AUDIT REPORT

LAMBETH APARTMENTS – SECTION 236/SECTION 8

MULTIFAMILY HOUSING REVIEW

PITTSBURGH, PA

2004-PH-1010

AUGUST 4, 2004

OFFICE OF AUDIT, MID-ATLANTIC
PHILADELPHIA, PA

Issue Date
August 4, 2004

Audit Case Number
2004-PH-1010

TO: Diana L. Gray, Director, Office of Multifamily Housing, Pittsburgh Area Office, 3EHMLAV

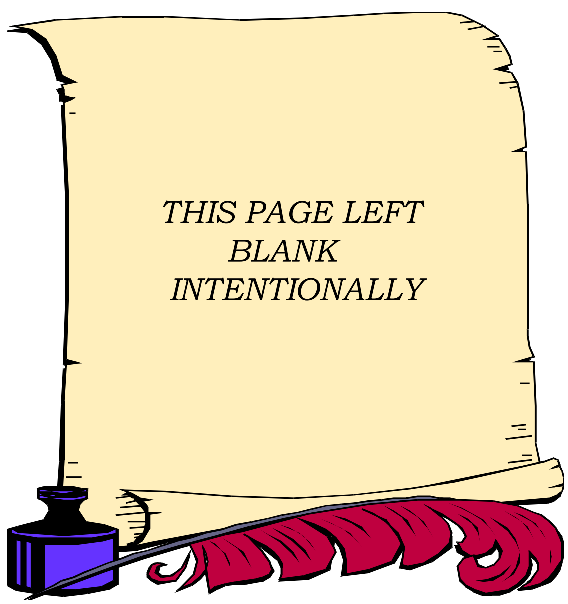
FROM: Daniel G. Temme, Regional Inspector General for Audit, Mid-Atlantic, 3AGA

SUBJECT: Lambeth Apartments – Section 236/Section 8 Multifamily Housing Review
Pittsburgh, PA

We performed an audit of the multifamily operations at Lambeth Apartments. The primary objective of our review was to assess HUD's concerns about management and operational problems at the property. Our audit covered the period from January 1, 2000 through November 30, 2002. This report contains two findings and applicable recommendations requiring action by your office.

In accordance with HUD Handbook 2000.06 REV-3, within 60 days please provide us, for each recommendation without management decision, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Additional status reports are required at 90 days and 110 days after report issuance for any recommendation without a management decision. Also, please furnish us copies of any correspondence or regulations issued because of the audit.

We appreciate the cooperation extended to us during the audit by Lambeth Apartments staff and Board of Directors; their outside legal counsel and management agent, along with Canterbury Place and the local HUD Pittsburgh Field Office staff. Should you or your staff have any questions, please contact Christine Begola, Assistant Regional Inspector General for Audit, at (410) 962-2520.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Executive Summary

In response to a request from the U.S. Department of Housing and Urban Development (HUD), Multifamily Pittsburgh Field Office, we performed an audit of the multifamily operations at Lambeth Apartments. The property is owned and managed by Episcopal Residences, Incorporated (ERI). The primary objective of our review was to assess HUD's concerns over management and operational problems identified during a management review at the property. Specifically, we wanted to determine if the (1) general management practices were in compliance with its Regulatory Agreement, Housing Assistance Payments Contract and applicable HUD rules and regulations, (2) project assets were used appropriately, and (3) tenant eligibility requirements were being met.

We found that ERI did not manage Lambeth Apartments in accordance with the terms of the Regulatory Agreement, Housing Assistance Payments Contract and other applicable HUD rules and regulations; used project assets to pay for ineligible and unsupported costs; and did not properly certify tenants' eligibility to ensure it received correct housing assistance payments. The results of our review are summarized below, and detailed in the Finding sections of this report.

ERI Did Not Manage Lambeth Apartments In Accordance With Its Regulatory Agreement

Episcopal Residences, Incorporated (ERI) did not manage Lambeth Apartments in accordance with its Regulatory Agreement with HUD and other applicable requirements. Specifically we found ERI distributed property funds without HUD's approval; used project funds to make unauthorized structural changes to the property; did not properly manage the property to maximize rental income; and made payments to its maintenance supervisor for questionable maintenance services. These violations occurred because ERI and its Board of Directors did not have policies and procedures in place to ensure the property was managed in accordance with its Regulatory Agreement with HUD. As a result, ERI spent \$209,081 on ineligible and \$258,819 on unsupported expenditures. We also estimate that the property lost \$280,115 in potential income due to the unauthorized changes in how the property was used and managed. These project funds could have been used to pay for reasonable and necessary operating expenses and needed repairs. Further, these actions have placed Lambeth Apartments in a non-surplus cash position since Fiscal Year 2000, and limited its ability to provide available affordable units to eligible low-income households.

ERI Could Not Adequately Support \$284,870 In Section 8 Housing Assistance Payments

Contrary to HUD regulations and its Section 8 Housing Assistance Payments contracts with HUD, Lambeth Apartments did not maintain proper documentation in the tenant files to support the Housing Assistance Payments it received from HUD from January 1, 2000 through November 30, 2002. Specifically, ERI could not document it completed the required tenant certifications that support tenants' eligibility in the Program and the Housing Assistance Payments received from HUD. This occurred because ERI did not maintain effective policies and procedures to ensure the property was managed in compliance with its HAP contract and applicable HUD regulations. As a result, Lambeth Apartments received $284,870 in Housing Assistance Payments from HUD that it could not adequately support.

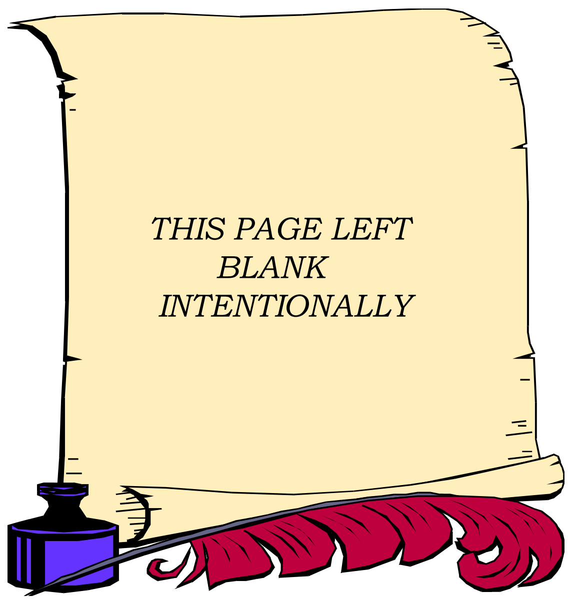
Recommendations

We recommend the Director of the Pittsburgh Area Office of Multifamily Housing take appropriate administrative action against ERI, as allowed in Section 11 of the Regulatory Agreement, for violating its Regulatory Agreement. We also recommend that HUD recover $209,081 of ineligible and $543,689 of unsupported payments from Lambeth Apartments. Further, we made a number of recommendations to improve the owner's management of this multifamily property.

Auditee Comments

We provided a draft of this report to the HUD staff and to Episcopal Residences, Incorporated's legal counsel on April 30, 2004 and discussed the findings and recommendations with all parties at an exit conference on May 14, 2004. At the exit conference legal counsel for ERI provided additional information. We reviewed this information and made appropriate changes to the report as necessary. A second draft was provided to ERI on May 19, 2004 for comment. We received a written response to the draft report on June 1, 2004. In total ERI's response contained 436 pages that consisted of an 11-page summary memorandum and 17 attachments totaling 425 pages.

Generally, ERI agreed with our recommendations on improving its management processes including the Section 8 Program, however, ERI strongly disagreed with our findings and recommendations concerning the ineligible and unsupported expenditures. At the end of each finding we summarized ERI's comments and provide our evaluation of those comments. Further, we included statements relating to its comments throughout the report. However, due to the overall volume of ERI's response, we only included the 11-page summary of the response as an attachment. The full response will be available upon request.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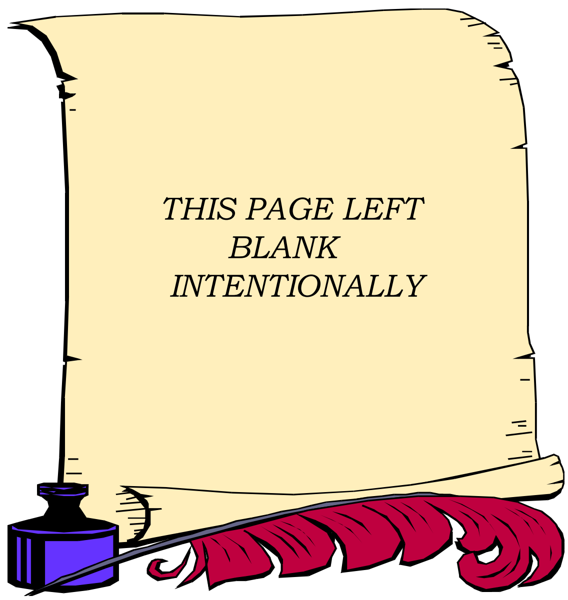
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Introduction

