UNITED STATES OF AMERICA
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
OFFICE OF HEARINGS AND APPEALS

In the Matter of:

MANTUA GARDENS EAST, INC.,
JAMES H. GRIER,

Respondents.

HUDALJ 12-F-043-CMP-3

February 1, 2013

INITIAL DECISION AND ORDER

On January 9, 2012, the U.S. Department of Housing and Urban Development ("HUD" or the "Government") served Mantua Gardens East, Inc. and James H. Grier (collectively, "Respondents") with a Pre-penalty Notice advising Respondents that HUD was considering levying civil money penalties against them for alleged violations of 12 U.S.C. § 1735f-15, 42 U.S.C. § 1437z-1(b), and their respective implementing regulations. HUD filed the threatened *Complaint* on May 15, 2012, alleging 99 separate violations and seeking penalties of just under $1.6 million. Respondents filed an initial *Answer* on June 15, 2012, and an expanded *Answer* on July 3, 2012. A hearing was conducted from September 10-12, 2012, in Philadelphia, Pennsylvania. Both parties filed Post-Hearing Briefs on November 30, 2012.

STATUTORY AND REGULATORY BACKGROUND

Under specific circumstances, the Government may impose a civil money penalty of up to $37,500 on the mortgagor of a property that includes five or more living units and that has a mortgage insured, co-insured, or held pursuant to the National Housing Act of 1937. 12 U.S.C. § 1735f-15(c)(1)(A)(i); 24 C.F.R. § 30.45. The same penalties may also be assessed against an officer or director of such a mortgagor. 12 U.S.C. § 1735f-15(c)(1)(A)(iii); 24 C.F.R. § 30.45(c)(3).[1]

Section 1735f-15(c) identifies several actions that would render a mortgagor liable for civil money penalties. Among these violations are the knowing and material:

[1] On January 18, 2013, HUD published a final rule increasing the amount of several civil money penalties pursuant to the Federal Civil Penalties Inflation Act of 1990, 28 U.S.C. § 2461. See 78 FR 4057. The new rule, effective February 19, 2013, increases the maximum potential civil penalty for violations under 24 C.F.R. § 30.45 from $37,500 to $42,500; and increases the maximum penalty for violations under 24 C.F.R. § 30.68 from $25,000 to $27,500. The rule has no effect on the instant proceeding, as it only applies to violations that occur after the February 19, 2013, effective date.

1. Conveyance, transfer, or encumbrance of the property without prior written approval by HUD. 12 U.S.C. § 1735f-15(c)(1)(B)(i).

2. Assignment, transfer, disposition, or encumbrance of the property's personal assets, including rents and other revenues. 12 U.S.C. § 1735f-15(c)(1)(B)(ii).

3. Failure to provide HUD with complete annual financial reports, including audited reports when required. 12 U.S.C. § 1735f-15(c)(1)(B)(x).

4. Failure to provide a project manager that is acceptable to HUD. 12 U.S.C. § 1735f-15(c)(1)(B)(xiv).

HUD may also impose civil money penalties on the owner of a property that receives project-based assistance under Section 8 of the National Housing Act, 42 U.S.C. § 1437f ("Section 8"); 42 U.S.C. § 1437z-1(b)(1)(A); 24 C.F.R. § 30.68(b). HUD may impose a maximum civil money penalty in the amount of $25,000 on any owner that knowingly and materially breaches a housing assistance payments contract. 42 U.S.C. § 1437z-1(b)(2)-(3); 24 C.F.R § 30.68(b)-(c).

The term "knowing" or "knowingly" is defined at 24 C.F.R. § 30.10 as "having actual knowledge of or acting with deliberate ignorance of or reckless disregard" for prohibitions that give rise to civil money penalty liability. The term "material" or "materially" is defined to mean "having the natural tendency or potential to influence," or "in some significant respect or to some significant degree." 24 C.F.R. § 30.10.

PROGRAM BACKGROUNDS

The Government alleges that civil money penalties against both Respondents are authorized because Respondents have failed to honor their obligations as participants in the Section 236 Program. The Program was initiated in 1968 to improve housing options for low-income families. 12 U.S.C. § 1715z-1(a). Under the Program, the Federal Housing Administration ("FHA") insures loans to private developers in exchange for a commitment to provide low-income housing through the life of the agreement. As part of the Program, HUD also tenders monthly interest reduction payments ("IRPs") to FHA-approved mortgagees on behalf of the developer/mortgagor, thereby reducing the mortgagor's interest payment to 1%. The HUD Secretary "is authorized to make such rules and regulations, to enter into such agreements, and to adopt such procedures as he may deem necessary or desirable" to ensure the success of the Program. 12 U.S.C. § 1715z-1(h).

Once a mortgage agreement has been entered into, it can only be terminated by prepayment or voluntary agreement between the mortgagor and HUD. 24 C.F.R. § 207.253. Prepayment of the mortgage terminates the mortgage contract as of the date of the prepayment, provided HUD receives at least 30 days' notice of the prepayment. 24 C.F.R. § 207.253(a). However, even if HUD does receive such notice in a timely manner, it must reject the prepayment if it determines that the property is still serving a need for low-income rental housing in the area. 12 U.S.C. § 1715z-15(a)(1). A determination that low-income housing remains necessary will also prevent HUD from accepting a voluntary termination request. Id. A mortgage contract may also be terminated if the property is conveyed to the FHA Commissioner. 24 C.F.R. § 207.253a.

The Government also alleges that Respondents have violated the terms of a Housing Assistance Payments ("HAP") Contract. As part of the Project-Based Voucher Program, HUD subsidizes tenants' rents by making Housing Assistance Payments to participating multifamily project owners on behalf of tenants. 42 U.S.C. § 1437f. In exchange, project owners execute a HAP Contract that establishes the amount of HAP subsidies and sets forth other requirements. The length of a specific HAP Contract may be negotiated between the project owner and HUD. The contract expires at the end of its term unless the project owner elects to renew it. However, the owner must notify all subsidized tenants, HUD, and the contract administrator of the contract's termination at least one year prior to the termination date. 42 U.S.C. § 1437f(c)(8)(A); 24 C.F.R. § 402.8(a). An owner who fails to provide the necessary notification is prohibited from raising rents until one year has elapsed from the date of the notification. 42 U.S.C. § 1437f(c)(8)(B); 24 C.F.R. § 402.8(a).

FINDINGS OF FACT

The Court has considered all matters presented by the parties, including the *Complaint*, the *Answer*, the exhibits, the testimony at hearing, and the post-hearing submissions by the parties. Based on a thorough and careful analysis of the entire record, the Court finds the facts as described below and further finds and takes cognizance of facts as described elsewhere in this *Initial Decision and Order*.

1. Respondent Mantua Gardens East, Inc. ("Respondent MGE, Inc.") is a non-profit corporation that was formed under the laws of the state of Delaware under the name Friends Housing, Inc. The corporation is registered in Pennsylvania as a foreign non-profit corporation whose purpose is to provide low-cost housing.

2. Friends Housing, Inc. changed its name to Mantua Gardens East, Inc. at some point in the early 1980s.

3. Respondent Grier has been president and chairman of the board of MGE, Inc. since the early 1980s. The corporation has four other board members, who are all tenants of the Mantua Gardens East Project (the "Project") and are all appointed by Respondent Grier. None of the other board members perform any official functions on behalf of MGE, Inc.

4. The Mantua Gardens East Project consists of 52 units in 19 row houses scattered within the Mantua neighborhood of Philadelphia, Pa.

5. On December 30, 1970, Respondent MGE, Inc. (then known as Friends Housing, Inc.) obtained a $720,000 loan from FHA (the "FHA Loan"). In exchange for the loan, Respondent MGE, Inc. executed a mortgage note ("Note") that was secured by a mortgage on the project property.

6. The Note's maturity date was May 1, 2012.

7. The Note required monthly mortgage payments of $5,279.75, which included interest payments at the annual rate of 8.5%. As part of the Section 236 Program, HUD made IRPs on behalf of Respondent MGE, Inc., leaving Respondent MGE, Inc. with an annual interest rate of 1%.

8. The mortgagee servicing the FHA Loan was First Federal Savings and Loan Association ("First Federal"), which later became Firstrust Savings Bank ("Firstrust"). Both First Federal and Firstrust were FHA-approved mortgagees authorized to receive IRPs from HUD.

9. Contemporaneously with executing the Note, Respondent MGE, Inc. entered into a Regulatory Agreement with HUD.

10. The Regulatory Agreement required Respondents to provide housing only to low-income families, as defined by HUD.

11. The Regulatory Agreement also required Respondents to maintain a "reserve for replacement" fund ("Reserve Account"), controlled by Firstrust. Funds from the Reserve Account were to be used to pay for repairs and maintenance at the Project, and could only be withdrawn with HUD's written consent.

12. The Regulatory Agreement prohibited Respondents from conveying, transferring, or encumbering any of the Project's real property without prior written approval from HUD. It also prohibited Respondents from assigning, transferring, disposing of, or encumbering the Project's personal property without prior approval.

