



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

August 12, 2014

MEMORANDUM NO:
2014-DE-1801

Memorandum

TO: Carol Galante
FHA Commissioner-Assistant Secretary, Office of Housing, H

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FROM: Ronald J. Hosking
Regional Inspector General for Audit, Denver Region, 8AGA

SUBJECT: Memorandum Report on the Wyoming Community Development Authority's
Role in the Village Creek Townhomes' 51 FHA Mortgage Defaults

INTRODUCTION

This memorandum is to request that you consider referring the Wyoming Community Development Authority (State Finance Agency) to the Mortgagee Review Board for its part in the inappropriate development of and loan origination for the Village Creek Townhomes. All 51 townhomes sold at a foreclosure auction on October 28, 2013, for just over \$1.7 million. We audited the Wyoming Housing Opportunities Association based on information obtained during our audit of the State Finance Agency, which indicated that 51 Federal Housing Administration (FHA) mortgages with the same borrower had defaulted. During this audit, we reviewed the development, loan origination, and management of the Village Creek Townhomes. We determined that the Association, the State Finance Agency, and the Cheyenne Housing Authority were all involved in some way with the Village Creek Townhomes. HUD chose not to provide written comments to this memorandum.

We identified the following information during our audit of the Association (OIG memorandum number 2013-DE-1801).

METHODOLOGY AND SCOPE

We reviewed the predevelopment and development documentation for the Village Creek project. Specifically, we analyzed the financing for the project and whether the project received other Federal funds. We reviewed the origination and servicing of the 51 FHA mortgages. Then, we

looked at how the Association managed and operated its home ownership conversion program, with the ultimate goal of home ownership for the Village Creek tenants. Specifically, we analyzed the current tenant files; reviewed the home ownership agreement; interviewed tenants; and interviewed Authority, Association, and State Finance Agency personnel familiar with the Village Creek development.

BACKGROUND

The State Finance Agency was the servicer of the 51 FHA loans, provided development loans for Village Creek, and managed Village Creek after the Association defaulted on its loans. Specifically, it provided expert guidance to both the Association on how to structure the loans and to the financial institution that underwrote the loans. It raised capital by selling tax-exempt mortgage revenue bonds to investors and received no State funding. A State statute created the State Finance Agency in 1975 as an instrumentality of the State for the purpose of raising capital to finance affordable housing.

In addition to the State Finance Agency, the key parties involved with the Village Creek development were as follows:

Wyoming Housing Opportunities Association, Inc., Cheyenne, WY

The Association is the general partner of Village Creek Limited Partnership, which owned Village Creek Townhomes from its start in 1995 to October 28, 2013. The Association took over as manager of Village Creek from 2003 to 2012. It is a nonprofit corporation formed to develop and manage affordable housing within the State of Wyoming. In 1993, the Authority created the Association. Volunteers direct the board. The Association seeks a variety of creative financing packages and partnerships to create affordable housing.

Cheyenne Housing Authority, Cheyenne, WY

The Authority developed Village Creek, managed Village Creek from 1994 to 2003, had Section 8 voucher tenants living at Village Creek, and pursued a purchase of Village Creek after the Association defaulted on the mortgages. The State of Wyoming created the Authority in 1971 to address the low-income housing needs of the community. A five-member board of commissioners appointed by the mayor and city council governs its activities.

Village Creek

The Association built and financed the Village Creek Townhomes in 1995 with low-income housing tax credits; loans from the State Finance Agency, Mercy Housing, and the Authority; and 51 single-family FHA-insured loans from the State Finance Agency. The legal owner of Village Creek was the Village Creek Limited Partnership, with the Association as the general partner and the Federal National Mortgage Association (Fannie Mae) as the investor-limited partner (Fannie Mae purchased the tax credits).

FHA showed the lender for the 51 FHA loans as American National Bank of Cheyenne (no longer in business). However, after closing, the loans transferred immediately to the State Finance Agency for servicing. Documentation reviewed showed that the State Finance Agency

provided expert direction and guidance to American National Bank loan officers during the origination of the loans.

