



Issue Date March 7, 2007

Audit Report Number 2007-FW-1006

TO: Herman S. Ransom
Director, Multifamily Housing Hub, 7AHM

Stephen B. Hollingshead
Deputy Assistant Secretary for Enforcement, S

FROM: Frank E. Baca
Regional Inspector General for Audit, Fort Worth Region, 6AGA

SUBJECT: Aberdeen Villa Apartments, Formerly Asbury Square Apartments, Tulsa, Oklahoma, FHA #118-35200, Spent Almost \$35,000 in Project Funds on Ineligible and Unsupported Costs

HIGHLIGHTS

What We Audited and Why

We audited Asbury Square Apartments (Asbury), located in Tulsa, Oklahoma, in response to a request from the U.S. Department of Housing and Urban Development's (HUD) Office of Multifamily Housing. The Federal Housing Administration insured the loan through HUD's multifamily accelerated processing (MAP) procedure.¹

The audit objectives were to determine whether the owner and its management agent used project funds in compliance with the regulatory agreement and HUD's requirements.

¹ Processing procedure designed to establish national standards for approved lenders to prepare, process, and submit loan applications for Federal Housing Administration multifamily mortgage insurance.

What We Found

Sheltering Palms - Tulsa I, LLC (Sheltering Palms), the owner and borrower, and Paramount Property Group, LLC (Paramount), the management agent, spent \$34,649 on ineligible and unsupported costs.

What We Recommend

We recommend that the director of HUD's Kansas City Office of Multifamily Housing require Sheltering Palms² to support or reimburse HUD's Federal Housing Administration insurance fund \$34,649. We also recommend that the directors of HUD's Departmental Enforcement Center and HUD's Kansas City Office of Multifamily Housing take appropriate administrative sanctions against Sheltering Palms and its principals/officers and Paramount and its owners.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We provided a draft audit report to the owner, management agent, and HUD on February 8, 2007. We held exit conferences with the owner and management agent on February 15, 2007, and February 16, 2007, respectively. In a February 22, 2007 written response, the director of HUD's Kansas City Office of Multifamily Housing agreed with the findings and provided corrective measures that his office would take.

The owner's and management agent's response and our evaluation of the responses are located in Appendix B. The owner's response included exhibits that are available for review upon request.

² Since Paramount served as Sheltering Palms' agent, we believe HUD should require Sheltering Palms to repay the funds.

TABLE OF CONTENTS

Background and Objectives	4
Results of Audit	
Finding: Sheltering Palms and Paramount Spent Almost \$35,000 in Project Funds on Ineligible and Unsupported Costs	5
Scope and Methodology	9
Internal Controls	10
Appendixes	
A. Schedule of Questioned Costs	11
B. Auditee Comments and OIG's Evaluation	12

BACKGROUND AND OBJECTIVES

Asbury Square Apartments (Asbury) is a 256-unit garden style apartment complex in Tulsa, Oklahoma. On November 29, 2000, Sheltering Palms - Tulsa I, LLC (Sheltering Palms), purchased Asbury for \$6.011 million using one-year renewable revenue bond anticipation notes issued by the Tulsa County Industrial Authority.³ On September 14, 2004, the Federal Housing Administration insured Asbury's \$9.098 million mortgage under Section 221(d)(4) of the National Housing Act. Federal Housing Administration insurance protects lenders against loss from mortgage defaults on projects involving either new construction or substantial rehabilitation of housing units for moderate-income and displaced families. Capmark Finance Bank (Capmark),⁴ and Sheltering Palms entered into a \$9.098 million mortgage agreement, secured with Tulsa County Industrial Authority bonds backed by Government National Mortgage Association securities.

Capmark used the multifamily accelerated processing (MAP) procedure to process the mortgage loan. The U.S. Department of Housing and Urban Development (HUD) developed the MAP procedure in an effort to quicken the Federal Housing Administration multifamily loan processing time. Under the MAP procedure, Capmark directed the preparation, reviewed required exhibits including the appraisal, and conducted the underwriting. HUD provides minimum oversight when loans are originated through MAP.

The owner allocated the \$9.098 million loan proceeds between paying down the mortgage debt and rehabilitating the property. In obtaining the insured loan, Sheltering Palms Foundation, Inc., had to sign and abide by its regulatory agreement with HUD. The regulatory agreement required Sheltering Palms Foundation, Inc., to operate the project responsibly. Asbury defaulted on its Federal Housing Administration-insured mortgage on September 1, 2005, before reaching final endorsement.⁵ HUD assumed Sheltering Palms' mortgage note on March 1, 2006. On May 24, 2006, HUD had paid \$8.746 million to settle the lender's claim. On December 6, 2006, HUD sold the project for \$3.379 million, a loss of \$5.367 million.