13. The Regulatory Agreement required Respondents to hire a project manager that was satisfactory to HUD.

14. HUD tendered a total of $1,359,208.38 in IRPs on behalf of Respondent MGE, Inc. between 1976 and 2008.

15. On July 29, 1983, Respondent MGE, Inc. executed a Financial Assistance Contract in exchange for a $210,174 Flexible Subsidy Loan ("Flex Loan") issued by HUD.

16. The Financial Assistance Contract included a Residual Receipts Note and a Use Agreement. All three documents were signed by Respondent Grier.

17. The Residual Receipts Note obligated Respondents to repay the Flex Loan in full when the FHA Loan matured or was prepaid.

18. The Financial Assistance Contract obligated Respondents to continue to operate the project in accordance with Section 236 Program regulations until July 1, 2011.

19. The Use Agreement required that Respondents operate the project in accordance with Section 236 Program regulations until July 2011, even if the Regulatory Agreement was terminated prior to that date.

20. Respondents were subject to the Section 236 Program regulations either via the Regulatory Agreement, the Financial Assistance Contract, or the Use Agreement. By signing the Financial Assistance Contract and the Use Agreement, Respondents were bound to comply with the Section 236 Program regulations until July 2011, regardless of the status of the Regulatory Agreement.

21. On July 20, 1983, Respondent MGE, Inc. executed a HAP Contract with HUD in which HUD would provide project-based rental subsidies for the Project's Section 8 tenants.

22. The original HAP Contract was for a term of five years, and was renewed consistently until June 2011.

23. Respondent MGE, Inc. received $4,807,926 in HAP payments between 1983 and 2011.

24. On November 1, 2005, Respondent Grier sent Firstrust a letter seeking Firstrust's assistance in voluntarily terminating the Regulatory Agreement. The letter stated that "[i]t is our interest to expand the mission of the corporation to include other activities than solely providing housing," and noted that Respondents wished to "free the Project of the [Regulatory Agreement]."

25. Some time prior to June 2006, Firstrust filed an Insurance Termination Request ("Termination Request") with HUD on behalf of Respondent MGE, Inc., seeking voluntary termination of the mortgage. The request was denied by HUD on July 3, 2006.

26. Respondent Grier exchanged correspondence with Firstrust on numerous occasions in 2007 seeking alternative methods to extricate Respondents from the obligations imposed by the Regulatory Agreement.

27. In an e-mail to Firstrust, dated October 12, 2007, Respondent Grier stated that "[W]e have signed and will honor a Use Agreement governing the Project to 2010. The Use Agreement states that we are required to do this even if the mortgage insurance…"[2]

28. On January 29, 2008, Respondent Grier sent Firstrust a letter requesting that Firstrust deposit $325,000 from the Reserve Account into an account at Wachovia Bank ("Wachovia Account"). Respondent Grier did not have HUD's permission to remove the funds from Firstrust.

29. Firstrust transferred the funds from the Reserve Account to the Wachovia Account on or about February 7, 2008, leaving the Reserve Account with $38,714.22.

30. Respondent Grier asked Firstrust not to inform HUD or Respondents' management company about the transfer.

31. Respondent MGE, Inc. entered into a Security Agreement with Wachovia on February 13, 2008, using funds from the Wachovia Account as collateral for a $325,000 loan ("First Wachovia Loan").

32. On February 21, 2008, Respondent Grier formed Mantua Gardens East, LLC ("MGE, LLC"). Respondent Grier was the lone shareholder. MGE, LLC never sought or received approval to be a FHA-approved mortgagee.

33. Respondent MGE, Inc. used the $325,000 First Wachovia Loan to loan approximately $170,000 to MGE, LLC. Respondent Grier has refused to disclose the whereabouts of the approximately $155,000 remaining from the First Wachovia Loan, citing his Fifth Amendment right against self-incrimination.

34. On February 25, 2008, Respondent Grier, acting as Managing Member for MGE, LLC, sent Firstrust a cashier's check for $170,218.28 "in full payment for the purchase of the above referenced Mortgage Loan as agreed." The letter that accompanied the cashier's check was on MGE, LLC letterhead and listed Respondent Grier as Managing Member and MagnoliaBECTON Scholarship Fund as the only other member.

35. MagnoliaBECTON Scholarship Fund does not exist, and did not exist on the date the letter was sent. Respondent Grier is and always has been the only member of MGE, LLC.

36. Respondents did not have prior HUD approval to use the Reserve Account funds as collateral for the First Wachovia Loan. HUD also did not consent to the sale of

[2] The abrupt end of this sentence is as it appears in the original e-mail. The context clues suggest the sentence was intended to conclude with "even if the mortgage insurance terminates," or some similar sentiment. Additionally, Respondent Grier's reference to the year 2010 in the e-mail is erroneous. The Use Agreement bound Respondents until 2011.

the mortgage to MGE, LLC, or the $170,000 loan to MGE, LLC that made the sale possible.

37. Respondent MGE, Inc. was required to make payments on the FHA Loan — in the amount of approximately $5,200 per month — to MGE, LLC, as the new mortgagee.

38. MGE, LLC was required to pay approximately $1,800 per month to MGE, Inc. as repayment of the $170,000 loan from MGE, Inc.

39. From February 2008 until May 2012, MGE, LLC received a net monthly gain of approximately $3,400 from Respondent MGE, Inc., for a total of approximately $224,400. Respondent Grier has refused to disclose the whereabouts of this income, citing his Fifth Amendment right against self-incrimination.

40. MGE, LLC is not an FHA-approved mortgagee, and so could not receive IRPs from HUD. As a result, MGE, Inc.'s mortgage interest rate increased from 1% to 8.5%.

41. On April 7, 2008, Respondent Grier executed an Open-End Mortgage and Assignment of Rents in exchange for a $50,000 loan from Wachovia ("Second Wachovia Loan"). As collateral for the loan, Respondent Grier pledged the building located at 610 N. 32nd Street, and its associated "estates, rights, tenements, hereditaments, privileges, rents, issues, profits, easements, and appurtenances of any kind…."

42. The building located at 610 N. 32nd Street is part of the Mantua Gardens East Project.

43. Respondent Grier did not have HUD's written approval to encumber the building or its property.

44. Respondent Grier has refused to disclose what became of the $50,000 from the Second Wachovia Loan, citing his Fifth Amendment right against self-incrimination.

45. Respondent Grier has acknowledged that he personally received a $50,000 "loan" from Respondent MGE, Inc. using proceeds from the First Wachovia Loan, as payment for an unrelated building project. Respondent Grier approved the loan on behalf of Respondent MGE, Inc.

46. Respondent Grier has acknowledged that he received at least $50,000 from MGE, LLC as an "advance" towards an "expected honorarium."

47. As part of the Regulatory Agreement, Respondent MGE, Inc. is required to submit annual financial reports to HUD via HUD's online Financial Assessment Sub-System ("FASS").

48. Respondent MGE, Inc.'s fiscal year ends on April 30.

49. In the fiscal year ending April 30, 2008 ("FYE 2008") Respondent MGE, Inc. had an outstanding FHA Loan principal balance of $162,970 and a Flex Loan principal balance of $210,174. It also received $340,273 in HAP payments and $40,395 in IRPs. In all, Respondent MGE, Inc. received more than $500,000 in federal financial assistance for the fiscal year.

50. Respondent MGE, Inc.'s Audited Financial Report for FYE 2008 was received by HUD on November 13, 2009, after the nine-month deadline. The report did not include the Flex Loan balance or any of the loans related to Wachovia or MGE, LLC.[3] Respondents' auditor disclaimed an opinion because he could not verify the Reserve Account funds or other account balances.

51. In FYE 2009, Respondent MGE, Inc. had an outstanding FHA Loan balance of $112,732 and an unchanged Flex Loan balance. It also received $340,726 in HAP payments and $40,113.43 in IRPs. In all, Respondent MGE, Inc. received more than $500,000 in federal financial assistance for the fiscal year.

52. Respondent MGE, Inc. did not file an audited report for FYE 2009. Instead, it filed an Owner-Certified Statement that did not mention the Flex Loan balance or any of the loans related to Wachovia or MGE, LLC.

53. In FYE 2010, Respondent MGE, Inc. had an outstanding FHA Loan balance of $56,886 and an unchanged Flex Loan balance. It also received $326,685 in HAP payments and $39,827.40 in IRPs. In all, Respondent MGE, Inc. received more than $500,000 in federal financial assistance for the fiscal year.

54. Respondent MGE, Inc. did not file an audited report for FYE 2010. Instead, it filed an Owner-Certified Statement that again did not mention the Flex Loan balance or any of the loans related to Wachovia or MGE, LLC.

55. Respondents did not fully comply with HUD's financial reporting requirements for FYE 2008, 2009, or 2010.

56. On July 1, 2010, Respondents signed a one-year "Watch List" HAP Contract. The Contract spelled out Respondents' notice obligations and rent restriction requirements.