The original Episcopal Church Home was a three-story building constructed in 1893. In 1968, the owners of the Episcopal Church Home formed the subsidiary Episcopal Residences, Incorporated (ERI), a non-profit corporation. ERI was formed to provide for elderly families and persons, on a non-profit basis, rental housing and related facilities and services to meet the needs of the aged. To accomplish this objective, ERI built Lambeth Apartments, a 202-unit, eight-story multifamily property in 1972 under Section 236 of the National Housing Act. Both the original Episcopal Church Home and Lambeth Apartments are located on the same property.[1]

In 1985, the owners of the Episcopal Church Home wanted to expand their elderly care facilities, so they entered into a relationship with the University of Pittsburgh Medical Center (UPMC). Under this relationship a third building was added to the property. This building is a six-story privately owned assisted living facility, which is managed by UPMC.[2] During this renovation phase, the three buildings were merged at various locations so that free access could be obtained for the residents of all three facilities. Also during that time the Episcopal Church Home changed its name and officially became Canterbury Place. Canterbury Place consists of the original three-story Episcopal Church Home and the six-story addition built in the 1980's.

All three entities, UPMC, Canterbury Place and Lambeth Apartments have separate Boards with various governing powers. However, several of the Board members are located on more than one Board. For example, the President of Lambeth Apartments' Board at the time of our review was Mr. Edmund Ruffin, who was also the Chairman of the Board for Canterbury Place until March 2002. Thus, with the shared property, connection of the buildings and shared Board members, an Identity of Interest relationship was established between Canterbury Place and Lambeth Apartments.

In May 2002, ERI obtained the services of SeniorCare to manage Lambeth Apartments. Prior to that the property was self-managed by salaried employees. However, as of January 31, 2004, SeniorCare resigned from its position. The property's books and records are currently located at 4003 Penn Avenue, Pittsburgh, Pennsylvania. We conducted our work through the assistance of SeniorCare, ERI's outside legal counsel, and Canterbury Place management.

The Section 236 Program, established by the Housing and Urban Development Act of 1968, combined federal mortgage insurance with interest reduction payments to the mortgagee for the production of low-cost rental housing. Under this program, HUD provided interest subsidies to lower a project's mortgage interest rate to as low as 1 percent. This program no longer provides insurance or subsidies for new mortgage loans, but existing Section 236 properties continue to operate under the program. The interest reduction payment results in lower operating costs and subsequently a reduced rent structure.

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[1] According to records located at the Allegheny County Courts, in order to meet City of Pittsburgh building ordinances, the Episcopal Church Home and Lambeth Apartments had to be viewed as being one building, having one Board and one owner. However, in order for ERI/Lambeth Apartments to participate in HUD's Section 236 & Section 8 Programs separate identities are required for the Board and properties to comply with HUD's rules and regulations.

[2] UPMC controls 60 percent of the Board and Canterbury Place controls 40 percent of the Board.

The Section 236 basic rent is the rent that the owner must collect to cover the property's operating costs given the mortgage interest reduction payments made to the property. The Section 236 market rent represents the rents needed to cover operating costs if the mortgage interest were not subsidized. All tenants pay at least the Section 236 basic rent for their property and, depending on their income level, may pay a rent up to the Section 236 market rent. Tenants paying less than the Section 236 market rent are considered assisted tenants. The Regulatory Agreement is the primary instrument controlling the mortgagor's use of project funds for Section 236 properties with HUD. In addition to Section 236, ERI has two separate Section 8 project-based contracts for 102 of the 202 units with HUD.

Audit Objectives

The primary objective of our review was to assess HUD's concerns over management and operational problems identified during a management review at the property. Specifically, we wanted to determine if the (1) general management practices of Lambeth Apartments were in compliance with its Regulatory Agreement, Housing Assistance Payments Contract and applicable HUD rules and regulations, (2) project assets were used appropriately, and (3) tenant eligibility requirements were being met.

Audit Scope And Methodology

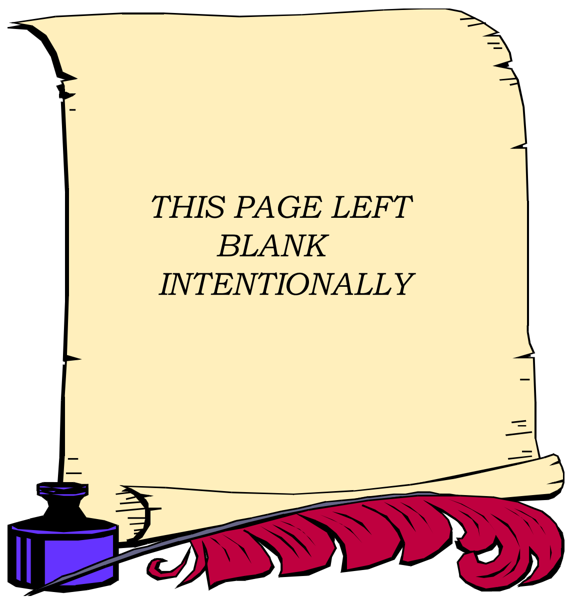
To achieve our objectives we:

- Reviewed laws, regulations and other applicable HUD program requirements, Board Minutes and Lambeth Apartments' various policies and procedures.
- Reviewed HUD program files and Lambeth Apartments' tenant files.
- Reviewed Lambeth Apartments' and Canterbury Place's accounting books and records including source documentation used to support the expenditures in relation to Lambeth Apartments.
- Interviewed HUD staff and various Lambeth Apartments associates, including SeniorCare managers, Canterbury Place management, various Board members and Lambeth Apartments residents.

We also reviewed 100 percent of the transactions from nine general ledger accounts that were selected using a non-statistical format, for our audit period. The transactions subject to our review totaled $981,766. In testing the

Housing Assistance Payments we randomly selected 8 months of HAP payments over a 3-year period, which totaled $293,510. In addition, we used a portion of this sample to randomly select a 1-month period to review 18 out of 102 tenant files to determine the accuracy of the documentation in the files.

The audit generally covered the period January 1, 2000 through November 30, 2002, but was expanded when necessary to include other periods. We conducted the audit in accordance with Generally Accepted Government Auditing Standards.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Episcopal Residences, Incorporated Did Not Manage Lambeth Apartments in Accordance With Its Regulatory Agreement With HUD

Episcopal Residences, Incorporated did not manage Lambeth Apartments in accordance with its Regulatory Agreement and other applicable HUD requirements. Specifically we found ERI distributed property funds without HUD's approval; used project funds to make unauthorized structural changes to the property, used project funds to pay for ineligible and unsupported miscellaneous expenses, and made payments to its maintenance supervisor for questionable maintenance services. Further, we found ERI did not properly manage the property to maximize rental income. These violations occurred because ERI and its Board of Directors did not have policies and procedures in place to ensure the property was managed in accordance with its Regulatory Agreement with HUD. As a result, ERI spent $209,081 on ineligible and $258,819 on unsupported expenditures. We also estimate that the property lost $280,115 in potential income due to the unauthorized changes in how the property was used and managed. As such, Lambeth Apartments may have lost $748,015[3] in project funds that could have been used to pay for reasonable and necessary operating expenses and needed repairs. Further, these actions have placed Lambeth Apartments in a non-surplus cash position since Fiscal Year 2000, and limited the availability of units in the market place as well as available units to low-income tenants. The questioned costs broken down by category are summarized below:

Description	Ineligible	Unsupported	Lost Revenue
Unauthorized Distribution of Funds	$188,436	$ 99,103	0
Unauthorized Use of Property	0	0	$280,115
Miscellaneous Payments	$ 20,645	$ 135,930	0
Maintenance Subcontractor Payments	0	$23,786	0
Total	**$209,081**	**$258,819**	**$280,115**

[3] Of this amount, $315,005 was paid to Canterbury Place.

Episcopal Residences, Incorporated Distributed Project Funds Without Proper Authorization From HUD

During the review of the Lambeth Apartments' accounts, we found ERI distributed property funds without receiving the approval from HUD as required by the Regulatory Agreement. Specifically, Sections 2(a) and 2(c) of the Regulatory Agreement state that the owners shall establish and maintain a reserve fund for replacements and a residual receipts fund. Disbursements from these funds, for whatever purpose, may be made only after receiving written consent from the Secretary of HUD.

