



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

2012-FW-1805

August 24, 2012

Memorandum

TO: Dane M. Narode,
Associate General Counsel for Program Enforcement, CACC

//signed//

FROM: Gerald R. Kirkland
Regional Inspector General for Audit, Fort Worth Region, 6AGA

SUBJECT: Final Civil Action: Bartlesville Health Care Center, Inc., Owners and Lender
Settled Alleged Violations of the False Claims Act

INTRODUCTION

Based on a request by the U.S. Department of Housing and Urban Development's (HUD) multifamily housing Kansas City hub office, we started an audit of three related nursing facilities in August 2008:

- Bartlesville Health Care Center, Inc., doing business as Silver Lake Care Center;
- Mannford Health Care Center, Inc., doing business as Cimarron Pointe Care Center; and
- Owasso Nursing Center, Inc., doing business as Sequoyah Pointe Living Center.

HUD alleged that the lender and owners misused the Section 232-223(f) refinancing program. Our initial audit objective was to determine whether the owners of Bartlesville, Mannford, and Owasso and the multifamily accelerated processing lender, Harry Mortgage, followed HUD requirements when refinancing the nursing facilities' mortgages. While performing audit work, we developed findings that warranted involvement by the U.S. Department of Justice (DOJ). We presented our findings to HUD's Office of General Counsel and DOJ.¹ The owners defaulted on the Bartlesville mortgage. HUD paid the mortgage insurance claim and sold the mortgage at

¹ This action was consistent with the Office of the Inspector General's initiative to pursue civil matters through HUD's Office of General Counsel and DOJ.

auction.² We worked with the Office of General Counsel's Office of Program Enforcement and DOJ to pursue the findings civilly.

SCOPE AND METHODOLOGY

To accomplish our objective, we

- Reviewed lender and HUD-Federal Housing Administration (FHA) mortgage documentation,
- Subpoenaed and reviewed each nursing facility's second mortgage documentation before the FHA refinance,
- Reviewed relevant Federal regulations including HUD handbooks and guidebooks,
- Interviewed each nursing facility's current and former owners, and
- Interviewed HUD and lender staff.

BACKGROUND

Bartlesville, Mannford, and Owasso were nursing facilities insured by FHA under Section 232 of the National Housing Act pursuant to the 223(f) program, which allows for the purchase or refinance of an existing nursing facility without substantial rehabilitation. Under the program, HUD would suffer any losses if the property went into default and subsequent foreclosure. In exchange for this insurance, the owners agreed to operate the property in accordance with a regulatory agreement. The 223(f) program had a "no cash out provision," meaning that owners could not receive funds when they refinanced their mortgages with FHA insurance. J. Max Jiles and Philip M. Green³ shared 50 percent ownership in Bartlesville and Mannford. Jiles, Green, and Gilbert Green, the father of Philip M. Green, shared ownership in Owasso.⁴ The owners refinanced each nursing facility with an FHA-insured loan:

- Bartlesville on March 11, 2004, for \$3.655 million;
- Mannford on April 16, 2004, for \$3.5 million; and
- Owasso on March 5, 2004, for \$3.315 million.

The HUD-approved multifamily accelerated processing lender was Harry Mortgage. The underwriter was Virgil M. Harry, Jr. The multifamily accelerated processing program allowed approved lenders to underwrite loans for Section 232-223(f) properties with HUD review and approval. Harry Mortgage is no longer in business.

RESULTS OF REVIEW

Less than 1 year before the FHA-insured refinance, Bartlesville obtained a non-FHA-insured second mortgage to pay its owners \$2.6 million. Harry Mortgage improperly included the second mortgage in the FHA-insured refinance and did not properly perform the required

² As of August 10, 2012, the owners were current on their mortgages for Mannford and Owasso.

³ HUD approved these individuals as owners.

⁴ Jiles owned 50 percent, while the Greens owned 25 percent each.

financial analysis. In addition, Harry Mortgage did not ensure that the refinance met the intent of the program to reduce the interest rate and debt service. Harry Mortgage should not have recommended to HUD that FHA insure this mortgage. As a result, the FHA-insured refinance mortgage inappropriately increased the risk to FHA's insurance fund, and the owners received approximately \$2.6 million at the time when they refinanced the nursing home with FHA insurance.

The Owners Inappropriately Received More Than \$2.6 Million From Mortgage Proceeds

The owners inappropriately received more than \$2.6 million by refinancing their non-FHA-insured mortgages with an FHA-insured mortgage. On June 27, 2003, Bartlesville's owners took out a \$3.183 million second mortgage against the property.⁵ This mortgage had a maturity date of 6 months with a lump-sum repayment. The mortgage proceeds remained in the bank in the form of certificates of deposit payable to the Bartlesville owners and guaranteeing the mortgage's repayment pending the FHA-insured refinance of the mortgage. On November 6, 2003, the owners reduced the second mortgage by \$600,000, leaving a balance owed of \$2.583 million.

Although Bartlesville created the second mortgage on June 27, 2003, it did not record the mortgage in its financial records until October 31, 2003. Before Bartlesville placed this debt upon the property, it had a total debt of \$811,376. Bartlesville received the FHA-insured mortgage of more than \$3.655 million on March 11, 2004. The FHA-insured mortgage paid off both the first mortgage, \$589,739, and the second mortgage, taken out less than a year earlier and used as a device to pay themselves cash distributions.

