AUDIT REPORT

WOOD HILLS ASSISTED LIVING FACILITY
MULTIFAMILY EQUITY SKIMMING

KALAMAZOO, MICHIGAN

2005-CH-1005

JANUARY 12, 2005

OFFICE OF AUDIT, REGION V
CHICAGO, ILLINOIS

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Issue Date	January 12, 2005
Audit Report Number	2005-CH-1005

TO: Barbara Chiapella, Acting Director of Detroit Multifamily Housing Hub, 5FHMLA
Margarita Maisonet, Director of Departmental Enforcement Center, CV
John W. Herold, Associate General Counsel for Program Enforcement, CE

FROM: Heath Wolfe, Regional Inspector General for Audit, 5AGA

SUBJECT: Wood Hills Assisted Living Facility; Kalamazoo, MI; Multifamily Equity Skimming of More Than $500,000 in Project Assets

HIGHLIGHTS

What We Audited and Why

We reviewed the books and records of the Wood Hills Assisted Living Facility (Project), a 60-bed assisted living facility in Kalamazoo, MI. The review was part of our effort to combat multifamily equity skimming. The review was also part of our nationwide review of nursing homes due to the increasingly high default rate and number of Federal Housing Administration (FHA) insurance claims being paid under the Section 232 program. We chose the Project due to its default status and more than $500,000 write-off of bad debt reported in its fiscal years 2001 and 2002 audited financial statements.

Our review objective was to determine whether the owner/management agent used Project funds in compliance with the Regulatory Agreement and the U.S. Department of Housing and Urban Development's (HUD) requirements.

What We Found

The owner of the Project, Wood Hills Limited Partnership, had inappropriately disposed of $518,633 in Project assets as of December 31, 2002, without obtaining HUD approval and in violation of its Regulatory Agreement. The Project was in a nonsurplus cash position and in default of its FHA-insured loan at the time of the disposition.

Wood Hills Limited Partnership also inappropriately loaned $12,885 of Project funds to Wood Hills LP, Inc., the identity of interest operator of the Project. The Project was in a nonsurplus cash position and/or in default at the time the Limited Partnership made the loans.

HUD incurred a loss of $1,024,653 on the sale of the Limited Partnership's mortgage note.

What We Recommend

We recommend that HUD's Acting Director of Multifamily Housing Hub, Detroit Field Office, ensure that Wood Hills Limited Partnership reimburses HUD's FHA insurance fund $518,633 for the inappropriate disposals cited in this report. We also recommend that HUD's Acting Director, in conjunction with HUD's Office of Inspector General, pursue double damages remedies if the Limited Partnership does not reimburse the insurance fund for the inappropriate disposals.

We also recommend that the Director of HUD's Departmental Enforcement Center and/or HUD's Associate General Counsel for Program Enforcement pursue action under the Program Fraud Civil Remedies Act against Wood Hills Limited Partnership's General Partner and impose civil money penalties and pursue administrative sanctions against the Limited Partnership and its owners.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We provided our discussion draft audit finding to Wood Hills Limited Partnership's Resident Agent and HUD's staff during the review. We held an exit conference with the Resident Agent and HUD's staff on November 9, 2004.

We requested Wood Hills Limited Partnership to provide comments on our draft audit finding by November 16, 2004. The Partnership's Resident Agent provided written comments dated November 14, 2004. The Agent agreed with our finding that the Partnership wrote-off the Project's assets. However, the Agent disagreed that the Limited Partnership loaned Project assets to Wood Hills LP, Inc. Further, the Resident Agent did not agree with our recommendations. We included the complete text of the Resident Agent's comments in appendix B of this report.

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BACKGROUND AND OBJECTIVE

Wood Hills Assisted Living Facility (Project) is a 60-bed assisted living facility in Kalamazoo, MI. The Project was insured under Section 232 of the National Housing Act and its Regulatory Agreement was executed on July 25, 2000. The Project's owner is Wood Hills Limited Partnership. Wood Hills LP, Inc. the identity of interest operator of the Project, is also the limited partner of Wood Hills Limited Partnership. The Project defaulted on its Federal Housing Administration (FHA)-insured mortgage in April 2001. The U.S. Department of Housing and Urban Development (HUD) assumed Wood Hills Limited Partnership's mortgage note on September 27, 2002. HUD sold the mortgage note on September 29, 2003, at a loss of $1,024,653.

