

FILED IN THE DISTRICT COURT
MAY 02 2008
Juanita M. Dixon
CLERK DISTRICT COURT

IN THE SECOND JUDICIAL DISTRICT
COUNTY OF BERNALILLO
STATE OF NEW MEXICO

STATE OF NEW MEXICO *ex rel.*
STATE INVESTMENT COUNCIL, and
STATE INVESTMENT OFFICE,

Plaintiffs,

vs.

No. 200804383
EV

VINCENT GALLEGOS, a/k/a
VINCENT "SMILEY" GALLEGOS, individually,
JOHN DOE, JANE DOE,
HUGHES & STRUMOR, Ltd. Co.,
a New Mexico corporation, and
ROBERT M. STRUMOR, individually,

Defendants.

COMPLAINT FOR DAMAGES

Plaintiffs, State of New Mexico, *ex rel.* State Investment Council and State Investment Office, through their attorneys Robles, Rael & Anaya, P.C. (Luis Robles, Esq.), states the following for their Complaint for Damages:

JURISDICTION AND PARTIES

1. The State Investment Council is composed of the governor, the state treasurer, the commissioner of public lands, the secretary; three public members appointed by the governor with the advice and consent of the senate, the state investment officer; and the chief financial officer of a state institution of higher education appointed by the governor with the advice and consent of the senate. The chairman of the State Investment Council is the governor.

2. The primary responsibility of the State Investment Council is to administer and manage New Mexico's three permanent trust funds: the Land Grant Permanent Fund, the Severance

Tax Permanent Fund, and the Tobacco Settlement Permanent Fund. In turn, the purpose of New Mexico's three permanent endowment trust funds is to contribute recurring revenues for the operating budget of the State and to provide resources to various fund beneficiaries. The State Investment Council investment goals are to preserve the permanent endowment funds for future generations and to provide future benefits by growing the funds at a rate at least equal to inflation.

3. State statute also creates the State Investment Office. The chief administrative officer of the State Investment Office is the State Investment Officer. The State Investment Officer has the authority to invest or reinvest money and purchase, sell or exchange investments or securities held in the permanent fund. The State Investment Officer formulates and recommends to the State Investment Council for approval investment regulations or resolutions pertaining to the kind or nature of investments and limitations, conditions and restrictions upon the methods, practices or procedures for investment, reinvestment, purchase, sale or exchange transactions that should govern the activities of the investment office. The State Investment Officer has the duty to see that money invested is at all times handled in the best interests of the State.

4. Plaintiffs, the State Investment Council and the State Investment Office, are hereinafter collectively referred to as the "SIC."

5. Plaintiff, the State of New Mexico, appear in this action on behalf the SIC because this litigation serves the public interest.

6. The SIC's offices are located in Santa Fe County, New Mexico.

7. Region III Housing Authority, is a political subdivision of the State of New Mexico created pursuant to the Regional Housing Law, NMSA 1978, § 11-3A-1 *et seq.* (1994) (*hereinafter*

referred to as “Region III”). Region III is not a defendant in this action; the SIC does not seek damages from Region III in this action.

8. Upon information and belief, Region III’s offices are located in Bernalillo County, New Mexico.

9. Upon information and belief, Region III Housing Authority, New Mexico, Inc., is a New Mexico Corporation created by Region III (*hereinafter* referred to as “Region III, Inc.”). Region III, Inc. is not a defendant in this action; the SIC does not seek damages or other relief from Region III, Inc. in this action.

10. Upon information and belief, Region III, Inc.’s offices were located in Bernalillo County, New Mexico.

11. Upon information and belief, Housing Enterprises, Inc., is a New Mexico corporation created by Region III and Region III, Inc. (*hereinafter* referred to as “HEI”). HEI is not a defendant in this action; the SIC does not seek damages or other relief from HEI in this action.

12. Upon information and belief, HEI’s offices were located in Bernalillo County, New Mexico.

13. Upon information and belief, Defendant, Vincent Gallegos, a/k/a Vincent “Smiley” Gallegos, is a resident of Bernalillo County, New Mexico (*hereinafter* referred to as “Gallegos”).

14. Upon information and belief, Defendants, John Doe and Jane Doe are agents of Gallegos who engaged in the activities set forth in detail in this complaint (*hereinafter* collectively referred to as “agents”). Upon information and belief, agents are residents of Bernalillo County, New Mexico.

15. Upon information and belief, Defendant, Hughes & Strumor, Ltd. Co., is a New Mexico corporation which provided legal services for Region III, Region III, Inc., HEI, and Gallegos as well as marketing/sales services for Region III, Region III, Inc., HEI, and Gallegos (*hereinafter* referred to as “Hughes & Strumor”).

16. Upon information and belief, Hughes & Strumor’s offices are located in Bernalillo County, New Mexico.

17. Upon information and belief, Defendant, Robert M. Strumor, is an attorney licensed to practice law in the State of New Mexico and is a partner in the law firm of Hughes & Strumor (“Strumor”).

18. At all material times, Strumor acted within the scope of his employment with Hughes & Strumor.

19. Upon information and belief, Strumor resides in Bernalillo County, New Mexico.

20. This Court has jurisdiction over the parties and the subject matter of this action.

21. Many of the activities undertaken by Defendants occurred in Bernalillo County, New Mexico.

22. Venue is proper in this Court pursuant to NMSA, 1978, § 38-3-1.

FACTS COMMON TO ALL COUNTS

I. THE REGIONAL HOUSING LAW, NMSA 1978, § 11-3A-1 *et seq.* (1994).

23. In an attempt to provide low-income people with safe and sanitary housing, the State Legislature enacted a statute entitled the Regional Housing Law, NMSA 1978, § 11-3A-1 *et seq.* (1994).

24. To achieve the State Legislature's policy goals, the Regional Housing Law created seven regional housing authorities.

