



Bay Vista Methodist Heights, San Diego, CA

Multifamily Trust Fund Agreement



Issue Date: March 14, 2013

Audit Report Number: 2013-LA-1003

TO: Thomas W. Azumbrado, Acting Director, Los Angeles Multifamily Hub,
9AHMLAP

Tanya E. Schulze

FROM: Tanya E. Schulze, Regional Inspector General for Audit, Los Angeles Region,
9DGA

SUBJECT: Bay Vista Methodist Heights, San Diego, CA, Violated Its Agreement With HUD
When Administering Its Trust Funds

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General (OIG), final results of our review of the Bay Vista Methodist Heights multifamily trust fund agreement.

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 213-534-2471.



March 14, 2013

Bay Vista Methodist Heights, San Diego, CA, Violated Its Agreement With HUD When Administering Its Trust Funds

Highlights

Audit Report 2013-LA-1003

What We Audited and Why

We audited Bay Vista Methodist Heights, San Diego, CA, to determine the full extent of the misuse of its trust funds. We selected Bay Vista for review based on a referral from the Office of Multifamily Housing, stating that Bay Vista violated its trust fund agreement with the U.S. Department of Housing and Urban Development (HUD) because the former chief financial officer transferred more than \$3 million in restricted funds into Bay Vista's operating account to meet general operating expenses rather than to develop, purchase, construct, preserve, and rehabilitate affordable housing.

What We Recommend

We recommend that the Acting Director of HUD's Los Angeles Office of Multifamily Housing require Bay Vista to (1) repay more than \$5 million to the trust fund from non-Federal funds; (2) support an additional \$1 million or repay the trust; (3) replace the management agent with a non-identity-of-interest agent; and (4) implement policies, procedures, and controls to restrict the use of trust funds to only allowable expenses and ensure that the trust funds are not commingled with other funds.

What We Found

Bay Vista violated its trust fund agreement with HUD. Specifically, it used more than \$5 million in trust funds without HUD's approval for ineligible operating expenses. In addition, Bay Vista could not support more than \$1 million in expenditures on draw requests that were approved by HUD.

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BACKGROUND AND OBJECTIVE

Bay Vista Methodist Heights is a nonprofit organization that purchased and developed a 268-unit apartment complex located in San Diego, CA, in 1969. The apartment complex was subject to a deed of trust note insured under section 221(d)(3) of the National Housing Act, with a principal amount of more than \$3.6 million and maturity date of January 1, 2010. Bay Vista sold the apartment complex to the Amerland Group, LLC, a California limited liability company, in July 2007. The sale involved a prepayment request to the U.S. Department of Housing and Urban Development (HUD), and as a condition of approval, HUD and Bay Vista entered into an agreement in February 2008, which required Bay Vista to deposit 75 percent of the net proceeds of the sale into a housing trust fund to be used to develop, preserve, construct, or rehabilitate affordable housing units with a production goal of 675 units. The property sold for \$21.4 million, and approximately \$14.8 million was deposited into the housing trust fund.

Bay Vista purchased two properties with the trust funds: Hillside Park Apartments, located in Hemet, CA; and Estancia, located in Desert Hot Springs, CA. It also purchased Tierra del Rey using the non-trust-fund portion of the apartment complex proceeds but rehabilitated the property using trust funds. In addition, Bay Vista used trust funds for the predevelopment cost of Lisbon Road, a 3.7-acre plot of land it owns.

Bay Vista's management agent is GMP Development Group, a limited liability and identity-of-interest company that was established and owned by the four Bay Vista managers. Three of the managers were also a part of the Bay Vista board. Since its inception, GMP has had no management clients except Bay Vista.

In July 2011, Bay Vista's general counsel, current chief executive officer, and owner of GMP identified irregularities concerning the balance in the trust fund. The chief financial officer was asked to provide accurate reports of trust fund withdrawals; however, questions were not adequately answered, and inaccurate reports were provided to the officers of Bay Vista. The chief financial officer was placed on administrative leave in September 2011 and later dismissed from Bay Vista. In August 2011, Bay Vista's independent auditor, who prepared the fiscal year end 2008 to 2010 financial statements, was hired as chief financial officer. He began to reconcile the balance of the trust fund and discovered unauthorized transfers to the Bay Vista operating account as well as unauthorized expenditures. He also determined that Bay Vista, Lisbon Road, and the Estancia properties were operating at a net loss and could not be sustained by the net operating profits at Hillside Park and Tierra del Rey, resulting in a significant cash shortfall of approximately \$2.7 million. His audit results were shared with an independent accounting firm that Bay Vista retained to determine the application of withdrawals from the trust account between February 2008 and August 2011. The firm determined that more than \$3.3 million was withdrawn from the trust account and used toward operating expenses and not for the requested purpose. Shortly thereafter, the chief executive officer and treasurer resigned.

The HUD Los Angeles Office of Multifamily Housing was notified of these deficiencies. Bay Vista volunteered to recapitalize \$3.3 million to the trust fund. It also referred the matter to the

Office of Audit for review. Bay Vista plans to recover the unauthorized trust fund withdrawals and recapitalize the trust account by pursuing its insurance policies.

