

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

In the Matter of:

EGAE, LLC, and MARLOW FAMILY EXEMPT
PERPETUAL TRUST,

Respondents.

18-AF-0227-CM-002

January 23, 2020

Appearances:

Mary C. Merchant, Esq.
Sakeena M. Adams, Esq.
United States Department of Housing and Urban Development

Marc A. Marlow
EGAE, LLC and Marlow Family Exempt Perpetual Trust
Pro Se

Before: Alexander **FERNÁNDEZ**, United States Administrative Law Judge

INITIAL DECISION AND ORDER

The United States Department of Housing and Urban Development (“HUD” or “Government”) filed a *Complaint for Civil Money Penalties* against EGAE, LLC (“Respondent EGAE”) and Marlow Family Exempt Perpetual Trust (“Respondent Family Trust”) (collectively “Respondents”). The *Complaint* seeks \$222,954 in civil money penalties, pursuant to 12 U.S.C. § 1735f-15 and 24 C.F.R. Part 30, for Respondent EGAE’s failure to submit timely audited financial reports for fiscal years 2013-2017. Respondents filed an *Answer* admitting that the audited financial reports were not filed but denying liability. Respondents also described, at length, circumstances surrounding the devaluation of Historic Tax Credit proceeds, which Respondents attribute to HUD.

On June 28, 2019, the Court issued the *Order Granting Partial Summary Judgment*, wherein the Court found that undisputed material facts exist and support a finding that Respondents were liable for failing to timely file five years of audited financial

reports.¹ However, the Court declined to impose the civil money penalties sought by HUD on summary judgment, because Respondents raised issues of material fact that must be considered by the Court pursuant to 24 C.F.R. § 30.80. Instead, the Court ordered that the matter should proceed to a hearing so that the Court could compile a complete record for consideration of the civil money penalties that would be imposed.

The hearing was held on July 30-31, 2019 in Anchorage, Alaska. The following witnesses testified at the hearing: Sean Gallagher, who was the production chief in HUD's Seattle Field Office; Gwendolyn Callaher, Branch Chief for HUD's Resolution Specialist Team in San Francisco; Jerry Cramer, Enforcement Analyst for HUD's Fort Worth Department Enforcement Center; Hope Phile, Settlement Office Director for HUD's Fort Worth Department Enforcement Center; and Marc Marlow, Manager for Respondent EGAE.

FACTUAL FINDINGS

Respondent EGAE is a "for profit" company formed under the laws of Alaska. Respondent EGAE owns the project known as McKinley Tower Apartments. McKinley Tower Apartments ("the Property") consists of 100 units in a building located in Anchorage, Alaska. Respondent Family Trust is the sole member of EGAE, LLC, and Mark Marlow is the manager of EGAE, LLC.

In 2005, Respondent EGAE took out a loan from CW Capital, LLC in the original principal amount of \$8,067,000, which was secured by the Property. Repayment of the loan was insured by HUD pursuant to Section 221(d)(4) of the National Housing Act, 12 U.S.C. § 1715(d)(4). In exchange for receiving the benefits of the loan insured by the Secretary, on March 8, 2005, Respondent EGAE entered into a Regulatory Agreement for Multifamily Housing Projects ("Regulatory Agreement") with HUD. The Regulatory Agreement requires, in pertinent part, that Respondent EGAE submit annual financial reports to HUD at the end of each fiscal year.

Since 2009, the McKinley Tower project has been referred to HUD's Department Enforcement Center ten times for alleged noncompliance with the Regulatory Agreement. Between 2008 and 2012, HUD's records show a history of unauthorized loans being disbursed to the owner, unauthorized disbursements of project funds, an underfunded security deposit account, and payments being made to identity-of-interest firms owned by Mr. Marlow that were in excess of market rates. The Department Enforcement Center and Mr. Marlow entered into a settlement agreement to resolve these issues.

In 2012, Respondent EGAE spent over \$20,000 for the project's annual financial statements. Respondent EGAE had surplus cash of \$91,643, and profits (before depreciation) of \$212,888. After 2012, Respondent EGAE stopped sending audited financial statements to HUD. For fiscal years 2013, 2014, 2015, 2016, and 2017, the

¹ The Court's findings of fact and rulings on summary judgment are incorporated into this *Initial Decision*. A copy of the *Order Granting Partial Summary Judgment* is also attached.

annual financial statements for the Property were due by the end of March the following year.²

HUD sent Respondent EGAE a series of pre-penalty notices reminding Respondent EGAE of the possible penalty for failing to file audited financial statements and requiring a response. In response, Respondent EGAE would either inform HUD that an accounting firm had been engaged to complete the audits or that Respondent EGAE intended to pay off the HUD-insured loan through a refinance thereby releasing Respondent EGAE of its obligations to comply with the Regulatory Agreement. Respondent EGAE never raised the issue of its ability to pay a civil penalty for its failure to file audited financial statements even though each pre-penalty notice specifically cited that factor as a possible affirmative defense or argument in mitigation.