A. Region I consists of the counties of Cibola, San Juan and McKinley;

B. Region II consists of the counties of Rio Arriba, Los Alamos, Taos, Colfax, Mora, Santa Fe and San Miguel;

C. Region III consists of the counties of Sandoval, Bernalillo, Valencia and Tarrant;

D. Region IV consists of the counties of DeBaca, Curry, Roosevelt, Union, Harding, Quay and Guadalupe;

E. Region V consists of the counties of Catron, Grant, Hidalgo and Luna;

F. Region VI consists of the counties of Lincoln, Chaves, Otero, Eddy and Lea;
and

G. Region VII consists of the counties of Socorro, Sierra and Dona Ana.

25. Each "regional authority created by the Regional Housing Law shall operate only within the area of its housing region."

26. The Regional Housing Law authorizes each housing authority "within its region, [to] prepare, carry out, acquire, purchase, lease, construct, reconstruct, improve, alter, extend or repair any housing project and operate and maintain the housing project."

27. "To standardize the delivery of affordable housing programs and services in New Mexico, regional authorities within their jurisdictions may . . . create partnerships between state, federal, city and county governments, nonprofit entities and the private sector that will provide the

necessary resources to carry out the planning, financing, development and delivery of affordable housing.”

28. “Every authority, in addition to other powers conferred by the Regional Housing Law, shall have, if authorized by resolution of its board and approved by the state board of finance, the power to create nonprofit corporations to carry out the powers and duties set forth in Section 11-3A-7 NMSA 1978 [of the Regional Housing Law].”

29. Before this and its related provisions were repealed by the State Legislature in 2007, the Regional Housing Law gave the individual housing authorities during the period of time in which the bonds in question in this case were issued the “power to issue bonds . . . to finance . . . the cost of the . . . acquisition . . . or repair of any housing project or housing undertaking.”

30. Despite having broad powers to deliver affordable housing, “[n]o authority shall construct or operate any housing project for profit.”

31. The Regional Housing Law specifically prohibits, without exception, the “acquisition of any direct or indirect interest in any ‘housing project’ (single family residence) of an authority by an officer or employee.”

32. The Regional Housing Law only allows regional housing authorities to assist persons of “low income.” “‘Low-income person’ means any individual, couple or family whose gross income does not exceed eighty percent of the resident’s particular county median income and who cannot afford to pay more than thirty percent of his gross income for housing rent or mortgage payments or a low-income person as defined by the federal government.”

II. THE GENERAL OPERATIONS OF THE REGION III HOUSING AUTHORITY AND ITS RELATED ENTITIES.

33. The Regional Housing Law, NMSA 1978, § 11-3A-1 *et seq.* (1994) created Region III.

34. As set forth in the Regional Housing Law, Region III's authority to provide affordable housing was limited to Bernalillo, Sandoval, Torrance, and Valencia counties.

35. Upon information and belief, Region III, Inc. is a 501(c)(3), New Mexico non-profit corporation set up by the Region III. Region III, Inc.'s Articles of Incorporation state that the objective of Region III, Inc. is to provide affordable housing for persons of lower and moderate income, and for charitable, religious, educational and scientific purposes within the meaning of section 501(c)(3) of the Internal Revenue Code, without profit to any officer or director.

36. In 2003, Region III, Inc. created HEI for the purpose of providing Region III with home acquisition and rehabilitation services.

37. Upon information and belief, HEI is a New Mexico non-profit corporation set up by Region III. The Internal Revenue Service has not designated HEI as a 501(c)(3). HEI's Articles of Incorporation state that the purpose of the corporation is to support and act on the behalf of Region III. Although the Articles indicate that HEI intended to be tax-exempt under Section 501(c)(3) of the Internal Revenue Code, the IRS has not granted tax-exempt status to HEI. HEI is no longer a corporation in good standing with the New Mexico Public Regulation Commission, Corporations Bureau.

38. Although Region III, Inc. and HEI have separate operating accounts, the two entities shared the same building and significant crossover of both management and personnel. The two

entities were each run by Gallegos and shared several of the same board members.

39. Gallegos was the executive director of both Region III, Inc. and HEI and oversaw the day-to-day operations of both entities.

40. During the actions and incidents which are material to this complaint, Gallegos acted outside of the scope of his duties to Region III, Region III, Inc., and HEI. Gallegos, in his capacity as an employee acting within the scope of his duties to Region III, Region III, Inc., and HEI, is *not* a defendant in this action; the SIC does *not* seek damages or other relief from Gallegos in his capacity as an employee acting within the scope of his duties to Region III, Region III, Inc., and HEI.

41. During the actions and incidents which are material to this complaint, the agents acted outside of the scope of their duties to Region III, Region III, Inc., and HEI. The agents, in their capacity as employees acting within the scope of their duties to Region III, Region III, Inc., and HEI, are *not* defendants in this action; the SIC does *not* seek damages or other relief from the agents in their capacity as employees acting within the scope of their duties to Region III, Region III, Inc., and HEI.

42. During all relevant times, Hughes & Strumor provided legal services to Region III, Region III, Inc. HEI, and Gallegos.

43. In addition to providing legal services, Strumor also marketed/sold securities to the SIC.

III. THE REVENUE BONDS ISSUED BY REGION III, INC. AND PURCHASED BY THE SIC.

44. On or about April 9, 2003 and June 7, 2003, Strumor traveled to the SIC offices to meet with SIC personnel.

45. During his visits to the SIC offices, Strumor met with the State Investment Officer and the State Investment Office employee who oversaw the fixed income securities for the State Investment Office (hereinafter referred to as "SIO employee").