The review was part of our efforts to combat multifamily equity skimming. The review was also part of our nationwide reviews of nursing homes due to the increasingly high default rate and number of FHA insurance claims being paid under the Section 232 program. We chose the Project due to its default status and more than $500,000 write-off of bad debt reported in its fiscal year 2001 and 2002 audited financial statements.

Our review objective was to determine whether the owner/management agent used Project funds in compliance with the Regulatory Agreement and HUD's requirements.

RESULTS OF AUDIT

Finding: Wood Hills Limited Partnership Inappropriately Disposed of More Than $500,000 in Project Assets

Wood Hills Limited Partnership, the owner of the Wood Hills Assisted Living Facility (Project), had inappropriately disposed of $518,633 in Project assets as of December 31, 2002. The Project was in a nonsurplus cash position at the time of the dispositions. Further, Wood Hills Limited Partnership had been in default of its mortgage since April 2001. Wood Hills Limited Partnership failed to obtain HUD approval for the disposition of Project assets as required by its Regulatory Agreement. The inappropriate dispositions included $504,038 in delinquent lease payments and $14,595 in operating advance receivables. HUD assumed Wood Hills Limited Partnership's mortgage note on September 27, 2002, and HUD paid Midland Mortgage Investment Corporation $2,544,664 for the mortgage. The unpaid principal balance of the mortgage note was $2,619,824. HUD sold the mortgage note to PAMI Atlantic, LLC, on September 29, 2003, for $1,595,171. The inappropriate disposition occurred because Wood Hills Limited Partnership did not follow its Regulatory Agreement and lacked effective procedures and controls to assure Project funds were used appropriately. As a result, fewer funds were available for debt service, and Project funds were not used efficiently and effectively. Further, HUD incurred a loss of $1,024,653 ($2,619,824 minus $1,595,171) on the sale of the mortgage note.

Wood Hills Limited Partnership Improperly Disposed of More Than $500,000 in Project Assets

Wood Hills Limited Partnership had inappropriately written off $518,633 in Project assets as bad debt as of December 31, 2002. The Project was in a nonsurplus cash position at the time of the dispositions. Further, Wood Hills Limited Partnership had been in default of its mortgage since April 2001. Wood Hills Limited Partnership failed to obtain HUD approval for the disposition of Project assets as required by its Regulatory Agreement. The inappropriate dispositions included $504,038 in delinquent lease payments and $14,595 in operating advance receivables.

Wood Hills LP, Inc. Failed to Make Lease Payments to Wood Hills Limited Partnership

Wood Hills LP, Inc., the identity of interest operator of the Project, failed to make $504,038 in lease payments to Wood Hills Limited Partnership from August 2000 through December 2002. Wood Hills Limited Partnership's Lease Agreement with Wood Hills LP, Inc., dated July 25, 2000, required Wood Hills LP, Inc., to make initial monthly lease payments of $27,802. The lease payments were for the Project's mortgage payment, mortgage insurance payment, replacement reserves, real estate taxes, and property insurance. Wood Hills Limited Partnership inappropriately wrote off $197,480 and $306,558 in delinquent lease payments as bad debt on December 31, 2001, and December 31, 2002, respectively.

Even though Wood Hills LP, Inc., failed to make its lease payments to Wood Hills Limited Partnership, Wood Hills LP, Inc., paid its Vice-President, who is also the Limited Partnership's Resident Agent, and its Vice-President's wife and son $184,500 in salaries from January 2001 through December 2002. Wood Hills LP, Inc., also paid Assisted Living Associates, LLC, the identity of interest management agent of the Project, $190,500 in management fees from August 2000 through August 2003. Wood Hills Limited Partnership's General Partner and Resident Agent, who each owned 50 percent of Assisted Living Associates, LLC, received salary and/or travel expenses from Assisted Living Associates, LLC. Further, Wood Hills LP, Inc., paid Fink Associates, LLC, an identity of interest marketing firm, $13,500 in marketing fees from April through August 2003. We believe these salaries and payments of $395,000 were an undue enrichment to Wood Hills Limited Partnership's General Partner, Resident Agent, and/or the Resident Agent's wife and son at the expense of the Project's financial position.

