

# **Bond Case Briefs**

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## **In Roach-Infested Slums, a Muni-Bond Default Spurs Big Questions.**

At the Warren and Tulane Apartments, crime-plagued complexes for impoverished residents of Memphis's south side, units were infested with roaches. There were broken windows, buckling ceilings, missing and damaged appliances. Sewage littered overgrown lawns.

"It's appalling," said Jessica Johnson-Peterson, who has lived at the 248-unit Warren apartments with her husband and four children since 2009. "We have to jump through extreme hoops to even get anyone's attention."

The conditions led the U.S. Department of Housing and Urban Development last month to cut off rent subsidies for more than 1,000 residents. With that, the financial fallout spread to a more distant group: Holders of \$12 million of municipal bonds that the owner, Global Ministries Foundation, sold through a Memphis authority in 2011 to buy the apartments. The loss of the federal funds caused the securities to default, pushing the price to as little as 21 cents on the dollar.

GMF, which is run by a Baptist minister and says on its website that everything it does is "for the glory of God and the eternal welfare of mankind," has built a 10,500-unit low-rent real estate empire with money raised through one of the riskiest corners of the municipal-bond market — local agencies with few, if any, employees and that exist only to sell tax-exempt debt for a fee.

With little regulatory oversight or responsibility for the projects they finance, the authorities have raised money for privately-run nursing homes, charter schools and even amusement parks. Almost 60 percent of defaulted municipal bonds were issued by such conduits, according to Matt Fabian, a partner at Concord, Massachusetts-based Municipal Market Analytics. In most cases, investors, not taxpayers, are left on the hook.

"Conduits have been a perennial problem in the market," said Christopher Taylor, the former executive director of the Municipal Securities Rulemaking Board, the industry's regulator. "I'm not saying affordable housing isn't a laudable goal, but is this the way in which you should use tax-exempt financing to do it — where there is no, essentially, governmental oversight and control?"

GMF, a Cordova, Tennessee non-profit founded in 2003, has raised \$400 million. It owns and operates 60 multifamily complexes in 8 states. It has issued debt through the Public Finance Authority, a Wisconsin agency with no employees, to buy apartments in Indiana, Alabama, Florida and Georgia. GMF used a conduit run by Gulf Breeze, Florida, to issue bonds for a project 360 miles (579 kilometers) away in Jacksonville, on the state's opposite coast.

### **Historical Challenges**

Richard Hamlet, GMF's president, said his organization has invested more than \$3 million in the Memphis apartments, which were contending with crime and poor maintenance by tenants before it purchased them five years ago. He said HUD rejected its proposal for a "substantial renovation" and opted to cut off federal funds instead.

"The properties had historical challenges with crime, resident upkeep and other issues," he said. "The unfortunate physical, crime and ancillary issues which have faced Warren and Tulane are challenging, but we did not retreat," said Hamlet. "Our management team, in addition to outside contractors we engaged, worked hard under very stressful conditions to mitigate physical deficiencies on the sites."

Hamlet said HUD is auditing his organization's other subsidized properties, though he said none have failed inspections and "all are in good standing." Priya Jayachandran, who oversees multifamily housing at HUD, declined to comment through a spokesman, citing ongoing discussions with GMF.

Following on-site visits to some buildings, Standard & Poor's put 25 GMF-backed bond issues on review for a downgrade last month, saying a decision to withhold funding from other complexes could jeopardize the money used to repay investors. Such a sanction is rare: Last year, HUD cut subsidies to just three of the 17,000 properties it assists.

"Some of them were in poor condition," Karen Fitzgerald, an S&P analyst, said of the GMF residences. "We put them on Creditwatch pending a full review not just because of the asset quality but also of the management as well as the audited financial statements."

### **Good Reputation**

In 2011, GMF used the Memphis Health, Educational and Housing Facility Board, which has three employees, to finance its purchase of the Warren and Tulane apartments, in an area where as many as 40 percent of the families live in poverty. A Las Vegas-based environmental consultant concluded that the apartments were in "good to fair" condition at the time, according to the official statement for the bond issue.

The Memphis health board had no responsibility to monitor GMF's apartments after the bonds were sold, Daniel Reid, chairman of the agency that issued the debt, said in an e-mailed response to questions. Beforehand, the agency investigates proposed projects, the applicant's experience and the financing structure, he said. It has worked with GMF on several transactions since 2011.

"GMF had maintained a good reputation with all sectors of the investment community, including rating agencies and HUD prior to the current default," Reid said.

Hamlet, a former executive at an apartment management and development firm, expanded into the housing business by starting a separate non-profit, GMF Preservation of Affordability Corp., in 2004. The housing unit transferred \$7.1 million to the ministry in 2014, according to federal tax filings, subsidizing its missionary work, which includes training pastors, producing a national radio program and undertaking evangelistic crusades overseas.

GMF's "main concern is for the residents of our affordable housing communities," Hamlet said. "We entered this space to make a difference in the lives of our residents."

GMF is also a lucrative family business. Hamlet was paid \$535,000 in salary and benefits in 2014, according to GMF's tax records. Four other family members received \$218,000. Hamlet said his compensation is in line with peers in the industry.

### **Failing Grade**

Conditions deteriorated after the GMF acquisition, according to federal inspection reports. HUD, which is responsible for overseeing the low-income housing it subsidizes, gave the apartments a score of 67 when they were inspected October 2012. A passing score is 60. In 2014, it dropped to 38.

After inspections in April and December 2015, HUD gave GMF a list of health and safety violations that required immediate response. The April inspection of 30 buildings and 25 units found “life threatening” breaches including exposed wires and blocked emergency exits, as well as buckled ceilings, cracked windows and leaking pipes.

In January, HUD found missing or inoperable smoke detectors, blocked emergency and fire exists and other deficiencies, according to a Feb. 3 letter from the agency. HUD cut off Section 8 project-based rental assistance payments, which are used to pay bondholders.

“The abatement came as a surprise to us,” Hamlet wrote in an e-mail to trustee Bank of New York Mellon that was disclosed in a bond filing.

GMF’s failure to comply with the conditions of its contract with HUD triggered a technical default. Without the federal subsidies, GMF is likely to miss payments due to investors within the next two years unless the apartments can be sold for enough money to retire the debt, S&P said on Feb. 19, when it cut the rating 10 ranks to CCC+, seven steps below investment grade.

Hamlet said the default is a rarity. “Our bond issues historically have performed well,” he said. This “is the first bond default I have had in my career in this space.”

GMF is in discussions with two separate groups interested in purchasing the Warren and Tulane apartments, Hamlet said in a March 7 letter to Bank of New York Mellon.

## **Scrutiny Elsewhere**

Officials have revealed poor living conditions at other GMF apartments. An August HUD inspection at a GMF’s Eureka Gardens complex in Jacksonville found mold, water damage, broken windows and appliances, and peeling paint. After being ordered to fix the violations, the building passed a follow-up inspection, said HUD spokesman Jereon Brown. At Serenity Towers, a 396-unit complex in Memphis, a report released last month by the city’s code enforcement unit found that more than a third of the apartments had bedbugs. The inspection also revealed broken and damaged windows, ceiling leaks and damaged toilets.

Hamlet said that GMF has spent “millions” in Jacksonville and \$200,000 to combat the bedbug infestation in Memphis, saying “much progress” has been made there.

Residents of the Warren and Tulane apartments are getting a fresh start: federal housing officials have begun planning to relocate them.

“I’m ecstatic,” said Jessica Johnson-Peterson. “I feel like it’s an opportunity to be able to provide better chances for my children and a better environment to raise my children.”

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