46. During these negotiations, Strumor represented to the SIO employee that:

A. Region III, Inc.'s proposed bonds followed the procedure set forth below:

1) After presenting a funding request to the trustee, Region III, Inc. would draw bond proceeds from the trustee for the purchase and rehabilitation of a single family residence;

2) Using the bond proceeds, Region III, Inc. would then purchase the property from a third party seller;

3) Using the bond proceeds, Region III, Inc. would rehabilitate the property;

4) Region III, Inc. would sell the property to a "low-income" individual;

5) After the "recycling" provisions of the bond ended, the proceeds from the sale of the property would be used to pay the principal and interest on the bond.

B. Region III, Inc. did not discuss that the bonds would be used to construct or operate any housing project for profit.

C. Region III, Inc. only assisted persons of "low income."

47. During his visits to the SIC offices, Strumor did not disclose to the State Investment Officer or the SIO employee that:

A. Region III, Inc. intended or planned on constructing or operating housing projects for profit.

B. Region III, Inc. intended or planned to subsidize persons who were *not* “low income.”

C. Region III, Inc. would use bond proceeds to acquire housing for Region III and Region III, Inc.’s officers or employees.

D. Region III, Inc. would use bond proceeds to purchase property which Region III, Inc. already owned or which was already financed by a third-party lender.

E. Initially, Strumor asked the SIO employee if Region III, Inc. could use bond proceeds for operating expenses (including salary and benefits). The SIO employee told Strumor no. However, Region III, Inc. would in fact use bond proceeds for operating expenses after the SIO employee had told Strumor that Region III, Inc. could not use bond proceeds for operating expenses.

F. Region III, Inc. would use proceeds from the sale of property for purposes other than to pay the debt owed on the bond.

G. Region III, Inc. would use bond proceeds to issue loans to other regional housing authorities for their operating expense.

48. Gallegos only met with the SIO employee during the April 9, 2003 meeting. Gallegos was not present for Strumor’s meeting with the SIO employee on June 7, 2003.

49. During his visit to the SIC offices on April 9, 2003, Gallegos did not discuss with the SIO employee how the proposed bonds worked or how Region III, Inc. intended to use the proceeds from those bonds. Instead, it was Strumor who explained how the proposed bonds worked and how Region III, Inc. intended to use the proceeds from those bonds.

50. After the June 7, 2003, meeting, Strumor, not Gallegos, negotiated Region III, Inc.’s proposed bond’s structure and interest rate with the SIO employee.

51. Relying in large part on Strumor's representations to the SIO employee and the bond documents, the SIC purchased two separate \$2,500,000 Taxable Single Family Residence Acquisition and Rehabilitation Revenue Bonds authorized by Region III and issued by Region III, Inc.

52. On July 1, 2003, Region III, Inc. issued the first bond, a \$2,500,00 Taxable Single Family Residence Acquisition and Rehabilitation Revenue Bonds (Series 2003A Bonds). The SIC purchased the Series 2003A Bonds from Region III, Inc.

A. The Series 2003A Bonds beared interest, payable on June 1st and December 1st of each year beginning December 1, 2003 (the "Interest Payment Date"), at 6.00% per annum:

Maturity date	Principal	Interest Rate
June 1, 2006	\$2,500,000.00	6.00%

B. According to the Series 2003A Bonds, the Trustee deposited the proceeds of the sale of the bonds as follows:

- 1) The sum of \$2,202,000.00 into the Acquisition and Rehabilitation Account of the Program Fund;
- 2) The sum of \$48,000.00 into the Cost of Issuance Account of the Program Fund; and
- 3) The sum of \$250,000.00 into the Reserve Fund.

C. If any of the following events occurred, Region III, Inc. was by the terms of Series 2003A Bonds in default:

- 1) Payment of the principal or redemption price of any bond is not made when the same becomes due and payable, whether at maturity or upon redemption or otherwise; or

2) Payment of any installment of interest on the bonds is not made as the same becomes due and payable; or

3) Default in the performance or observance of any other of the covenants, agreements, or conditions on the part of Region III, Inc. contained in the Series 2003A Bonds.

53. On April 1, 2004, Region III, Inc. issued a second bond, \$2,500,000 First Supplemental Trust Indenture (Series 2004A Bonds) which superceded the 2003A bond, provided for the issuance of an additional \$2,500,000, and secured both bonds. The SIC purchased the Series 2004A Bonds from Region III, Inc.

A. The Series 2004A Bonds beared interest, payable on June 1st and December 1st of each year beginning December 1, 2004 (the "Interest Payment Date"), at 6.50% per annum:

Maturity date	Principal	Interest Rate
June 1, 2007	\$2,500,000.00	6.50%

B. According to the Series 2004A Bonds, the Trustee deposited the proceeds of the sale of the bonds as follows:

1) The sum of \$2,202,000.00 into the Acquisition and Rehabilitation Account of the Program Fund;

2) The sum of \$48,000.00 into the Cost of Issuance Account of the Program Fund; and

3) The sum of \$250,000.00 into the Reserve Fund.

C. If any of the following events occurred, Region III, Inc. was by the terms of Series 2004A Bonds in default:

- 1) Payment of the principal or redemption price of any bond is not made when the same becomes due and payable, whether at maturity or upon redemption or otherwise; or
- 2) Payment of any installment of interest on the bonds is not made as the same becomes due and payable; or
- 3) Default in the performance or observance of any other of the covenants, agreements, or conditions on the part of Region III, Inc. contained in the Series 2004A Bonds.

54. The Series 2003A Bonds and the Series 2004A Bonds set forth how Region III, Inc. obtained bonds funds, how those funds are spent, and how they are repaid.

A. The bonds provide that, “the Issuer [Region III, Inc.] proposes to issue, sell and deliver the Bonds to make available funds to finance the acquisition and rehabilitation of single family residences for sale to persons of low income. . .”

