



U.S. Department of Housing and Urban Development
Office of Inspector General for Audit, Midwest
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AUDIT MEMORANDUM
00-CH-211-1809

July 5, 2000

MEMORANDUM FOR: Howard G. Goldman, Director of Minneapolis Multifamily Hub,
Minnesota State Office

FROM: Dale L. Chouteau, District Inspector General for Audit, Midwest

SUBJECT: Harbor View Estates
Multifamily Equity Skimming
Duluth, Minnesota

We completed an audit of the books and records of Harbor View Estates. We performed the audit to determine whether Project funds were used in compliance with the Regulatory Agreement and other agreements, and applicable HUD policies and procedures. The review was part of our Operation Safe Home initiative.

We found that Duluth Harbour Investments, Incorporated, the former owner of Harbor View Estates, inappropriately disbursed \$356,638 of Project operating funds while the Project was in a non-surplus cash position and/or while its mortgage was in default. The expenditures included: \$113,924 for repayments of owner advances and/or loans; \$62,062 for loan payments of identity-of-interest companies; \$45,926 for unsupported payments to related parties; \$44,967 for transfers to related parties' bank accounts; \$42,860 for non-Project utility costs; \$23,844 for garnished operating funds; \$16,300 for security deposit funds disbursed for unidentifiable expenses; and \$6,755 for unsupported miscellaneous expenses. We also found that Melhus Management Company, a former management agent of the Project, improperly received \$5,899 of Project funds for excess management fees and unauthorized lease-up fees. As a result, the Project's expenses were overstated and there were fewer cash resources available for debt service or to pay reasonable and necessary operating expenses timely.

During the audit, the Project's mortgage was assigned to HUD which resulted in a Federal Housing Administration insurance claim of over \$1.6 million. HUD foreclosed on the Project and

sold it at auction for over \$2.1 million. HUD executed settlement agreements with the Presidents of Duluth Harbour Investments and Melhus Management Company effective June 16, 2000 and June 13, 2000, respectively. Under the terms of the settlements, Duluth Harbour Investments and Melhus Management Company agreed to reimburse HUD \$8,399. The \$8,399 includes \$2,500 for our audit costs, and \$5,899 for the excess management fees and unauthorized lease-up fees. The President of Duluth Harbor Investments also agreed to be debarred from doing business with the Federal Government. HUD issued limited denials of participation against Melhus Management Company and the former Vice President of Duluth Harbour Investments. Based on the settlement agreements and the administrative action taken by HUD, we consider this matter closed.

If you or your staff have any questions, please contact me at (312)353-7832.

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President of Duluth Harbour Investments, Incorporated (2)
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President, Melhus Management Company (2)