Wood Hills Limited Partnership Inappropriately Wrote Off Operation Advance Receivables

Wood Hills Limited Partnership paid $41,961 in Project expenses from July through December 2000 that should have been paid by Wood Hills LP, Inc. Contrary to the Regulatory Agreement, Wood Hills Limited Partnership also loaned $12,885 to Wood Hills LP, Inc., from December 2000 through July 2001. The loans occurred while the Project was in a nonsurplus cash position and/or in default of its mortgage. Wood Hills Limited Partnership failed to obtain HUD approval for the loans. The Project's fiscal year 2001 audited financial statements stated Wood Hills LP, Inc., repaid $40,251 through capital improvements, cash, furniture, and equipment from July 2000 through December 2001. Wood Hills Limited Partnership inappropriately wrote off the remaining $14,595 on December 31, 2001.

Further, Wood Hills LP, Inc., did not purchase the furniture included in the repayment. Wood Hills Limited Partnership's General Partner certified in the Project's fiscal year 2001 audited financial statements that the Project had $210,241 in furnishings. However, the $210,241 included $11,878 for furniture that Wood Hills LP, Inc., did not purchase.

HUD Incurred a Loss of More than $1 Million on the Sale of Wood Hills Limited Partnership's Mortgage Note

Wood Hills Limited Partnership had $518,633 less in Project funds to make mortgage and Reserve Fund for Replacement payments due to the inappropriate dispositions. Further, HUD approved the use of $148,869 from the Project's Reserve for Replacement account to pay for two mortgage payments, operating advances, interest on operating advances, and service fees.

In a September 5, 2002, letter, HUD's Chicago Regional Office of the Departmental Enforcement Center requested Wood Hills Limited Partnership's General Partner have Wood Hills Limited Partnership's owners or Wood Hills LP, Inc., pay $212,075 ($197,480 in delinquent lease payments and $14,595 in operation advance receivables), written off as bad debt as of December 31, 2001, into the Project's operating and escrow accounts. HUD's Departmental Enforcement Center also requested the General Partner to submit a payment plan between Wood Hills Limited Partnership and Wood Hills LP, Inc., for $245,067 in delinquent lease payments as of August 1, 2002. Neither Wood Hills Limited Partnership's owners nor Wood Hills LP, Inc., made the $212,075 payment. Further, the General Partner did not submit a payment plan for the $245,067.

HUD assumed Wood Hills Limited Partnership's mortgage note on September 27, 2002 and paid Midland Mortgage Investment Corporation $2,544,664 for the mortgage. The unpaid principal balance of the mortgage note was $2,619,824. HUD sold the mortgage note to PAMI Atlantic, LLC on September 29, 2003, for $1,595,171. As a result, HUD incurred a loss of $1,024,653 on the sale.

Recommendations

We recommend that HUD's Acting Director of Multifamily Housing Hub, Detroit Field Office, ensure that Wood Hills Limited Partnership

1A. Reimburse HUD's FHA insurance fund $518,633 for the inappropriate disposals cited in this report.

We also recommend that HUD's Acting Director of Multifamily Housing Hub, Detroit Field Office, in conjunction with HUD's Office of Inspector General,

1B. Pursue double damages remedies if Wood Hills Limited Partnership does not reimburse the FHA insurance fund for the inappropriate disposals cited in this report.

We also recommend that HUD's Director of Departmental Enforcement Center and/or HUD's Associate General Counsel for Program Enforcement

1C. Impose civil money penalties against Wood Hills Limited Partnership and its owners for the inappropriate loans and disposition of Project assets cited in this report that violated the Project's Regulatory Agreement.

1D. Pursue action under the Program Fraud Civil Remedies Act against Wood Hills Limited Partnership's General Partner for incorrectly certifying in the Project's fiscal year 2001 audited financial statements that the Project had $11,878 more in furnishings than it actually owned.

1E. Impose administrative sanctions against Wood Hills Limited Partnership and its owners for the inappropriate disposition of Project assets cited in this report.

SCOPE AND METHODOLOGY

We performed the review at HUD's Detroit and Grand Rapids Field Offices and the Project from April through October 2004. To accomplish our review objectives, we interviewed HUD's staff, the Project's employees, Wood Hills Limited Partnership's Resident Agent and General Partner, and employees from Freedman and Goldberg Certified Public Accountants, the independent public accountant who audited Wood Hills Limited Partnership.