B. “Bond Proceeds shall be used to acquire and rehabilitate single family residences and shall be used to pay the principal of and interest on the Bonds if the Bond Fund and the Reserve Fund [has] insufficient moneys on deposit to make such payments.” The term “low income” is defined as “persons and families of low income as defined by the Act as amended.”

C. Collectively the bonds allocated a total of \$4,404,000.00 of the bonds proceeds to the Acquisition and Rehabilitation Account, \$96,000.00 to costs of issuance, and \$500,000.00 reserved for payment of interest on the Bonds.

D. As contemplated by the terms and conditions of the bonds, the physical and financial processes of acquiring, rehabilitating and selling single family residences was a well defined and straightforward process. After the “recycling” provision of the bonds had ended, the

bonds provided that Region III, Inc. shall, upon receipt, pay to the Trustee, all proceeds of the sales of single family residences acquired by Region III, Inc. The Indenture required Region III, Inc. to follow the procedure set forth below:

1) After presenting a Bond Requisition Certificate to the Trustee, Region III, Inc. would draw bond proceeds from the Trustee for the purchase and rehabilitation of a single family residence;

2) The Trustee would release bond proceeds, in the amount certified on the Bond Requisition Certificates, into the operating account of Region III, Inc.;

3) Using the bond proceeds, Region III, Inc. would then purchase the property from a third party seller;

4) Using the bond proceeds, Region III, Inc. would rehabilitate the property;

5) Region III, Inc. would sell the property to a "low-income" individual, 80% of median income as defined by the Indenture and Regional Housing Law; and

6) Even during the recycling period of the Bond, the proceeds from the sale of the property would be deposited with the Trustee for payment of principal and interest on the Bonds.

55. In mid-May, 2006, Strumor sent counsel for the State Investment Office an unsolicited, proposed Second Supplemental Trust Indenture.

56. In mid-May of 2006, Region III informed the State Investment Office that there were insufficient funds to repay the principal and interest of the Series 2003A Bond due on June 1, 2006. Subsequently, Region III requested an extension of the maturity date.

57. On May 31, 2006, the State Investment Office met with representatives of Region III including Region III Chairman Filo Sedillo, Gallegos, Region III accountant Dennis Kennedy, and Strumor. Region III informed the State Investment Officer that little to no money existed to repay the Bonds. Region III once again requested the extension of the maturity date of the Series 2003A Bond by executing a Second Supplemental Indenture.

58. Based on its fiduciary duties to the citizens of the State of New Mexico, the State Investment Office responded that it could not 1) extend the maturity date without additional financial consideration, and 2) extend the maturity date without conducting additional due diligence to evaluate the prudence of executing the Second Supplemental Indenture.

59. After June, 2006, SIC began to learn that Region III, Inc. violated the terms and conditions of the Series 2003A Bonds and the Series 2004A Bonds, regarding how Region III, Inc. obtained bonds funds, how those funds were spent, and how they were repaid. Thus, Region III, Inc. defaulted on the Series 2003A Bonds and the Series 2004A Bonds.

60. Region III, Inc. defaulted on the Series 2003A Bond by failing to repay the principal amount before the maturity date of June 1, 2006.

61. As a result of the default, the SIC has an actionable breach of contract claim against Region III, Inc.

62. The SIC has worked diligently to mitigate its damages. In doing so, the SIC has recovered \$137,118.82.

63. As of May 1, 2008, Region III, Inc. owes SIC the principal amount of \$5,025,463.85 with interest accruing at a rate of 6.5 percent per year.

IV. GALLEGOS' FAILURE TO COMPLY WITH THE TERMS OF THE REVENUE BONDS.

64. Gallegos and his agents did not follow the processes of acquiring, rehabilitating and selling single family residences as contemplated by the revenue bonds. In most instances, Gallegos and his agents followed the process listed below:

A. Gallegos and his agents by way of a Bond Requisition Certificate, would draw bond proceeds from the Trustee allegedly for the purchase and rehabilitation of a property - not necessarily a single family residence;

B. Gallegos and his agents would transfer the bond proceeds to HEI;

C. HEI would purchase the property from a third party seller;

D. HEI would often obtain additional financing for the purchase of the properties;

E. HEI would sell or lease/purchase the home to anyone—typically non “low income” individuals— and in many cases investors;

F. Gallegos and his agents would not deposit proceeds from the sale of the property with the Trustee; and

G. The proceeds from the sale of the property would be deposited into the operating accounts of Region III, Inc. and/or HEI.

65. Generally, Gallegos and his agents would identify a property to purchase. Gallegos and his agents would then draw bond proceeds from the Trustee for the purchase price, plus anticipated rehabilitation costs, and “additional costs” which, most often, equaled the rehabilitation costs. The bond proceeds initially would be deposited in a Region III, Inc. operating account then

transferred to an HEI operating account for the purpose of making the initial purchase of the property.

66. If the property was to be resold, typically Gallegos and his agents would arrange for the First State Bank to provide a mortgage to the purchaser in an amount sufficient to pay for the property and the purchaser's closing costs. The mortgage proceeds would be used to purchase the property from HEI and then be deposited into HEI's operating account.

67. If the property was to be sold through a lease purchase arrangement, HEI would first "sell" the property to Region III, usually at a marked-up price. Region III, Inc. would then obtain a mortgage loan from First State Bank, where the proceeds would be used to fund the "purchase" of the property from HEI. Region III, Inc. would then enter into a lease-purchase agreement with the lease-purchaser who would make mortgage payments to a third party loan servicer for the benefit of First State Bank or its assignee of the loan. The actions undertaken by Region III, Inc. and HEI were performed by Gallegos and his agents.

68. By the way of this procedure, Region III, Inc./HEI acquired and sold either by lease/purchase or sale a total of 46 single family residences resulting in proceeds of approximately \$4,000,000.00. Region III, Inc./HEI only made payments of proceeds to the Trustee on eight of those transactions in an amount of \$802,056.00. The \$802,056.00 was either used to pay the quarterly interest payments of the Bonds or recycled from the Trustee for additional property purchases. The actions undertaken by Region III, Inc. and HEI were performed by Gallegos and his agents.