The audit objectives were to determine whether the owner and its management agent used project funds in compliance with the regulatory agreement and HUD's requirements.

³ Sheltering Palms Foundation, Inc., a nonprofit corporation, owns Sheltering Palms - Tulsa I, LLC.

⁴ Formerly called GMAC Commercial Mortgage Bank.

⁵ HUD had not conducted the final closing of the mortgage insurance transaction, which occurs after completion of construction, although HUD had approved the cost certification.

RESULTS OF AUDIT

Finding: Sheltering Palms and Paramount Spent Almost \$35,000 in Project Funds on Ineligible and Unsupported Costs

Sheltering Palms and Paramount Property Group, LLC (Paramount), spent \$34,649 in project funds on ineligible and unsupported costs. The expenditures included paying contractors for work not completed, drawing down funds without support, and repaying owners without surplus cash. These deficiencies occurred because of Sheltering Palms' and Paramount's insufficient understanding of and lack of controls to comply with the regulatory agreement, the construction contracts, the building loan agreement, and HUD Handbook 4370.2, REV-1. As a result, Sheltering Palms and Paramount deprived the project of the misused funds and could not rent unrepaired units.

Paramount Paid Two Contractors for Work Not Completed

Paramount paid two contractors \$16,800 for repairs to units that were not completed. Both contractors had an identity-of-interest relationship with the former site manager, which may have led to preferential treatment.

Violating the regulatory agreement and contract terms, Paramount paid Absolute Construction Co. (Absolute)⁶ \$12,000 to repair a fire-damaged unit.⁷ Absolute did not restore the unit and, according to Paramount officials, left town. Paramount officials agreed that they paid the contractor before the work was completed. While the contract terms required installment payments of \$4,000 at the beginning, after installation of drywall, and upon completion, the entire \$12,000 was paid in advance of the contract terms. In addition to the \$12,000, Asbury lost at least 17 months' rent (approximately \$9,010) on the unit.⁸

The regulatory agreement required Sheltering Palms to "maintain the mortgaged premises...in good repair and condition." If the project's insurance company paid to repair units damaged by fire, the owner was required to use the insurance funds in accordance with the mortgage terms.⁹ The mortgage agreement required that the owner use the insurance funds to either repair the unit or pay down the mortgage note.

⁶ Absolute had the same address as the former site manager, and it appears that the former site manager's brother signed the contract for Absolute.

⁷ The insurance company paid a \$10,500 claim for the fire damage.

⁸ The unit was not repaired or rentable as of July 21, 2006, when we observed the unit.

⁹ Regulatory agreement, section 7.

According to the contract between the contractor and the owner, Absolute agreed to (1) replace sheetrock, prime, and texture; (2) repair interior doors; (3) replace/repair frame in damaged areas; (4) replace or repair all fixtures; (5) install new cabinets and countertops; (6) repair air ducting; (7) replace and or repair electrical; and (8) clean the unit.

Absolute did not complete the repairs to the one-bedroom unit.

1. Three of four bedroom walls needed sheetrock;
2. Two of three interior doors were burned;
3. The fixtures throughout the unit were either missing or incomplete;
4. There was a kitchen countertop, but it did not appear new;
5. The kitchen sink did not have a water faucet;
6. One of the new kitchen cabinets was not attached to anything;
7. There was no heat and air vent in the kitchen;
8. Uncovered electrical outlets had wires hanging from them; and
9. The unit was not clean; for example, the bathtub was filled with fire debris.

The owner should support or repay the \$12,000 that it wrongly paid to Absolute.

In the second instance, Paramount submitted invoices for \$8,400 for work to “make ready” units that were not rentable,¹⁰ contrary to the regulatory agreement, the building loan agreement, and the change order to the construction contract with Fenix Constructors Inc. (Fenix). Under a change order to the general rehabilitation contract,¹¹ Paramount hired Acme¹², a related party, to make ready 33 units at a cost of \$19,600. Acme did not make ready 14 of the 33 units, and Paramount submitted invoices for \$8,400 for the 14 units. The lender used contract funds to pay Fenix \$4,800 for eight of those units, with the remaining \$3,600 being part of Fenix’s claim against the property.¹³ The owner should support or repay the \$4,800 in insured mortgage funds that were spent on units not completed.

