract as well as those available through civil and criminal prosecution.

Recipients of HUD-assisted loans must use funds in accordance with their agreements (closing documents and regulatory agreement) with HUD. In this case, the loan funds for each property covered the purchase of the property and the costs to rehabilitate each. As renovations were completed, the general contractor is paid from the loan funds. If the owner did not make the improvements that were required and did not draw down the loan funds, the loan would not reach final closing until the repairs were completed. If the owner took the loan funds and

submitted false documents claiming that work was done when it was not, he would be subject to the following legal statutes.

Criminal equity skimming (12 U.S.C. 1715z-19) occurs when an owner willfully uses loan proceeds or property income for anything that is not necessary for the property other than distributions in accordance with requirements. The owner can be fined up to $500,000 and imprisoned up to 5 years. The statute of limitations is five years to bring an action under criminal equity skimming.

Civil equity skimming (12 U.S.C. 1715z-4a) is similar to criminal equity skimming except the intent does not have to be proved. The owner is subject to double the amount of the damages. An action can be brought under this section at any time up to and including six years after HUD discovers the misuse of loan proceeds or property income.

The False Claims Act is the government's principal weapon in the prosecution of fraud. One may be held either civilly or criminally liable for submitting a fraudulent claim to the government for payment or approval.

The Civil False Claims Act, codified at 31 U.S.C. 3729-3733, provides that any person (including a corporate entity) who knowingly submits or who knowingly causes someone else to submit false claims for payment of government funds is liable for treble damages and civil penalties of $5,500 to $11,000 per false claim. Under the False Claims Act, an action must be brought within six years after the date a person committed the violation. A person submitting a false claim could also be charged under the Criminal False Claims Act, 18 U.S.C. 287. The statute of limitations is five years from the date of occurrence for the Criminal False Claims Act.

Question 3: What is the application and approval process for determining whether an individual meets the standards of HUD-assisted loans under Section 221(d)(4)?

The Section 221(d)(4) program is used by profit-motivated sponsors and it insures mortgage loans to facilitate the new construction or substantial rehabilitation of multifamily rental or cooperative housing for moderate-income families. Participants of the Section 221(d)(4) program must apply for FHA-insured multifamily financing with an FHA-approved lender. The following briefly explains the approval process.

Preapplication: As part of the traditional application process, the sponsor had an initial conference or preapplication meeting with the local HUD multifamily office to determine the preliminary feasibility of the project before a SAMA or a feasibility letter is submitted. For MAP, the sponsor works with a MAP-approved lender, which submits certain required exhibits for the preapplication stage. If the proposal is approved, the lender is invited to submit a firm commitment application. An environmental assessment is required for this program.

Application: In traditional application processing, following HUD's issuance of a SAMA (new construction) or feasibility letter (substantial rehabilitation), the sponsor submits a formal mortgage insurance application through a HUD-approved mortgagee to the local HUD multifamily office for processing. For MAP, the lender submits the required exhibits, including

a full underwriting package, which are then reviewed by the local HUD multifamily housing office before a firm commitment is issued.

Award: The local HUD multifamily housing office is to review the application to determine whether the proposal is feasible. Considerations include market need, zoning, architectural merits, capabilities of sponsors, availability of community resources, etc. If the project meets program requirements, HUD issues the lender a commitment to insure the project mortgage.

HUD currently uses MAP almost exclusively for Section 221(d)(4) loans. The creation of the MAP guidelines merely standardized the fast-track processing across all HUD field offices so that the procedures would be consistent and required HUD approval of the lenders that underwrite loans. The HUD-approved lenders prepare underwriting documents and analysis to determine the eligibility of the owner, project, and rehabilitation activity. Based on its analysis, the lender recommends whether HUD should approve the project for insurance.

HUD's Columbus Office of Multifamily Housing office used traditional application procedures to underwrite and approve the mortgages for the six Columbus complexes. On November 6, 1996, an initial conference was held for the six complexes between HUD and the lender, Armstrong Mortgage Company. On November 15, 1996, HUD sent Armstrong Mortgage Company a letter inviting it to submit a separate firm application for the Section 221(d)(4) program to rehabilitate the complexes. HUD also asked Armstrong Mortgage Company to submit additional information with its application. HUD issued the commitment for insurance on August 8, 1997.

Question 4: Does HUD have adequate resources to sufficiently monitor, evaluate, and manage the stock of Section 221(d)(4) properties?