69. As a direct result of this prohibited procedure, Gallegos and his agents diverted funds from the repayment of the bond to the operating accounts of Region III, Inc. and HEI.

70. Region III, Inc. was left without funds to repay the revenue bonds and Region III, Inc. defaulted on the principal payment of the 2003A Series Bond.

A. BOND DRAWS WHICH VIOLATED THE TERMS OF THE REVENUE BONDS.

71. In violation of the terms of the bonds, Gallegos and his agents drew bond proceeds to purchase property already owned and for which other financing had been obtained. The first five bond draws were used to purchase five properties in Edgewood, New Mexico that had already been acquired by Region III, Inc. or HEI and were financed by bank loans as described below:

A. 6 Fernandez, Edgewood. On July 29, 2003, Region III, Inc. drew bond proceeds in the amount of \$67,500.00. Region III, Inc. had purchased this property a year earlier (July 11, 2002) from HUD for \$19,000.00. Moreover, Region III, Inc. had already borrowed \$167,500.00 from New Mexico Community Development Fund to obtain this property. Additionally, Region III, Inc. had previously borrowed \$4,000.00 for rehabilitation of this property from the New Mexico Mortgage Finance Authority ("NMMFA") for which Region III, Inc. gave NMMFA a second mortgage.

B. 19 Adams, Edgewood. On July 29, 2003, Region III, Inc. drew bond proceeds in an amount of \$72,000.00 for a property it had previously purchased on December 6, 2002 for \$37,144.00.

C. 14 Bonnie Lane, Edgewood. On July 29, 2003, Region III, Inc. drew bond proceeds in a amount of \$68,000.00 for a property it had previously purchased on December 23, 2002 for \$43,250.00.

D. 12 David Drive, Edgewood. On July 29, 2003, Region III, Inc. drew bond

proceeds in an amount of \$67,500.00 for a property it had previously purchased on May 14, 2002 for \$43,100.00.

E. 615 Union, Edgewood. On July 29, 2003, Region III, Inc. drew bond proceeds in an amount of \$68,000.00 for a property it had previously purchased on or about February 1, 2003 for an unknown sum.

F. Central/ Skylark property, Las Cruces, New Mexico. On October 8, 2004, Defendants purchased this vacant land parcel for \$138,678.00. During January 2005, Region III, Inc. drew bond proceeds in the amount of \$300,000.00 to purchase this raw land. However, the bond proceeds were never used for this purpose, but instead were used to make a personal loan to VSG, Inc. a company wholly owned by Gallegos.

72. In addition to utilizing bond proceeds for properties that had previously been purchased, Gallegos and his agents failed to purchase properties for which bond proceeds were drawn.

73. On February 4, 2004, Gallegos and his agents drew \$880,000.00 in bond proceeds for purchase and rehabilitation of 16 Residences in Las Vegas, NM. However, only 14 residences were actually purchased. Of the 14 residences purchased, only 13 were rehabilitated. One residence (2417 Cholla), in which Region III, Inc. intended but failed to purchase, was rehabilitated by mistake at a cost of \$29,120.00.

74. Gallegos and his agents made loans to other entities for their general operating budgets including:

A. Region VII Housing Authority or a nonprofit corporation created by Region

VII Housing Authority, Region VII Housing Authority, New Mexico, Inc. ("Region VII, Inc.") in the amount of \$560,460.00;

B. Region IV Housing Authority in the amount of \$95,553.00; and

C. Region I Housing Authority in the amount of \$347,260.00.

B. GALLEGOS AND HIS AGENTS PROVIDED RESIDENCES TO PROHIBITED RELATED INDIVIDUALS.

75. The Regional Housing Law prohibits the "acquisition of any direct or indirect interest in any 'housing project' (single family residence) of an authority by an officer or employee."

A. Denise Padilla is an employee of Region III, Inc. During August of 2003, HEI sold a residence in Belen, New Mexico to Padilla for \$92,700.00. Upon information and belief, Defendants did collect financial information from Padilla. Region III, Inc. payroll records indicate Padilla's income for 2003 was approximately \$34,500.00. Although low income for a family of two in Valencia County is \$34,700, Padilla's additional family income was not taken into account in determining Padilla's eligibility for assistance.

B. Eugene Hurtado was a commissioner of Region III and a board member of both Region III, Inc. and HEI. During July of 2004, Region III, Inc. sold a residence, on a lease-purchase contract, in Pena Blanca, New Mexico to Hurtado. At the time of sale, Region III, Inc.'s files indicate that the income of Hurtado and his wife was \$89,000.00 annually. To qualify for "low income" status in Santa Fe County for a family of two, Hurtado and his wife would have to make no more than \$42,250.00. In Sandoval County, where Hurtado resided, the limit is \$34,700.00. Thus, Hurtado's income was over 200% more than a "low income person," yet he was receiving the benefit of low income housing. In November of 2004, HEI paid Hurtado \$20,025.00 for

“construction services” on the residence he purchased from Region III, Inc. Hurtado and Gallegos signed the check.

C. Jim Raia is an employee of Region III, Inc. During December of 2004, HEI sold a residence in Albuquerque to Raia for \$126,300.00. Upon information and belief, Defendants did collect financial information from Raia. Region III, Inc. payroll records indicate that Raia’s income for 2004 was approximately \$47,000.00 and approximately \$50,000.00 for 2005. These figures do not take into account additional family income that is required to be counted in determining low-income status. Low income status for a family of two in Bernalillo County is \$34,700.00.