ERI Used Project Funds To Prepay A Sponsor Loan

On May 23, 1972, Episcopal Church Home provided a start-up loan to Episcopal Residences, Incorporated, to complete the construction of Lambeth Apartments. The original loan balance was for $307,048 and is not to be paid off until year 2014, the year in which the insured mortgage matures. As of Fiscal Year 2001, the value of the loan was $118,612. Per the original loan agreement and the Regulatory Agreement, prepayments could be made on this loan, but only if they were paid using the residual receipts, and only after obtaining prior written approval from HUD. During our review, we were unable to locate any documentation to support that ERI received permission from HUD to make prepayments on this loan. In fact, the property was in a non-surplus cash position, so there were also no residual receipts to use to pay this loan off. When we asked for support documentation to determine how the loan was being paid off, ERI could not provide the support or an explanation as to why there was a downward trend on the loan balance recorded in the financial statements.

During the exit conference ERI's lawyer provided copies of Board minutes that they believed provided an explanation. It is ERI's contention that the original amount of the loan, $307,048, was never needed and thus a portion of that loan was paid back during the property close out process. We reviewed the information ERI provided us during the exit conference, and noted that there were several dollar values mentioned within the minutes and other documentation. However, we could not determine if HUD ever approved a certain dollar amount to be written off and if so, what that dollar value should be. We consider the $188,436 decrease in loan value without proper authorization or support a violation of the Regulatory Agreement.

ERI Used Project Funds To Renovate Its Boiler System Before Obtaining HUD Approval

In 1999, Canterbury Place assisted living facility was going through an extensive renovation project. As part of that project Lambeth Apartments' Board decided to replace its old boiler system with a new system that was to be located in the basement of Lambeth Apartments. This new system would serve the older wing of Canterbury Place (the three-story Episcopal Church Home) along with Lambeth Apartments. The Board had stated in its decision that this renovation would allow Lambeth Apartments the opportunity to accomplish a costly and much needed renovation at a lesser expense since it would be sharing the costs with Canterbury Place. In the decision it noted the project would cost approximately $81,000 and the funds would be paid out of the Reserve for Replacement Fund.

Section 2(a) of the Regulatory Agreement states that disbursements from the Reserve for Replacement fund may be made only after receiving written consent from HUD. The Agreement further states in Section 6(d) that the owners shall not, without the prior written approval from HUD, remodel, add to, reconstruct, or demolish any part of the property. Although we noted ERI notified HUD in March 1998 of its intention to upgrade its boiler system and share related costs with Canterbury Place, Lambeth Apartments could not provide any documentation to show it received HUD's permission for this renovation prior to completing it in 1999. It was not until May 2000, after the Board contacted HUD and requested $46,897 from the Reserve for Replacement account to cover the cost of the renovation, did HUD send a letter approving the use of the Reserve for Replacement funds. The letter also expressed that no further shared expenditures between Canterbury Place and Lambeth Apartments were to take place without seeking HUD's approval first.

Renovations Lead To Allocation Of Unsupported Gas Bills

After the renovation in late 1999, the gas company sent gas bills to Canterbury Place management, who would then allocate the cost based on a 60/40 split.[4] According to Lambeth Apartments' prior CPA, Lambeth Apartments owed $99,103 for gas bills for the period of October 1999 – December 2001 that Canterbury Place had not yet billed them for. However, when we asked for the supporting documentation for this expense, neither Lambeth Apartments nor Canterbury Place could provide invoices to show how the $99,103 was being calculated. We consider this liability to be unsupported.

Episcopal Residences, Incorporated Used the Property for Purposes Not Approved by HUD

We found ERI took 14 rental units offline without first obtaining HUD approval. ERI used these units for storage for Canterbury Place, to operate a commercial health clinic, guest rooms, employee apartments, and lost several units due to property renovations. We estimate that the lost rent revenue from these units totaled at least $280,115. The table that follows shows the breakdown of the units that were taken offline and the associated lost rent revenue.

Description	Number of Units	Amount	Time Frame
Guest Rooms	2	$ 74,696	1987 – 2002
Employee Apartments	2[5]	$ 67,459	1997 – 2002
UPMC Health Clinic	4	$ 65,252	1996 – 2002
Storage Units Used by Canterbury Place	4	$ 48,472	1999 – 2002
Units Lost to Renovation	2	$ 24,236	1999 – 2002
Total	**14**	**$280,115**	

[4] The 60/40 split was based upon an engineering study completed by a professional mechanical consulting engineering firm. The drawings provided with the study showed that there were two meters feeding the three buildings, one meter appeared to cover Lambeth Apartments and the older portion of Canterbury Place and the second meter appeared to cover Canterbury Place only.
[5] One unit was included in our calculation because the management agent included this unit on their rent roll reported to HUD.

Section 6(h) of the Regulatory Agreement states that the owners shall not permit the use of the dwelling accommodations of the project for any purpose except for the use it was originally intended, or permit commercial use greater than was approved by HUD. Because the owners of the property allowed these unauthorized uses of the property, and did not collect a commercial rent for the units used by Canterbury Place, we estimate that the property lost $280,115 in revenue.

Episcopal Residences, Incorporated Paid Miscellaneous Expenditures That Were Ineligible or Not Properly Supported

The Regulatory Agreement requires that all books and records of the property be maintained in a reasonable condition for proper review. However, we found Lambeth Apartments' general ledger and cash disbursement files for Fiscal Year 2000 did not reconcile. In addition, from our review of $981,766 in expenditures in our audit period, we identified $20,645 of ineligible expenses and $135,930 of expenses that were not properly supported. The ineligible expenses represented miscellaneous costs ERI paid without first obtaining the proper authorization from HUD. Examples of such expenses include payments for the installation of a fence, management fees paid to its CPA, and payments made on behalf of the tenants when it was the tenants' responsibility to cover the expense. The unsupported expenses represent payments made to Canterbury Place for the health and pension insurance, maintenance contract and a service coordinator.

Maintenance Director Received Payments for Questionable Maintenance Services

Under an agreement between Lambeth Apartments and Canterbury Place, the Maintenance Director of Canterbury Place was hired by ERI to supervise and manage the maintenance activities of Lambeth Apartments. We found ERI violated its Regulatory Agreement and other applicable HUD requirements when the maintenance supervisor provided himself additional payments of $23,786 for questionable maintenance services he provided Lambeth

Apartments as a subcontractor. These services included installing linoleum flooring and carpet cleaning services.

HUD Handbook 4381.5, Management Documents, Agents and Fees, states an agent/owner is expected to solicit written cost estimates from at least three contractors or suppliers for any contract, ongoing supply or service which is expected to exceed $10,000 per year. In addition, for any contract less than $5,000 per year the agent/owner should solicit verbal or written cost estimates to ensure that the project is obtaining the services for the lowest possible cost. Further, the Regulatory Agreement in Section 9(b) states, "Payment for services, supplies or materials shall not exceed the amount ordinarily paid."

According to Lambeth Apartments' maintenance staff, carpet cleaning was a routine duty they were to perform. However, the Maintenance Director procured the carpet cleaning and floor installation services without obtaining the required cost estimates or issuing a contract for his subcontractor's services. Therefore, we question whether the costs paid by Lambeth Apartments for these services were reasonable or necessary. For example, the flooring invoices submitted by the Maintenance Director to Lambeth Apartments were 35-41 percent higher than labor prices charged by a national hardware store.[6] Thus, we consider the entire $23,786 to be unsupported.

Episcopal Residences, Incorporated Did Not Properly Manage the Property to Maximize Rental Income

Under the Regulatory Agreement with HUD, ERI agreed to operate the property efficiently and effectively to provide decent, safe, and sanitary housing to low- to moderate-income people. We found ERI violated this requirement by not maintaining an accurate rent roll, allowing the vacancy rate to continue to increase, not charging the proper rent amount and renting more market rent units than allowed under the regulations.

[6] The national hardware store price included a more difficult installation with a sub-flooring and one-roll linoleum rather than the peel n' stick sheets installed by the Maintenance Director.

Management Agent Could Not Determine The Actual Rent Roll

When SeniorCare took over as the management agent for Lambeth Apartments, it noted that ERI had not maintained an accurate rent roll. The owners had been reporting to HUD they had 202 units available for rent. SeniorCare attempted to create the rent roll, but found it very difficult due to the condition of the records in the property files. Since we could not rely on the documentation in the files we completed an independent verification of the units at the property.

We found Lambeth Apartments actually had 208 units, instead of the 202 units it reported to HUD, with only 191 being used as rental units. Of the total available units, only 152 units (73 percent) were actually occupied by market and assisted tenants. In part, the difference between the reported and actual units can be attributed to ERI taking units offline without HUD approval.