[3] In essence, the FYE 2008 financial report is silent about the transfer of the Reserve Account funds, the encumbrance of the property's real and personal assets, and the purchase of the mortgage Note.

57. The Pennsylvania Housing Finance Agency ("PHFA") was the contract administrator for the Mantua Gardens East Project. PHFA subcontracted administrative duties to the Pennsylvania Multifamily Asset Managers.

58. Respondents did not provide any notice to HUD, PHFA, or the Project's subsidized tenants before the Watch List HAP Contract expired on June 30, 2011.

59. Prior to the expiration of the Watch List HAP Contract, Respondents' management agent, Community Realty Management ("CRM"), advised Respondents of the notice requirement and the consequences of failing to provide notice to Respondents' tenants.

60. On September 6, 2011, Respondents issued a Notice to All Tenants informing them that all subsidized tenants would have to sign new leases and pay rents that were $100 below the HUD-defined market rental amount.

61. On October 7, 2011, Respondents issued a flyer entitled "Rent Increase," which stated that "all subsidized Tenants must pay HUD approved Market Rent." Id. The flyer also stated that it would reduce the market rent rate for certain tenants in order to make the rental increases "less of a hardship as well as minimize evictions and retain most of the Tenants."

62. Respondents began issuing Vacate Notices to formerly subsidized Project tenants as early as September 28, 2011, and required those tenants to pay the increased market rent retroactively, starting from July 2011.

63. On July 1, 2011, Respondents fired CRM as the management agent without HUD's approval. Respondents received, on that date and at multiple points thereafter, correspondence from HUD and CRM informing Respondents that they were prohibited from terminating CRM without HUD's approval.

64. In a July 5, 2011, e-mail from Respondent Grier to the president of CRM, sent after receiving the correspondence from HUD and CRM, Respondent Grier reiterated that CRM was fired and stated that he was qualified to self-manage the project because he was a real estate broker licensed by the Pennsylvania Real Estate Commission.

65. Respondent Grier was not a licensed real estate broker at the time he sent the July 5, 2011, e-mail, and had not been so for more than a decade.

66. Respondent Grier has been managing the Project since July 1, 2011, without HUD's approval.

DISCUSSION

I. Respondents' Liability

The Government's *Complaint* seeks a total civil money penalty of $1,472,500 against both Respondents, and alleges 99 separate violations of federal statutes, HUD regulations, and contractual obligations.[4] The requested penalties include $212,500 jointly and severally against both Respondents, and $1,260,000 against Respondent MGE, Inc. alone.

The alleged violations, their maximum statutorily defined penalties, and the amounts the Government is seeking, are as follows:

Count (s)	Description	Penalty Maximum	Penalty Sought
1	Encumbering Project's Personal Property	$37,500	$25,000
2	Encumbering Project's Real Property	$37,500	$25,000
3	Transferring and Encumbering the Reserve Account	$37,500	$37,500
4	Terminating CRM Without Prior HUD Approval	$37,500	$25,000
5	Failing to Comply with Financial Reporting Requirements for FYE 2008	$37,500	$25,000
6-7	Failing to Comply with Financial Reporting Requirements for FYE 2009 and FYE 2010	$37,500	$37,500
8	Failing to Notify the Contract Administrator One Year Prior to Terminating the HAP Contract	$25,000	$15,000
9	Failing to Notify HUD One Year Prior to Terminating the HAP Contract	$25,000	$15,000
10-54	Failing to notify the Project's Subsidized Tenants One Year Prior to Terminating the HAP Contract	$25,000	$15,000
55-99	Raising Rental Amounts on The Project's Subsidized Tenants Without Providing Prior Notice	$25,000	$15,000

Respondents' actions with regard to these alleged violations are largely uncontested. Indeed, there are very few questions of fact left in play. Respondent Grier has consistently acknowledged that he, in fact, committed or caused to be committed most of the acts alleged by HUD.[5] He also acknowledges that he was acting in his

[4] In its *Post-Hearing Brief*, the Government amended its original *Complaint* to dismiss Counts 17, 25, 44, 47, 62, 70, 89, and 92. The amended *Complaint* therefore trims Respondent MGE, Inc.'s potential penalty by approximately $200,000. To maintain continuity, the Court will continue to refer to Counts 1-99. However, the true Counts are 8-16, 18-24, 26-43, 45-46, 48-61, 63-69, 71-88, 90-91, and 93-99.

[5] Respondents open their *Post-Hearing Brief* by stating that they "readily accept as fact, that many of the acts cited in the Claim are unchallenged."

capacity as president and sole authority for Respondent MGE, Inc. when he committed said acts, and that he knew that the Regulatory Agreement and HAP Contract prohibited said acts. He has candidly stated that his primary motivation was to free the Project from the strictures of the Regulatory Agreement. For whatever reason, after more than 30 years as a participant in the Section 236 and Section 8 Programs, Respondents simply were no longer willing to comply with HUD's requirements. Respondents sought to escape from under the Regulatory Agreement, and Respondent Grier believed he had come upon a plan to accomplish that goal. The actions that ensued bring us to this point.

Respondents' defense rests entirely on their staunch contention that Respondent Grier's plan to extricate the Project from HUD oversight succeeded in either 2006 or 2008. Specifically, Respondents argue that either (1) the Regulatory Agreement was "constructively terminated" after HUD denied Respondents' request to voluntarily terminate the mortgage in June 2006; or (2) the Regulatory Agreement became null and void in February 2008 after Firstrust sold the Note to a non-FHA-approved entity, who paid the mortgage in full. Each argument merits individual consideration.

a. Effect of Denial of Voluntary Termination Request

Some time prior to June 2006, Respondents, via Firstrust, filed a Termination Request with HUD seeking voluntary termination of the mortgage insurance on the Note. HUD rejected the request on July 3, 2006, citing the Project's failure to submit multiple reports and to sign a Use Agreement relating to the Request.[6] Respondents contend that they had, in fact, submitted the required documents, but HUD either misplaced or deliberately discarded them. Respondents that the justification for the denial was pretextual, and the real reason for the denial was to retaliate against Respondent Grier for filing a complaint against HUD's Philadelphia regional office in 1998. Respondents claim that the "errors and wrongful reasons for denial" on HUD's part rendered the Termination Request "constructively approved." This argument is meritless.

Respondents have cited no authority supporting their proposition that a Termination Request tainted by allegations of bad faith entitles them to unilaterally overrule the denial. Respondent Grier acknowledged on the stand during the hearing that he made no attempt to challenge the basis for HUD's denial at the time, and did not independently confirm that the requisite documents had been properly filed with HUD. Rather, he stated that it "was Firstrust's role to do anything to object to the denial." If the denial was predicated on animus between HUD personnel and Respondent Grier, it is unclear why Respondents would expect Firstrust to be the party raising the challenge rather than Respondents themselves. It is also unclear from Respondent Grier's testimony whether he ever requested that Firstrust raise such an objection.

[6] The Use Agreement referred to here is unrelated to the Use Agreement Respondents signed as part of the Flex Loan. Marilyn Edge, a Housing Program Officer in HUD's Office of Asset Management, testified at the hearing that, had the termination request been approved, Respondents would have been required to sign a second Use Agreement, extending their Section 236 obligations through the loan's maturity date of May 2012. Tr. 92: 18 – 93: 1. The Use Agreement signed as part of the Flex Loan expired in July 2011.

Rather than object to what they viewed as an unfair denial of the Termination Request, Respondents simply chose to ignore HUD's decision. The Court is aware of no legal theory that allows a party to disregard an agency decision with which it disagrees. If Respondents questioned the validity of HUD's justifications, the proper approach would have been to seek justice via an appeal to HUD, and ultimately, authorities outside of HUD should the case require it.[7] Regardless, there is no legal support for Respondents' position that an automatic "constructive approval" of the Request was a legitimate legal outcome even if such a conspiracy existed. The claim is therefore unpersuasive. The Court finds that both the mortgage insurance and the Regulatory Agreement remained in effect beyond June 2006.[8] As a result, Respondents were prohibited from transferring, encumbering, assigning, conveying or disposing of the Project's real or personal property without HUD's prior written approval.

It is uncontested that Respondents did not have HUD approval (and expressly attempted to conceal their actions from HUD) when they transferred $325,000 from the Reserve Account at Firstrust to an account at Wachovia. Similarly, they did not have approval to use those funds as collateral for the First Wachovia Loan or to use the 610 N. 32nd Street property and its associated rents, etc., as collateral for the Second Wachovia Loan. These actions were in direct violation of the Regulatory Agreement and statutory and regulatory protocols. Respondents were aware of these prohibitions at all relevant times. Moreover, these actions each had a significant material effect on the Project's resources and overall viability.[9] Accordingly, the Court holds that the Government has proven Respondents' liability as to Counts 1, 2, and 3.

b. Effect of Sale/Payment of Mortgage Note

Respondents next argue that, even if the Regulatory Agreement survived the Termination Request, it became null and void after Firstrust sold the Note to MGE, LLC, a non-FHA-approved mortgagee. In their *Second Answer*, they state that "the mortgage insurance cancelled or terminated on its own terms by the sale of the Mortgage Document to an UNINSURABLE ENTITY." The cancellation of the mortgage insurance, they argue, also served to nullify the Regulatory Agreement, thereby putting the Mantua Gardens East Project beyond HUD's reach.