76. The proceeds of the sale of the properties to third parties and the proceeds of the lease-purchase financing obtained by Region III, Inc. were not deposited with the Trustee to repay the bond proceeds, as required by the Indenture.

C. GALLEGOS AND HIS AGENTS PROVIDED RESIDENCES TO INDIVIDUALS WHO DID NOT MEET THE DEFINITION OF LOW INCOME.

77. The Regional Housing Law and the Revenue Bonds only allows regional housing authorities to assist persons of “low income.” “‘Low-income person’ means any individual, couple or family whose gross income does not exceed eighty percent of the resident’s particular county median income and who cannot afford to pay more than thirty percent of his gross income for housing rent or mortgage payments or a low-income person as defined by the federal government.” Federal government requirements indicated that “low income persons” is universally defined as those earning no more that 80% of median income adjusted for family size.

78. There are numerous instances where Gallegos and his agents purchased properties

from bond proceeds and either sold or leased to persons not of low income, including the following:

A. Region III, Inc. sold a property at 615 Union in Edgewood, NM to Presbyterian Hospital Services in a sale-leaseback transaction;

B. Four residences in Las Cruces, New Mexico were sold to an investor, Hank Harenberg, who resold the residences at "market rates" without consideration of the income status to the purchasers;

C. The 33 single family lots in Las Cruces, NM, upon which HEI was to construct new single family homes, are under contract to sell to an investor who is to resell the residences "at market rates" and divide the profits with HEI without regard to the income status of the purchasers. This agreement is contrary to public policy and thus unenforceable because the agreement violates the Regional Housing Law.

D. MISUSE OF BOND PROCEEDS FOR THE BENEFIT OF GALLEGOS AND OTHER EMPLOYEES.

79. On January 10, 2005, HEI made a \$300,000.00 loan to VSG, Inc., a company wholly owned by Gallegos. Upon information and belief, there is no promissory note or other evidence of indebtedness in Region III's, Region III, Inc.'s, or HEI's files. Rather, an entry entitled, "N/R VSG, Inc." is found in HEI's books. The loan to VSG, Inc. was approved by the HEI board of directors the day after it was made. Minutes taken during the Board of Directors meeting of January 11, 2005, cryptically state just prior to adjournment: "Mr. Gallegos discussed a loan agreement on personal property which was approved by the board."

80. On January 10, Region III, Inc. wrote a \$300,000.00 check (check #4406) to HEI.

The memo on the check states "2004-DA9 thru DA28", a reference to the lots HEI purchased in Las Cruces two months earlier.

81. HEI made its check #2180 dated January 10, 2005 in the amount of \$300,000.00 to U.S. Title. The memo on the check states: "Purchase of 2004DA9 thru 2004DA28." That transaction was closed on October 8, 2004 through Las Cruces Abstract and Title. U.S. Title, in turn, issued check #458381970, dated January 10, 2005 payable to "V. Gallegos." Prior to this time, on December 16, 2004, over a month after the Las Cruces lots were purchased, Region III, Inc. drew \$300,000.00 of bond proceeds ostensibly for the purchase of those lots.

82. As noted in the January 2005 financial statements, HEI for the first time booked the Central/Skylark properties (DA9 through DA28) as assets, even though they had been purchased in October 2004. The amount booked was \$12,000.00 (\$600.00 for each lot) although the purchase price for the land was \$138,678.00. The same financial statements booked liabilities associated with those properties totaling \$300,000.00, presumably representing the \$300,000.00 transferred from Region III, Inc. to HEI for the VSG loan on January 10th.

83. The principal of this loan was repaid on July 31, 2006.

84. On August 1, 2006, Region III, Inc./HEI appeared before the N.M. Legislative Finance Committee.

85. Upon information and belief, Region III, Inc.'s payroll records indicate substantially disproportionate contributions allocated to the employee retirement plans for Gallegos, Dennis Kennedy, and Denise Padilla. Employer/Employee matching contributions to the 403(b) employee plan range from 1:1 for some employees to more than 3:1 for Denise Padilla in 2005 and 2006 and 7:1 for Vincent "Smiley" Gallegos in 2005 and 2006.

86. Additionally, Region III, Inc. established a 457(b) employee plan benefitting only Gallegos and Kennedy. As of September 2006, Region III, Inc. contributed \$17,911.50 to Kennedy and \$23,285.52 to Gallegos. Kennedy is only a part-time employee and has claimed not to be an employee at all, but a contractor.

E. GALLEGOS AND HIS AGENTS FAILURE TO FOLLOW THE REPAYMENT PROCEDURES SET FORTH IN THE REVENUE BONDS.

87. The bond proceeds deposited into Region III, Inc./HEI's operating accounts after the presentation of a Bond Requisition Certificate provided to the Trustee equaled \$4,153,921.00.

88. The net proceeds resulting from third party sales contracts and lease purchase financing, as a product of properties purchased with bond proceeds, were also deposited into Region III, Inc. and HEI, Inc.'s operating accounts in the amount of \$4,051,929.00.

89. The costs of acquisition, rehabilitation and closing for the purchase and sale of properties totaled \$4,646,279.00.

90. The difference between net deposits and costs equals a cash flow of \$3,559,571.00 from bond proceeds transactions that should have been returned to the Trustee for repayment of the Bonds.

91. The cash flow, listed below, roughly coincides with the amount Region III, Inc./HEI should have repaid under the revenue bonds from sales. It also represents the bulk of Region III, Inc./HEI's overall cash flow for the period beginning with the first draw of bond proceeds through June 30, 2006.

Total deposits:

Net bond proceeds received	\$4,153,921
Total proceeds from closings	\$4,051,929
Total deposits	\$8,205,850

Total disbursements:

Total consolidated acquisition, rehabilitation & closing costs (4,646,279)

Net deposits:

Retained in Region III, Inc./HEI operation accounts \$3,559,571

92. During that same period, Region III, Inc./HEI expended \$1,003,273.00 in loans to other Regional Housing Authorities and over \$1,900,000.00 in payroll, including over \$570,000.00 to Gallegos.