A Sheltering Palms official certified that the units were rentable when they were not. Another Sheltering Palms official signed the building loan agreement, which required owner officials to complete the construction according to drawings and specifications. Before owner officials could request advances, they were required to complete an application for insurance of advance of mortgage proceeds.¹⁴ When an owner official completed the application for the change order work, he certified that the contractor had satisfactorily completed the work “in accordance

¹⁰ Paramount records provided evidence that the units were not rentable after its subcontractors made the repairs.

¹¹ Fenix and Paramount agreed that Paramount would be responsible for selecting the units to repair, hiring the subcontractors, and ensuring the completion of the units.

¹² The former site manager’s brother also owned Acme.

¹³ Fenix did pay Acme.

¹⁴ Form HUD-92441, paragraphs 2 and 4(a).

with the contract drawings.” The change order to the construction contract with Fenix required that Fenix make the units rentable.

Paramount Officials Drew Down Escrowed Working Capital Funds without Support

Paramount officials used \$9,768 in project funds for unsupported costs. Under the loan, Capmark established a working capital account to pay for marketing and rent-up costs,¹⁵ real estate taxes, property insurance premiums, ground rents, assessments, and interest. Paramount officials requested escrowed working capital funds from the lender to purchase office furniture and equipment for the leasing office.

To support their request, Paramount officials sent Capmark unpaid invoices from NAPA Construction (NAPA), a related party,¹⁶ for goods that NAPA gave to Asbury free of charge. Capmark released working capital funds to the project for the unpaid invoices because Paramount officials indicated that the project had paid the invoices. Paramount officials did not provide documentation to show that they used the funds for any costs that could be paid from the working capital account as required by HUD Handbook 4370.2, REV-1.¹⁷ In part because Paramount officials drew down working capital funds for unsupported costs, the escrow was exhausted before the project was completed.

Paramount Repaid the Owner for an \$8,081 Loan

Violating the regulatory agreement, Paramount repaid Sheltering Palms \$8,081 for a short-term loan that it made to the project. Sheltering Palms officials loaned the funds to the project when they paid the power company to avoid electricity cutoffs. The project had no surplus cash at the time of the loan repayment and had not made any surplus cash calculations. Under the regulatory agreement, the project cannot repay the owner from nonsurplus cash.¹⁸ Paramount officials either misunderstood or disregarded the regulatory agreement when they repaid Sheltering Palms with nonsurplus cash.

¹⁵ This included “equipment and supplies essential to initial rent-up, etc.”

¹⁶ NAPA’s owner is the husband of Paramount’s president.

¹⁷ HUD Handbook 4370.2, REV-1, chapter 2, section 6.

¹⁸ Regulatory agreement, section 6(b).

Conclusion

We attribute the deficiencies noted to Sheltering Palms' and Paramount's insufficient understanding and in some cases disregard of the regulatory agreement, the construction contracts, the building loan agreement, and HUD Handbook 4370.2, REV-1. Another contributing cause was the lack of internal controls and procedures. As a result, Paramount paid \$34,649 in project funds for ineligible and unsupported costs while in a nonsurplus cash position. In addition, Sheltering Palms and Paramount failed to properly keep the project in good repair and condition as required by the regulatory agreement.¹⁹ These deficiencies resulted in fewer project funds being available for mortgage repayment.

The owner defaulted on the HUD-insured mortgage note and the lender assigned the note to HUD. HUD used \$8.746 million in insurance funds to settle the lender's claim and sold the project for \$3.379 million, a loss of \$5.367 million.

Recommendations

We recommend that the director of HUD's Kansas City Office of Multifamily Housing require Sheltering Palms to

- 1A. Support or reimburse HUD's Federal Housing Administration insurance fund \$16,800 paid to two contractors for incomplete work.
- 1B. Support or reimburse HUD's Federal Housing Administration insurance fund \$9,768, which it drew down from the working capital account without proper support.
- 1C. Reimburse HUD's Federal Housing Administration insurance fund \$8,081, which it received from the project when the project did not have surplus cash.
- 1D. Take appropriate administrative sanctions against Sheltering Palms and its principals/officers and Paramount and its owners.

We recommend that HUD's Assistant Secretary for Enforcement

- 1E. Take appropriate administrative sanctions against Sheltering Palms and its principals/officers and Paramount and its owners.

¹⁹ Regulatory agreement, section 7.