Respondents also raise the theory that the Regulatory Agreement exists only as long as there is a mortgage to insure. They argue that once the Note was assigned to MGE, LLC and the mortgage was paid in full, the Project was no longer insured by

[7] However, as will be addressed later in this *Decision*, evidence adduced at the hearing suggests Respondents' suspicion of HUD's motivations may not have been entirely unfounded.

[8] The Court's finding that the Regulatory Agreement remained in effect at least until February 2008 renders the Flex Loan's Use Agreement redundant at this stage. Respondent's actions would have been prohibited under either authority.

[9] Respondent Grier sought protection under the Fifth Amendment of the U.S. Constitution rather than disclose what happened to the approximately $155,000 left over from the First Wachovia Loan and the $50,000 from the Second Wachovia Loan. However, according to statements he makes in his deposition, at least $100,000 from these two loans was transferred directly to him. Respondent Grier therefore put the Project's assets at risk at least in part for his own financial gain.

HUD. As a result, the Secretary no longer had jurisdiction to impose penalties because HUD is only authorized to impose civil money penalties on "any mortgagor of a property that includes 5 or more living units and that has a mortgage insured, co-insured, or held pursuant to this chapter" or any officer or director of a corporate mortgagor. 12 U.S.C. § 1735f-15(c)(1)(A)(i), (iii); 24 C.F.R. § 30.45(c)(1), (3).

The Government contends that Respondents' obligations did not terminate with the sale or payment of the Note. HUD regulations specify that the insurance contract can only be prematurely terminated by prepayment, voluntary agreement, or a transfer of the mortgage to HUD. 24 C.F.R. §§ 207.253, 207.253a. Respondents met none of these conditions: the Termination Request was denied, the mortgage was never transferred to HUD, and the evidence shows that Respondents did not intend for the sale of the Note to be interpreted as a prepayment. These are the only three termination mechanisms listed in the regulations. Respondents evidently held a genuine belief that an assignment to a non-FHA-approved mortgagee was a fourth option. That belief was erroneous.

The payment of the Note in 2008 also does "not deprive HUD of jurisdiction to maintain the enforcement action and, ultimately, to impose penalties" related to violations occurring between 2009 and 2011. Yetiv v. HUD, 503 F.3d 1087, 1090 (9th Cir. 2007). Although Respondents' fundamental argument is correct; civil money penalties can only be imposed upon a mortgagor that has a mortgage insured, co-insured, or held by HUD; Respondents did not follow the proper steps. If Respondents had properly prepaid the mortgage in 2008, HUD would have terminated the mortgage insurance at that point and Respondents would no longer be subject to HUD regulations.[10] However, because Respondents did not follow the mandated termination procedures, they did not properly terminate the mortgage insurance even though the mortgage was paid. The Regulatory Agreement therefore remained in effect until the mortgage's maturity date of May 1, 2012.

Even assuming the payment of the Note[11] did cancel the Regulatory Agreement, Respondents would not have been free of HUD oversight. Respondent Grier admits that he signed a Use Agreement in connection with the Flex Loan in 1983. That Agreement required Respondents to comply with Section 236 Program regulations until July 1, 2011, regardless of the status of the Regulatory Agreement. Respondent Grier was aware of his continuing responsibilities under the Use Agreement; he stated as much in an e-mail to

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[10] The Government in Yetiv sought civil money penalties because the respondent failed to file financial records, in violation of his Regulatory Agreement. Prior to the final determination and the assessment of penalties, the respondent paid the mortgage in full. He then claimed HUD had no jurisdiction to levy penalties because the prepayment terminated the Regulatory Agreement. The court disagreed because the alleged violation occurred before the payment of the mortgage, and liability attaches at the time of the violation. 503 F.3d at 1091; San Francisco BayKeeper, Inc. v. Tosco Corp., 309 F.3d 1153, 1159-60 (9th Cir. 2002).

[11] The mortgage Note's natural maturity date was May 1, 2012. Respondent Grier sent Firstrust a cashier's check for $170,218.28 on February 8, 2008, that he characterized as "full payment for the purchase of the … Mortgage Loan." Respondent Grier therefore orchestrated the payment of the mortgage more than four full years before it was due. By definition, this was a "prepayment" of the loan, though not one that complied with regulatory requirements. It appears from the record that Respondent Grier's reluctance to identify it as such was motivated by a desire to sidestep HUD's prepayment procedures and to avoid making required repairs to the Project.

Firstrust in October 2007. In light of this actual knowledge, Respondents can make no credible argument that they were ever beyond HUD's jurisdiction. HUD is therefore authorized to impose civil money penalties for any violations occurring up to at least May 1, 2012.

The Court finds that Respondents were at all times bound to comply with the Regulatory Agreement and its underlying statutes and regulations. They have admitted to the actions alleged by the Government, and so are liable for civil money penalties in connection with each of the enumerated Counts in the revised *Complaint*.

II. Determining Penalty Amount

Having concluded that Respondents' actions subject them to civil money penalties, the Court must consider whether the requested penalty amounts are appropriate. HUD regulations specify that the Court weigh the following aggravating and mitigating factors in determining the penalty amount:

- Gravity of the Offense
- History of Prior Offenses
- Respondents' Ability to Pay
- Injury to the Public
- Benefits Received by Respondents
- Benefits Received by Others
- Deterrence
- Degree of Respondents' Culpability
- Injury to Tenants
- Other Matters as Justice May Require

24 C.F.R. § 30.80.

Each factor must be considered, although not every factor will apply directly to every charge. Sundial Care Center, Inc. and Teresa Wong, HUDALJ 08-055-CMP, 2009 WL 6869730 (March 25, 2009). The presence or absence of any particular factor is not determinative. South Texas Mortg. Corp., HUDALJ 04-003-MR, 2005 WL 6521927 (April 12, 2005). However, a particularly compelling factor may be enough to support the imposition of a maximum penalty. In re: Yetiv, HUDALJ 02-001-CMP, 2003 WL 2596134, *11 (Sept. 2, 2003).

After considering the factors, the Government elected to pursue less-than maximum penalties for all but three of the alleged violations. The rationale for these penalties was laid out in detail in the Government's *Post-Hearing Brief*, as well as in the *Complaint* itself. The Court cannot, however, accept the Agency's analysis. It is the opinion of the Court that HUD's penalty assessment was the result of a biased, outcome-determinative consideration of the enumerated factors.

The figure the Government ultimately settled upon was one specifically calculated to bring financial ruin upon Respondents. The Government's primary intent here was not merely to hold Respondents accountable for their improper conduct, it was to levy a debilitating blow against Respondents themselves.[12] The civil money penalty mechanism was merely a means to that end. This is a wholly inappropriate use of HUD's statutory power.

HUD's own witness[13] admitted during the hearing that HUD's Departmental Enforcement Center began the penalty inquiry with the goal of bankrupting Respondents. After noting that the Project is worth approximately $1.5 million, the witness stated:

> "I think where we came from it was looking at, 'Well, what is the property worth?' and the combined amount for the HAP contracts is about what the property may be worth. The idea might be that it would be appropriate to force the sale of the property from [Respondent MGE, Inc.] to another nonprofit to run it in a way that is in accordance with our requirements."[14]

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[12] Respondent Grier has described the Government's action as a "high-handed government lynching." The Court would not classify it quite so dramatically. Regardless, one could argue that the Government's impure intent constitutes a form of vindictive prosecution, generally defined as "prosecution to deter or punish the exercise of a protected statutory or constitutional right." See U.S. v. Pedro Dominguez, OCAHO Case No. 96C00027, 1998 WL 356924, at *31 (May 15, 1998). As discussed earlier, Respondent Grier hypothesizes that this proceeding is the latest salvo in the Government's longstanding plan to punish him for filing a complaint against HUD's regional office in 1998. It is unclear, however, whether the Government's plan to bankrupt Respondents was the product of a vendetta, or born of HUD's genuine desire to see the Mantua Gardens East Project in the hands of a more responsible and less cantankerous owner. In either case, the motivation does not align with the purpose of the civil money penalty mechanism.