93. Upon information and belief, Region III, Inc.'s and HEI's only other significant source of income is fee income from conduit bond transactions amounting to approximately \$100,000 per year.

V. GALLEGOS' AND HIS AGENTS' EFFORTS TO CONCEAL THE MISAPPROPRIATION OF BOND PROCEEDS FROM SIC.

94. The revenue bonds require Region III, Inc. to submit, at the end of each calendar quarter, a "detailed status report with respect to the acquisition, rehabilitation and sale of single family residences."

95. Gallegos and his agents submitted the quarterly status reports to both the Trustee and the SIO, and certified the reports as being accurate.

96. Because Gallegos and his agents certified the reports, the SIC and the Trustee accepted these reports as accurate.

97. According to these reports, Region III, Inc. did not enter into many sale agreements.

98. Therefore, neither the Trustee nor the SIC had any expectation that 1) proceeds from sales existed, and 2) that funds should have been deposited with the Trustee for repayment of the Bonds.

99. Region III's reports were highly inaccurate and misleading. The reports do not contain all the properties for which the bond proceeds were drawn, and contain inaccurate information about actual purchase prices and rehabilitation costs. Furthermore, the reports do not contain accurate information regarding the status of properties, most importantly sales.

100. Gallegos and his agents acted with scienter in that they knew that the statements issued or disseminated in the name of Region III, Region III, Inc., and HEI were materially false and misleading.

A. Gallegos and his agents knew that such statements or documents would be issued or disseminated to the SIC.

B. Gallegos and his agents knowingly and substantially participated in or acquiesced to the issuance and dissemination of such statements or documents as primary violations of the federal securities laws.

C. As set forth herein in detail, Gallegos and his agents, by virtue of their receipt of information reflecting the true facts regarding the use of the bond proceeds, their control over and/or their associations with their co-defendants, participated in the fraudulent scheme alleged herein.

101. The statutory safe harbor under the Private Securities Litigation Reform Act of 1995, which applies to forward-looking statements under certain circumstances, does not apply to any of the allegedly false statements pleaded in this Complaint.

A. The statements alleged to be false and misleading herein all relate to then-existing facts and conditions.

B. In addition, to the extent certain of the statements alleged to be false may be

characterized as forward-looking, they were not adequately identified as “forwardlooking statements” when made and there were no meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the purportedly forward-looking statements.

C. Alternatively, to the extent that the statutory safe harbor is intended to apply to any forward-looking statements pleaded herein, Gallegos and his agents are liable for those false forward-looking statements because, at the time each of those forward-looking statements was made, the particular speaker had actual knowledge that the particular forward-looking statement was materially false or misleading, and/or the forward-looking statement was authorized and/or approved by Gallegos and his agents who knew that those statements were false when they were made.

102. Through the actions and inactions described in this complaint, Gallegos and his agents and Strumor prevented SIC from discovering all Defendants’ misconduct until July 2006.

VI. BREACH OF CONTRACT BY REGION III, INC.

103. Region III, Inc. offered to the highest bidder two separate \$2,500,000 Taxable Single Family Residence Acquisition and Rehabilitation Revenue Bonds authorized by Region III and issued by Region III, Inc.

A. On July 1, 2003, Region III, Inc. issued the first bond, a \$2,500,00 Taxable Single Family Residence Acquisition and Rehabilitation Revenue Bonds (Series 2003A Bonds). The SIC accepted and purchased the Series 2003A Bonds from Region III, Inc.

B. On April 1, 2004, Region III, Inc. issued a second bond, \$2,500,00 First Supplemental Trust Indenture (Series 2004A Bonds) which provided for the issuance of an

additional \$2,500,000 and securing both bonds. The SIC accepted and purchased the Series 2004A Bonds from Region III, Inc.

104. The consideration set forth in the revenue bonds was fair and reasonable.

105. The SIC has performed all conditions, covenants, and promises required by it on its part to be performed in accordance with the terms and conditions of the bonds.

106. Region III, Inc. breached the terms and conditions of the bonds.

**COUNT I: UNJUST ENRICHMENT BY
GALLEGOS, AGENTS, and HUGHES & STRUMOR**

107. The factual allegations made in paragraphs 1 through 106 are incorporated and re-alleged in this count.

108. All Defendants have knowingly benefitted at SIC's expense.

109. All Defendants have knowingly benefitted at SIC's expense in a manner such that allowance of the other to retain the benefit would be unjust.

110. As a proximate cause of all Defendants' unjust enrichment, SIC suffered economic harm.

111. As a proximate cause of all Defendants' unjust enrichment, the SIC is entitled to restitution and other equitable remedies such as an accounting or a constructive trust.

112. Based on the conduct described above, the SIC is entitled to punitive damages against Defendants, jointly and severally.

113. The SIC is entitled to their attorney's fees and costs.

**COUNT II: VIOLATION OF SECTION 10(b) OF
THE EXCHANGE ACT AND SEC RULE 10b-5 BY GALLEGOS AND AGENTS**

114. The factual allegations made in paragraphs 1 through 113 are incorporated and re-alleged in this count.

115. This Count is asserted against Gallegos and is based upon Section 10(b) of the 1934 Act, 15 U.S.C. § 78j(b), and SEC Rule 10b-5 promulgated thereunder.

116. During all material times, Gallegos, singly and in concert with agents and others, directly engaged in a common plan, scheme, and unlawful course of conduct, pursuant to which he knowingly or recklessly engaged in acts, transactions, practices, and courses of business which operated as a fraud and deceit upon the SIC.

117. Gallegos failed to disclose material information to the SIC, making the statements actually made to the SIC actually misleading.

