



University Village, LLC, Orem, UT

Section 223(f) Multifamily Program



To: Tom Azumbrado, Regional Director, West Multifamily Region, 9AHMLAP

//signed//

From: Ronald J. Hosking, Regional Inspector General for Audit, 8AGA

Subject: University Village Took Distributions Without Being in a Surplus-Cash Position or Having Prior HUD Approval

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of University Village, LLC, Orem, Utah multifamily section 223(f) program.

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 8M, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at <http://www.hudoig.gov>.

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



Audit Report Number: 2016-DE-1004
Date: September 28, 2016

University Village Took Distributions Without Being in a Surplus-Cash Position or Having Prior HUD Approval

Highlights

What We Audited and Why

We audited University Village Apartments in Orem, UT because the U.S. Department of Housing and Urban Development (HUD) had found ineligible withdrawals and substandard physical conditions at the property. Our objective was to determine whether University Village complied with its HUD multifamily Federal Housing Administration regulatory agreement when taking distributions.

What We Found

University Village took unauthorized distributions without being in a surplus-cash position or having prior HUD approval. It took nine unauthorized distributions from April 2014 to March 2016 totaling more than \$305,000.

What We Recommend

We recommend that the Director of HUD's Denver Office of Multifamily Housing Programs require University Village to (1) repay the project \$305,351 for the unauthorized distributions and (2) develop and implement policies for owner distributions to ensure that it complies with its regulatory agreement.

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Background and Objective

University Village Apartments is an 83-unit, three-story family apartment project located at 1270 South Sandhill Road in Orem, UT, and owned by University Village, LLC. The company has two managing members who have an equal share in the ownership of the property. The managing members also own Stonecrest Group, LLC, which manages the property and the managing member's other non-Federal Housing Administration (FHA)-insured properties. FHA insurance fund insures lenders against mortgage default loss and facilitates the purchase or refinancing of existing multifamily housing. The program allows for long-term mortgages (up to 35 years) that can be financed with Government National Mortgage Association (GNMA) Mortgage-Backed Securities. This eligibility for purchase in the secondary mortgage market improves the availability of loan funds and permits more favorable interest rates.

The owners originally purchased the subject property in August 2005 for \$4.5 million. In May 2012, the company received an FHA section 223(f) cash-out refinance loan in the amount of \$4.52 million. During the loan closing, the managing members executed a regulatory agreement with the U.S. Department of Housing and Urban Development (HUD) in which they agreed to be bound by the terms and conditions of the regulatory agreement for a mortgage loan insured by FHA. These terms include certain restrictions on taking owner distributions from project funds.



One of the regulatory agreement restrictions states the project can only take distributions at certain times of the year, and only after a HUD-designed computation shows that there is 'extra' cash that can be taken as distributions, and only up to that calculated amount.

Our audit objective was to determine whether University Village complied with its HUD multifamily FHA regulatory agreement when taking distributions.

Results of Audit

Finding : University Village Took Unauthorized Distributions

University Village took distributions without being in a surplus-cash position or having prior HUD approval. This condition occurred because University Village lacked controls over the distribution of surplus cash and did not fully understand the rules for taking surplus cash. As a result, more than \$305,000 was unavailable to help maintain the property, which recently failed a HUD physical inspection.

University Village Took Unauthorized Distributions

University Village took distributions without being in a surplus-cash position or having prior HUD approval. According to University Village’s regulatory agreement with HUD,

1. Any distributions of funds require prior written approval from HUD.
2. HUD allows distributions of project funds only after the end of a semiannual or annual fiscal period and only in an accounting period immediately following the computation of surplus cash.

On October 26, 2015, HUD’s Departmental Enforcement Center notified University Village that it had taken \$41,898 in unauthorized distributions. On November 5, 2015, University Village paid HUD back its project funds for the unauthorized distributions identified. However, we identified nine additional unauthorized distributions to the owners or to a non-project bank account totaling more than \$305,000. The regulatory agreement requires that University Village take distributions only from surplus cash and deposit all funds into an account in the project’s name. University Village deposited the unauthorized distributions in the Stonecrest Group money market account instead of the dedicated University Village project account.