[13] The Court finds that the witness' testimony on pages 233-240 of the transcript is particularly instructive on the Department's motivations behind imposing the penalty amounts at bar. Although through HUD's case presentation other reasons for the penalty amounts were proffered, the Court discounts those reasons as *post-hoc* justifications that are simply not credible. Based on the Court's observations of the witnesses at bar and the testimony developed, the Court is left to conclude that HUD's penalty assessments in this case were calculated to financially cripple Respondents and force a sale of the property, just as the witness testified. When conflicting evidence exists in the record, the Court must resolve such conflicts. Thunder Basin Coal Co. v. S.W. Pub. Serv. Co., 104 F.3d 1205, 1212 (10th Cir. 1997) (noting that the fact finder "has the exclusive function of appraising credibility, determining the weight to be given to the testimony, drawing inferences from the facts established, resolving conflicts in the evidence, and reaching ultimate conclusions of fact"); see also Webco Indus., Inc. v. NLRB, 217 F.3d 1306, 1311 (10th Cir. 2000) (citing NLRB v. Wilhow Corp., 666 F.2d 1294, 1299 (10th Cir. 1981)) ("As to the credibility determinations of the ALJ, the determination of credibility is particularly within the province of the hearing examiner and the Board."); Webco, 217 F.3d at 1311 (citing E. Eng'g & Elevator Co. v. NLRB, 637 F.2d 191, 197 (3d Cir. 1980)) ("ALJ's credibility resolutions deserve great weight to the extent they are based on testimonial evidence of live witnesses and the hearing judge has had the opportunity to observe their demeanor.").

[14] The Government does not deny that a forced sale is its preferred outcome. Upon instructions from the Court to specifically discuss the witness' testimony on the subject, the Government stated that "the forced sale of the Project would have a salutary effect." The accuracy of this conclusion is irrelevant to the present proceeding. Whether Respondents are "good" landlords is not a question that is before this Court. The only relevant questions are "Did Respondents commit the alleged violations?" and "What is the appropriate penalty amount?"

Having identified $1.5 million as the proverbial "knockout blow," the Government's initial request of a $1.6 million penalty cannot be considered a mere coincidence. Instead, the Court finds that HUD assessed Respondents' ability to pay a potential fine, and then deliberately tailored its penalty assessment to arrive at a figure that exceeded that amount. The U.S. Constitution prohibits the Government from using a respondent's ability to pay a penalty to assess enhanced liability for that penalty. U.S. Const. Amend. XIV; <u>Assoc. Trust Fin. Servs.</u>, 1997 WL 346366594, at *3 ("A wealthy respondent must be in precisely the same jeopardy as a poor one when accused of violating the law."). Rather than using Respondents' ability to pay a fine as a mitigating factor, as is standard practice, the Government perverts the intent of this factor by setting its penalty request at a figure it knows Respondents cannot financially survive. In doing so, the Government corrupted its penalty assessment analysis.[15] The Court therefore cannot rely on HUD's assessment, and must conduct its own analysis of the penalty factors.

<u>Count 1 — Encumbering the Project's personal property</u>[16]

Respondents are liable for using the profits, rents, etc., of the 610 N. 32nd Street building as collateral for the Second Wachovia Loan. The Government seeks a penalty of $25,000 rather than the statutory maximum of $37,500.

Gravity of the Offense: By using Project property as collateral on a loan, Respondents exposed the Project to significant risk. The only discernible purpose of the Second Wachovia Loan was for Respondent Grier's own benefit. This is a particularly grave violation of the trust bestowed upon him by HUD and the tenants of Mantua Gardens East. Rental income, in particular, must be protected at all costs because it is a vital revenue source that allows the Project to meet its financial obligations. Respondents deliberately put that income in harm's way, thereby jeopardizing the Project, its tenants, and HUD's investment. Respondents did this in full knowledge that the Regulatory Agreement expressly forbids such encumbrances.

Injury to the Public: HUD claims that Respondents actions compromised the agency's ability to provide low-cost housing for needy families. This is certainly true, and for this Count the amount of injury involved is fairly easily quantifiable. Respondent Grier encumbered the Project's personal property in exchange for a $50,000 loan, the fate of which remains a mystery. Respondent Grier has, in effect, caused the disappearance of

[15] The Government confuses the issue further by conducting a universal factor analysis rather than explaining its rationale for each charge, or group of charges. This is a perplexing approach because not every factor is applicable to every charge. For example, the injury to tenants is particularly relevant in assessing Respondents' violations of the HAP Contract, but bears little relation to Respondents' failure to notify the contract administrator of the contract's impending expiration. Additionally, the Government's analysis fails to draw a clear line between the factor analysis and the penalties requested. The *Post-Hearing Brief* argues strongly for maximum penalties. However, as noted previously, the Government actually only seeks maximum penalties for 3 of the 99 counts. The Court has no way to gauge how or why the Government arrived at its figures. This further suggests that the factor analysis did not directly inform the ultimate penalty request.

[16] Certain factors apply equally to all of the Counts and so will not be included in the individualized analysis. Rather, these factors will be discussed under a standalone "umbrella" section.

$50,000 in taxpayer money. In the event of a default on the Second Wachovia Loan, the building's rents and profits, etc., will also be forfeit. Exposing the Project's property to the risk of forfeiture does injury to the public, the ultimate beneficiaries of HUD's housing programs.

Benefits to the Respondents: Respondent Grier sought Fifth Amendment protection rather than disclose what became of the proceeds from this loan. The Court therefore infers that he has repurposed those funds for his own benefit. This warrants a maximum penalty. There is no evidence that Respondent MGE, Inc. benefitted from this loan.

Degree of Respondents' Culpability: Respondent Grier is entirely culpable for encumbering the Project's personal property. He acted alone, and with full knowledge that he was violating the Regulatory Agreement. The Court must infer that the full balance of the $50,000 loan inured to his benefit. Respondent Grier has yet to acknowledge his malfeasance or express any sign of remorse. Accordingly, a maximum penalty is warranted.

Injury to Tenants: Respondents' actions on this Count had no direct impact on any Project tenants. However, the forfeiture of the building's personal property in the event of default would have severe ramifications for tenants. The encumbrance of this property therefore created a prospective injury to tenants.

<u>Conclusion</u>: Respondents' actions put Project property in direct risk, for the purpose of lining Respondent Grier's own pockets. This is an unconscionable dereliction of their responsibilities as HUD program participants. The Court therefore finds that a maximum penalty of **<u>$37,500</u>** is appropriate for **<u>Count 1</u>**.

<u>Count 2 — Encumbering the Project's real property</u>

Respondents are liable for using the 610 N. 32nd Street building as collateral for the Second Wachovia Loan. The Government seeks a penalty of $25,000 rather than the statutory maximum of $37,500.

Gravity of the Offense: The gravity of this offense is nearly identical to Count 1, and warrants the same penalty. There is simply no telling what Respondent Grier did with the $50,000 proceeds of this loan. As a result, HUD has no way of knowing the likelihood of default. The forfeiture of the Project building could result in the eviction of the building's tenants, and potentially the financial failure of the Project itself. Respondents thus risk losing everything for a $50,000 payday.

Injury to the Public: The forfeiture of the building and potential failure of the Project would decrease low-income housing opportunities in Philadelphia, thereby harming all Philadelphia residents. In addition, the ability to violate HUD regulations with impunity would compromise HUD's mission, thus harming the public at large.

Benefits to the Respondents: Respondent Grier sought Fifth Amendment protection rather than disclose what became of the proceeds from this loan. The Court therefore infers that he has repurposed those funds for his own benefit. There is no evidence that Respondent MGE, Inc. has benefitted from this loan. Indeed, Respondent MGE, Inc.'s value is lessened as a result of the loan, because one of its buildings is now encumbered.

Degree of Respondents' Culpability: Respondent Grier is entirely culpable for encumbering the Project's personal property. He acted alone, and with full knowledge that he was violating the Regulatory Agreement. The Court must infer that the full balance of the $50,000 loan inured to his benefit. Respondent Grier has yet to acknowledge his malfeasance or express any sign of remorse.

Injury to Tenants: Had Respondents defaulted on this loan, the residents of 610 N. 32nd Street could well have found themselves homeless. Indeed, a default could be the first domino leading to the failure of the entire Project, thereby affecting every tenant.

<u>Conclusion</u>: Respondents' extreme culpability, the gravity of this offense, and the goal of deterrence mandate a maximum penalty. There is no justification for pledging a Project building — and putting vulnerable tenants at risk of homelessness — for personal gain. Respondents deliberately and brazenly violated the Regulatory Agreement with full knowledge that their actions were prohibited. A maximum penalty of **<u>$37,500</u>** is warranted for **<u>Count 2</u>**.

<u>Count 3 — Transferring and encumbering the Reserve Account</u>

Respondents are liable for transferring the Reserve Account from Firstrust to Wachovia without HUD's permission, and using the funds from that account as collateral for the First Wachovia Loan. The Government seeks a maximum penalty of $37,500.

Gravity of the Offense: Respondents' actions were deliberate, pre-meditated, and had an immediately injurious effect on the ability of the Project to meet its maintenance expenses. In addition, Respondents were well aware that permission was required to transfer the account, and simply disregarded their statutory, regulatory, and contractual obligations. Their explanation for transferring the account — seeking to ensure FDIC protection in the event of a banking collapse — is disingenuous.[17] The true motivation for removing the funds was to invalidate the Regulatory Agreement.