Respondent EGAE defaulted on its loan, which was assigned to HUD requiring HUD to pay over 6.4 million dollars. At the end of 2017, Respondent EGAE had a total equity amount of \$5,641,894.21. Respondent Family Trust currently has a 51 percent interest in an office building adjacent to the project. The office building is valued at \$13 million dollars. The office building receives around \$113,500 per month in rent, but pays \$82,000 per month for its mortgage.

LEGAL CONCLUSIONS ON SUMMARY JUDGMENT

On summary judgment, the Court found that Respondents are liable for violations of the Civil Money Penalty statute for failing to file audited financial statements for fiscal years 2013, 2014, 2015, 2016, and 2017. The Court also noted that the scope of this case was limited to a determination of whether Respondents violated the Civil Money Penalty Act and, if so, the amount of the civil money penalties to be imposed.

CIVIL MONEY PENALTY

Having concluded that Respondent EGAE's actions subject Respondents 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:

- (a) The gravity of the offense;
- (b) Any history of prior offenses;
- (c) The ability to pay the penalty, which ability shall be presumed unless specifically raised as an affirmative defense or mitigating factor by the respondent;
- (d) The injury to the public;
- (e) Any benefits received by the violator;
- (f) The extent of potential benefit to other persons;
- (g) Deterrence of future violations;

² The financial statements were due on March 31, 2014, March 31, 2015, March 30, 2016, March 31, 2017, and March 31, 2018, respectively.

- (h) The degree of the violator's culpability;
- . . . and
- (j) Such 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. In re Sundial Care Center, HUDALJ 08-055-CMP, 2009 HUD ALJ LEXIS 21 (HUDALJ Mar. 25, 2009). 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 (HUD ALJ Sept. 2, 2003).

After considering the penalty factors, the Government elected to pursue the maximum penalties for each violation resulting from Respondent EGAE's failure to file audited financial statements. The rationale for these penalties was laid out in detail in the Government's *Post-Hearing Brief*, as well as in the *Complaint* itself.

In response, Respondents repeatedly argue that HUD's denial of their master lease proposal in 2006 was made in error and resulted in \$2,466,416.80 in damage to Respondents, which outweighs any amount of civil money penalties that can be imposed. For that reason, Respondents claim they should not be required to pay any amount to HUD for the failure to file audited financial statements.³

1. Gravity of the offense

The failure to file audited annual statements is extremely serious. In re Premier Invs. I, Inc., HUDALJ 06-022-CMP, 2007 HUD ALJ LEXIS 61, *13 (HUDALJ Jun. 29, 2007). Risks to the insurance fund may arise from unauthorized distributions and misuse of project funds by HUD-insured mortgagors, which may go undetected where audits are not available. In re Entercare, Inc., HUDALJ 01-061-CMP, 2002 HUD ALJ LEXIS 27, *15 (HUDALJ Dec. 31, 2002); In re Lord Commons Apartments, HUDALJ 05-060-CMP, 2007 HUD ALJ LEXIS 59, *18 (HUDALJ Jul. 20, 2007).

HUD witnesses testified that the purpose of audited financial statements is to give HUD an assessment of where the project is financially, and how money is being distributed. A repeated failure to file audited financial statements is of great concern, because HUD cannot get a picture of the finances of a project and access the risk of a project is extended.

Mr. Cramer specifically discussed HUD's concerns regarding unauthorized disbursements being made by the Project that were disclosed before Respondent EGAE ceased filing audited financial statements. Mr. Cramer testified that, "we believe that had

³ Respondents also request that HUD be ordered to amend Respondent EGAE's note and outlines the new terms of the note that should be imposed. The Court's purview in this case is limited to a determination of whether a violation of the Civil Money Penalty statute occurred and, if so, the amount of any civil money penalty to be imposed. The Court does not have the authority to order the remedy requested by Respondents.

we gotten the financial statement, we may have been able to catch some of the problems and possibly even prevented the loan from being assigned to HUD.”