The Second Mortgage Was Improperly Included

The September 30, 2003, financial statements submitted by the owners did not include the \$3.183 million second mortgage created in June 2003. However, since the second mortgage was included in the refinance, Harry Mortgage was or should have been aware of the second mortgage. According to HUD requirements,⁶ Harry Mortgage was not to recognize debt recently placed against Bartlesville that increased the mortgage or circumvented program intent. Further, HUD requirements prohibited the owners from taking out equity when they refinanced the loan.⁷ The owners used the second mortgage, which was issued by a bank owned by one of the owners, to improperly increase the mortgage for the sole purpose of receiving cash as a result of the FHA refinancing, in direct violation of HUD's no cash out rule.

The Financial Analysis Was Inadequate

In addition to improperly including the second mortgage, Harry Mortgage failed to perform an adequate financial analysis. The Multifamily Accelerated Processing (MAP) Guide required

⁵ The stated purpose of the second mortgage was capital improvement; however, the second mortgage as a device to pay themselves cash distributions.

⁶ MAP Guide, paragraph 8.9.E.6

⁷ MAP Guide, paragraph 3.11.J

Harry Mortgage to determine Bartlesville's present liquidity and future financial capacity.⁸ These financial analytical tools, if used properly, would have helped Harry Mortgage and HUD to determine whether Bartlesville would have been able to pay its current debts and sustain its business to pay its long-term debts. However, Harry Mortgage did not include all debt and address the liquidity issues within its underwriting narrative.⁹ Without an accurate financial analysis, Harry Mortgage did not make a sound underwriting decision as to whether Bartlesville would have been an acceptable risk for HUD.

In addition to failing to properly perform a financial analysis, Harry Mortgage did not obtain the required supporting schedules, specifically, a notes and mortgages payable schedule. HUD required¹⁰ that the notes and mortgages payable schedule include the name, type of account, payment terms, maturity date, current portions, past-due amounts, and noncurrent amount. If Harry Mortgage had obtained this schedule, HUD may have become aware of the second mortgage that was not eligible to be included in the refinance.

The FHA-Insured Mortgage Failed To Meet Program Intent

Harry Mortgage also failed to determine whether the refinance met the intent of the program. HUD describes the intent of the program as lowering the interest rate, reducing the debt service, and making needed repairs.¹¹ Contrary to the program intent, the FHA-insured mortgage contained a higher interest rate and higher debt service than both the first and second mortgages. Additionally, the amount of needed repairs listed was only \$1,065. This amount did not justify increasing the mortgage debt amount by \$2.6 million. Even though Harry Mortgage had the responsibility to follow regulations as an approved multifamily accelerated processing lender, the owners carried the responsibility to provide complete and accurate information.

The Civil Process

Bartlesville's owners defaulted on its mortgage in December 2008. Column Guaranteed¹² submitted a mortgage insurance claim to HUD in March 2009. HUD paid claims totaling more than \$3.2 million. In December 2009, HUD sold Bartlesville's mortgage at auction for around \$620,000.¹³

On July 22, 2010, HUD's Office of Program Enforcement formally requested that DOJ file suit against an owner and the underwriter of Bartlesville based on our audit work. Although the request included only one owner, both owners and the underwriter settled the allegations for a total of \$5.325 million on July 30, 2012.¹⁴ The settlement agreements contained neither an admission of liability by the owners and underwriter nor a concession by the United States that

⁸ MAP Guide, paragraph 8.4.A.2

⁹ The lender noted only net income in its financial analysis.

¹⁰ MAP Guide, paragraph 8.4.B.2

¹¹ MAP Guide, paragraph 3.11.J

¹² Column Guaranteed became the owner of the loan on September 1, 2007.

¹³ An owner's son purchased Bartlesville's mortgage at auction.

¹⁴ The settlement included the false claim on Bartlesville and one count of violating provisions of the Financial Institutions Reform, Recovery, and Enforcement Act for each nursing facility.

its claims were not well founded. HUD will receive more than \$2.644 million to cover its losses, with the remaining amount going to the U.S. Department of the Treasury.

The Mannford and Owasso nursing facilities had transactions similar to those of Bartlesville. The owners received distributions amounting to \$2.4 million for Mannford and \$1.3 million for Owasso. As of August 10, 2012, Mannford and Owasso were still in operation, and the mortgage payments were current.

DOJ's Civil Division, Frauds Section and HUD's Office of Program Enforcement were instrumental in resolving the findings on Bartlesville. Without their knowledge and willingness to engage the issue, FHA's insurance fund would have lost more than \$2.6 million. The negotiated settlements reimbursed HUD for its loss, with additional funds going to the U.S. Department of the Treasury, and will allow HUD to seek recourse, if necessary, concerning Mannford and Owasso.

Conclusion

Harry Mortgage and the owners did not follow HUD rules and regulations when applying for FHA insurance on Bartlesville. Harry Mortgage inappropriately included the second mortgage in the refinance, failed to perform a sufficient financial analysis, and did not ensure that the mortgage was within the intent of the program. Harry Mortgage is no longer a HUD-approved multifamily accelerated processing lender. In addition, the owners did not disclose accurate financial statements showing the creation and use of the second mortgage. As a result, HUD lost more than \$2.6 million due to the owners' and lender's actions.

Through the civil settlement, the Government will receive \$5.325 million from the owners and lender. HUD will receive \$2.644 million, the amount it lost on the sale of the note,¹⁵ and the U.S. Department of the Treasury will receive \$2.680 million.

RECOMMENDATION

We recommend that HUD's Office of General Counsel, Office Program Enforcement,

- 1A. Allow HUD OIG to post the \$2,644,089 settlement to HUD's Audit Resolution and Corrective Actions Tracking System.

¹⁵ This amount includes the insurance claim of more than \$3.2 million minus the amount recovered at the mortgage auction of around \$620,000.