

UNITED STATES OF AMERICA
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
BOARD OF CONTRACT APPEALS
Washington, D. C.

In the Matter of:

CHARLES R. HOLIFIELD and
HOUSING MANAGEMENT
CONSULTANTS, INC.,

Appellants

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: HUD Docket No. 80-443-D1
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Appearances:

For the Appellant: Moss & Walton
Indianapolis, Indiana
BY: John O. Moss, Esquire

For the Government: HUD Office of General Counsel
Washington, D. C.
BY: Donald Grant, Esquire

DETERMINATION

Statement of the Case

By letter dated April 6, 1979, appellant, Charles R. Holifield and Housing Management Consultants, Inc. (hereinafter referred to collectively as "appellant") were notified that by reason of specified irregularities in the performance of their responsibilities, they were temporarily denied participation in some activities of the Department of Housing and Urban Development, for a period of twelve months commencing April 6, 1979. The denial was limited to activities under the jurisdiction of the Assistant Secretary for Housing, and to the geographic area of the State of Indiana, except to the extent that other HUD field offices given notice might extend the denial to their respective jurisdictions in accordance with applicable regulations.

The Area Manager's action was based on four alleged irregularities relating to the appellant's management of FHA Project [REDACTED] ("Eastside I") and FHA Project [REDACTED] ("Eastside II") in Indianapolis, Indiana. Those irregularities were identified in the notice to appellant. In substance, they were as follows:

1. The disposition of tenants' security deposits for both Eastside I and Eastside II was not adequately explained;
2. A rent subsidized apartment in Eastside I was regularly used by one [REDACTED] Maultsby ("Maultsby"), an ineligible tenant who was an acquaintance of appellant, and rental records for the apartment were incomplete;
3. Appellant issued a series of checks drawn on Eastside I project funds totaling \$1,800.00 for an alleged auditing fee to Maultsby, who did not deliver the required audit; and
4. Appellant was tardy, nonresponsive or uncooperative in providing project records to HUD as requested.

The letter offered appellant an opportunity for an informal hearing with the Area Manager. Following an adverse decision, appellant filed a timely appeal pursuant to 24 C.F.R. §24.7, and a hearing was held on November 20, 1979 in Washington, D.C.

FINDINGS OF FACT

Eastside I and Eastside II are scattered-site, multi-family housing projects, each of approximately 135 units. The projects were sponsored by the Eastside Baptist Housing Corporation in Indianapolis, Indiana, and assisted by HUD-FHA mortgage insurance under Section 236 of the National Housing Act, as amended, 12 U.S.C. §1715z-1 (1970) (Exh. G-11 and 12). They were also assisted by housing assistance and rent supplement payments (Exh. G-13; tr. 154).

In 1971 and in 1973, appellant contracted to manage Eastside I and Eastside II, respectively (Exh G-11 and 12). Mr. Holifield executed both property management contracts. These agreements required the managing agent, inter alia, to maintain necessary records, collect rents, evict delinquent

tenants, retain and segregate tenants' security deposits, and provide regularly prescribed financial reports (Exh. G-11, paras. 6, 10, 11, 18; Exh. G-12, para. 4). HUD, as assignee of the project mortgage, reserved its right of approval of the management agreement related to Eastside II and did not endorse the instrument (Tr. 49-50; Exh. G-11). Nevertheless, all parties appear to have treated both management agreements as continuously effective through March 1978 (Tr. 238-39).

In the fall of 1977, negotiations failed to resolve the two projects' financial difficulties, and thereafter HUD foreclosed. HUD was confirmed as mortgagee in possession of Eastside I and Eastside II by Court orders dated March 2 and March 10, 1978, respectively (Exh. G-19 and 20). Appellant's tenure as managing agent of the projects terminated at that time (Tr. 238-39). The Court orders required the mortgagor-defendants and their agents to turn over to the United States all property of the mortgagor, including bank accounts, tenants' security deposits, and all other property connected with or used in the operation of the mortgaged properties. The Indianapolis Area office acted promptly to take possession of the assets and records relating to both projects (Tr. 86-99, 145-46).

Despite prompt efforts, HUD never received the total amount of tenants' security deposits for which Eastside I and Eastside II records showed appellant liable. Appellant's own evidence showed that at the time the security deposit funds were transferred to HUD on March 8, 1978, the Eastside I security deposit liability was \$8,542.65, but that only \$1,058.12 was on hand and subsequently transferred to HUD, leaving a deficiency of \$7,484.53. That same evidence accounted for the differential by recording disbursement of security deposit funds to various rental and payroll accounts. Similarly, appellant's evidence showed an Eastside II security deposit liability of \$7,033.50 as of March 14, 1978 and that \$1,210.90 was transferred to HUD leaving a deficiency of \$5,822.60. Appellant testified, that most of the deposits had been used to pay utility bills. Other evidence shows transfers of such deposits to payroll and other accounts (Tr. 54-58, 67-68, 144-46, 214-15, 239-41; Exh. G-14 and 17, A-5).