To determine whether the owner/management agent used Project funds in compliance with the Regulatory Agreement and HUD's requirements, we reviewed

- The Regulatory Agreements among HUD, Wood Hills Limited Partnership, and/or Wood Hills LP, Inc.;
- HUD's project files and correspondence related to the Project;
- HUD's Real Estate Management System and Financial Assessment Subsystem information related to the Project;
- Wood Hills Limited Partnership's Certificate of Limited Partnership and Limited Partnership Agreement;
- Wood Hills Limited Partnership's and Wood Hills LP, Inc.'s financial records;
- Wood Hills Limited Parnership's audited financial statements for the years ending December 31, 2000, 2001, and 2002;
- Wood Hills GP, Inc.'s and Wood Hills LP, Inc.'s Articles of Incorporation and By-laws; and
- The State of Michigan Family Independence Agency's licensing information for the Project.

We also reviewed Title 12, United States Code, sections 1715 and 1735; Title 31, United States Code, section 3801; 24 Code of Federal Regulations, parts 24 and 232; and HUD Handbooks 2000.06, REV-3; 4350.1, REV-1; 4370.2, REV-1; and 4381.5, REV-2.

The review covered the period January 1, 2002, to December 31, 2003. This period was adjusted as necessary. We performed our review in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined the following internal controls were relevant to our review objectives:

- Program Operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.

- Validity and Reliability of Data – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.

- Compliance with Laws and Regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

- Safeguarding Resources – Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

We assessed the relevant controls identified above. However, our assessment of the controls was limited since HUD assumed and sold Wood Hills Limited Partnership's mortgage note on September 29, 2003.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weaknesses

Based on our review, we believe the following items are significant weaknesses:

- Program Operations – Wood Hills Limited Partnership did not operate the Project according to its Regulatory Agreement. Wood Hills Limited Partnership disposed of Project assets while in a nonsurplus cash position and without approval from HUD (see finding).

- Validity and Reliability of Data – Wood Hills Limited Partnership's General Partner certified in the Project's fiscal year 2001 audited financial statements that the Project had $210,241 in furnishings. However, the $210,241 included $11,878 for furniture that Wood Hills LP, Inc., did not purchase (see finding).

- Safeguarding Resources – Wood Hills Limited Partnership inappropriately wrote-off $518,633 of Project assets as bad debt and loaned $12,885 of Project funds to Wood Hills LP, Inc., while in a nonsurplus cash position and without approval from HUD. Further, Wood Hills Limited Partnership inappropriately included $11,878 for furnishings in the Project's fiscal year 2001 audited financial statements (see finding).

Appendixes

Appendix A

SCHEDULE OF INELIGIBLE COSTS

Recommendation Number	Ineligible 1/
1A	$518,633
Total	$518,633

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.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation	Auditee Comments

WOOD HILLS LIMITED PARTNERSHIP, LLC
3708 WEST MICHIGAN AVENUE
KALAMAZOO, MI 49006

November 14, 2004

Brent Bowen, Assistant Regional Inspector General for Audit
U.S. Dept. of HUD-Office of Inspector General
77 West Jackson Blvd., Suit 2646
Chicago, IL 60604

Re: response to Draft findings – Wood Hills Limited Partnership, LLC

Dear Mr. Bowen:

Following are the written responses of the verbal responses I presented in our meeting on November 9, 2004 in the Detroit office of HUD. My comments will follow the items presented in the Draft Findings Report in the letter of November 1, 2004.

The items stated under ***Federal Requirements Regarding The Use Of Project Funds*** reference the regulations included in the loan documents for the HUD insured loan. As such, we have no disagreement with these statements.

Before responding to the specific findings, it is important to note that fraud implies a deliberate act to deceive for personal or corporate gain. Throughout all of the time in question, Wood Hill Limited Partnership, LLC did not engage in any fraud or attempt to deceive HUD or Midland Mortgage with regard to our operations or use of funds from the operations. Nor did Wood Hills LP, Inc. Nor did any of the shareholders.

Your findings:

1. ***Wood Hills Limited Partnership Inappropriately Disposed of over $500,000 in Project Funds***

   The write off of $518,633 in project assets was an accounting action at the end of the fiscal year. We used an accounting firm that was HUD approved and, as such, we expected them to conduct the audit and take end of year actions that were in keeping with the loan document.

Comment 1

   HUD had that audit for over two years without raising an issue with the audit. In addition, writing off that amount did not result in any gain for anyone. We assumed this accounting action was in keeping with what HUD guidelines allowed. Using the phrase "inappropriately disposed of…" implies we realized a financial gain from this act. Wrong. If it was done inappropriately, it was a

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Ref to OIG Evaluation	Auditee Comments

Comment 2
Comment 1

mistake that could have been corrected by an accounting change. Acceptance of this audit by HUD conveys acceptance of the audit actions taken. HUD did not inform us of any improper actions nor did we receive a question seeking clarification or explanation of the audit.