As noted *supra*, the FHA-insured mortgage became delinquent and was ultimately assigned to HUD requiring HUD to pay over 6.4 million dollars from its insurance fund. These facts support the imposition of the maximum penalty. See Premier Invs. I, Inc., 2007 HUD ALJ LEXIS 61 at *14 (“Unauthorized distributions and mortgage delinquencies are the very violations the annual audit review process was intended to prevent.”).

2. History of prior offenses

There is no evidence in the record that Respondents have a history of prior offenses.

3. Ability to pay the penalty

On summary judgment, the Court noted that Respondents presented no evidence that they were unable to pay the penalty sought by HUD in this case. However, the Court declined to grant summary judgment on this factor without giving Respondents, who were proceeding *pro se*, another opportunity to present evidence in support of this claim.

Respondents have the burden to establish that they are not able to pay the amount of penalty sought. Premier Invs. I, Inc., 2007 HUD ALJ LEXIS 61 at *15. And, a claim of inability to pay must be supported by documentary evidence. Grier v. United States HUD, 418 U.S. App. D.C. 185, 191 (2015) (“An ability to pay is presumed unless a party raises it as an affirmative defense and provides documentary evidence.”)

At the hearing, Respondents reiterated their position that HUD’s error caused Respondents to be unable to maximize the value of the Historic Tax Credit, and cost Respondents over \$400,000 in cash. Respondents claim they are unable to pay the penalty for this reason. However, instead of presenting documents, such as financial records and evidence of liabilities, Respondents focused on HUD’s denial of the use of a Master Lease in 2006. Even if Respondents’ allegation that HUD caused a \$400,000 loss to Respondents is true, it is insufficient to demonstrate an inability to pay without additional information as to Respondents’ financial standing. See Premier Invs. I, Inc., 2007 HUD ALJ LEXIS 61 at *20 (finding that the existence of a \$153,000 judgement against the respondents “does not argue against the [maximum penalty sought by HUD]”).

Without documentary evidence of Respondents’ inability to pay, the Court presumes Respondents are able to pay the penalty sought by HUD. Moreover, at the hearing, HUD presented documentary evidence that, based on the most recent financial records obtained from Respondents in discovery, Respondent EGAE had a total equity amount of \$5,641,894.21. Mr. Marlow also testified that Respondent Family Trust currently has a 51 percent interest in an office building adjacent to the project. The office building is valued at \$13 million dollars. The office building receives around \$113,500 per

month in rent, but pays \$82,000 per month for its mortgage. HUD's unchallenged evidence supports a finding that Respondents are able to pay the maximum penalty sought by HUD. See Sundial Care Center, Inc., 2009 HUD ALJ LEXIS 21 at *51 (taking into consideration the respondents' interest in land, which had a value that exceeded the penalty sought by HUD).

4. Injury to the public

"In considering the factor of injury to the public, an assessment of the harm caused to the integrity of HUD's programs and the costs of enforcement and litigation should be made." Premier Invs. I, Inc., 2007 HUD ALJ LEXIS 61 at *15. And, "damage to the integrity of HUD programs, exhibited by an inability to accurately assess risk to its insurance fund occurs when Respondents fail to submit audited financial statements." Id.

As noted *supra*, Respondents' failure to file audited financial statements deprived HUD of the opportunity to assess the projects finances. HUD was, therefore, without crucial information to assess the risk to its insurance fund. However, this is not a concrete loss to HUD and the public. The fact that HUD had the flexibility to wait for years in hopes that Respondent EGAE would file audited financial statements suggests that receipt of the reports, though undoubtedly required, was not as urgent as HUD suggests. Moreover, HUD's claim that the \$6.4 million-dollar payout from its insurance fund may have been avoidable is speculation.⁴

Still, HUD presented records demonstrating the efforts made by HUD staff to obtain Respondent EGAE's compliance with their obligations under the Regulatory Agreement. Documents in the record demonstrate numerous communications among HUD field offices, HUD's Enforcement Center, and Mr. Marlow. The time and resources expended to gain Respondent EGAE's compliance constitute an injury to the public. Id.

5. Benefits received by the violator

HUD claims Respondents benefited by not incurring the costs for audited financial statements. HUD's records show that Respondent EGAE spent an average of \$20,000 a year on audits. Respondents do not dispute this. Therefore, by failing to conduct five audits, Respondents had a windfall of about \$100,000. See Lord Commons Apartments, 2007 HUD ALJ LEXIS 59 at *20 ("Respondents benefitted economically from the violations in an amount at least equal to the total costs that they would have incurred if the audited financial reports had been prepared and submitted to HUD as required.")