HUD Handbook 4371.1, Financial Operation and Accounting Procedures for Insured Multifamily Projects ("the Handbook"), requires that tenants' security deposits be segregated and maintained in a trust account and that

The balance in the account must not at any time be less than the aggregate of all outstanding obligations under said account for security deposits (Exh. G-1, para. 9b at p. 9).

This requirement is imposed by other contractual and regulatory authorities as well (Tr. 57-58).

While applicant was the management agent for Eastside I, apartment [REDACTED] at [REDACTED] North Illinois Street was rented to one [REDACTED] Fletcher. Fletcher paid a subsidized rental of \$39.00 per month from December, 1977 through March, 1978 (Exh. G-6 to 10; tr. 26-27, 122-23). However, except for one unexplained payment, rental payments stopped after March 1978, the month in which HUD took possession of the projects under Court Order (Exh G-2, -9, -10, -19, -20; Tr. 18-19, 122-23).

There was no certification of Fletcher's eligibility for a rental subsidy among the records received by HUD for the apartment or the tenant (Tr. 101). Attempts to contact the tenant of record to collect rent, to recertify eligibility for subsidy, and ultimately to evict the tenant for delinquent rent failed (Exh. G-2, to -5; Tr. 19-24).

Several months after HUD took possession, HUD representatives inspected the premises. Notice of eviction had been given, and entry was made in late November, 1978. The inspection disclosed that the apartment had been recently occupied, apparently by a "short" but very "large" man. HUD representatives found evidence in the apartment of a move in progress, a refrigerator in use, a shotgun, and two or three suits for a "very large" man but no women's clothes (Tr. 22-24, 100, 105-7). Testimony also established that Maultsby was a "short" but "a very large man" who might have weighed "350 or so" (Tr. 106).

Despite repeated requests, both before and after HUD assumed possession, records material to the past and ongoing operation of Eastside I and II were never received by HUD or its representatives (Tr. 64, 94-95, 145-58). In particular, the required audited annual financial reports for both Eastside I and Eastside II for their respective fiscal years ending in February and March of 1975, 1976, and 1977, were never received (Tr. 64, 107-13, 118, 141, 148, 239). Two draft financial statements for Eastside II, unsigned either by the accountant or the owners, uncertified, and in a form which did not conform to HUD requirements, were received from Maultsby (Tr. 64-65, Exh. G-22, -23). The only financial "records" ever produced for Eastside I were a few work papers Maultsby brought to a hearing (Tr. 243).

Despite the absence of annual financial reports, several payments allegedly totaling \$1,800.00 were made to Maultsby by appellant from Eastside I project funds, allegedly for the preparation of financial statements for that project (Tr. 107-13, 242-43, 247). Eastside I monthly reports to HUD show that partial audit fee payments to Maultsby totaled at least \$2,450.00 not \$1,800.00, and appellant's evidence showed payments of \$3,450.00 (Exh. G-21A, 21B, and 21C; A-7, tab 7). Appellant's Exhibit 5 refers to \$1,800 in audit fees comprised of a \$1,500.00 retainer and a \$300.00 progress payment. Consequently, the evidence established that at least \$1,800.00 in audit fees was paid to Maultsby in respect of Eastside I and that the actual payments probably totaled at least \$2,450.00 and possible even \$3,450.00.

Holifield testified that the purpose of the payments related to a conversion of the project and would not have been made if he had considered foreclosure of the project to be assured (Tr. 212-13). He also testified that in March, 1978 HUD representative Rae E. Ginger came to his office to take custody of project records and that she told Maultsby that HUD did not need the audit report and would not pay for it. (Tr. 247).

In addition to appellant's failure to produce the required financial statements, certain other records that were promptly sought, pursuant to Court Order and otherwise, were never produced or were produced only after delays and in materially incomplete condition. The deficiencies in the records were noted within days of the time HUD became mortgagee in possession (Tr. 167). Among the documents missing were bank books and other financial records, tenant ledger cards, and records of certifications of tenant eligibility for occupancy and subsidy (Tr. 64-65, 91-98, 100-02, 145-47, 155, 164-65). Itemized receipts signed by Jereline Fleming on behalf of HUD purported to show that many of such records were transferred to and received by HUD (Exh. A-1, Tr. 124-34). Nevertheless, because of the deficient state of the records that were transferred, a substantial number, if not the majority of the individual tenants' eligibility had to be specially recertified (Tr. 155, 164-66, 168-70). Because HUD did not receive records on all of the units, it could not match tenants with the apartments or identify vacancies, and ultimately had to order its management company to obtain and confirm the necessary information in a door-to-door survey. (Tr. 146-47).