During our review, Bay Vista's Estancia property fell under a receivership and is in foreclosure status. In addition, its Lisbon Road property is still raw land, and Bay Vista is attempting to sell it or locate a joint contributor to assist in developing the land due to the lack of excess cash to develop the property. As of the most recent HUD approved draw request, dated June 2012, the trust account had a remaining balance of \$316,404 of the original \$14.8 million, despite the acquisition of only 432 affordable housing units including the Estancia's 120 units and the Lisbon Road property. With the absence of the Estancia units, Bay Vista was able to meet only 312 of its 675-unit good faith production goal, or 46 percent.

The objective of this review was to determine the full extent of the misuse of its trust funds.

RESULTS OF AUDIT

Finding: Bay Vista Violated Its Agreement With HUD When Administering Its Trust Funds

Bay Vista violated its agreement with HUD when administering its trust funds. It used more than \$5 million in trust funds without HUD's approval for ineligible operating expenses. In addition, it could not support more than \$1 million in expenditures and spent \$14,250 on ineligible items included on draw requests that were approved by HUD. This condition occurred because Bay Vista failed to exercise proper supervision and oversight of its trust accounts and lacked adequate policies, procedures, and controls to monitor and limit the use of its trust funds. As a result, funds were not disbursed and used to promote the development of additional affordable housing for qualified, low-income persons.

Trust Funds Were Inappropriately Used for Operating Expenses

Bay Vista inappropriately transferred more than \$5 million of its trust funds into an operating account to be used for operating expenses that were not originally approved by HUD. Paragraph E, section 2, of the trust fund agreement required HUD approval before Bay Vista withdrew trust funds (see appendix C). Although Bay Vista did request and obtain HUD's approval to draw \$11.3 million in trust funds for the intended acquisition of Devonshire, Casa del Sol, Vista Gardens, the Palms of La Mesa, and Plaza del Sol Apartments, it did not ultimately acquire these properties. Instead, it withdrew and transferred more than \$5 million¹ of these funds to its Bay Vista operating account through multiple fund transfers. Bay Vista spent its trust funds on inappropriate operating expenses without HUD's knowledge or approval. Therefore, more than \$5 million in expenses are ineligible and should be repaid.

Trust Fund Submission Requests Were Unsupported and Ineligible

When Bay Vista submitted its trust fund submission requests to HUD, it only provided a spreadsheet with descriptions of expenses. Some of the descriptions listed were not detailed enough or appeared misleading, resulting in HUD believing that the expenses were trust fund eligible and approving the requests.

¹ Because Bay Vista did not provide the accounting firm it hired with a complete set of records, it identified only \$3.3 million in inappropriate transfers (see Background and Objective), an understatement of almost \$2 million.

However, after reviewing the source documentation, we determined that of the eight HUD-approved trust fund draw requests sampled, five included more than \$1 million in unsupported and \$14,250 in ineligible expenses (see chart below for details). Four of the eight requests were prepared when the former chief financial officer was still employed at Bay Vista and responsible for managing financial transactions, while one request was prepared after the former chief financial officer was dismissed. Of the more than \$1 million in unsupported expenses, \$18,599 was requested after the former chief financial officer was dismissed from Bay Vista. This amount represented the salaries of the managers that were not supported by timesheets or other documentation and was based on an estimate rather than the actual number of hours worked. The other unsupported amounts were related to legal and consulting, management and development costs, senior housing project development, payroll personnel, and other unsupported expenses such as payments to the former treasurer. We requested the backup documentation for these items from the chief executive officer; however, she was unable to provide them due to a lack of documentation or lack of knowledge of where the documentation might be located. The ineligible expenses charged were operating in nature and should not have been charged to the trust. They consisted of time spent studying for a broker’s exam, preparing and revising a conflict-of-interest policy, and drafting the property management agreement between GMP and Bay Vista (see paragraph C, Section 4 of the trust fund agreement in appendix C).

Ineligible and unsupported expenses from drawn requests					
Type of Expense	Request #4 & #7	Request #11	Request #14	Request #17	Total
Ineligible expenses	\$ 11,550	\$ 2,700	\$ -	\$ -	\$ 14,250
Ineligible Total	\$ 11,550	\$ 2,700	\$ -	\$ -	\$ 14,250
Unsupported legal/consulting	\$ -	\$ 77,571	\$ 396,000	\$ 18,599	\$ 492,170
Unsupported management/ development costs	\$ 42,000	\$ 66,000	\$ -	\$ -	\$ 108,000
Unsupported senior housing project development	\$ -	\$ -	\$ 113,069	\$ -	\$ 113,069
Unsupported payroll personnel	\$ -	\$ -	\$ 233,013	\$ -	\$ 233,013
Unsupported other	\$ -	\$ 108,500	\$ 1,500	\$ -	\$ 110,000
Unsupported Totals	\$ 42,000	\$ 252,071	\$ 743,582	\$ 18,599	\$ 1,056,252

Bay Vista Lacked Proper Policies, Procedures, and Supervision To Prevent Overspending of Trust Funds

The profits earned from Hillside Park and Tierra del Rey Apartments were not sufficient to independently maintain the operations at the Estancia and Lisbon Road properties, which were operating at a net deficit. In addition, Bay Vista was unable to financially support excessive GMP and Bay Vista managers’ salaries, GMP owner distributions, GMP’s management fees, unreimbursed personnel expenses on Bay Vista credit cards, its administrative office costs, and other operating related costs without drawing money from the trust funds (see appendix D).