Management Allowed The Vacancy Rate To Increase

We found that Lambeth Apartments was not properly managed to maximize occupancy and generate revenue for the property. The HUD Occupancy Handbook 4350.3 discusses how the owners of the property are to maintain a marketing plan to assist the owners in marketing the property. However, we were unable to locate any such plan during our review. In fact, our review showed that there was very little marketing of the property even going on. For example, the site manager that was hired by the Management Agent left their employment on August 23, 2002. A new site manager was not hired for 10 weeks. For those 10 weeks, there was essentially no one present in the office to take phone calls, answer tenants' questions, accept rent, or accept leasing applications. The main office of Lambeth Apartments was essentially closed. During this time period, there were approximately 39 vacant units (or 19 percent vacancy).[7]

When we questioned Lambeth Apartments' management and their legal counsel on the vacancy and marketing issues they told us the vacant units were efficiency units and were difficult to rent. However, we dispute this fact. Our review showed that there were actually 12 one-bedroom units and 27 efficiency units vacant. In addition, we found in the

[7] Based upon our observation of the 208 units when we conducted our independent unit verification.

February 2000 Board Minutes, the Board discussed how the vacancy rate had improved over the prior year and that a waiting list was going to have to be reinstated to accommodate any prospective clients. According to the February 2002 Board Minutes the reported occupancy rate at the beginning of Fiscal Year 2002 was as high as 96 percent.

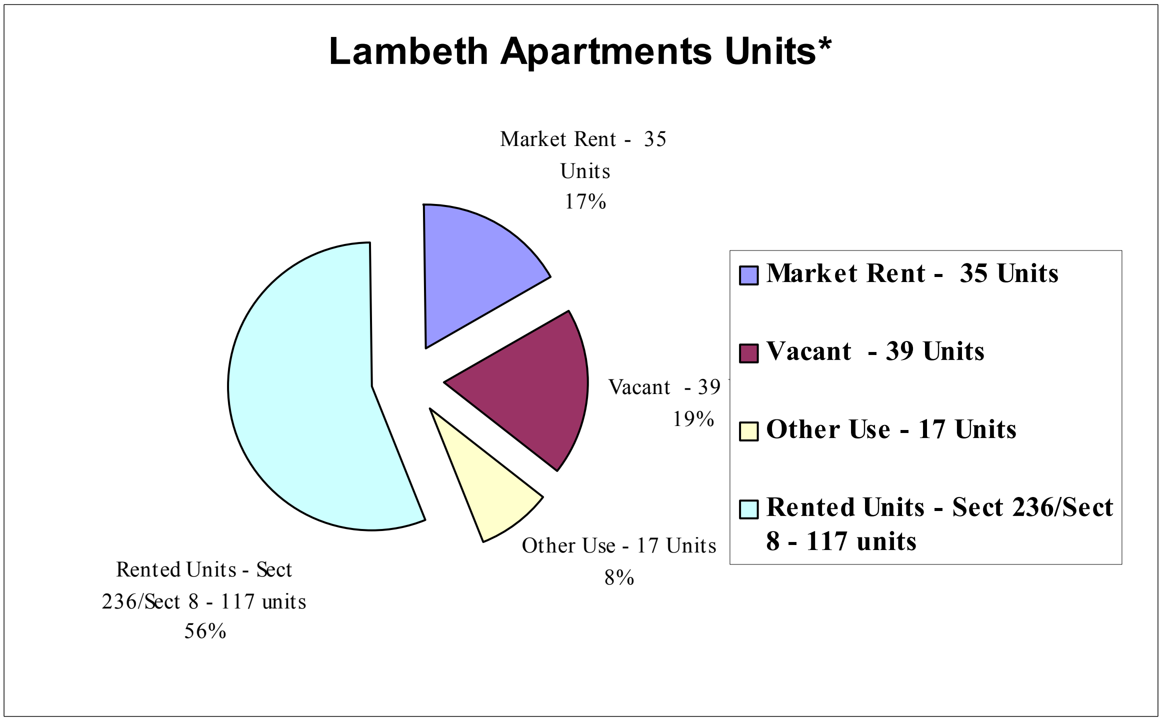
Not All Tenants Were Paying The Proper Rent

In addition to not properly insuring the occupancy rate of the property remained steady, ERI was not charging the proper rent to the tenants. This is a direct violation of Section 4 of the Regulatory Agreement, which states the owners will insure that the proper rent is be charged to each tenant. During July 2002, after SeniorCare had started managing the property, it found the problem concerning the rental rate and forwarded letters to 12 tenants who were being charged the incorrect rent. Three of the 12 tenants' rent had not been increased since 1997. In addition, these three tenants were either current or recently retired Lambeth Apartments employees. These residents explained that they had a verbal agreement with the owners to pay a reduced rental rate.

Number Of Allowable Market Rate Units Exceeded Requirements

Section 236 of the Code of Federal Regulations, Subparts C and D, discusses how the owners are to determine the eligibility of a tenant for occupancy at the property. These sections allow for tenants who can pay below and above market rent. However, before admittance of an applicant who can pay the market rent, the owner must obtain written approval from HUD if the number of tenants already paying market rent exceeds 10 percent of the number of units authorized under the Section 236 Program.

Although Lambeth Apartments had reported 202 units to HUD under the Section 236 Program, we determined it had only 191 available units. As such this allowed them to use 19 units for market renters without HUD approval. However, when we conducted our independent unit verification we identified 35 market renters. Thus, Lambeth Apartments exceeded the allowable market rate units by 16 units and was not in compliance with the requirements.



* Based upon our observation of the 208 units when we conducted our independent unit verification.

Auditee Comments

ERI's Board of Directors stated it has started to take steps to address the issues raised in this finding concerning the overall management of the property. Specifically, the Board hired SeniorCare Network, which has been succeeded by Pennrose Management Company, to manage the property. The Board also intends to attend training and implement policies and procedures to ensure that the Section 236 Program is being managed and maintained in accordance with the Regulatory Agreement and HUD regulations.

However, ERI's Board of Directors strongly disagreed with all of the items that the OIG identified as ineligible expenditures. For example, ERI disagreed with our opinion that the $188,436 in prepayments for the start up loan were ineligible. In its response, ERI stated that not all of the funds were needed when the original mortgage was issued and thus HUD approved these funds to be returned to the sponsor. ERI also disagreed with the OIG's assessment of $14,211 of the $20,645 in miscellaneous ineligible expenditures identified.

The Board also disagreed with the auditor's interpretation of how the property lost revenue through the use of 14 units. For example, the Board questioned why the auditors would continually question the use of four units for the Benedum Clinic when it had received HUD approval for these units to be taken off line to be used for the clinic. They also questioned the use of four storage units that had never been on the rent roll and were otherwise never intended for residential use.

In addition, the Board disagreed with the unsupported gas and miscellaneous expenditures questioned by the OIG. The Board stated that they provided all of the gas bills relating to the unsupported costs and cannot understand why the OIG would continue to question them. In addition, since Lambeth Apartments has not paid for all of the expenditures then the recommendation has no basis.

Lastly, ERI disagreed with the OIG's assessment of the maintenance supervisor's role at the property. Specifically, the Board stated that the Canterbury Place staff member was only assisting the Lambeth Apartments' maintenance team and not supervising them. In addition, the additional work completed outside of the scope of the staff members' service agreement was of nominal value and did not violate HUD bidding requirements.

OIG Evaluation of Auditee Comments

We are pleased that the Board started to take the appropriate action to improve the overall management of the apartments. However, we disagree with the Board's position that HUD approved the $188,436 prepayment to the sponsor loan. As explained in the finding, we reviewed the additional support provided to us by ERI's legal counsel and found several inconsistencies among the statements in the minutes. In addition, we never noted a formal approval from HUD stating that these funds could be returned to the sponsor.

We also disagree with the Board's assessment that the property did not lose revenue through the unauthorized use of the units, by the fact that the units were either approved by HUD to be removed or the units were not rentable. For example, we concur that HUD approved two of the units for the Benedum clinic to be removed from the rent roll and our calculation of lost revenue takes that approval into account. However, the Director of the Pittsburgh Multifamily Division only recently retroactively approved the other two units, and based upon discussions we had with members of the HUD's Office of General Counsel, we question whether the Director had the authority to retroactively make this approval. As for the four storage units, we were unable to determine if they were ever used for residential purposes, however, that is beside the point. The unit space is being utilized by Canterbury Place for storage at no cost, thus the potential for additional revenue remains.

We continue to question the unsupported gas bills provided by ERI. Although ERI's legal counsel provided us copies of over $237,365 in gas bills, no one has been able to provide evidence of how the funds are related specifically to Lambeth Apartments. For example, in the engineering study completed by the professional mechanical consulting engineering firm, P.L. Frank, Incorporated, provided to us by Canterbury Place managers, it showed that there were two separate gas meters connected to the three buildings. One gas meter fed directly to Canterbury Place while the other gas meter was for Lambeth Apartments and the old portion of Canterbury Place. Thus, to include all gas bills in total and than allocate Lambeth Apartments 40 percent of the cost does not provide adequate support for the questioned costs. In addition, in the support provided there was $81,235 in forgiven bills by the gas supplier to Canterbury Place. We question if Canterbury Place was no longer responsible for these two bills why it would continue to request Lambeth Apartments to pay its portion totaling $32,494.