APPLICABLE REGULATIONS

The departmental regulation applicable to temporary denials of participation, 24 C.F.R. Part 24 (1978), provides in pertinent part as follows:

§24.4 Definitions.

* * *

(f) "Contractors or grantees." Individuals, ... and public or private organizations that are direct recipients of HUD funds or that receive HUD funds indirectly through non-Federal sources including, but not limited to, ... those in a business relationship with such recipients ..., all participants, or contractors with participants, in programs where HUD is the guarantor or insurer

* * *

(h) "Temporary denial of participation." ... a temporary denial is an exclusion from HUD programs by an Area Office Director, Insuring Office Director or a Regional Administrator for a specified period not to exceed twelve months. The denial is limited in effect to the jurisdiction of the office initiating the action and the specific program under which this action is taken.

§24.5 General (a) ... temporary denial of participation and conditional participation are measures which may be invoked by offices of the Department either to exclude or to disqualify contractors and grantees from participation in Department programs. These measures shall be used for the purpose of protecting the public and are not for punitive purposes.

(b) Department action to exclude or to disqualify contractors and grantees from participation in its programs, or to reconsider such measures, shall be based upon all available relevant facts.

* * *

§24.18 Temporary denial of participation; conditional denial.

(a) Causes and conditions under which a temporary denial of participation may be invoked.

(1) An Area Director, Insuring Office Director or Regional Administrator may issue an order which denies the participation in Departmental programs of a contractor or grantee.

(2) Causes for denial of participation shall include:

(ii) Adequate evidence of irregularities in contractor's or grantee's past performance in a Department program

DISCUSSION

As the actual property manager for the two HUD assisted projects, Eastside I and Eastside II, appellant falls within the regulation's definition of "Contractors or Grantees." Appellant was a contractor with a participant in the Section 236 program, pursuant to which HUD was insurer of the mortgages on Eastside I and Eastside II. 24 C.F.R. 24.4(f)(1979).

1. Security Deposits

Appellant's handling and use of the tenants' security deposits for the projects were unauthorized and irregular. Two witnesses testified that HUD never obtained possession of all funds which were required to be held in escrow as the tenants' security deposits (Tr. 98-99, 144-46). Appellant's own documentary evidence, as well as the Government's evidence, showed the tenants' security deposit accounts short \$7,484.53 for Eastside I and \$5,822.60 for Eastside II at the time they were transferred to HUD on March 8 and March 14, 1978, respectively (Exhs. A-7, G-18).

Both testimony and documentary evidence established that the security deposit liability for Eastside I was substantially unfunded after May 1976 and that security deposit funds had been transferred to payroll and other accounts (Tr. 65-68, 77-78, 144-147, 162-163, 213-15; Exh. G-14, 17, 21A, 21B, 21C; A-1). Holifield's testimony that he submitted monthly reports either in blank where the security deposit liabilities were unfunded or with a zero balance for the tenants' security accounts, and his concession that he used previously existing security deposits to pay utility bills amply corroborates the irregularity charged (Tr. 4, 215-25, 239-41). Neither that testimony nor appellant's evidence, that the funds were used for payroll, utility bills, and perhaps other purposes excuses its contractual obligations to segregate such funds in an escrow account. If anything, such evidence confirms that appellant misapplied funds (Exh. A-5, tr. 56-58, 77-78, 241).

Paragraph 9 of the Handbook obligates property managers to segregate and maintain tenants' security deposits in a trust account. That paragraph specifies categorically that, "The balance in the [security deposit] account must not at any time be less than the aggregate of all outstanding obligations under said account for security deposits" (Exh. G-1, p. 9). The Housing Management Agreement applicable to Eastside II also required that the security deposits be "deposited by the Agent in an account separate from all other accounts and funds" (Exh. G-11). A similar requirement was recorded in the Housing Assistance Plan contract applicable to Eastside I (Exh. G-13 at p. 9). Appellant's evidence showed that a copy of the Handbook had been mailed to him (Exh. A-7, letter, Dodd to Housing Management Consultants dated June 20, 1977).