This occurred because Bay Vista did not have proper policies and procedures in place to monitor and limit the use of its trust funds. Since then and as part of its plan to recapitalize the HUD trust account, Bay Vista had drafted procedures to prevent the recurrence of unauthorized trust fund withdrawals; however, the procedures had not been fully implemented. Further, Bay Vista did not exercise proper supervision and oversight of the uses of its trust accounts, which according to the three managers, was largely the responsibility of the former chief financial officer. The former chief executive officer admitted that he was lax in supervising the former chief financial officer because he “trusted the guy.” The current chief executive officer stated that she and the former chief financial officer were basically running Bay Vista and that the former chief executive officer and treasurer were not always in the office and relied heavily on the two managers to acquire properties and handle the financial aspects of the organization.

Conclusion

Bay Vista did not fully comply with the terms of its trust fund agreement with HUD and was unable to meet its production goal of 675 units. It misused more than \$5 million in trust funds without HUD’s approval for ineligible operating expenses. In addition, it could not support more than \$1 million in expenditures and spent \$14,250 on ineligible items that were included on draw requests approved by HUD. As a result, funds were not disbursed and used to promote the development of additional affordable housing for qualified, low-income persons.

Recommendations

We recommend that the Acting Director of HUD’s Los Angeles Office of Multifamily Housing require Bay Vista to

- 1A. Repay the \$5,178,293, transferred without proper HUD approval and used for ineligible expenses, to the trust fund from non-Federal funds.
- 1B. Provide support showing the eligibility and reasonableness of the \$1,056,252 in trust funds disbursed or repay the trust fund from non-Federal funds.
- 1C. Repay \$14,250 in ineligible expenses to the trust fund from non-Federal funds.
- 1D. Replace GMP Development Group as Bay Vista’s management agent with a non-identity-of-interest agent.

- 1E. Implement proper policies, procedures, and controls to restrict the use of trust funds to only allowable non-operating-type expenses and ensure that the trust funds are not commingled with Bay Vista's and its properties' operating funds.

SCOPE AND METHODOLOGY

We conducted our onsite work at the Bay Vista administrative office located in San Diego, CA, between May and December 2012. Our audit period generally covered the period July 2009 to August 2011. We expanded our scope as necessary.

To accomplish our objective, we

- Reviewed the HUD and Bay Vista trust agreement.
- Reviewed the GMP and Bay Vista administrative management agreement.
- Reviewed Bay Vista's trust, operating, and property operating bank accounts and corresponding general ledger entries.
- Reviewed GMP's payroll and members' distribution accounts.
- Reviewed Paychex reports, internally maintained reports, and contract labor charges to Bay Vista.
- Reviewed management and administrative fee charges to Bay Vista.
- Interviewed current and former managers and staff.
- Interviewed the independent accounting firm that performed a review of the trust accounts.
- Interviewed HUD staff.
- Reviewed Bay Vista's fiscal yearend 2008 through 2010 financial statement audit reports.
- Reviewed trust fund submission requests, expenses, and supporting documentation.
- Reviewed board meeting minutes, resolutions, and the list of Bay Vista's board members.

From a universe of 19 trust fund submission requests, we reviewed a nonstatistical sample of 8 requests totaling more than \$3.5 million. HUD approved the drawdowns, which included expenses related to the administration of various properties, rehabilitation of Tierra del Rey, legal expenses for Estancia, and a loan modification bid to preserve the Lisbon Road property. Of the eight requests, five were selected because they occurred when the former chief financial officer was still heavily involved in managing the financial transactions at Bay Vista. We selected three additional requests that occurred after the former chief financial officer was

dismissed to determine whether changes were made in retaining supporting documentation for expenses after the former chief financial officer's dismissal. We chose this approach since testing 100 percent of the population would not have been feasible. Therefore, the sampling results apply only to the items tested and cannot be projected to the universe or population.

We performed an extensive analysis of the trust fund deposits into the Bay Vista operating account since the trust funds were commingled with other sources of funds. We reviewed more than \$11 million by tracing the deposits from Bay Vista's various trust accounts, property operating accounts, other Bay Vista accounts, reimbursement for credit card charges, refund of escrow fees for properties not purchased, and nontrust proceeds from the sale of the Bay Vista apartments, as well as other deposits from which the sources of funds were not identifiable. Due to the number and complexity of transactions between the Bay Vista and GMP accounts, we were able to review only \$6.9 million of the \$11 million in payments from the Bay Vista operating account. We targeted larger payments made to one source.

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:

- Effectiveness and efficiency of program operations – Policies and procedures intended to ensure that trust funds are used for eligible purposes.
- Reliability of financial information – Implementation of policies and procedures to reasonably ensure that relevant and reliable information is obtained to adequately support program expenditures.
- Compliance with applicable laws and regulations – Implementation of policies and procedures to ensure that trust fund activities comply with applicable HUD rules and requirements.