HUD also suggest that Respondents may have benefited from unauthorized distributions during the period that the financial statements were not filed. HUD presented evidence that in 2010 and 2011, unauthorized distributions totaling \$286,354 were paid to

⁴ HUD presented evidence that the multifamily insurance fund is funded by insurance premiums by mortgagors doing business with the department. HUD may reinvest money from the fund into other programs such as those that provide housing. Evidence that the violations caused a loss to the insurance fund would support a finding of injury to the public. Entericare, Inc., HUDALJ 01-061-CMP, 2002 HUD ALJ LEXIS 27 at *15.

affiliates of Respondents. HUD notes that it is unable to determine whether this practice continued, because Respondent EGAE ceased filing audited financial statements after HUD raised the issue of the unauthorized distributions.

There is no evidence in the record that Respondents were able to secrete a continued practice of making unauthorized distributions for their benefit by refusing to file audited financial statements. Therefore, the Court cannot reach a determination that Respondents benefited in this regard. See U.S. Dep't of Hous. & Urban Dev. v. Crestwood Terrace P'ship, HUDALJ 00-002-CMP, 2001 HUD ALJ LEXIS 66, *15 (HUDALJ Jan. 30, 2001) (declining to speculate as to whether unauthorized disbursements may have benefitted the respondent when audited reports are not available to confirm such claims).

6. Extent of potential benefit to other persons

HUD acknowledges that it is impossible to determine the potential benefit to others in this case without the audited financial statements that would reveal any such benefit.

7. Deterrence of future violations

“Deterrence is a permissible and socially useful goal. Any penalty will theoretically provide deterrence.” Sundial Care Center, Inc., 2009 HUD ALJ LEXIS 21 at *52-53 (taking into consideration the respondents’ interest in land, which had a value that exceeded the penalty sought by HUD). However, for a penalty to be effective in deterring future violations, the penalty imposed must be substantially greater than the cost of compliance to encourage compliance within the industry. Crestwood Terrace P'ship, 2001 HUD ALJ LEXIS 66 at *15.

Here, HUD presented evidence that each audited financial statement would cost Respondent EGAE roughly \$20,000. For each of the five audited financial statements between 2013 and 2017 that Respondent EGAE failed to file, HUD seeks penalties between \$42,500 and \$48,144.⁵ Therefore, the penalty HUD seeks is more than double the amount it would have cost for Respondent EGAE’s compliance and is adequate for deterring future violations.

8. Degree of the violator’s culpability

Respondents’ *Answer* alleges, “The negative impact of being shorted the Historical Tax Credit proceeds cannot be overstated. The financial stresses imposed on the project are directly related to the audits being late.” And, in an October 15, 2018 meeting, Mr. Marlow told HUD that the historic tax credit issue had negatively impacted his project.

⁵ For violations taking place between February 19, 2013 and August 15, 2016, the maximum civil money penalty the Secretary may impose for each violation is \$42,500. 12 U.S.C. § 1735f-15(c); 24 C.F.R. § 30.45; and 78 Fed. Reg. 4057 (Jan. 18, 2013). For violations taking place between August 16, 2016 and June 28, 2017, the maximum civil money penalty the Secretary may impose for each violation is \$47,340. 12 U.S.C. § 1735f-15(c); 24 C.F.R. § 30.45; and 81 Fed. Reg. 38931 (June 15, 2016). For violations taking place on or after June 29, 2017, the Secretary may impose a civil money penalty of up to \$48,114 for each violation. 12 U.S.C. § 1735f-15(c); 24 C.F.R. § 30.45; and 82 Fed. Reg. 24521 (May 30, 2017).

“The responsibility for insuring that annual financial statements are filed in a timely and acceptable manner lies squarely with [the persons], who executed the agreement on behalf of [the respondent company]. Lord Commons Apartments, 2007 HUD ALJ LEXIS 59 at *22.

There is no evidence in the record that Respondents were unable to pay for the audits. In fact, HUD presented evidence that in 2012, Respondent EGAE had surplus cash of \$91,643, and profits (before depreciation) of \$212,888. Based on this evidence, the Court reasonably concludes that Respondents had the means to pay for the 2013. And, Respondents have not produced evidence to the contrary.