The Handbook constitutes a directive of the Secretary with which appellants had agreed to comply in the management agreements (Exh. G-11 at p. 1, G-12 at p. 14). Appellant did not contest this issue, and it was evident from his testimony that he was familiar with the substance of the requirement (Tr. 213-15, 237-41). Both the failure to deliver the security deposit funds to HUD and the admitted misapplication of the funds to pay utility bills or for other purposes represented violations of specific obligations in the management agreement (Tr. 213-14). The alleged failure of HUD to take exception to reports submitted by appellant that showed a zero balance or to so notify appellant does not excuse the irregularity established on this record (Tr. 84).

2. Unauthorized Occupancy

The evidence is insufficient to prove that Maultsby was an unauthorized occupant of Eastside I [REDACTED] at [REDACTED] North Illinois Street, as alleged. The evidence is also insufficient to establish that an unauthorized occupancy of that apartment occurred with appellant's knowledge or connivance. On this record, no connection was established between Maultsby and the apartment in question. The allegation that the very large man's clothes found in the apartment in November, 1978 might have fit Maultsby because of his very large size is pure speculation. No other evidence was offered either that Maultsby occupied the apartment or that the apartment was occupied by an ineligible tenant while appellant was project manager.

The copies of receipts in evidence which appear to reflect rent payments by Sylvia Fletcher with one exception run only from December 1977 through March 1978, the date HUD took possession of the projects by Court order and appellant's management responsibilities ended (Exh. G-2, 6, to 10; Tr. 122-23). The apartment was not entered and inspected until late November 1978, approximately eight months later (Tr. 40). There is no evidence whatever that the apparently recent occupancy by a male, discovered in November 1978 extended back to March of that year or earlier during appellant's tenure as manager of the projects. Rae E. Ginger's testimony that she "believed we had a report that Mr. Maultsby was occupying a unit in one of the Eastside Buildings" fails to connect Maultsby with the particular apartment or show an ineligible occupancy while appellant was property manager.

3. Annual Financial Statements

The record establishes that appellant willfully ignored the essential project management obligation to submit audited annual financial statements (Exh. G-1 at p. 13, G-11 at p. 6, G-13 at p. 16). Appellant was clearly familiar with the requirement (Tr. 239). The testimony establishes that HUD officials repeatedly requested the delinquent annual financial reports for both Eastside I and Eastside II for the fiscal years ending 1975, 1976 and 1977 by notices sent in June, August, November and December of 1977 (Exh. G-15, A-7; Tr. 64). The evidence establishes that despite these requests and its contractual obligation, appellant never furnished the statements (Tr. 11-15, 64-65, 113, 141, 147-49, Exh. G-22 and 23). The two unsigned and uncertified statements furnished in draft did not in any way satisfy appellant's contractual obligation.

Holifield himself admitted that he did not submit the required audits and did not have permission from HUD not to submit them (Tr. 239). He testified, moreover, that he had not engaged the accountant in time to provide the required audits and that the projects had been unable to afford the audits after 1975 (Tr. 202-06, 211-12, 239-40). The failure to submit the audited annual financial statements is thus clearly established, and under the circumstances is clearly irregular.

The evidence is conflicting in regard to the substantial amount of fees paid to Maultsby for audit work which was never delivered. Appellant himself testified that he paid some \$1,800.00 to Maultsby for audits of Eastside I but that Maultsby never submitted anything to appellant except some work papers in connection with a conference (Tr. 202-06, 242-43, 246-47). However, Appellant's Exhibit 7, "Eastside Corp. I Audit Fee Payment", shows a series of payments totalling \$3,450.00 to Maultsby & Associates spanning the period November 4, 1977 through February 24, 1978. (Exh. A-7, tab 7). In addition, monthly reports to HUD relating to Eastside I for November and December 1977 and January 1978 record audit payments to Maultsby & Associates totaling \$2,450.00 (Exh. G-21A, 21B, 21C; tr. 107-13). It is thus clear that at least \$1,800.00 in audit fees was paid to Maultsby as alleged.

The explanation for the timing of so large an expenditure for audit fees, after the project had allegedly been unable to afford them for more than three years, is unpersuasive. Holifield testified that the payments were made to Maultsby in connection with the conversion and workout that appellant was attempting to negotiate for the project, that the expenditures would have been "useless" if he had expected the projects to be foreclosed, and, that they would have been better applied under that expectation to utility bills (Tr. 203-04, 212-13). Consequently, I find that the timing and circumstances of these substantial payments, coupled with the clearly established willful failure of appellant to deliver to HUD delinquent audited financial statements for three prior years despite repeated official requests establishes project management irregularities more than sufficient to support the temporary denial of participation imposed because of the third and fourth grounds described in the April 6, 1979 letter.