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:

- Bay Vista did not have adequate controls and proper oversight to reasonably ensure that its trust funds were used for eligible purposes (finding).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/	Unsupported 2/
1A	\$5,178,293	
1B		\$1,056,252
1C	\$14,250	
Total	\$5,192,543	\$1,056,252

- 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 Comments²

Comment 1

	<p>APPENDIX B</p> <p>AUDITEE COMMENTS AND OIG'S EVALUATION</p> <p>BACKGROUND OF BAY VISTA'S ACCESS TO TRUST FUND MONIES</p> <p>Pursuant to the Trust Fund Agreement after February 3, 2008, Bay Vista began to seek to expand the supply of low to moderate income housing in its immediate operating area (San Diego) as well as the other nine (9) Southern California counties.</p> <p>Despite very intense negotiations during December in Los Angeles between HUD's LA Multifamily Office Hub Program Advisor [REDACTED] and Bay Vista's attorney, over the reduction of the unit production goal, Bay Vista did ultimately commit to a "good faith" 675 unit production goal in the Trust Fund Agreement. [REDACTED] insisted the 675 unit production commitment was a "good faith goal" and Bay Vista's success would never be measured by its ability to actually obtain 675 units. Yet in the <u>Background and Objective Section of the OIG Audit Report</u>, Bay Vista's performance and acquisition of 432 affordable housing units notably accomplished by the close of its first full year of operations under the trust agreement is immediately minimized by the report. Bay Vista did in fact own and operate The Estancia Apartments in Desert Hot Springs for approximately four years,¹ that demonstrates a 64% unit production goal, which including the planned development of 52 units on the Lisbon land, that goal was reached within the first thirteen (13) months of Bay Vista's operation under the trust fund agreement.² Thus, during its first year of operations Bay Vista showed exceptional performance toward reaching its unit production goal, despite information and communication obstacles suffered as a result of its interaction with the HUD LA Multifamily Hub Office as described below.</p> <p>All prior Bay Vista management and staff were laid off commensurate with the sale of the original 268 unit garden style apartment complex at 4888 Logan Ave, and a new team was installed which consisted of four managers with varying degrees of association with the previous existing Bay Vista organization. The CEO and COO (Chief Operating Officer) both had been associated with Bay Vista for 25 and 15 years respectively as members of the Bay Vista Board of Directors. The CEO then hired a CFO with whom he had previously shared an office in association with his own tax and bookkeeping business and had known in excess of 25 years. The CEO also hired an attorney who had previously performed some duties as a consultant to the Bay Vista Board of Directors and had also used the services of the CEO in his tax preparation business for several years. The CEO and newly hired CFO proceeded to hire a CPA and tax preparer to perform an audit of Bay Vista for the fiscal year 2008. That CPA also prepared subsequent annual audited financial statements of Bay Vista for 2009 and 2010, as well as the financial analysis of the Estancia Apartments in Desert Hot Springs, CA used for acquisition. This CPA had also been</p> <p><small>¹ Over the three years, ten months of Bay Vista owned The Estancia Apartments, Bay Vista losses as calculated by Impac Commercial which held BV's mortgage on Estancia were in excess of \$1,211,329. ² The Estancia Apartments were sold <u>December 28, 2012</u>.</small></p> <p>Page 2</p>
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* Names redacted for privacy reasons

² The auditee provided a cover letter to its response (page 1) that it requested not be included as part of its response.

previously associated with both the CEO and CFO for years sharing an office for a period of time with the CEO and serving alongside the CFO in the Vietnam. All of these previous relationships between the CEO, CFO and CPA were unknown by the individuals serving as Bay Vista's Attorney and the COO during this time. Bay Vista's Attorney had been employed full time elsewhere during the negotiation and sale of Logan Ave, but had participated in some of the meetings connected with the sale as a consultant and began to serve on a full time basis during the final stages of acquisition of Tierra Del Rey, which was purchased with non-trust fund proceeds of the Logan Ave sale.

One factor in the decision to sell the Logan Avenue property was the radical change in the surrounding neighborhood during the 39 years Bay Vista owned and managed the property. The area had become plagued with gang-related shootings and other criminal activity, culminating in a murder with occurred on the Logan Avenue property in December 2005 and a serious shooting incident of an innocent bystander in the Spring of 2006. As a result of these incidents, when Bay Vista embarked upon the task of acquiring new properties it desired to create an entity which would distance the non-profit organization somewhat from the liability associated with the daily management and control of these types of circumstances. This was the reason for the creation of GMP Development Group, approved by the Bay Vista Board and named for Rev. [REDACTED] the previous pastor of St Paul United Methodist Church who conceived of and was responsible for the construction of 4888 Logan Avenue in 1969. The Bay Vista Board approved the four managers of Bay Vista (who were at that time the only existing employees of Bay Vista, other than an accounts payable clerk) to be the managers of GMP with the knowledge and understanding that GMP would be permitted to seek other property management clients once Bay Vista business was functioning smoothly. However, GMP immediately began to be used by the CFO as a vehicle to funnel funds from Bay Vista accounts to the CEO and CFO, and later to the COO and from the trust fund to Bay Vista operating accounts and then to GMP accounts. In addition, the CFO set up two separate Paychex payroll accounts (one account in the name of GMP and one account for Bay Vista) and began to issue payroll checks from both accounts to himself, the CEO and the COO. As the OIG Audit report cites, this activity continued and accelerated during the years of 2009 thru 2011.