The Association contracted with the Authority to manage Village Creek from 1995 to 2003. In 2003, the Association terminated its contract with the Authority and assumed full management responsibilities for the project. In 2012, the Association's board determined that it did not have sufficient cash flow to keep the project viable so the board voted to stop making its mortgage payments and let all 51 FHA mortgages go into default. On November 27, 2012, the State Finance Agency received a letter informing it of the board's decision.

The unpaid principal balance on the loans was more than \$1.4 million. After the loans defaulted, the State Finance Agency exercised its right to the assignment of rents on the townhomes. Also, it received from HUD an extension of 3 additional months to commence the foreclosure process (through June 2013). The 51 townhomes sold at a foreclosure auction on October 28, 2013, for just over \$1.7 million.

RESULTS OF THE REVIEW

The HUD Wyoming field director worked with the State Finance Agency and the Authority to find a way to obtain HUD financing quickly so they would not lose the low-income tax credits due to time constraints. A multifamily project was not an option because such projects generally took 2 to 3 years to be approved; therefore, the parties decided to use single-family FHA mortgages on each townhome. The ultimate goal of the Village Creek project was to have the current tenants purchase the properties at the end of the 15-year tax credit period for the remaining principal loan balance. Neither, the Association, the State Finance Agency, nor the Authority entered into agreements with the tenants to ensure that they would have the option to purchase the units at the end of the 15-year tax credit period. In 2001, the State Finance Agency modified the loan to lower the monthly payment on the mortgages. The modification added to the length of the loan.

We obtained the HUD case binder for the Village Creek townhome at 221 Hacienda Court, Cheyenne, WY. We reviewed the contents according to FHA requirements and noted the following issues:

- The form HUD-1, Settlement Statement, indicated that both the borrower and the seller were the president of the Association. Cash was due from both the borrower and the seller.
- On the HUD-1 addendum, the president of the Association signed in the borrower section, stating, "I certify that I (we) have not been paid or reimbursed for any of the cash down-payment." Then he signed in the seller section, stating, "I certify that I have not and will not pay or reimburse the borrower(s) for any part of the cash down-payment." He incorrectly certified as both the borrower and seller.
- On the mortgage credit analysis worksheet, under "Do you own more than 4 dwellings?" the borrower checked "no," which is not correct because Village Creek is a 51-unit development.

Additionally, there were three master HUD case binders (one for each townhome type). We reviewed these materials for the type of townhome reviewed above (two bedroom) and noted the following additional information presented to HUD pertaining to creating affordable housing. This information was for 300 Hacienda Court, Cheyenne, WY:

- The appraisal for model B was \$67,000, and a note stated, “Bid for project appears high due to developer fee that will be returned as tax credits, large outlay for A&E [architectural and engineering] design fees, contingencies, interest reserves, reserve funds, and consulting fees.” Additionally it stated, “Tax credits and subsidized rents will allow occupants to buy at fixed price in 15 years.”
- The Village Creek fact sheet contained development specifics as follows:
 - “...units will be leased to the families for fifteen years, after which they will be sold to the families for approximately \$35,000 per unit”;
 - [The State Finance Agency] “arranged financing for the families at 6.5% interest, which equates to a family housing payment of approximately \$250 per month when the units are sold to the families”;
 - “...the debt service on this project has been structured so that at the end of the Tax Credit period, when the tenants take ownership of their units, they will be paying less than \$35,000 for their individual homes”; and
 - [Project summary] “...through the combined efforts of Wyoming Housing Opportunities Association, Inc., the Cheyenne Housing Authority, the Wyoming Community Development Authority, and the City of Cheyenne, fifty families, who rely on housing assistance will be provided an opportunity to become homeowners.”

The State Finance Agency played a key role in the development and the loan origination of Village Creek. However, it did not ensure that safeguards or agreements were in place with the tenants to guarantee the tenants would be given the opportunity to purchase the units at the reduced FHA principal balance. Further, it did not practice due diligence in ensuring that these loans conformed to HUD standards. Therefore, once the loans closed, the FHA insurance fund was at risk for default.

RECOMMENDATIONS

We recommend that the FHA Commissioner-Assistant Secretary, Office of Housing,

- 1A. Refer the State Finance Agency to the Mortgagee Review Board for its part in the development and foreclosure of 51 FHA mortgages.