118. The purpose and effect of said scheme, plan, and unlawful course of conduct was, among other things, to induce SIC to purchase Region III, Inc.'s revenue bonds.

119. The willfulness, motive, knowledge, and recklessness of Gallegos is therefore imputed to acts and inaction of Gallegos' agents.

120. As a result of the failure to disclose material facts, the information Gallegos and his agents disseminated to the SIC was materially false and misleading as set forth above.

121. In ignorance of the duty to disclose the false and misleading nature of the statements described above and the deceptive and manipulative devices and contrivances employed by Gallegos and his agents, the SIC relied, to their detriment, on the integrity of Gallegos' and his agents' statements and affirmations.

122. Had the SIC known the truth, the SIC would not have purchased the revenue bonds.

123. As a proximate result of Gallegos' and his agents' conduct, the SIC has suffered substantial damages as a result of the wrongs herein alleged in an amount to be proved at trial.

124. By reason of the foregoing, Gallegos and his agents' directly violated Section 10(b) of the Exchange Act and SEC Rule 10b-5 promulgated thereunder in that he:

A. employed devices, schemes, and artifices to defraud;

B. failed to disclose material information; or

C. engaged in acts, practices, and a course of business which operated as a fraud and deceit upon the SIC in connection with their purchases of the revenue bonds.

125. Based on the conduct described above, the SIC is entitled to punitive damages against Gallegos and agents, jointly and severally.

126. The SIC is entitled to its attorney's fees and costs.

**COUNT III: VIOLATION OF NEW MEXICO SECURITIES
ACT OF 1986, NMSA 1978, § 58-13B-1 *et seq.* BY GALLEGOS AND AGENTS**

127. The factual allegations made in paragraphs 1 through 126 are incorporated and re-alleged in this count.

128. This Count is asserted against Gallegos and his agents and is based upon New Mexico Securities Act of 1986, NMSA 1978, § 58-13B-1 through 26.

129. During all material times, Gallegos, singly and in concert with his agents, directly engaged in a common plan, scheme, and unlawful course of conduct, pursuant to which he knowingly or recklessly engaged in acts, transactions, practices, and courses of business which operated as a fraud and deceit upon the SIC.

130. Gallegos and his agents failed to disclose material information to the SIC, making the statements actually made to the SIC actually misleading.

131. The purpose and effect of said scheme, plan, and unlawful course of conduct was, among other things, to induce SIC to purchase Region III, Inc.'s revenue bonds.

132. The willfulness, motive, knowledge, and recklessness of Gallegos is therefore imputed to acts and inaction of Gallegos' agents.

133. As a result of the failure to disclose material facts, the information Gallegos and his agents disseminated to the SIC was materially false and misleading as set forth above.

134. In ignorance of the duty to disclose the false and misleading nature of the statements described above and the deceptive and manipulative devices and contrivances employed by Gallegos and his agents, the SIC relied, to their detriment, on the integrity of Gallegos' and his agents' statements and affirmations.

135. Had the SIC known the truth, the SIC would not have purchased the revenue bonds.

136. As a proximate result of Gallegos' and his agents' conduct, the SIC has suffered substantial damages as a result of the wrongs herein alleged in an amount to be proved at trial.

137. By reason of the foregoing, Gallegos and his agents directly violated the New Mexico Securities Act of 1986, NMSA 1978, § 58-13B-1 *et seq.* in that they:

- A. employed devices, schemes, and artifices to defraud;
- B. failed to disclose material information; or
- C. engaged in acts, practices, and a course of business which operated as a fraud

and deceit upon the SIC in connection with their purchases of the revenue bonds.

138. Based on the conduct described above, the SIC is entitled to punitive damages against Gallegos and agents, jointly and severally.

139. The SIC is entitled to its attorney's fees and costs.

**COUNT IV: NEGLIGENT MISREPRESENTATION
BY HUGHES & STRUMOR AND STRUMOR**

140. The factual allegations made in paragraphs 1 through 139 are incorporated and re-alleged in this count.

141. Strumor failed to exercise reasonable care or competence when he provided false information to the SIO employee regarding the purchase of Region III, Inc.'s bonds.

142. The SIC justifiably relied upon Strumor's representations.

143. As a proximate cause of Strumor's negligent misrepresentations, the SIC suffered economic harm.

144. As a proximate cause of all the SIC's damages, SIC is entitled to compensatory damages in an amount a jury will determine.

145. Based on the conduct described above, the SIC is entitled to punitive damages against Hughes.

146. Under the doctrine of respondeat superior, Hughes & Strumor is financially responsible for the acts of Strumor.

147. The SIC is entitled to its attorney's fees and costs.

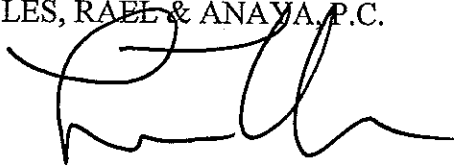
WHEREFORE, Plaintiffs, State of New Mexico, *ex rel.* State Investment Council and State Investment Office respectfully requests that this Court:

A. Enter judgment for Plaintiffs and against Defendants as set forth in the Complaint for Damages;

- B. Award compensatory damages in favor of the Plaintiffs against all Defendants, jointly and severally, for the damages sustained as a result of the wrongdoings of Defendants, together with interest thereon;
- C. Award punitive damages in favor of the SIC against all Defendants, jointly and severally, as a result of their intentional and illegal wrongdoings, together with interest thereon;
- D. Award Plaintiffs' attorney's fees and costs incurred in this action;
- E. Grant extraordinary equitable and/or injunctive relief as permitted by law, equity and federal and state statutory provisions sued on hereunder; and
- F. Granting such other and further relief as the Court may deem just and proper.

Respectfully submitted,

ROBLES, RAEL & ANAYA, P.C.



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