In order to request and secure trust fund releases, Bay Vista's attorney had repeatedly requested telephonically, by memorandum, and in several meetings with HUD LA Multifamily Hub Program Advisor [REDACTED] and Interim Director [REDACTED] what the request procedures/requirements for the composition of trust fund withdrawals should be. Bay Vista was repeatedly refused access to these procedures. [REDACTED] and [REDACTED] contended the written requests for information and a trust fund release to acquire Hillside Park in Hemet, CA (sent via Express Mail and signed for by HUD LA Staff) were never received. Bay Vista also requested the right to move its trust fund from Premier Bank (which [REDACTED] had represented as Bay Vista's one and only choice to locate the trust fund) to Comerica Bank. Both the Hillside Park deal and the requests for the formal procedures/requirements to release trust funds became so frustrating and contemptuous Bay Vista sought the intervention of its San Diego and Riverside Congressional Representatives. Bay Vista's request to [REDACTED] to relocate the trust fund was ignored and maligned as impossible, until Bay Vista secured a meeting August 12, 2008 at the HUD LA Multifamily Hub Office with [REDACTED] and [REDACTED], during which using the trust fund agreement as a guide Bay Vista's attorney successfully argued the restrictions interpreted by [REDACTED] and [REDACTED] were nonexistent. [REDACTED] signed a letter that day approving the trust fund relocation to Comerica and a withdrawal necessary to close the Hillside Park acquisition. Bay

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Comment 2

* Names redacted for privacy reasons

Comment 2

Vista was never provided proper guidelines for trust fund withdrawal requests from the HUD LA Multifamily Hub office. Finally, after piecing together information from Amerland personnel (the entity to whom Bay Vista had sold the Logan Ave property) and demanding another meeting in October 2008 with the help and involvement of ██████████, Field Director of the San Diego HUD office, in January 2009, almost a full year after opening its trust fund, was Bay Vista able to submit its first regularly documented trust fund withdrawal request to Interium HUD LA Multifamily Hub director ██████████ and newly installed director ██████████.

Comment 3

These contentious difficulties set up a pattern of Bay Vista distancing itself and its business from HUD, instead of creating a collaborative partnership as anticipated by the trust fund agreement. Thus, while Bay Vista may have “failed to implement policies, procedures and controls to restrict the use of trust funds to only allowable expenses and ensure the trust funds were not commingled with other funds,” as the OIG Audit Report cites, this nine month ordeal with the HUD LA Multifamily Hub Office kept Bay Vista embroiled in bureaucracy and delay at a time when operating procedures could have been established.

Comment 4

BAY VISTA’S GUIDELINES FOR WITHDRAWALS/ INAPPROPRIATE USE OF TRUST FUNDS

It is not entirely accurate that no policies and procedures to restrict use of trust funds to allowable expenses were formally established. Beginning in January 2009 Bay Vista did have a procedure for trust fund withdrawals. It was as follows:

A. Due Diligence Period. In final consideration of the acquisition of each property, all previous property operation reports (rent rolls, current profit & loss statements, seller’s financial statements, etc.), zoning info confirmed, several property inspections completed by Bay Vista staff, general due diligence research, risk management reports and physical need assessment information, appraisal, title report, environmental report, chart of acquisition costs and expenses, a signed purchase agreement was negotiated and finalized, the Bay Vista Board of Directors approved the proposed acquisition, and typically escrow was opened.

B. Preparation of Trust Fund Submission. The complete trust fund submission was prepared³ (containing all the information above along with all HUD required documentation), including a trust fund authorization form, and delivered at a previously scheduled meeting to the HUD LA Multifamily Hub office. At that scheduled meeting, the trust fund submission was then explained and supported by Bay Vista’s attorney first with a HUD senior project manager and trust specialist, whom in that meeting cited any required changes or supplemental materials needed;

C. Approval of the Trust Fund Submission. After the trust fund submission was supported and explained to the satisfaction of the HUD senior project manager and trust specialist, in a subsequent meeting scheduled to immediately follow that initial meeting, the HUD LA Multifamily Hub director after

³ All required documents were assembled by Bay Vista’s attorney and all associated expense charts were prepared by BV’s CFO.
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* Names redacted for privacy reasons

consultation with the project manager and trust specialist posed any remaining questions of her own concerning the subject withdrawal/transaction of the trust fund submission request. After the HUD director's review and questions were satisfied, she would then sign the trust fund authorization form.

D. Obtaining the Trust Fund Monies- Bay Vista's Internal Procedure. If a signed trust fund authorization form was received by Bay Vista's attorney at or after the above described meeting, it was passed over to the CFO, who then faxed the form to the account manager, Senior Vice President/Financial Consultant [REDACTED] at Comerica Securities. [REDACTED] under the policy established between Bay Vista, [REDACTED] and Comerica at the time the signature cards to the trust fund account were signed and trust fund monies were transferred to Comerica, who was to provide for the amount of the withdrawal to be permitted by the online transfer by Bay Vista's CFO of the authorized amount of funds set forth by the authorization form. The authorized amount designated on the trust fund authorization form was to be transferred from the trust fund to whatever Bay Vista Comerica account the CFO designated.

The breakdown of this procedure occurred in two areas. First the authorized amount of the withdrawal from the trust fund was never limited as it should have been using the Bay Vista procedure as it was to be implemented by Comerica, and second, the CFO proceeded to make numerous withdrawals from the trust fund in various increments (the amounts were made in his discretion) over a period of time which totaled an amount in excess of the amount permitted by the trust fund authorization form.