SCOPE AND METHODOLOGY

We conducted the audit in Oklahoma City at Paramount's office, HUD's Office of Multifamily Housing, and our office. We also visited and toured the project in Tulsa, Oklahoma. The review period was from June 1, 2004, through May 31, 2006. We conducted the review from May 17 through December 13, 2006. During the review, we performed the following steps:

- Reviewed HUD requirements, background information, the regulatory agreement, and other criteria related to Asbury and HUD's insured mortgage project.
- Conducted interviews with HUD officials,²⁰ the lender, the owner, management agent officials, and other individuals related to the rehabilitation.
- Reviewed selected Asbury rent rolls.
- Reviewed a sample of disbursements and deposits in the accounting records and their supporting documentation. We performed a data analysis with ACL, which is a database tool, on the check amounts and selected a sample of 10 checks with amounts that were not within the expected range. We selected 28 additional transactions from our review of the project's bank statements, check register, and general ledger. The selection consisted of payments to and from related parties and other unusual payments. The conclusions reached relate only to the sample items tested and cannot be projected to the universe or population.
- Toured several apartments and the common areas in the apartment complex on July 21, 2006, to determine whether repairs had been completed and units were rentable.

We performed the review in accordance with generally accepted government auditing standards.

²⁰ Some of the officials involved with Asbury have retired.

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

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

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Policies and procedures that Paramount implemented to reasonably ensure that it administered the HUD-insured project in conformity with HUD requirements.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weaknesses

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

- Paramount did not have controls that ensure compliance with the regulatory agreement, the construction contracts, the building loan agreement, and HUD Handbook 4370.2, REV-1.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible <u>1/</u>	Unsupported <u>2/</u>
1A		\$16,800
1B		9,768
1C	\$8,081	—
Totals	\$8,081	\$26,568

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 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



Sheltering Palms Foundation, Inc.

9045 La Fontana Blvd. Suite C-12
Boca Raton, FL 33434
Tel: (561-477-2860) Fax: (561-483-9892)

February 26, 2007

Mr. Frank E. Baca
U.S. Dept. of Housing and Urban Development
Regional VI, Office of Inspector General
819 Taylor Street, Room 13A09
Fort Worth, TX 76102

Re: Aberdeen Villa Apartments, Formerly Asbury Square Apts., Tulsa, OK.
FHA #118-35200, Audit Report # 2007-FW-100X

Dear Mr. Baca:

I have reviewed the draft report you submitted and wish to take issue on only one charge. Before I do, I would like you to know that Sheltering Palms Foundation, sole owner of Sheltering Palms - Tulsa I, LLC, has acted in an honest and professional manner during the time this property was under its ownership. Sheltering Palms - Tulsa I, LLC, never withdraw any funds from the property, yet Sheltering Palms Foundation, Inc. poured in over \$363,000 of its own money (see attached #1) for the upkeep of this property during difficult financial periods.

I can not contest your claims of \$26,568 for money paid to contractors where work was never completed. I was completely unaware of the situations you have uncovered, and it appears from your report, that some illegal dealings took place between the site manager and some contractors. I am going to request that Paramount Property Group file a claim under their employee dishonesty insurance coverage for return of this money.

The last item of reimbursement, \$8,081.00 which Sheltering Palms Foundation, Inc loaned the property, is a charge which is completely unfair. If you will note from my attachment, these funds were wired directly to AEP, the utility company, on Oct. 27, 2004. It was done to insure that electricity would continue to flow to the property and work could continue on the rehabilitation project. This was done one day after I sent a letter to Henry Coors, of GMAC Commercial Mortgage Bank, (see attached #2) telling him of the problems we were experiencing as well as the need for additional funding of the Initial Operating Deficit account if this project is to survive. Had the \$8,081.00 not been sent to the utility company, power would have been turned off and everything would have come to a standstill, thus insuring the failure of the project. Another reason this had to be done immediately was due to the time delay associated with filing a request for funds, obtaining approval from GMAC and HUD, before actually receiving the funds.

Comment 1

Comment 2

I trust you will understand that our decision was motivated by the dire need to try and stabilize what was becoming an untenable situation. In light of these facts I hope you will see fit to eliminate the \$8,081.00 reimbursement charge.

I am also including (see attached #3) a copy of the Construction Oversight Agreement between Sheltering Palms - Tulsa I, LLC and Mr. Lou Porta. Mr. Porta acted as our consultant as he had over 40 years experience in the multifamily housing market, both in construction and management. Sheltering Palms made every effort to see that the rehabilitation of this property would be accomplished in a timely manner and within budget allocations.

At the end of the rehabilitation period, when it became clear that the property could not financially support itself, we put together a "Workout Plan" and submitted it to GMAC. It was promptly rejected. Should you wish a copy of this report, please let me know and I will forward one to you.

I welcome your response and would be more than willing to discuss the reasons for this projects failure and what methods might be instituted to prevent such a situation from happening again.