Finally, during our review of the maintenance services provided by the Canterbury Place staff member, it became apparent that he had more than an assist role while working at Lambeth Apartments. On several occasions when we discussed maintenance issues with the Lambeth Apartments' maintenance staff, they would defer to the Canterbury Place employee to answer our questions. In addition, the Canterbury Place staff member would decide when a particular bill should be paid and signed off on several invoices. As for the additional services provided by the Canterbury Place employee outside of the original agreement between Canterbury Place and Lambeth Apartments, these services should have been bid out. In fact, the auditee in its response even concurs with this evaluation. In its response ERI quotes the same criteria we do in our report, however, it added "…it appears that the word "less" was actually meant to be "more than $5,000," as the Handbook fails to provide for bidding on services between $5,000 and $10,000…" Since the costs ranged from $5,600 to $11,436 during the 3 years questioned, the costs should have been properly bid out.

Recommendations

We recommend the Director of Pittsburgh's Office of Multifamily Housing:

1A. Require the owners of Lambeth Apartments to repay the property $209,081 for the ineligible expenditures.

1B. Require the owners of Lambeth Apartments to provide proper support documentation for $258,819 in unsupported expenditures. If these funds cannot be supported they should also be paid back to the property.

1C. Follow Section 11 of the Regulatory Agreement, which states:

   i. Written notification should be provided to the owners of Lambeth Apartments notifying them of the numerous violations under the Regulatory Agreement.

   ii. If the violation is not corrected within 30 days, the owners should be declared in default of their mortgage.

1D. Require the owners of Lambeth Apartments to:

i. Formally submit a request to HUD to approve the rental units it has taken off-line that are currently being used for unauthorized commercial purposes.

ii. Establish a lease agreement with Canterbury Place for the Benedum Clinic, storage space and any other space occupied by Canterbury Place employees or equipment within Lambeth Apartments' building. The rental rates to be charged are to be equal to the Commercial rate and approved by HUD.

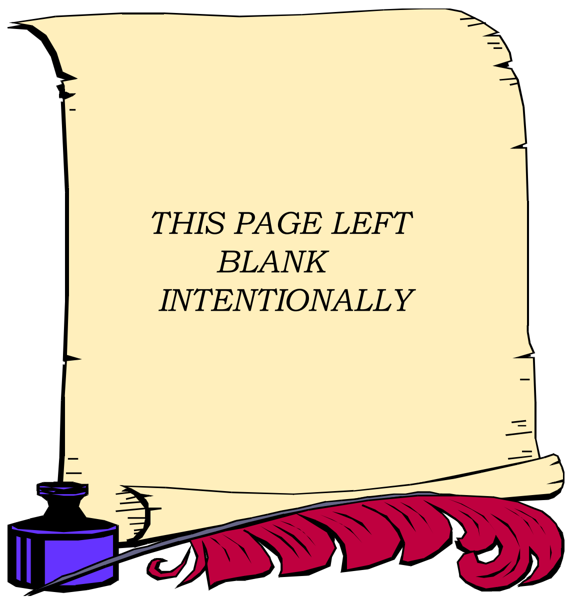
IE. Require Lambeth Apartments' two guest room units and two staff housing allowance units (that do not have prior HUD written approval) be returned to the rent rolls as marketable units, unless they obtain approval from HUD.

IF. Require the Lambeth Apartments' owners and Board of Directors to attend mandatory training to obtain an understanding of the management process of federally subsidized properties, specifically concentrating on the use of the Regulatory Agreement and HAP contract.

1G. Require the owners to establish agreements, with HUD's approval, between Lambeth Apartments and Canterbury Place concerning any shared expenses, including maintenance and/or managerial type contracts. These agreements should be documented and approved by HUD before any further payments are made to Canterbury Place.

IH. Establish and implement policies and procedures to ensure the Section 236 Program is being managed and maintained in accordance with the Regulatory Agreement and HUD regulations.

II. Require the owners of Lambeth Apartments to close any open recommendations relating to the latest management and occupancy review conducted by HUD.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Lambeth Apartments Could Not Adequately Support $284,870 in Section 8 Housing Assistance Payments

Contrary to HUD regulations and its Section 8 Housing Assistance Payments contract with HUD, Lambeth Apartments did not maintain proper documentation in the tenant files to support the Housing Assistance Payments it received from HUD from January 1, 2000 through November 30, 2002. Specifically, Lambeth Apartments could not document it completed the required tenant certifications that support tenants' eligibility in the Program and the Housing Assistance Payments it received from HUD. This occurred because the owners of Lambeth Apartments did not maintain effective policies and procedures to ensure the property was managed in compliance with its HAP contract and applicable HUD regulations. As a result, Lambeth Apartments received $284,870 in Housing Assistance Payments from HUD that it could not adequately support.

ERI Did Not Complete Required Yearly Tenant Certifications

The owners currently have two Section 8 HAP contracts with HUD, encompassing 102 units. In accordance with these HAP contracts and its Regulatory Agreement, the owners agreed to determine the eligibility of each tenant that participates in the Section 8 Program on a yearly basis by completing the tenant certifications and re-certifications. Further, the owners are required to verify this information and maintain it for 3 years. The owners are also required to follow-up with any family who does not provide the required certification data within the established timeframe and initiate HUD-prescribed enforcement actions, if necessary. However, we found Lambeth Apartments did not follow these requirements and tenant certifications did not reconcile to rent payments they submitted and received from HUD. From January 1, 2000 through November 30, 2002, Lambeth Apartments received $284,870 of payments.

Not All Housing Assistance Payments Were Adequately Supported

In order to determine the accuracy of the Section 8 Housing Assistance Payments the owners submitted to HUD, we selected 8 months of vouchers over a 3-year period. This was equivalent to reviewing 807 Section 8 tenant-assisted rent payments. We then compared the amounts billed to the supporting tenant rent eligibility certifications in Lambeth Apartments' files. From this review we found 94 of the HAP rent payments (or 12 percent) did not match the information in the tenant files. Further, we found management did not complete the tenant re-certifications in Fiscal Year 2000 until five months past their annual certification due date. Under the HAP contract, owners must re-certify family income annually to determine circumstances that may affect the amount of rental assistance the family receives. Thus, the owners could not verify the accuracy of their tenant's eligibility with the HAP rent payments they were requesting.

Move-Out Dates Were Inaccurate Or Not Documented

We also found that the recorded move-out dates for tenants were often inaccurate or not documented in the files. For example, we found examples of move-out dates being documented for deceased tenants up to 74 days after the published obituary dates.[8] Since many of the tenant files contained inaccurate or missing move-out dates, we question the validity of the Housing Assistance Payments Lambeth Apartments received during January 1, 2000 through November 2002.

Section 8 Tenant Files Contained Numerous Deficiencies

During our review of the 807 individual HAP payments noted above, we selected a non-statistical sample of 18 tenant files from the September 2002 HAP registers. Our objective in reviewing these 18 tenant files was to determine the accuracy and completeness of the documentation noted in the Section 8 files. From this review we identified numerous deficiencies which are summarized below.

- Six of the eighteen tenant files (33 percent) did not include the proper move-out forms or dates.
- Six of the eighteen tenant files (33 percent) did not have third-party verifications completed to verify the supporting documents submitted by the tenants in order to determine Section 8 eligibility as required by HUD Handbook 4350.3.
- Five of the eighteen tenant files (28 percent) did not have signed HUD forms located in the file to verify the owners certified to the tenants' eligibility.

[8] HUD's Regulations permit Section 8 payments not to exceed 14 days after a tenant has passed.

- Twelve of the eighteen tenant files (67 percent) documented a different Housing Assistance Payment amount than what was being billed on the September 2002 billing. In some cases, the amounts differed because the tenant had moved out but was still being claimed on the HAP billing.

- Three of the eighteen tenant files (17 percent) were not re-certified annually.

Auditee Comments

The ERI Board relied on a professional manager to maintain its tenant records. It was not until the manager was absent for an unforeseen amount of time that problems with file maintenance surfaced. Once the problems were brought to the Board's attention, professional management was contracted to resolve the issue. With the new management team in place, first SeniorCare and now Pennrose Management Company, 100 percent of the tenants have been recertified with adjustments being carried back to January 2002. Furthermore, ERI is now revisiting its existing 2000 and 2001 rent rolls and records to determine what tenants resided at Lambeth Apartments in 2000 and 2001 to demonstrate a good faith attempt that the tenants that received Section 8 did so legitimately.

OIG Evaluation of Auditee Comments

We are pleased that the ERI Board and Lambeth Apartments' management has taken on such an overwhelming task. Once the review is completed, it will provide the Board, HUD and the OIG the assurance they all need to know that the Section 8 funds distributed to Lambeth Apartments were done so properly.