Each and every transfer from the trust fund was made from a password protected online account originating from the CFO's computer, by the CFO. In this way it was possible for numerous trust fund withdrawals to be accomplished by the CFO without Bay Vista attorney's knowledge or any manager in the Bay Vista organization. The OIG Audit Report states, "Bay Vista inappropriately transferred more than \$5 million of its trust funds. "when in fact Bay Vista did not authorize any withdrawal amount or transfer amount of funds from the trust fund in excess of the signed, approved trust fund authorization form amount, which was signed by the HUD LA Multifamily Hub director. **Not one of the individuals whose names were on the trust fund account bank signature cards ever made one withdrawal from the trust fund account. All withdrawals, transfers, etc from the trust fund account were accomplished by the former CFO via the online Comerica site through the use of the CFO's personal password protected access.**

Comment 5

Again, the OIG Audit Report states, "Bay Vista inappropriately transferred more than \$5 million of its trust funds into an operating account to be used for operating expenses that were not originally approved by HUD." Bay Vista wishes to emphatically note these withdrawals were never authorized by Bay Vista, but were all completed by the former CFO of Bay Vista in the manner described above. The OIG Audit Report also states, "Although Bay Vista did request and obtain HUD's approval to draw \$11.3 million in trust funds for the intended acquisition of Devonshire, Casa del Sol, Vista Gardens, the Palms of La Mesa and Plaza del Sol Apartments, it did not ultimately acquire these properties. Instead it withdrew and transferred more than \$5 million of these funds to its Bay Vista operating account through multiple fund transfers." It must be noted here that The Housing Trust Fund Agreement Section C:4, allows "the Owner (of the trust fund) to use the Trust Account for any expenses related to the predevelopment, acquisition, development, preservation, construction and/or rehabilitation of units intended to be developed as Affordable Housing Units, regardless of whether such Affordable Housing

Comment 5

Comment 6

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* Names redacted for privacy reasons

Comment 6

Units are developed or the related transaction closes so long as the Owner has proceeded in good faith.”

In the case of each of the acquisitions cited above by the OIG Audit Report, Bay Vista did in fact proceed in good faith and was unable to close these transactions for various reasons. Terms of a final Purchase Agreement was unable to be negotiated on The Devonshire Apartments; the loan servicing entity Capmark/ Berkadia Commercial, refused to allow Bay Vista to assume the existing loans on both the Plaza del Sol and Casa del Sol Apartments and other debt structure was financially infeasible; the existing condition of Vista Gardens miserably failed a Risk Management Inspection; and in addition to Bay Vista’s shortage of closing funds, at the final hour The Palms of La Mesa Roof Inspection revealed 4 overlays of roofing which would require over \$400,000 to repair. Escrow was opened in each of these deals except Devonshire and was closed after significant efforts were extended by Bay Vista to complete these transactions. In the Devonshire and Vista Garden deals the Bay Vista attorney remained involved in the escrow proceedings until she secured the wired funds used to open escrow were returned to the Bay Vista account to which she was directed by the CFO, only to later learn the CFO did not then transfer those returned funds back to the trust fund. Only one individual at Bay Vista had access to online withdrawals, transfers from and to the trust fund and Bay Vista operating accounts, and that person was the CFO. No Bay Vista director, nor officer or manager ever made any transfer, withdrawal into the trust fund or Bay Vista operating account.

Comment 7

It should also be noted that while the OIG Audit Report notes on page 6, that “of the eight HUD-approved trust fund draw requests sampled---four of the eight requests were prepared when the former chief financial officer was still employed at Bay Vista,” when in fact seven of the eight HUD-approved trust fund draws both were prepared and those approved amounts plus additional unapproved trust fund amounts were accessed during the time the former CFO remained employed at Bay Vista.

DISCOVERY AND RECOVERY OF THE UNAUTHORIZED EXPENDITURES

Having prior corporate experience, Bay Vista’s attorney from the period of 2009 [(when she was first informed GMP was to begin to collect property management fees from Bay Vista) as provided for in the GMP Administrative and Management Agreement between Bay Vista and GMP (which she had drafted)], understood the necessity for and thus began to request regular financial reports from the CFO detailing the performance of Bay Vista’s properties as well as the Bay Vista organization itself. Her requests were met by the CFO with numerous excuses. A request was then made directly to the CEO that he should be aware and more diligent in obtaining for all managers and the Board of Directors periodic and accurate financial reports from the CFO. The CEO agreed to request regular financial reports from the CFO. These requests were made by the CEO sporadically and in response minimal reports began to be produced periodically. These periodic reports were still insufficient and inadequate. The CFO continued to blame Bay Vista’s conversion from Quick Books accounting software to the newly acquired Rent Manager accounting software, which had been specifically chosen for its accurate property management acumen. This did not seem like a plausible reason for the delay.

Comment 8

However, over a period of approximately the next year and a half, Bay Vista's attorney's repeated requests to both the CFO and the CEO (she initiated meetings with the CEO offsite a minimum of five times for breakfast to make these requests) to renew her request for financial reports on the Bay Vista properties, trust fund balances, payments to GMP and expenditures largely went unanswered. Instead of producing the information, in response a growing sentiment was created among the Bay Vista managers the attorney was uncooperative, demanding, personally attacking the CFO with concerns unrelated to Bay Vista business and the CFO's lack of accountability. This was communicated to her by the CEO. There were also significant periods of time the CFO was absent from the office for serious health related issues.