Table 1 outlines the dates and amounts of the distributions:

Table 1

Date	Amount	Description
4/10/2014	\$8,380	Distribution - for owner note
5/12/2014	8,380	Distribution - for owner note
12/17/2014	10,000	Distribution - Stonecrest
4/13/2015	30,000	Transfer to Money Market
5/26/2015	37,195	Distribution - for owner note
7/15/2015	24,396	Distribution
7/15/2015	42,000	Distribution

12/10/2015	45,000	Transfer to Money Market
3/16/2016	100,000	Transfer to Money Market
Total	305,351	

For the distributions listed above, University Village did not complete the required surplus-cash computation or obtain prior HUD approval before taking the distributions. HUD’s Real Estate Assessment Center (REAC) reviews the annual computation of surplus cash and may require additional information or corrections before approving distributions. Table 2 shows the REAC reviewed annual surplus-cash computation from 2012 to 2015 for University Village.

Table 2

Computation year	Surplus cash (deficiency)
2012	\$(56,121)
2013	(39,605)
2014	(38,459)
2015	73,860

From 2012 to 2014, University Village was in a negative-cash surplus position; therefore, it could not take distributions. At the end of 2015, University Village was in a surplus-cash position, which normally would allow it to make a distribution in 2016. However, it could not take distributions until it repaid all of its unauthorized distributions from previous years.

University Village Lacked Controls Over the Distribution of Surplus Cash

University Village lacked controls over the distribution of its surplus cash. Specifically, it lacked controls to ensure that it completed the required surplus-cash computations before making owner distributions and made owner distributions only when in a surplus-cash position. The project accountant stated that University Village was generally aware of the distribution requirements in the regulatory agreement but did not fully understand the rules for taking surplus cash.

Project Funds Were Unavailable for Required Repairs

More than \$305,000 was unavailable to help maintain the property, which recently failed a HUD physical inspection. On June 19, 2014, REAC assessed an inspection score of “68c*.” Any score below 79 requires an annual inspection. The “c” in the score represents at least one life-threatening health and safety deficiency, while the “*” denotes at least one inoperable smoke detector. HUD performed another inspection of the property on August 6, 2015, and assessed an inspection score of “42c*.” All inspections with a score of 59 and below are subject to referral to HUD’s Departmental Enforcement Center (DEC). The DEC manages the day-to-day recovery and enforcement strategies for selected high-risk properties. They work directly with owner to achieve compliance with property physical assessment requirements. University Village could have used the \$305,000 in unauthorized distributions to address maintenance deficiencies identified by HUD.

Finally, if the owners continue to not comply with the surplus cash distribution requirements outlined in the regulatory agreement, then they are subject to criminal penalties, civil liability, and administrative sanctions.

Recommendations

We recommend that the Director of HUD's Denver Office of Multifamily Housing Programs require University Village to

- 1A. Repay the project \$305,351 for the unauthorized distributions from non-project funds.
- 1B. Develop and implement policies for owner distributions to ensure compliance with its regulatory agreement.

Scope and Methodology

Our audit work covered University Village, LLC's records from 2012 to 2016. We performed our work between May and June 2016 at the management office located at 1800 North State Street, Provo, UT.

To accomplish our objective, we

- Reviewed background information and applicable laws and regulations.
- Reviewed various reports and documents to determine the financial and physical unit conditions of the project. The reports and documents included information contained in HUD's Real Estate Management System and documents maintained by the multifamily project manager assigned to monitor the project.
- Performed a walk-through inspection of the exterior of the project and reviewed HUD inspection reports to determine the project's overall physical condition.
- Reviewed the reserves for replacement account.
- Reviewed the FHA section 223(f) cash-out refinance loan documentation.
- Reviewed all bank statements associated with the project from 2012 to 2016.
- Reviewed the 2012, 2013, and 2014 audited financial statements.
- Interviewed the managing member and chief financial officer of University Village, LLC.
- Interviewed HUD staff responsible for the program.

Using University Village, LLC's bank records from May 2012 to March 2016, we identified a total of 94 financial transfers to and from the project account totaling \$1.87 million. We determined that the greatest risk for unauthorized distribution by the auditee would be in those financial transactions that were greater than or equal to \$1,500. We reviewed the 63 financial transfers meeting those criteria. The 63 transactions totaled \$1.73 million, or 96 percent of all transfers. We did not use statistical sampling due to the small number of transactions; therefore, the results apply only to the 63 financial transfers reviewed.