Recommendations

We recommend the Director of Pittsburgh's Office of Multifamily Housing require the owners of Lambeth Apartments to:

2A. Repay HUD all HAP payments received from January 2000 through November 2002 ($284,870) that they cannot adequately support.

2B. Provide adequate documentation to support all HAP payments they received after November 2002. Any unsupported or ineligible payments should be returned to HUD from the project funds.

2C. Establish written policies and procedures to ensure that all required documentation is maintained in the tenant files to support the HAP payments.

Management Controls

In planning and performing our audit, we obtained an understanding of the management controls that were relevant to our audit. Management is responsible for establishing effective management controls. Management controls, in the broadest sense, include the plan of organization, methods, and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Management Controls

We determined the following management controls were relevant to our audit objectives:

- Policies and procedures developed to manage the property in accordance with the Regulatory Agreement,
- Cash management of the property,
- Documentation maintained to support expenditures and cost eligibility,
- Procedures developed on how to maintain the HAP tenant files, and
- Policies developed on the reporting of HAP payments.

We assessed all of the relevant control categories identified above, to the extent they impacted our audit objectives.

Significant Weaknesses

A significant weakness exists if management controls do not give reasonable assurance that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data are obtained, maintained, and fairly disclosed in reports. Based on our review, we believe the following items are significant weaknesses:

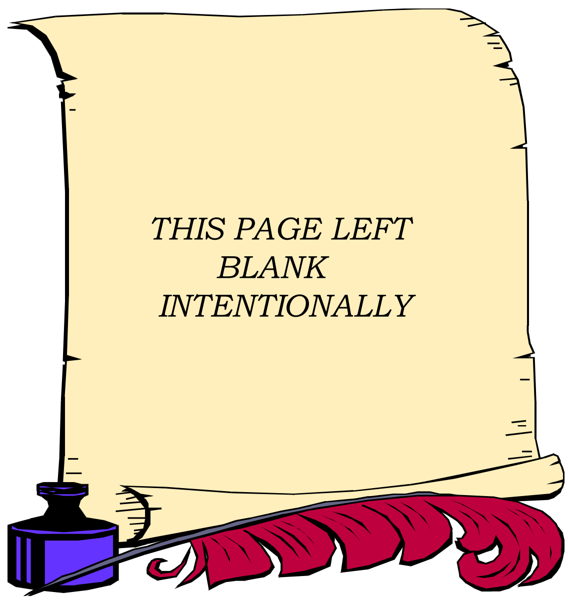
- Lambeth Apartments did not have a system in place to ensure that the Regulatory Agreement was being followed (see Finding 1).
- Lambeth Apartments did not have policies and procedures in place to ensure costs incurred were for eligible activities, properly supported by appropriate

source documentation, and were allowable under the Regulatory Agreement (see Finding 1).

- Lambeth Apartments did not have the effective policies and procedures in place to ensure that the HAP payments were properly supported (see Finding 2).

Follow Up On Prior Audits

This is the first audit of the Lambeth Apartments' Section 236 and Section 8 Programs by HUD's Office of Inspector General.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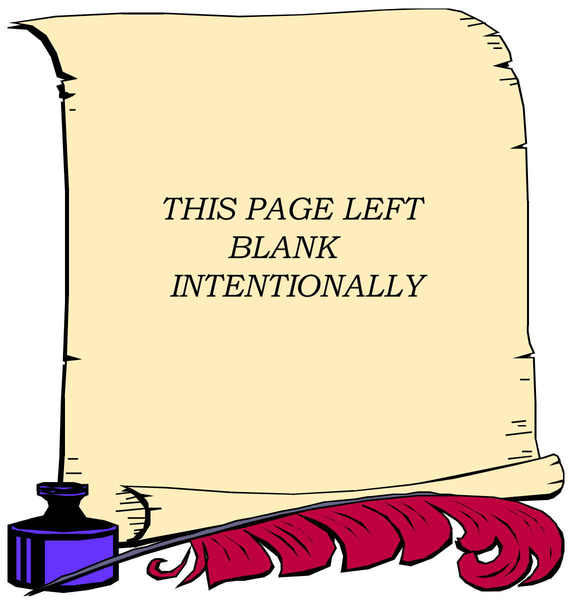
Schedule of Questioned Costs

Recommendation Number	Type of Questioned Cost Ineligible 1/	Unsupported 2/
1A	$209,081	
1B		$258,819
2A		$284,870
	$209,081	$543,689

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law, contract or federal, state or local policies or regulations.

2/ Unsupported costs are costs charged to a HUD-financed or HUD-insured program or activity and eligibility cannot be determined at the time of audit. The costs are not supported by adequate documentation or there is a need for a legal or administrative determination on the eligibility of the costs. Unsupported costs require a future decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of Departmental policies and procedures.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Auditee Comments

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June 1, 2004

Via Federal Express:

Daniel G. Temme
Regional Inspector General for Audit
U. S. Department of Housing and Urban
Development/OIG - Audit
The Wanamaker Building, Suite 1005
100 Penn Square East
Philadelphia, PA 19107-3380

Re: Lambeth Apartments

Dear Mr. Temme:

I am writing on behalf of our client Episcopal Residences, Inc. ("ERI") in response to the draft audit report that was issued on May 19, 2004. We are providing this letter as a supplement to our previous submissions to and discussions with the OIG, including that information provided at the exit conference of Friday, May 14, 2004. We provide our responses to the each of the draft findings under the headings contained in the draft audit.

I. Finding #1: Episcopal Residences, Incorporated Did Not Manage Lambeth Apartments in Accordance With Its Regulatory Agreement With HUD

A. Episcopal Residences, Incorporated Distributed Project Funds Without Proper Authorization From HUD

1. *Prepayment of Sponsor Loan*

Response: The OIG has provided no documentation or other basis to support the contention that the Sponsor Loan was prepaid in violation of the Regulatory Agreement. Rather, documents related to the Sponsor Loan and its use for construction costs support the conclusion that any payments made on the Sponsor Loan were made in compliance with the Regulatory Agreement.

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The relevant documents include a letter from the HUD Pittsburgh office dated May 17, 1972, the Residual Receipts Note (Sponsor Loan Note), the Maximum Insurable Mortgage (HUD 2580), May 22, 1973 Minutes, August 29, 1974 Minutes, and Episcopal Church Home related minutes dated June 30, 1971, February 9, 1972, May 22, 1973 and October 1, 1974, copies of which are attached hereto respectively as Tabs 1 through 6.

In the May 17, 1972 letter from the HUD Pittsburgh Office, the sponsor was advised that the closing would take place May 23, 1972 and that the HUD Insured Mortgage Loan of $3,644,900 would not be sufficient to cover the estimated cost of the Project. The sponsor was further advised that the Mortgagor would have to deposit $307,068 with the Mortgagee (Pittsburgh National Bank) at initial closing to be disbursed prior to the disbursement of HUD funds to cover the cost of the Project.

Following completion of construction, ERI submitted its audited Cost Certification as required by HUD. In response, HUD issued its Maximum Insurable Mortgage (FHA Form No. 2580). As shown in the 2580, HUD determined the recognized "Actual Cost" of Improvements to be $3,710,234 and the Total Cost of Land & Improvements to be $3,790,234. HUD also determined that the Maximum Insurable Mortgage would remain $3,644,900, thus the gap between the Total Cost of Land & Improvements was reduced from $307,068 to $145,335. In addition based on this information, it is clear that HUD disbursed the entire balance of the mortgage to the mortgagor which was then free to return the unused balance of $161,734 (the difference between the amount advanced by the sponsor and the final gap amount) to the sponsor. This would have reduced the residual receipts note balance to $145,334.

This is confirmed in Minutes of a Meeting of the Board of Directors of the Sponsor (then known as Episcopal Church Home) held on August 29, 1974. Those minutes state that HUD has informed the Corporation that the balance in the Construction Account may be transferred back to the sponsor.

The OIG notes that the current outstanding balance on the residual receipts note appears to be $118,612 which is about $28,000 less than the $145,334 balance that appears to have been in place following final endorsement of the mortgage note. This difference can be explained in several ways. First of all, the Total Cost of Land & Improvements as shown on the 2580 included $80,000 for the land. The sponsor has indicated in Minutes dated May 22, 1973 and in subsequent conversations that they considered the cost of the land to be donated. At the same time, the sponsor has provided other advances over the years. Given that most of this activity took place 30 years ago and the OIG has provided no evidence to refute the

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documentation provided or show any payments to the sponsor have been made, it is unreasonable for HUD or the OIG to sustain this finding.

2. *Merging of Boiler/Heating System Lead to Unsupported Gas Bills*

Response: At the exit conference we questioned why this finding has not been removed since the OIG has been provided with copies of all relevant gas bills. Ms. Begola informed us that the finding remains in the audit because only one of the two existing gas meters is in Lambeth's name and that the OIG has not received proof that Lambeth is served by gas that feeds the second meter.