In addition, HUD has produced evidence that it made repeated attempts to obtain Respondents’ compliance. For instance, HUD sent several pre-penalty notices to Respondent EGAE before ultimately filing the *Complaint*. In response, Mr. Marlow would assure HUD that the audits would be done or that the loan would be refinanced eliminating Respondent EGAE’s obligations under the regulatory agreement. However, Mr. Marlow never claimed the audits had not been performed due to a lack of funds. Accordingly, the Court finds that Respondents are wholly culpable for the violations.

9. Other matters as justice may require

Respondents claim HUD’s denial of their master lease was an error that resulted in \$2,466,416.80 in damages. Respondent EGAE claims it was unfairly treated, because there is no evidence that HUD had ever denied a master lease proposal other than Respondents’. In support, Respondents cite to a Mortgagee Letter issued by HUD outlining its policy for authorizing the use of Master Leases to maximize the benefits of tax credits including Federal and State Historic Tax Credits. Respondents also presented an e-mail from a developer who was able to utilize the master lease structure on a project that closed with HUD on September 8, 2009.

HUD acknowledges that Respondent EGAE was denied the use of a master lease structure. And, HUD does not dispute Respondents’ claim that the denial resulted in the diminishment of the value of the historic tax credits Respondents expected. Instead, HUD notes that, at the time Respondents sought approval of the master lease structure, there was not yet a policy for authorizing the use of master leases. For that reason, HUD staff was required to reject proposals for master leases until HUD could develop a policy to which such proposals could conform.

Respondents’ evidence demonstrates unfortunate circumstances that may have resulted in financial losses to Respondent EGAE. However, there is no evidence that Respondent EGAE’s project was treated differently than other similarly situated projects. Although Respondents claim HUD did not deny other proposals to use master leases, Respondents fail to produce evidence that, when their proposal for a master lease was denied by HUD, HUD was authorizing the use of master leases in other projects. At the hearing, Mr. Gallagher testified credibly that HUD’s practice was to deny proposals for master leases until HUD could create a policy for the use of such leases. In addition, Mr.

Gallagher noted that the mortgagee letter publishing HUD's policy for master leases was effective October 19, 2009, and there was no indication that it could be applied retroactively.

The timing of Respondent EGAE's request for approval of its master lease proposal is unfortunate. Even Mr. Gallagher noted that had the request been made in the fall of 2009, Respondent EGAE's proposal likely would have been approved if it satisfied HUD's requirements. Still, there is no evidence that Respondents were unfairly treated. On the contrary, the record demonstrates that HUD had a practice of denying master lease proposals until HUD could formulate policy on the issue. Therefore, this factor neither aggravates nor mitigates the civil money penalties to be imposed.

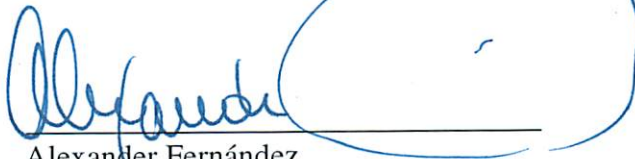
Conclusion

Based on the foregoing, the Court finds adequate evidence exists supporting the imposition of the penalties sought by HUD. Respondent EGAE's failure to file audited financial statements for 2013-2017 constitute violations of its obligations under the Regulatory Agreement. Such violations caused injury to the public while Respondents received a windfall of about \$100,000. Respondents are wholly culpable and have not demonstrated an inability to pay. Accordingly, the imposition of the maximum allowable penalty is warranted for each violation.

It is hereby **ORDERED** that Respondents, jointly and severally, shall pay in full \$ 222,954 in civil money penalties to the HUD Secretary.

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**,

A handwritten signature in blue ink, appearing to read "Alexander Fernández", is written over a horizontal line. To the right of the signature is a large, hand-drawn blue oval.

Alexander Fernández
Administrative Law Judge

Attachments: *Order Granting Partial Summary Judgment*, issued June 28, 2019.

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
Scanned electronic document: secretarialreview@hud.gov

Copies of appeal documents. Copies of any petition for review or statement in opposition shall also be served on the opposing party(s), and on the HUD Office of Administrative Law Judges.

Finality of decision. If not timely appealed, the *Initial Decision and Order* becomes the final agency decision as indicated in 24 C.F.R. § 26.50.

Judicial review of final decision. After exhausting all available administrative remedies, any party adversely affected by a final decision may seek judicial review of that decision in the appropriate United States Court of Appeals. A party must file a written petition in that court within 20 days of the issuance of the Secretary's final decision.