The essential information to evaluate the adequacy of the field office and headquarters staffing and workload levels from 1996 to the current time were not readily available and we cannot directly respond to the question. However, evidence existed that HUD staff monitored and evaluated problems with these complexes in accordance with its procedures and in a relatively timely manner as shown below.

Project monitoring is an integral part of HUD's responsibilities. In 1998, HUD created the Real Estate Assessment Center, which has a major role in evaluating the physical and financial status of HUD's portfolio. The physical inspections are contracted out to independent third parties, and the financial statements are submitted electronically and evaluated by HUD staff. HUD's multifamily offices also conduct onsite management reviews that are designed to work in conjunction with Real Estate Assessment Center inspections and financial statement reviews. OIG also performs audits of specific properties from time to time to determine whether the owners are complying with HUD requirements.

For the six Columbus complexes, the Real Estate Assessment Center referred the annual financial statements for the years 2000 to 2003 to HUD's Departmental Enforcement Center for financial noncompliance. The annual financial statements identified underfunded tenant security deposits, unauthorized loans of project funds, unauthorized distributions of project funds, failure

to invest the reserve accounts, and comingling of project funds. On February 26, 2004, HUD's Columbus Office of Multifamily Housing also conducted a management review of the six complexes to determine compliance with HUD's regulations and management procedures and practices. In the report, dated March 19, 2004, the Columbus Office of Multifamily Housing rated the complexes' maintenance as below average and the financial management, general management, and overall rating as unsatisfactory. Some of the findings the Columbus Office of Multifamily Housing cited in its management review included commingling of funds, underfunded tenant security deposits, failure to submit financial reports on a timely basis, and that all six complexes were in mortgage delinquency status.

The Departmental Enforcement Center's review of the complexes' financial statements found that there were unauthorized loans and unauthorized distributions totaling $660,935. In May 2005, HUD issued notices of violation of the six complexes' regulatory agreements. In January 2008, the president of Columbus Properties proposed to pay $275,410 to settle the violations, depending on his financial ability to pay. As of July 22, 2010, HUD's tolling agreement[1] with the president of Columbus Properties expired. Therefore, the Federal civil statute of limitations expired under which HUD could pursue a settlement. Further, the Federal criminal statute of limitations has also expired to pursue the unauthorized loans and unauthorized distributions since more than five years have passed.

Question 5: What is the total current exposure to FHA for all HUD-assisted loans, and what is the total amount of losses from defaulted mortgages auctioned to recoup on defaulted loans?

According to HUD's Office of Multifamily Housing Asset Management, as of August 31, 2009, HUD had 11,911 multifamily insured properties in its portfolio with an unpaid balance of $58.8 billion.

Public Law 104-134, The Debt Collection Improvement Act of 1996, provides government agencies with the authority to sell government-held assets. Specific language in this law requires that assets "will be disposed of under an asset sales program within 1 year after becoming eligible for sale, or later than 1 year if consistent with an asset sales program and a schedule established by the agency and approved by the Director of the Office of Management and Budget."

Between 2004 and 2009, 514 multifamily mortgages were assigned to HUD following a financial default of the mortgage loans with an unpaid balance of $2.9 billion. Of the 514, HUD sold 327 of the mortgage notes in a mortgage sale, which resulted in $1 billion in losses. During this period, HUD collected $1.6 billion in insurance premiums. The following table shows the yearly losses.

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[1] A "tolling agreement" is an agreement between the Department and a third party that suspends or temporarily stops the statute of limitations. It agrees to waive the right to claim that a lawsuit should be dismissed due to the expiration of a statute of limitations. Its purpose is typically to allow a party additional time to assess the legitimacy or viability of their claims and/or the amount of their damages without the necessity of filing an action. During the tolled period, the parties waive any defense by way of any statute of limitations which would otherwise exist.

Fiscal year	*Number of loans*	*Loan balance*	*Sale amount*	*Loss*
2004	80	$491,891,569	$286,227,713	$205,663,856
2005	104	886,880,072	540,890,373	345,989,698
2006	51	308,045,903	204,400,869	103,645,034
2007	29	292,235,579	145,789,038	146,446,541
2008	23	129,575,967	50,383,301	79,192,665
2009	40	214,634,250	93,970,595	120,663,655
Totals	**327**	**$2,323,263,342**	**$1,321,661,891**	**$1,001,601,451**

RECOMMENDATION

Based on the results of our review, this report contains no recommendation.