Addressing the concern identified by Ms. Begola at the exit conference, first, we are unaware of the drawings alluded to in footnote 5 of the draft report. It is our client's clear and informed understanding that the gas that flows through both meters serves both facilities. No document or drawing has been presented by HUD or the OIG which would contradict this understanding.

Second, the study completed by Arthur Schock Engineers addressed the "gas usage" by Lambeth and Canterbury Place. A copy of the study, which was approved by HUD, is attached hereto as Tab 7. The engineer reviewed the building plans, the facilities, and the gas equipment and determined that of the total gas supplied to the Canterbury and Lambeth buildings through the two meters, approximately 41.5% of the gas was consumed by Lambeth and 58.5% by Canterbury. Because Lambeth previously was and continues to be assessed only 40% of the total of the gas bills for both lines as measured by both meters, Lambeth is actually benefiting by the 60/40 allocation. The important point is that Lambeth is being billed properly according to its gas usage. As such, there is no basis for this finding.

As a precautionary measure, we are again providing at Tab 8 another copy of all relevant gas bills in case issues persist as to the legitimacy of the billing itself.

Please also note that although Canterbury Place has billed ERI for the disputed amount, ERI has not yet paid Canterbury. Regardless of the OIG's conclusion as to the legitimacy of the gas billing, the recommendation that the amount be repaid has no basis as the ERI has yet to reimburse Canterbury Place for any of the questioned gas bills.

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B. The Owners Used the Property for Purposes Not Approved by HUD

The draft report estimates that Lambeth lost $280,115 in revenue for the alleged unauthorized use of the property. Although we dispute that finding, we recognize that the draft report places no liability on ERI for the alleged unauthorized use. Because this section remains in the draft report, we are compelled to address the issues raised in hopes of having this section omitted from the final report.

1. *Benedum Clinics*

Response: The continued existence of this finding is frustrating, as we provided OIG on multiple occasions the documentation detailing HUD's written and explicit approval of the use of these units as clinics. ERI received HUD approval for the current use of these units, and therefore this finding should be deemed cleared. HUD approved their current use because the units provide a significant benefit to the residents of the properties. Copies of the HUD approval letters are attached hereto as Tabs 9 & 10.

Any concern that the clinics serve non-project residences has no basis. Shikha Iyengar, the executive director for Canterbury Place, contacted the clinics and confirmed that they are used solely for residents of Lambeth and Canterbury Place. Ms. Iyengar's memorandum regarding this issue is attached as Tab 11. Also, through previous correspondence it was brought to our attention that the OIG discovered a website that stated that the Benedum Clinic was open to the general public. After reviewing the internet links provided by the OIG, we confirmed that the Benedum Clinic identified in those links was a different clinic in a different location (the Oakland business district within the City of Pittsburgh) than the one operated in the Lambeth building. Attached hereto as Tabs 12 & 13 are correspondence and e-mails detailing the research into the internet links identified by the OIG.

2. *Guest Rooms (Units 227 and 423)*

Response: The two units utilized as guest rooms created no loss to HUD because the rooms were efficiencies and there were other, more attractive efficiencies available which were not rented. Efficiency units have always been very difficult to rent, and are increasingly being eliminated in most buildings. Regardless of the marketability of efficiencies, the 2000 HUD-approved rent schedule noted that the guest rooms were non-revenue producing. A copy of the 2000 rent schedule is attached hereto as Tab 14. These units have been returned to the rent roll but the property manager has been unable to lease them.

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3. *Employee Apartments (Units 6 and 819)*

Response: Unit 6 is not on the HUD approved rent roll. This is a basement unit, occupied by a maintenance supervisor for the purpose of providing the property with the benefit of a maintenance personnel available "24/7." Refer to the rent schedule attached hereto as Tab 14.

Unit 819 was for a period occupied by the night security guard but was placed back on the rent roll effective March 1, 2003 because the staff was restructured. This use of unit 819 complied with HUD policy and is appropriate. This unit was empty. Moreover, similar and more attractive units were also available for lease at this time. HUD policy permits property units to be made available when there is no demand for the units and occupying them with property staff is beneficial. Because there was no demand for this unit, there was no loss of revenue.

4. *Storage Units (319, 321, 419, 421)*

Response: These units were never on the rent roll. Units 319 and 419 were constructed without windows, and Units 321 and 421 have just one window. None of these rooms have bathrooms or kitchens as they were never intended for residential use. Their inclusion in the draft report is therefore unsupported by the facts.

5. *Units Lost to Renovation (Units 127 & 129)*

Response: These units are studio units. Unit 127 was never on the rent roll, being used as an office for visiting nurses in the 1980's and as a office for the service coordinator in the early 1990's. However, the service coordinator's office was moved to another location as this unit, and Unit 129, were located directly above the boiler-room, making them both too hot year-round to retain occupants. In 1998/99, they lost their windows in order to create the solarium. Although HUD never formally approved their removal from the rent roll in writing, Mr. John Makowski, the HUD Asset Manager, who was aware of the planned work and who was on-site frequently during this renovation observed and orally approved the work, and recognized that the units, although on the HUD rent-roll, were in fact unrentable.

Conclusion to Section I(B): Based on the information provided in the preceding paragraphs, as well as the documents attached hereto, the draft audit conclusion that the property lost revenue through the unauthorized use of units is not reasonable. The units in question were either approved to be removed from the rent roll by HUD, or they were not rentable units.

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C. The Owners Did Not Properly Manage the Property to Maximize Rental Income

Response: The ERI Board has taken steps to address the issues raised in this finding by first hiring SeniorCare Network, Inc. to manage the property. SeniorCare Network, Inc. completed a 100% file audit and recertified every tenant. SeniorCare Network, Inc. has been succeeded by Pennrose Management Company. Both SeniorCare Network, Inc. and Pennrose Management Company are recognized regional leaders in the management of affordable housing projects and have the skills and expertise to ensure that the problems raised by the OIG do not reoccur.

Furthermore, the Board intends to establish and implement policies and procedures to ensure that the Section 236 Program is being managed and maintained in accordance with the Regulatory Agreement and the HUD regulations. The Board further intends to attend training to understand the management of a Section 236 property. As you know, the Board is also attempting, subject to HUD approval, to sell Lambeth Apartments to a developer who would completely renovate this aging facility.

Moreover, in addition to the steps described above, the Board will consider retaining an independent consultant, with HUD approval, to report upon the operation of the property and its compliance with HUD requirements. The consultant recommended to them is a former asset manager and supervisor at HUD. Since her retirement, HUD, through a contractor, retained her to conduct occupancy and management reviews in Michigan and Pennsylvania. In this manner the ERI Board intends to ensure the smooth operation of the property and compliance with HUD requirements.

D. Miscellaneous Expenditures Are Not Properly Supported

1. *$135,930 in Unsupported Expenses*

Response: ERI did not receive a detailed spreadsheet identifying the unsupported expenses until May 19, 2004. While our client will use its best efforts to address the expenses contained in the spreadsheet, there are approximately 200 disputed items and they were not provided with sufficient time to specifically address them by the June 2, 2000 deadline for this written response. Upon our client's preliminary review, the majority of these expenses appear to be ordinary, everyday operating costs and expenses that were reviewed annually by an independent auditor and placed in an audited financial statement submitted to and reviewed by HUD.

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As a general response, the ERI Board reasonably relied on a professional manager to maintain its operating accounts. The manager operated the location for many years without problem. The Board therefore reasonably relied on the management to maintain an adequate accounting system.

2. *$20,645 in Ineligible Payments*

a. $6,434 to Steve Parsons

Response: The Board has considered suing Mr. Parsons for the amount in question. However, considering the amount in controversy and the cost of litigation, the Board to date has been reluctant to commence litigation.

b. $8,810 to North American Fencing Company

Response: We contacted North American Fencing Company and received an invoice and contract describing the work. The work required the removal and hauling of an existing six foot fence located next to Lambeth at the corner of Fisk Street and Penn Avenue, and its replacement with a new aluminum fence. A copy of the invoice and contract are attached hereto as Tab 15. The contract contains a drawing detailing that the work was made for Lambeth's benefit, and not for Canterbury Place.

The OIG spreadsheet indicates that this expenditure is invalid because HUD failed to approve it. HUD approves the annual budget, but not individual expenditures unless they are paid from the Reserve for Replacements Account. The mortgage servicer only releases such funds from the Reserve for Replacements Account contingent upon receiving HUD approval. Because the funds did not come from the Reserve for Replacements Account, HUD was not required to approve this disbursement. As the work completed by North American Fencing Company was a legitimate expense, this finding is unsupported.

c. $1,753 to James E. Huckestein, Inc.