Injury to the Public: By flagrantly disobeying HUD requirements, Respondents jeopardized the viability of the Project and risked the forfeiture of the $325,000 collateral. Moreover, there is no indication what became of the approximately $155,000

[17] Respondents have stated that they "avoided extraordinary risk (2008 banking crisis) to project [sic] our funds by distributing Reserve for Replacement deposits to multiple FDIC banks to assure deposit insurance coverage adequate to cover the $250,000 limit per bank. We are being fiscally tortured for doing this without HUD prior approval. We should have been applauded." This explanation is patently false because Respondents transferred more than the $250,000 FDIC-insured limit to Wachovia. The funds were therefore no better distributed, and thus no more secure, than they had been at Firstrust. Moreover, had Respondents truly been motivated by an urge to secure the funds, they would not have immediately used them as collateral for the First Wachovia Loan.

left over after the loan from MGE, Inc. to MGE, LLC. The transfer and encumbrance of the Reserve Account, and the loan that followed, were deliberately intended to further Respondents' goal of circumventing their obligations to HUD. If this scheme had been successful, other program participants may have been tempted to try similar ploys. The scheme therefore had the potential to significantly threaten HUD's mission in Philadelphia and elsewhere.

Benefits to the Respondents: Once again, Respondent Grier raised his Fifth Amendment privilege rather than disclose the whereabouts of the $155,000 balance from this account. The Court infers that he has repurposed those funds for his own benefit. Additionally, he has acknowledged that he personally received at least $50,000 in payments that can be directly traced to the Reserve Account. Respondent MGE, Inc. received no benefit from the transfer of the Reserve Account.

Degree of Respondents' Culpability: Respondents were aware that they were not permitted to transfer the Reserve Account without HUD's permission. Respondent Grier devised this scheme, put it into action, and reaped a large portion of the benefits, all while knowing his actions were prohibited. He misled Firstrust into believing the transfer of the Reserve Account was authorized, asked them not to contact HUD or the management agent, and then refused to return the funds to Firstrust upon demand.

Injury to Tenants: By depleting the Reserve Account and selling the mortgage Note to MGE, LLC, Respondents financially crippled the Project. This event eventually led to the Project being placed on the Watch List, which decreased the size of the HAP payments and further led the Project down the road to insolvency. The transfer and encumbrance of the Reserve Account was therefore highly injurious to the Project's tenants, and warrants a substantial penalty.

Conclusion: Respondents' conduct was particularly egregious and injurious. The transfer and encumbrance of the Reserve Account was the key to Respondent Grier's entire scheme, and opened the door for the violations that followed. It is essential that Respondents and others understand that agreements with HUD cannot be so easily cast aside. The Court finds that maximum penalty of **$37,500** is appropriate for **Count 3**.

Count 4 — Terminating CRM without HUD's approval

Respondents are liable for unilaterally firing CRM without approval from HUD. The Government seeks a penalty of $25,000 rather than the statutory maximum of $37,500.

Gravity of the Offense: Respondents were fully aware that HUD approval was required before firing CRM. Respondents no longer felt they were bound by the Regulatory Agreement, and so were uninterested in complying with HUD's requirements. They did not, however, put any effort into confirming the accuracy of their belief before continuing their scheme.

Injury to the Public: Management agents play a vital role in protecting HUD's investments. The Regulatory Agreement specifically requires a HUD-approved agent because they ensure that project resources are collected, monitored, and disbursed according to government requirements, among other important functions. By terminating CRM, Respondents substantially hindered HUD's ability to gauge the physical and financial health of the Project.

Benefits to the Respondents: Respondent Grier has been self-managing the Project since CRM's termination, which is itself a violation of HUD requirements. Having disposed of CRM, Respondent Grier was free to act with near impunity. Respondents have also saved money by not having to pay CRM or another management company. They have therefore received significant benefits.

Degree of Respondents' Culpability: Respondents are entirely culpable. They flagrantly ignored their obligations, even after receiving stern letters from HUD informing them that they were in violation of the Regulatory Agreement. It appears Respondent Grier did not appreciate CRM's interference with his plans, and wanted complete control over the Project's business affairs.

Injury to Tenants: By firing CRM, Respondent Grier removed a significant obstacle to his plans. CRM attempted to dissuade Respondent from terminating the HAP Contract, and informed him of the consequences of not providing notice prior to the contract's cancellation. Respondent Grier refused to heed their advice, to the detriment of the Project's tenants.

Conclusion: Respondents' complete disregard for the serious ramifications of their actions, even after repeated warnings, warrants imposition of maximum penalties. The Court therefore finds that **$37,500** is an appropriate penalty for **Count 4**.

Count 5 — Failure to comply with financial reporting requirements for FYE 2008

Respondents violated the Regulatory Agreement when they failed to file complete, audited financial reports for FYE 2008. The Government seeks a penalty of $25,000 rather than the statutory maximum of $37,500.

Gravity of the Offense: Respondents deliberately withheld information from the auditors in order to conceal their various financial transgressions. Besides omitting the Flex Loan, the report failed to mention the $170,000 loan to MGE, LLC and the encumbrances of the Project's real and personal property. This suggests Respondents knew they were violating the Regulatory Agreement, and wished to prevent the auditors from informing HUD of their activities.

Injury to the Public: The purpose of HUD's financial reporting requirements is to allow the Agency to ascertain the financial health of its investments. The more government funding a property receives, the more important it is for HUD to have a clear picture of that property's financial activities. By preventing the auditors from accessing the

Project's records, Respondents deliberately obscured HUD's view of its investment. Had Respondents complied with their obligations, the auditors could have flagged the inappropriate transfers and encumbrances and mitigated the risks to HUD, and, by extension, to the public.

Benefits to the Respondents: Respondents stonewalled auditors and withheld information for the primary purpose of concealing their improper activities and furthering their plan to escape from the Regulatory Agreement. Their actions allowed them to perpetuate the scheme without raising red flags at HUD.

Degree of Respondents' Culpability: Respondents are fully culpable because they prevented the auditor from uncovering the truth about their financial transgressions and deliberately attempted to mislead HUD. After putting the Project's funds and property at risk, Respondents attempted to hide their actions and continue their scheme.

Injury to Tenants: Respondents' actions on this Count had no direct impact on any Project tenants. However, this violation was in furtherance of an overall agenda that had or could have had devastating repercussions for tenants.

<u>Conclusion</u>: Respondents' actions represent deliberate malfeasance and prove that Respondents recognized the impropriety of their actions. This undercuts Respondents' arguments that the reporting omissions were good faith errors and that they truly believed they were no longer bound by HUD's rules. Based on the high degree of culpability and the substantial need for deterrence, the Court finds that a maximum penalty of <u>**$37,500**</u> is necessary for <u>**Count 5**</u>.

<u>Counts 6-7 — Failure to comply with financial reporting requirements for FYE 2009 and FYE 2010</u>

Respondents are liable for failing to file audited financial records for FYE 2009 and FYE 2010. The Government seeks the maximum penalty of $37,500 for each violation.

Gravity of the Offense: A substantial sanction is warranted here because Respondents did not even attempt to comply with HUD rules. They have never explained why they failed to file audited reports in 2009 and 2010, when they did so (albeit deficiently) in 2008. The explanation they have offered — that they received less than $500,000 in federal financial support and so were not required to submit audited records — is meritless because they submitted such records in 2008 and earlier, when they received similar amounts of federal aid. The most reasonable explanation for Respondents' actions in 2009 and 2010 is that they wanted to conceal their illicit transactions, even from the eyes of their own auditors.

Injury to the Public: Respondents' brazen attempts to hide their improper transactions directly interfered with HUD's ability to monitor the Project and protect its investment. Respondents continually deny that they were under any obligation to submit financial reports at all after 2008. The fact that they did so in 2009 and 2010 is strong evidence that they recognized the inherent weakness of their argument. Their claim that these reports were filed voluntarily out of "good faith" is outlandish; the reports were intended to prevent HUD from accomplishing its mission. As such, the injury to the public is high.

Benefits to the Respondents: By eliminating the auditor's role, Respondents were able to completely conceal their inappropriate financial dealings. This allowed them to perpetuate their scheme without raising red flags at HUD.

Degree of Respondents' Culpability: Respondents are highly culpable. The auditor disclaimed their FYE 2008 report because of Respondents' lack of cooperation. After recognizing that the auditor would not be complicit in their deception, Respondents eliminated the auditor's role altogether and filed Owner-Certified Statements rather than audited reports. The purpose in doing so was to help cover up their previous violations. Accordingly, this factor supports the imposition of a maximum penalty.

Injury to Tenants: Respondents' actions on this Count had no direct impact on any Project tenants. However, this violation was in furtherance of an overall agenda that had or could have had devastating repercussions for tenants.