We did not rely on computer-generated data as audit evidence or to support our audit conclusions. We based all of our conclusions on source documentation reviewed during the audit. We also used source documentation obtained from HUD and the auditee for background information purposes.

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(s). 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:

- Controls over compliance with Regulatory Agreement that have been implemented to reasonably ensure that purchasing activities, record keeping, payments to vendors, and income-reporting activities comply with applicable laws and regulations.

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:

- University Village did not have controls to ensure that distributions complied with applicable laws and regulations.

Appendixes

Appendix A

Schedule of Questioned Costs

Recommendation number	Ineligible 1/A
1A	\$305,353
Totals	305,353

- 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.

Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

Comment 1

Comment 2

Comment 3

Comment 4

Comment 5

Comment 6

University Village, LLC

1270 S Sandhill Rd, Orem, UT 84604
PO Box 970070, Orem, UT 84697 Bookkeeper@CrestwoodApts.com (801) 374-4770

September 21, 2016

TO WHOM IT MAY CONCERN:

Re: Response to HUD Audit findings

Unauthorized distributions:

We had understood that it was acceptable to make payments on the owner's note. In May of 2014 we were told to make no further payments and to repay distributions of \$41,898. We did so.

As part of the mortgage approval process in 2012 we were asked to provide banking records for checking and the savings for deposits and extra funds. The checking account is under the name of University Village, LLC and the Savings is a Money Market account under the name of Stonegate Group, LLC, a sister company. We were not asked to make any changes. After closing we used the accounts for only University Village transactions.

The \$10,000 paid in December 2014 was a portion of invoice #1153 of \$21,134.10 dated November 30, 2014. There were two payments; one for \$10,000 and another for \$11,134.10.


In 2015 we used the surplus cash form, determined we had surplus cash position and took distributions. According to an email from our HUD contact, we do not need to supply the form to her. She reviews the forms at year end only. This was prior to the failed inspection.

Failed Inspection and project funds:

On August 4, 2015 the inspector reviewed the property. He said that he didn't normally do inspections, but they were shorthanded. He noticed there were no blanks covering the unused portions in the electrical panels in each unit and maintenance area. This was our fourth HUD inspection. The electrical panels had been in this condition since we purchased the property and had passed all previous inspections for HUD and fire inspectors. He listed each of these as a Health and Safety violation, which resulted in a very low score on the inspection report. There were few other items or repairs noted. We went through each unit and put a blank cover in all electrical boxes within three days after the inspection.

In the audit report it says the unauthorized distributions contributed to the "maintenance deficiencies identified by HUD." We disagree with that statement. We repaired everything listed on the inspection list within the month. Also, at the end of the year there was \$57,599 in checking and \$105,271 in the money market. This is not a shortage.

Sincerely,



Ruth Ann Andreason
Financial Controller

OIG Evaluation of Auditee Comments

- Comment 1 The regulatory agreement states that the project can take distributions only from surplus cash. Making payments on an owner's note is a distribution and therefore not authorized because the project was not in a surplus cash position until 2015.
- Comment 2 The regulatory agreement requires the project to deposit its funds into a University Village account. Although the project provided a list of bank accounts during the underwriting process, it did not have approval to deposit project funds into a non-project account. Transferring or depositing funds into the Stonecrest Group account from the project is considered a distribution.
- Comment 3 During our review, we found that the \$10,000 was a distribution taken from the project account. University Village can work with HUD to show this went to authorized project expenses.
- Comment 4 As stated in the finding, the project cannot take distributions until it has repaid all of its unauthorized distributions from previous years. While the project might not have realized it had outstanding unauthorized distributions, it is the project's responsibility to ensure compliance with its regulatory agreement. If HUD later determines the project made unauthorized distributions prior to the surplus cash distribution, the owners must repay the prior unauthorized distributions and then recalculate its surplus cash position.
- Comment 5 University Village can work with HUD to clear the physical inspection discrepancies.
- Comment 6 It is our stance that if the project had not taken the unauthorized distributions it could have used those funds to better maintain the project.