Response: We followed up with James E. Huckestein, Inc. regarding the services that were completed at the property and inquired whether the work specified in the invoice was completed for the benefit of Lambeth or Canterbury Place. My associate was able to speak directly with the employee, Mr. Dennis Ross, who completed the work. Upon a review of J. E. Huckestein records, Mr. Ross was able to confirm that the work was completed for the

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benefit of Lambeth. Attached as Tab 16 please find a letter from the employee detailing that the work was completed for the benefit of Lambeth.

d. $3,648 towards Air Conditioning

Response: As stated previously, ERI did not receive a detailed spreadsheet identifying this and the unsupported expenses until May 19, 2004. While our client will use its best efforts to address the expenses contained in the spreadsheet, they were not provided with sufficient time to specifically address these expenses in this written response.

In a discussion with the individual who was the property manager during the period under review, the property manager confirmed that the purchase of air-conditioning units was the responsibility of the tenants. However, she noted that the sleeve for the through-wall units was an awkward size, and that most retailers failed to carry a size suitable for the Lambeth units. The management staff was able to locate a vendor, Grainger, that carried air-conditioning units that would fit the sleeve. Lambeth therefore made arrangements to take tenants to Grainger to purchase units directly, or Lambeth would purchase the units and get reimbursed by the tenants.

The ERI Board and current management staff have had insufficient time to determine if the units in question in the OIG spreadsheet were properly reimbursed.

E. Maintenance Director Received Payments for Questionable Maintenance Services

Response:

Again, ERI has repeatedly made it clear that Mike Orr was not, nor was ever, the maintenance director for Lambeth. Your conclusions to the contrary have not been supported by any documentation. Through an agreement reached between ERI and Canterbury Place, Canterbury Place provided maintenance staff, including Mr. Orr, to be used at the discretion of ERI to meet ERI's regular maintenance needs. This was more effective and less expensive than hiring additional staff at Lambeth. The procurement of services at Lambeth, as well as the supervision of maintenance staff, was the responsibility of management at Lambeth, and not Mr. Orr. Mr. Orr had no discretionary authority to direct business to himself. Work performed by Mr. Orr was reasonable and necessary for the continued repair and maintenance of the property and required to be performed. ERI agrees that Mr. Orr was hired directly to perform specific work at Lambeth. This work was beyond the scope of the contract with Canterbury Place and

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was for work performed in Mr. Orr's own time and not during his hours of work for Canterbury Place.

As noted in the spreadsheet provided by the OIG, Mr. Orr was paid $6750 in 2000, $11,436 in 2001 and $5600 in 2002. The draft audit considers these expenses to be unsupported. This conclusion is without any basis. The draft audit relies on HUD Handbook 4381.5, which provides that an "agent is expected to solicit written cost estimates from at least three contractors…for service which is expected to exceed $10,000 per year." As we noted in the exit conference, however, previous billing for this work rarely approached $10,000. It was therefore not reasonably "expected" that the $10,000 bid requirement would be reached. The Handbook however goes further and states "[f]or any contract…estimated to cost less than $5000 per year, the agent should solicit verbal or written cost estimates…" (emphasis added). Parenthetically, it appears that the word "less" was actually meant to be "more than $5000", as the Handbook fails to provide for bidding on services between $5000 and $10,000, and as the "less than" requirement would require bidding for service contracts of nominal value. The Handbook's use of "should" indicates that the requirement is not obligatory.

The draft audit also supports its conclusion by making a comparison of the work completed by Mr. Orr to labor provided by a "national hardware store". The draft report fails to provide additional support for its "national hardware store" comparison, thus depriving us of any opportunity to evaluate this comparison.

The conclusions reached in this section are contrary to the facts and HUD policies. As the management agent did not violate HUD bidding requirements, nor is there any evidence that the costs were unreasonable, this conclusion should be stricken from the draft audit.

II. Finding #2: Lambeth Apartments Cannot Adequately Support $284,870 in Section 8 Housing Assistance Payments

A. Housing Assistance Payments Were Not Always Adequately Supported for the period of January 1, 2000 through November 30, 2002

B. Section 8 Tenant Files Were Not Complete

Response to A & B: The ERI Board relied on a professional manager to maintain its tenant records. The manager operated the location for many years without problem. Most of the problems with file maintenance arose when the manager was absent for an unforeseen protracted period of time due to a series of medical conditions. Once the file

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maintenance problem was brought to the Board's attention, professional management was contracted to resolve this issue. Starting with SeniorCare Network, Inc., and now with Pennrose Management Company, ERI has taken steps to ensure that the property is managed by a reputable and experienced affordable housing management agent to ensure compliance with all HUD policies and regulations. In 2002, SeniorCare Network, Inc. did a complete rebuild of all tenant files. As part of this activity, all tenants' incomes were recertified and adjustments were made retroactive to January 1, 2002. The discrepancies found were insignificant totaling only $804 for the entire year.

Furthermore, ERI is now revisiting its existing 2000 and 2001 rent rolls and records and comparing them to the rebuilt 2002 and 2003 files to determine for HUD and OIG, to the extent possible, what tenants resided at Lambeth in 2000 and 2001 but were no longer tenants when the income certifications were obtained in 2002. While not a substitute for lost files, it is a good faith attempt to demonstrate what tenants were legitimate recipients of Section 8 assistance.

ERI's current auditor, Mr. Ronald Miller, CPA, has already examined the 2002 and 2003 HAP actual payments and reviewed them against the rebuilt 2002 and 2003 records. His review revealed that only insignificant adjustments were required when basing the HAP payments off the rebuilt records. A copy of this spreadsheet providing such detail is attached hereto as Tab 17. Mr. Miller was also able to track total HAP payments made to Lambeth during the years 1997 through 2003 (excluding 1999), his review indicates that the HAP payments have declined somewhat but have remained relatively consistent. While the records in question are incomplete, Mr. Miller's analysis reveals that the management agent's failure to maintain records had only an insignificant effect on the request for HAP payments. Thus, there is no basis for a finding that there was any overpayment by HUD.

Moreover, as mentioned before, to ensure the property operates in accordance with HUD requirements the ERI Board is considering engaging an independent consultant who will report directly to the Board. This consultant will perform an occupancy and management review, and provide the results to the Board. To demonstrate the Board's concern and desire to implement changes where required and thus ensure compliance with HUD requirement, the report will be shared with HUD.

Pepper Hamilton LLP
Attorneys at Law

Daniel G. Temme
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III. Concluding Remarks to Draft Audit.

Under Finding I of the draft audit, we have supplied documentation to justify the removal of Points A (Episcopal Residences, Incorporated Distributed Project Funds Without Proper Authorization From HUD), B (The Owners Used the Property for Purposes Not Approved by HUD) and E (Maintenance Director Received Payments for Questionable Maintenance Services) from the draft audit. Regarding Point C (The Owners Did Not Properly Manage the Property to Maximize Rental Income), the ERI Board has taken steps to ensure that property is properly managed to maximize rental income. Regarding Point D (Miscellaneous Expenditures Are Not Properly Supported), we have provided documentation justifying the removal of some questioned costs; we will require additional time however to investigate the remaining costs.

Under Finding II of the draft audit, we continue to make a good faith attempt to obtain and collect all relevant data to support the HAP payments made for the years in question. We look forward to a substantially revised audit report and a meeting with HUD in the very near future.

One point cannot be overemphasized: the ERI board has been and is made up of a dedicated group of civic-minded members of the Pittsburgh community volunteering their time to carry out the charitable missions of ERI and HUD. They have acted in good faith and without compensation. They should be supported in their efforts.

Very truly yours,

Raymond N. Baum

RNB/df
Enclosures
cc: Edmund S. Ruffin III, Esquire
John P. Davis, Esquire
Gerald Salzman, Esquire
Diana Gray (w/encs.)
Christine Begola
Debra Braun

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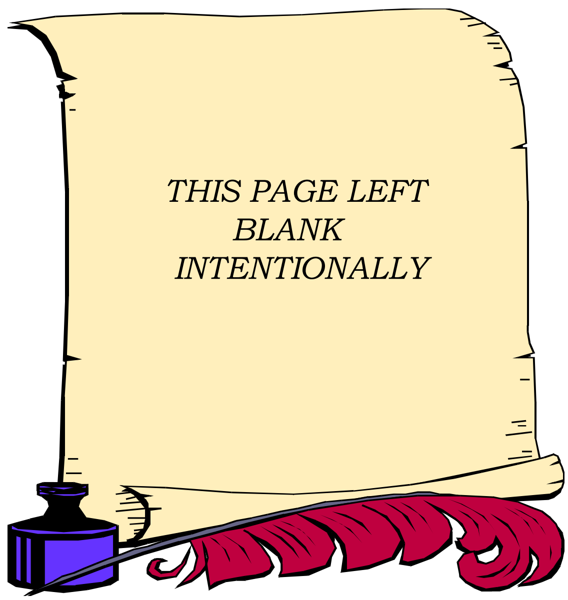
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