Finally in February 2011 during preparation for the closing of escrow on The Palms of La Mesa, an 78 unit apartment complex Bay Vista was acquiring, the CFO stated Bay Vista was \$100K short of funds to close. This seemed impossible, as the figures obtained from the CFO during the preparation of the trust fund submission indicated there was more than sufficient money in the trust fund to cover the acquisition. Even though the trust fund submission had been approved and the trust fund authorization form signed by HUD, pursuant to Bay Vista policy, no funds were to be removed from the trust until the close of escrow. While contemplating how to get access to the Comerica trust fund account balances without the CFO's knowledge, weeks later Bay Vista's attorney having negotiated a carry back from the seller for the \$100,000 deficiency, communicated the figure required to close and inquired again of the CFO the balance of the trust fund. At this point the CFO communicated Bay Vista was now \$400,000 short of the funds necessary to close. The weekend following this conversation, Bay Vista's attorney broke into the CFO's desk and verified and identified irregularities concerning the trust fund balance. She immediately informed the director of the HUD LA Multifamily Hub Office.

Bay Vista's independent auditor was scheduled to begin work as the new CFO in a week, thus Bay Vista's attorney having both reported her findings to the HUD LA Multifamily Hub Office and requested guidance, now enlisted the new CFO in determining the status of the trust fund account. What is now evident after OIG's Audit Report, is that limited information and limited access may was given to both the independent accounting firm and independent fraud investigator of both the Bay Vista's trust fund account, operating accounts and the GMP management account by Bay Vista's newly hired CFO.

Despite the findings of the OIG Audit Report there was no formal request by the HUD Los Angeles Office of Multifamily Housing to recapitalize the trust. However, Bay Vista drafted a plan to recapitalize the trust fund account and submitted such along with a plan to implement new procedures to ensure future trust fund withdrawals. Bay Vista has diligently followed that recapitalization plan, making claims to all its insurance carriers, but to date all insurance claims have been denied. Bay Vista has recently requested a subrogation insurance attorney review all of the correspondence between Bay Vista and the insurance companies to whom claims were made for the reimbursement of the \$5M trust funds. Bay Vista does not believe any possibilities for insurance recovery remain unchallenged, but nevertheless continues to pursue all means of recovery.

OIG Evaluation of Auditee Comments

- Comment 1** We agree that Bay Vista attempted to meet its “good faith” 675 unit production goal. However, only 432 affordable housing units were purchased by June of 2012, and due to the sale of Estancia (December 2012), Bay Vista’s production goal decreased to 312 since it was unable to maintain such units. To add clarification, we added “good faith” to the Background and Objectives section of our report.
- Comment 2** Although we cannot speak for the HUD LA Multifamily HUB office, we did note that paragraph E, section 2 of the trust fund agreement outlines procedures HUD intended to implement to aid in the disbursement of trust funds. Please see Appendix C of the audit report for details.
- Comment 3** Although we cannot speak for the HUD LA Multifamily HUB office, it is our understanding that Bay Vista previously had a contentious relationship with HUD. However, Bay Vista could still have developed internal procedures and controls even if there were issues dealing with HUD. In addition, when the new director was installed in January of 2009 and problems with the HUD LA Multifamily HUB office were alleviated, Bay Vista still did not establish adequate operating procedures and controls to prevent further misspending of trust fund monies. Bay Vista cited the former chief financial officer as the cause for all the inappropriate transfers; however, he was not put on administrative leave until September 2011. Bay Vista had ample time to establish operating procedures prior to September 2011 to address its internal control weaknesses.
- Comment 4** Our report cited that Bay Vista lacked proper policies, procedures, and supervision to prevent overspending of its trust accounts. We did not state that Bay Vista had no policies, procedures, and supervision. We agree that Bay Vista had procedures to prepare its trust fund submissions and internal procedures to draw down the funds; however, it lacked the policies, procedures, and supervision to control how the funds were spent once they have been drawn down from the trust account – as noted by Bay Vista’s acknowledgement in the breakdown of procedures.
- Comment 5** We acknowledge Bay Vista’s assertion that the withdrawals were not authorized by Bay Vista but were completed by the former chief financial officer. However, it was Bay Vista’s responsibility to ensure the trust funds were used in accordance with the agreement, including ensuring appropriate procedures and controls were in place to prevent misuse of the funds.
- Comment 6** We agree that Bay Vista attempted to purchase Devonshire, Casa del Sol, Vista Gardens, the Palms of La Mesa, and Plaza del Sol apartments and have stated in the report that Bay Vista intended to purchase such properties. Our report did not

question the fact that Bay Vista attempted to purchase these properties but did question how the funds were actually used.

Comment 7 We disagree. Five of the eight requests that we selected and reviewed were prepared when the former chief financial officer was employed at Bay Vista and the remaining three requests reviewed were prepared after the former chief financial officer was dismissed. We did not review all of the submission requests from when the former chief financial officer was employed at Bay Vista.

Comment 8 We amended our report to state that Bay Vista volunteered to recapitalize its trust.