Sincerely,


Eugene Sandler
First Vice President

cc: HP
Enclosures



P.O. Box 14116
Oklahoma City, OK 73113
Phone 405.842.4393
Facsimile 405.810.0611

February 23, 2007

Frank E. Baca
Regional Inspector General
U.S. Department of Housing and Urban Development
Region VI, Office of the Inspector General
819 Taylor Street, Room 13A09
Fort Worth, TX 76102

RE: Aberdeen Villa Apartments Audit Report Number 2007-FW-100X

Dear Mr. Baca:

This letter is to act as a response to the above-mentioned audit report dated February 8, 2007 and the findings included therein.

Finding: Paramount Paid Two Contractors For Work Not Completed

We did pay Absolute Construction to complete the fire-damaged unit at Aberdeen Villa. There are times that it is standard practice for a contractor to require payment up front in order for them to purchase the needed supplies and materials to complete the contracted job, as was this case. We obviously did not foresee that the job would not be completed and for the contractor to be unreachable.

The work on the "make ready" units was completed on units that seemed to be habitable, but it was not until later that it was discovered that they could not be. This occurs numerous times in this industry, sometimes actually moving a resident into the unit before finding out that it has issues that cannot be immediately resolved. In those instances, the resident is transferred. Not only did this happen with some of the units included in the make ready portion of the rehab, but also with the newly remodeled "Fenix" units. The Fenix units were completely rehabbed with new carpet, tile, appliances, hardware, and etc. until they were discovered to be uninhabitable. This is a daily event in the apartment industry, and in most cases cannot be determined until weather conditions actually affect the unit.

Comment 3

Page 1 of 2

Paramount Property Group tried to achieve the maximum make-readies within the scope of the funds available, and once those funds have been utilized, it was an impossibility to achieve the type of income needed to address the remaining units. The property continues to be shadowed by the negative public persona from its past, and cannot seem to move past that.

Comment 4

Finding: Paramount Officials Drew Down Escrowed Working Capital Funds Without Support

Although Napa Construction was never paid for the desks, executive chairs, guest chairs, bookcase, computer tower, monitor, keyboard, and mouse, all of the above items were delivered to the property where they remain as part of the property inventory. All of these items are located in the Aberdeen Villa Rental Office and can be accounted for. The funds received for these items were deposited into the property's operating account and utilized for property expenses.

Finding: Paramount Repaid the Owner For An \$8,081.00 Loan

Comment 5

This amount was never earmarked as a "loan", but was instead used to cover utility costs to American Electric and Power when the electric service was in danger of disconnection. The purpose of these funds was to ensure that the power to the property remained on (it is an all bills paid property) without interruption. Once the property received the funds through rent collection to cover this bill, Sheltering Palms was reimbursed for that expense through the direction of Sheltering Palms and Gene Sandler.

Although many mistakes were made during the loan origination and the rehabilitation of the property, the bulk of this audit seems to point the finger at Paramount Property Group, as we are the most obvious source. However, all parties involved need to be reviewed, including Capmark, The Department of Housing and Urban Development, and Sheltering Palms Foundation, to name a few.

Sincerely,

Melissa Wheeler
Sr. Vice President
Paramount Property Group

OIG Evaluation of Auditee Comments

- Comment 1** We thank Sheltering Palms Foundation, Inc. (Sheltering Palms) officials for their positive response. According to the schedule provided by Sheltering Palms, it provided \$363,803 of its own funds to the project. However, \$317,371 (87 percent) of the funds were provided prior to HUD's firm commitment dated July 6, 2004.
- Comment 2** Sheltering Palms loaned funds to the project when they paid project expenses. As discussed in the report, the regulatory agreement prohibits the project from using nonsurplus cash to repay loans for whatever purpose without HUD approval.
- Comment 3** It is difficult to understand how Paramount staff would not have known that the units made rentable by Acme were not habitable. Paramount's records showed that the units still needed repairs after Paramount's staff had submitted Acme's invoices for payment. Thirteen of the 14 units needed carpet replacement or shampooing costing from \$700 to \$1,000 per unit. Seven units needed new tile. Eleven units needed painting. Thirteen units needed appliances. There were no indications that weather conditions would have caused the issues or that any tenants ever lived in the 14 units made ready by Acme.
- Comment 4** Paramount officials have not been able to locate documents to show that the working capital funds went for marketing and rent-up costs, real estate taxes, property insurance premiums, ground rents, assessments, or interest as required by the MAP guide.
- Comment 5** We acknowledge that the \$8,081 loan from the owner was never earmarked as a loan in Asbury's records. However, the owner had loaned the funds to the project when it paid the power company to avoid electricity cutoffs. Under the regulatory agreement, the project needed surplus cash and HUD approval to repay the loan. As noted in our report, the project did not have surplus cash or HUD approval.