<u>Conclusion</u>: By filing misleading reports, Respondents managed to temporarily hide their actions from HUD's view. More important than "what" Respondents did, however, is "why" they did it. Respondents sought to pull the wool over HUD's eyes, in hopes that they would not investigate the Project's untenable financial situation. Flagrant deception of this sort is unacceptable and warrants a maximum penalty. Accordingly, Respondents shall pay a penalty of <u>**$37,500**</u> for <u>**Count 6**</u> and <u>**$37,500**</u> for <u>**Count 7**</u>.

<u>Counts 8-54 — Failing to notify the Contract Administrator, HUD, and the Project's subsidized tenants one year prior to terminating the HAP Contract</u>

Respondent MGE, Inc. is liable for terminating the HAP Contract without providing the statutorily required one-year notice to PHFA, HUD, or the Project's Section 8 tenants. The Government seeks a penalty of $15,000 for each violation rather than the statutory maximum of $25,000.

Gravity of the Offense: The mission of the Section 8 Program is to provide affordable, safe housing for low-income families. These families are among the most vulnerable in American society, because absent the Program, many of them would be unable to afford housing of any kind. Low-income families often do not have the financial means to absorb unexpected price increases. The notice requirements exist to protect these families from unexpected turbulence in their housing situations, and to allow HUD time to coordinate with the families. Respondents knew that notice was required, and knew that they could renew the Watch List HAP Contract for a year to allow for the proper notice period. They refused to do so. This factor suggests that a substantial penalty is in order.

Injury to the Public: Respondents' actions compromised the Agency's ability to provide low-cost housing for needy families. However, the degree of injury involved is almost impossible to quantify.

Benefits to the Respondent: The violation of the notice requirement, on its own, did not provide any concrete benefit to Respondents. In fact, the termination of the HAP Contract was disastrous to Respondent MGE, Inc., as the loss of the HAP payments severely impacted their ability to meet their financial obligations.

Degree of Respondent's Culpability: Respondents balked at renewing the HAP Contract because they objected to Mantua Gardens East's classification as a Watch List property. They were faced with three options: (1) accept the one-year Watch List classification and send a contemporaneous notice to all required parties; (2) sign a long-term HAP Contract; or (3) terminate the contract with the knowledge that they could not raise rents until one year after the notice was delivered. They chose a fourth option; terminate the contract and raise rents immediately. Respondents were explicitly informed of the repercussions of the termination, and knew that any increase in rental prices would violate the Regulatory Agreement.

Respondents' argument that they had no intention not to renew the Contract is irrelevant. They were bound to provide one year's notice before terminating the existing HAP Contract. Thus, once they formed the intent to end the contract, they were obligated to extend the contract up to one-year from that date. It makes no difference whether they formed that intent 2 weeks or 52 weeks prior to the contract's end date. It was not a lack of foresight that caused the violation; it was their failure to compensate for it that ran them afoul of HUD requirements.

Injury to Tenants: Respondents' actions resulted in severe injury to the Project's subsidized tenants. Rather than the year they should have received, Respondents gave the tenants only weeks or months to restructure their lives. This caused them substantial emotional and economic stress. A maximum penalty is therefore appropriate.

<u>Conclusion</u>: The notice requirement exists to protect those families that are among the most vulnerable in society. In these instances, Respondents gave no notice; none whatsoever. As such, the potential impact on tenants is at maximum, warranting a maximum assessment. The Court therefore concludes that a maximum penalty of $**<u>25,000</u>** is appropriate for **<u>Counts 8-54</u>**.

<u>Counts 55-99 — Raising rental amounts on the Project's subsidized tenants without providing proper notice</u>

Respondent MGE, Inc. is liable for improperly raising rental amounts on tenants without providing the notice required in the HAP Contract. The Government seeks a penalty of $15,000 for each violation rather than the statutory maximum of $25,000.

Gravity of the Offense: After terminating the HAP Contract, Respondents informed the Project's subsidized tenants that they would have to sign new leases that, for the most part, required them to pay significantly more than they had been paying during the term of the contract. Respondents' primary goal in increasing rents was to offset the income lost when HUD stopped making HAP payments. Increasing rental prices without providing one year of notice is prohibited in the HAP Contract, as Respondent MGE, Inc. knew. Respondents' disregard of this requirement put significant stress on all affected tenants.

Injury to the Public: If Respondent MGE, Inc. is allowed to ignore the notice requirement and increase rent on subsidized tenants without facing significant penalties, other Section 8 Program participants would likely follow suit. As a result, the program would lose much of its effectiveness, and HUD's ability to provide low-cost housing to needy families would be seriously compromised. This would constitute a significant injury to the public, as it could theoretically increase the number of homeless families living in America.

Benefits to the Respondent: Respondent MGE, Inc. has generated significantly more revenue from renters after terminating the HAP Contract. Additionally, Respondent Grier has indicated on several occasions that he hoped to turn the Project into a profit-generating property populated in part by higher-income tenants. It is to Respondents' benefit if low-income tenants were forced to move elsewhere, as that would make more apartments available for market-rate renters. The record contains several eviction notices sent to formerly subsidized tenants, and Respondent Grier has stated that several former tenants moved out of the Project in the months after the termination of the HAP Contract. The Court therefore finds that Respondent benefitted by raising rental prices on formerly subsidized tenants.

Degree of Respondents' Culpability: Respondent MGE, Inc. was informed prior to the HAP Contract's termination date that it was required to give one year's notice before raising rents on subsidized tenants. This information was ignored. The evidence shows that Respondent was aware of the repercussions of its actions, but elected to forge ahead regardless.

Injury to Tenants: The improper raising of rents caused substantial injury to the Project's subsidized tenants, as they were required to either pay more for their apartments or seek housing alternatives elsewhere. There were no guarantees that they could find acceptable Section 8 housing in a timely manner. Respondent MGE, Inc.'s action caused incalculable emotional stress for affected tenants. This injury was wholly preventable.

Respondent's failure to take the necessary steps to protect the Project's tenants warrants a significant penalty.

Conclusion: Respondent MGE, Inc. had the right to terminate the HAP Contract at the end of its term. It did not have the right, however, to raise rent without providing one year's notice that such an increase was forthcoming. Respondent was advised of its obligations, and the consequences of ignoring them, but chose to disregard this information. Blatant disregard of a program participant's obligations to HUD warrants imposing a maximum penalty. Accordingly, the Court finds that a maximum penalty of **$25,000** per Count is necessary for **Counts 55-91**.

Umbrella Factors

Ability to Pay: The Government seeks $212,500 in joint and several penalties against Respondent Grier and Respondent MGE, Inc., and another $1,260,000 in penalties against Respondent MGE, Inc., alone. The burden rests with the respondent to show that it cannot pay the requested amount. Campbell v. U.S., 365 U.S. 85, 96 (1961). Respondents here have consistently stated that the penalties represent "fiscal capital punishment." However, they have introduced no evidence whatsoever to substantiate their claims of financial vulnerability. What's more, Respondent Grier has flagrantly disobeyed Court Orders requiring him to submit an Assets Affidavit so the Court can gain an accurate understanding of his economic viability. Respondent Grier has been served with no less than four Orders requiring him to file the documentation necessary to substantiate his claim of financial impoverishment.[18] On the final two occasions, he was warned that failure to timely comply would expose him to contempt charges and the imposition of sanctions. Despite this, Respondent Grier has continued his pattern of delay and obfuscation. His explanations and justifications ring increasingly hollow. The Court is now convinced that Respondent Grier never intended to file an Assets Affidavit, and is instead deliberately attempting to conceal his financial resources. The Court notes that he sought Fifth Amendment protection when asked to explain the whereabouts of the $155,000 remainder from the First Wachovia Loan; the $50,000 Second Wachovia Loan; and the approximately $224,400 paid by MGE, Inc. to MGE, LLC.[19] While it is his right to refuse to supply self-incriminating testimony, it is in turn the Court's right to make negative inferences based on that refusal. The only reasonable inference that can be drawn from Respondent Grier's actions is that an Assets Affidavit would reveal that he has repurposed Project funds for his own benefit. Despite his assertions to the contrary,

[18] The *Order Instructing Respondent James H. Grier to Submit Assets Affidavit* was issued October 12, 2012, with a deadline of November 2, 2012. The *Case Management Order* was issued December 7, 2012, with a deadline of December 14, 2012. The *Order to Show Cause Why Summary Affirmance Should Not be Granted* was issued January 23, 2013, with a deadline of January 29, 2013. Finally, the *Order Denying Request for Extension of Time* was issued January 29, 2013, with a deadline of 6:00 p.m. that day. None of these deadlines were met.

[19] Respondent Grier stated in his *Answer to the Order to Show Cause*, filed January 29, 2013, that he believed the *Order* was a violation of his Fifth Amendment rights. The right against self-incrimination must be claimed, it does not attach automatically. U.S. v. Rendahl, 746 F.2d 553, 55-56 (9th Cir. 1984). Respondent Grier affirmatively asserted this right at the hearing with regard to the vanished loan and mortgage payment proceeds. He expressly did not do so with regard to the Assets Affidavit, stating that "Respondents accept the mandate to comply with the Order of the Court."

the Court therefore finds that Respondent Grier has the means to pay any penalty assessed.