4. Project Records

The record adequately supports the Area Manager's charge that appellant had "been from time to time, tardy, nonresponsive or uncooperative in providing requested Project records to HUD." Appellant's failure to deliver the annual financial statements discussed above is a clear example.

The Indianapolis Area Office acted promptly to take possession of the records of the two foreclosed projects after the March 1978 Court Orders (Tr. 86-99). It is also well established that the deficiencies in the condition of the records received were evident within days after HUD assumed possession of the projects, and thus were attributable to appellant's mismanagement and not the actions of subsequent managers. (Tr. 167-170).

Although demand was made upon appellant for all project records with the aid of the Court order, the evidence established that what records were produced, were produced in stages and were incomplete in significant and burdensome respects. The inventory of records transferred establishes that some records were in fact transferred on March 6 and March 8, 1978, but it does not establish the condition, currency, or accuracy of those records (Exh. A-1). For example, the discrepancy involved in the transfer of 102 tenant folders for a project of 135 units is nowhere satisfactorily explained (Tr. 175, Exh A-1).

Jereline Fleming, former Property Disposition Branch Realty Specialist in the Indianapolis Area Office, specifically identified missing items such as bank books, security deposit money and some of the tenant ledger cards. (Tr. 11-15, 91-101). Such items are normally required for each transfer of possession (Tr. 179). Fleming's testimony was corroborated by Ginger, who testified that the lack of tenant records prevented HUD from matching tenants with apartments thereby requiring a special door-to-door canvass for that purpose (Tr. 145-47, 176-81). In particular, their testimony established the failure to deliver records certifying the eligibility of tenants for occupancy and rent subsidy (Tr. 8-15, 154-55, 164-65).

Appellant's failure to maintain and transfer such records breached the applicable provisions of the management agreements (Exh. G-12 at p. 8, G-11 at pp. 6-7). The incomplete and inaccurate records required successor property managers to perform services not normally required, such as special recertification of existing tenants receiving rental assistance. (Tr. 169-70, 179, 244-46).

CONCLUSIONS OF LAW

1. Appellant is a contractor within the meaning of 24 C.F.R. §24.4(f) and is therefore subject to an order by the Area Manager temporarily denying to him participation in Department programs under 24 C.F.R. §24.18(a).

2. Appellant had a contractual obligation to collect, retain, and maintain tenants' security deposits in a separate trust account and had no authority to disburse or expend such funds to pay utility bills or for any other purpose. The temporary denial of participation was properly based on the allegation that appellant had improperly handled the tenants' security deposit accounts.

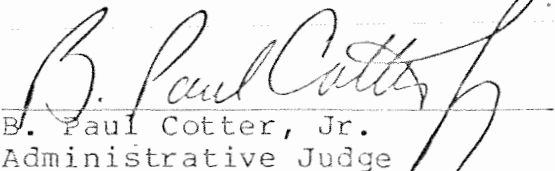
3. The evidence is insufficient to establish either that [REDACTED] Maultsby improperly used Eastside I [REDACTED] at [REDACTED] North Illinois Street or that appellant knew or participated in the improper usage alleged. The temporary denial of participation, therefore, could not properly be based upon this alleged irregularity.

4. Eastside I Project funds amounting to at least \$1800.00 were paid to [REDACTED] Maultsby for preparation of audited financial statements, but the requested statements were never delivered to or received by HUD. No good cause is shown to explain this delinquency. The record as a whole supports the conclusion that the payments were not in the best interest of the project or HUD, particularly in consideration of when the payments were made and appellant's failure to deliver the audited financial statements to HUD as required. In the view most favorable to appellant, the payments to Maultsby comprised, at the least, negligent use of project funds and negligent failure to obtain, prepare, and deliver financial statements required by the Contract. These circumstances constitute sufficient evidence of irregularities in appellant's performance to support the denial of participation in Department programs.

5. The government acted promptly and diligently in attempting to obtain the records of Eastside I and Eastside II to which it was entitled under the terms of the contract and pursuant to Court orders. Despite repeated requests, appellant failed promptly to furnish the records of the Projects to HUD as required. The dereliction was significant, material, and burdensome to the Government. These performance deficiencies constituted irregularities which amply supported the Area Manager's temporary denial of participation.

CONCLUSION

Upon consideration of the public interest and the entire record in this case, Charles R. Holifield and Housing Management Consultants, Inc. were properly denied participation in programs under the jurisdiction of the Assistant Secretary for Housing in Indiana from April 6, 1979 until April 6, 1980.


B. Paul Cotter, Jr.
Administrative Judge
HUD Board of Contract Appeals

Issued at Washington, D.C.
on September 16, 1980.