Appendix C

CRITERIA

1. **Housing Trust Fund Agreement**

Paragraph C, Section 4

Use of Trust Account for Affordable Housing Units: The owner may use the trust account for any expenses related to the predevelopment, acquisition, development, preservation, construction and/or rehabilitation of units intended to be developed as Affordable Housing Units, regardless of whether such Affordable Housing Units are developed or the related transactions closes so long as the owner has proceeded in good faith. Such expenses may include, but shall not be limited to the following:

- a) Predevelopment and development costs
- b) Application fees, loan fees and discounts
- c) Appraisal, consultant, legal, architectural, and engineering fees
- d) Reasonable administrative and office overhead and expenses
- e) Reasonable insurance costs
- f) Fees for consultants assisting in evaluating affordable housing opportunities
- g) Corporate filing fees, franchise, business, and other related taxes
- h) Trustee fees and other fees related to administration of the Trust Account
- i) Costs associated with investigations of the owner and/or the property being conducted by HUD's Office of Inspector General

2. **Housing Trust Fund Agreement**

Paragraph E, Section 2

Disbursement of funds - Using the trust fund authorization form or similar form approved by the parties to this agreement, HUD shall instruct the Depository Bank to disburse funds from the Trust Account only upon and in accordance with a written request, along with supporting documentation, from the owner, which has been approved by HUD, Los Angeles Hub Director. The owner shall make such a request at least 30 days prior to the date such disbursement is desired.

3. **Housing Trust Fund Agreement**

Paragraph F, Section 1

Default -

- a) The owner's failure to use the trust account in accordance with the terms of this agreement or to make materially false statements to HUD concerning the use of the trust amount, shall constitute a default under this agreement. HUD shall provide the owner with written notice of any default under this agreement and a reasonable opportunity of not less than 30 days to cure or explain the alleged default.

b) On the termination of this agreement, HUD Secretary's finding that the owner did not act in good faith.

4. **Housing Trust Fund Agreement**

Paragraph F, Section 2

Remedies - If the owner fails to cure any default of the trust agreement occurring during the term of the agreement, the trust agreement may be terminated by HUD. Upon termination or expiration of this trust, any funds remaining shall be disbursed to a tax exempt corporation selected by the owner and approved by HUD, to be used to acquire, develop, preserve, construct, and or rehabilitation affordable housing units.

5. **Use Agreement**

Paragraph 9, Section c

The books and records, documents and other papers relating to the financial condition of the project shall at all times be maintained in accordance with Generally Accepted Accounting Principles which can be subjected to an audit performed in accordance with Generally Accepted Auditing Standards and shall be subject to examination and inspection at any reasonable time by the Secretary or his duly authorized agents. The Owner shall keep copies of all written contracts or other instruments that affect the Project, all or any of which may be subject to inspection and examination by the Secretary or his agents.

Appendix D

SUMMARY OF PAYMENTS FROM BAY VISTA OPERATING ACCOUNT

Type of expense	Amount
Deposited into payroll account but no supporting documentation explaining the transfer of funds	\$ 1,609,500
Managers' (including three managers who received double pay) and office staff's salaries and health benefits for the period June 20, 2010, to July 16, 2011	\$ 915,611
Trust fund LLC deposits – used to pay for operating expenses of properties, salaries, and management fees to GMP	\$ 608,000
Paychex – salaries for three managers between February 1, 2009, and July 31, 2011	\$ 461,756
Union Bank 4355 – payroll and management distributions	\$ 50,000
Chase 6708 – deposited into payroll account	\$ 50,000
TDR 7412 (operating fund) – GMP's management fees, contract labor, other operating expenses, and manager distributions (including additional transfers to payroll account)	\$ 440,318
HSP 7180 (operating fund) – GMP's management fees, contract labor, other operating expenses, and manager distributions (including additional transfers to payroll account)	\$ 650,915
Estancia 8315 (petty cash fund) – GMP's management fees, contract labor, other operating expenses, and manager distributions (including additional transfers to payroll account)	\$ 777,928
Estancia 8505 (operating fund) – GMP's management fees, contract labor, other operating expenses (includes transfers to payroll account), and manager distributions	\$ 53,290
Union Bank 8414 – Management fees charged for period July 2009 to February 2010 and management distributions	\$ 345,447
Management fees charged directly to Bay Vista operating account	\$ 132,778
Management fees, distributions, and salaries subtotal	\$ 6,095,545
Type of expense	
Bay Vista credit card 6902 – Bay Vista-issued credit card used for personal and business expenses and not reimbursed	\$ 100,060
Type of expense	
Security Business Bank – Lisbon property's mortgage and interest	\$ 117,647
First Republic Bank – Hillside Park's interest and mortgage payments	\$ 285,000
North Island Credit Union – Tierra del Rey's interest and mortgage payments	\$ 135,303
54th Street LLC and PS Business Park – for lease on administrative building previously and currently occupied by GMP and Bay Vista	\$ 53,767
Lisbon 8612	\$ 4,000
Orion – consulting payment of former chief financial officer's assistant	\$ 115,595
Donations to St. Paul's United Methodist Church and Summerbridge Charitable Donation	\$ 34,700
Deposited into 7701 for Internet, supplies, cable, phone charges, etc.	\$ 34,116
Stipends for board members	\$ 7,700
Other operating costs subtotal	\$ 787,828
Total	\$6,983,433³

³ The total payments out of the Bay Vista operating account is not all inclusive of its expenses.