Respondent MGE, Inc.'s primary asset, meanwhile, is the Project itself, which all parties agree is valued at approximately $1.5 million. The Court finds that Respondent MGE, Inc. also has the ability to pay a reasonable penalty assessment. The question remains, however, how to determine what constitutes a reasonable penalty. The Government requested a penalty of $1,260,000 against Respondent MGE, Inc., alone, for the violations alleged in Counts 8-99. Following its own analysis supra, the Court arrives at a total penalty of $2,325,000 for Respondent MGE, Inc. The first amount represents approximately 85% of the company's value. The second amount is approximately 150% of the company's value. To assess either amount completely would require the Court to ignore the mitigating factor of "ability to pay" as enumerated in HUD's very regulations. It is true that the mere fact that a penalty might drive a respondent past the point of insolvency does not militate against authorizing such a penalty when it is justified. Entercare, Inc., HUDALJ 01-061-CMP (December 31, 2002). However, in Entercare, the Court had no knowledge of the value of the asset in question and assessed the maximum penalty, reluctantly, to protect the public fisc. Id. ("However, without an audit based upon a complete disclosure, I am unable to assess the impact a $137,000 fine will have on Respondent's operations.") At bar, there is no dispute that either amount supra would cripple the company. As such, the Court is obligated to consider not whether the Government is likely to recover the full penalty, but whether the respondent can pay the penalty and survive.

The record is entirely devoid of evidence that would show what penalty amount Respondents could realistically pay. Respondent MGE, Inc. has shown only what amount it cannot pay — $1.5 million and above. The Government, for its part, was never concerned with determining what amount Respondent MGE, Inc. could survive, because it did not intend for the company to survive at all. It therefore falls to the Court to determine what amount represents an appropriate punishment for the Respondent's many transgressions. Accordingly, the Court finds that Respondent MGE, Inc. can reasonably pay a civil money penalty of up to 30% of the company's value, or $450,000.

History of Prior Offenses: The Government contends that Respondents are "repeat offenders with little regard for their obligations to HUD." The Court disagrees. It is true that Respondents have faced a litany of lawsuits, complaints, and investigations over the course of the past decade. For example, they have been debarred by HUD for a period of five years and been sued by both Firstrust and present/former tenants. However, the actions that spawned those proceedings are the same ones at issue here. The Government acknowledged in its initial *Complaint* that Respondents have not been previously adjudged to have violated any HUD requirements and have no history of prior offenses. Accordingly, Respondents are not "repeat offenders."

Deterrence: The gravity, scope, and negative impact of Respondents' actions require severe sanctions. HUD program participants "must not form the belief that they can fail to comply with statutory, regulatory, and contractual obligations without suffering significant penalties. The penalties assessed must be greater than the benefits enjoyed from non-compliance with the law; otherwise [participants] may be tempted to believe that it 'pays' to violate the law, and the penalties will have no deterrent value. Yetiv, 2003 WL 25961324, at *11.

The sheer brazenness of Respondents' scheme also strongly supports a sizeable penalty as a means to deter other would-be violators. Respondent Grier believed he had found a loophole in HUD's regulations that would allow him to use the Mantua Gardens East Project for his own purposes. Had he succeeded, others would surely have attempted to follow his example. The penalty imposed on these Respondents should dissuade others from making such an attempt.

Benefit to Others: There is nothing to suggest that anyone besides Respondents — and in some cases only Respondent Grier — benefitted in any material way from any of the above violations.

Other Matters: After approximately 30 years as participants in the Section 236 and Section 8 Programs, Respondents decided they no longer wanted to be bound by HUD requirements. They sought their release in 2006, but were denied a voluntary termination of the loan. Rather than accept this outcome and wait just six more years for the mortgage to reach its natural maturity date, Respondent Grier embarked upon an elaborate scheme to break free of HUD oversight. Whether his ultimate goals were laudatory, as he claims (educational scholarships for Project children, etc.), or greedy, as the evidence suggests, is irrelevant. His actions in pursuit of those goals were designed to violate the Regulatory Agreement, and then to capitalize on the violation of that Agreement. As such, he has acted in direct opposition to his responsibilities as a HUD program participant. This warrants the severest of sanctions.

HUD, however, is not entirely innocent here. As the evidence shows, HUD's underlying motivation was to deal Respondents a financially fatal injury rather than to punish their violations of their regulatory, statutory, and contractual obligations. The Government misused one of its most effective tools to achieve this result. It is no cure to say that HUD felt its actions were in the public interest. Heavy-handed behavior of this sort inevitably erodes the public's faith that their government will treat them fairly and objectively. Here, HUD allowed other undisclosed factors to interfere with the decision-making process, even though doing so did them no additional benefit. A legitimate, good-faith assessment of the penalty factors would have likely arrived at a penalty that was roughly similar to what the Government requested. The Court cannot, however, ignore HUD's actions simply because those actions did not substantially affect the final figure. If Respondents' malfeasance serves to increase their penalty, surely the Government's should serve to lessen it. Accordingly, the Court will reduce the total penalty award by 25% to reflect HUD's improprieties.

CONCLUSION

Respondents knowingly and materially breached the Regulatory Agreement when they encumbered the Project's real and personal property, including the Reserve Account; transferred the Reserve Account from the FHA-approved mortgagee without HUD approval; and terminated the management agent without HUD approval. Respondents further breached the Regulatory Agreement when they filed a deficient audited financial record for FYE 2008, and filed Owner-Certified Statements instead of audited financial records for FYE 2009 and FYE 2010.

These acts constitute violations of 12 U.S.C. § 1735f-15(c) and warrant the imposition of civil money penalties. Accordingly, after an independent consideration of the mandated factors, the Court finds Respondents Grier and MGE, Inc. liable for $262,500 in joint and several penalties, broken down as follows:

- Count 1: $37,500
- Count 2: $37,500
- Count 3: $37,500
- Count 4: $37,500
- Count 5: $37,500
- Count 6: $37,500
- Count 7: $37,500

The Court finds that a 25% reduction in this penalty is appropriate. Accordingly, a penalty of $196,875 is authorized.

Respondent MGE, Inc. knowingly and materially breached the HAP Contract when it failed to notify PMAM, HUD, and 41 subsidized Project tenants one year prior to the expiration of the HAP Contract. Respondent also breached the HAP Contract when it raised rental prices on the 41 subsidized Project tenants without providing the aforementioned notice.

These acts constitute violations of 42 U.S.C. § 1437z-1(b) and warrant the imposition of civil money penalties. After an independent consideration of the mandated factors, the Court finds Respondent MGE, Inc. liable for $2,325,000 in penalties, broken down as follows:

- Count 8: $25,000
- Count 9: $25,000
- Counts 10-16: $25,000 per Count
- Counts 18-24: $25,000 per Count
- Counts 26-43: $25,000 per Count
- Counts 45-46: $25,000 per Count
- Counts 48-54: $25,000 per Count
- Counts 55-61: $25,000 per Count

- Counts 63-69: $25,000 per Count
- Counts 71-88: $25,000 per Count
- Counts 90-91: $25,000 per Count
- Counts 93-99: $25,000 per Count

Respondent MGE, Inc. does not have the ability to pay this penalty, however. In recognition of this fact, the penalties for Counts 8-99 are hereby reduced to $450,000. In addition, a 25% reduction in the penalty is appropriate. As a result, Respondent MGE, Inc. shall pay a penalty of $337,500.

It is hereby

ORDERED that Respondents shall pay to the HUD Secretary the following civil money penalties in full:

1. Respondents, jointly and severally — $196,875.

2. Respondent MGE, Inc. — $337,500.

These penalties are immediately due and payable by Respondents without further proceedings, except as described below. Respondents are prohibited from using Project income to pay these penalties. 12 U.S.C. § 1735f-15(d)(5); 24 C.F.R. § 30.45(h); 24 C.F.R. § 30.68(d).

So **ORDERED**,

/s/

Alexander Fernández
Administrative Law Judge

Notice of appeal rights. The appeal procedure is set forth in detail at 24 C.F.R. §§ 26.50, 26.52. This *Initial Decision and Order* may be appealed by any party to the HUD Secretary by petition for review. Any petition for review must be received by the Secretary within 30 days after the date of this *Initial Decision and Order*. An appeal petition shall be accompanied by a written brief, not to exceed 15 pages, specifically identifying the party's objections to the *Initial Decision and Order* and the party's supporting reasons for those objections. Any statement in opposition to a petition for review must be received by the Secretary within 20 days after service of the petition. The opposing party may submit a brief, not to exceed 15 pages, specifically stating the opposing party's reasons for supporting the ALJ's determination.

Service of appeal documents. Any petition for review or statement in opposition must be served upon the Secretary by mail, facsimile, or electronic means at the following:

U.S. Department of Housing and Urban Development
Attention: Secretarial Review Clerk
451 7th Street S.W., Room 2130
Washington, DC 20410
Facsimile: (202) 708-0019