As to the $14,595.00 included in this finding, it is also an accounting action that did not result in any gain for any shareholder. The only money Limited, LLC had was what LP, Inc. paid to it. What this amount covers is unclear, but Limited, LLC only received money from LP, Inc when it was needed for expenses beyond the mortgage payment. Therefore, we assume that the recoding of this amount was part of the year end accounting – not an attempt to take from Limited, LLC for gain of LP, Inc. or any shareholder. If the past due mortgage payments should have stayed on the books of Limited, LLC, we assumed HUD, in its review of our audit, would have raised a question. We could have corrected the audit. No one gained from we consider is an audit reporting mistake.

Comment 1

Parenthetically Wood Hills LP, Inc. continues to carry on its books the debt for past mortgage payments due to Limited, LLC so that there was no attempt to deceive HUD.

It is a reach to conclude that Wood Hills Limited Partnership, LLC engaged in fraud or behavior in violation of the loan agreement for corporate or personal gain of any of the shareholders.

Again, LP, Inc. supplied Limited, LLC with any money that Limited, LLC spent, not the reverse. The recording of income and expenses may have been in error but not the result of deliberate attempts to deceive and defraud anyone.

2. ***Wood Hills LP, Inc. Failed To Make Lease Payments To Wood Hills Limited Partnership***

Agreed. After about seven months Wood Hills LP, Inc. did not have the cash from operations to make full payments due to a significant drop in occupancy and the fact that the monthly payments of the loan exceeded what cash Wood Hills LP, Inc had after operations. That financial fact, however, existed for the entire 13 years of operations prior to the HUD insured loan.

Comment 1
Comment 2

Our response to the finding of inappropriate write-off of debt by Limited, LLC is the same as in Finding 1. This amount continues to be carried as debt on the books of LP, Inc. HUD had the 2001 and 2002 audit and never asked for clarification, never rejected the audit, never questioned us about the audit. Therefore, we assumed HUD's review of the audit, with no response, meant that HUD accepted the audit as received.

It is important under this finding to understand the context in which this loan was made. A review of the financial reports from Wood Hills LP, Inc. as part of our loan application – which HUD and Midland underwriters has for over 14 months prior to the execution of the loan – will show that Wood Hills LP, Inc. never had more than $21,000 available after expenses. And, we were not making any tax payments at that time. A loan that required more than $28,000 a month payment when contrasted with our pre-loan income and expense experience seems like a mistake on the part of HUD and Midland. I was not the Resident Agent at that so that I do not if know if the monthly payment amount was presented to us. The first time I saw the amount was when we received the first mortgage payment notice.

Sometime after January, 2001 we notified Midland that making the payments were a problem and would continue to be a problem. In order to make the payments our occupancy would have to be close to 100% every month and our expenses would have to remain stagnant for many years to come.

We began to offer regular reports to both Midland and HUD about our actions to reduce and manage expenses and to hold our occupancy. After working with us and reviewing our operations, Midland decided to return the loan to HUD in September 2003. During that time I worked with the work-out person at Midland. He had two consultants review our operations to make suggestions. There were no findings that we were operating in such a manner that created our financial problems.

As part of the loan application, we were directed to have our project appraised by a HUD approved appraiser. We paid for this appraisal as part of our pre-loan expenses. This appraisal came back at $3.2 million, in spite of the fact that we had an appraisal conducted a year earlier for $1.7 million. We were told at the time that there are different ways of appraising a project and HUD accepted the method used in the $3.2 million appraisal.

3. ***Wood Hills Limited Partnership, LLC Inappropriately Wrote-off Operation Advance Receivables***

Wood Hill Limited Partnership, LLC did not loan or give any money to LP, Inc since it had no money to give except what LP, Inc. gave it. We assume that the exchange of money between the two entities was an accounting action for audit purposes. Again, we would expect a response from HUD after its review as to the correctness of the audit. We paid to have a HUD approved audit and assumed that that was what we received. We know that an inquiry from HUD would have been responded to by our auditors and the situation would have been corrected.

The $11,878.00 reported as purchased furniture is a mistake. We think that what happened was at the end of the year our auditors asked for all correspondence we had with HUD. The Memo requesting the money from HUD for the furnishings was included by the auditors by mistake. We suppose that there was no Memo

Ref to OIG Evaluation **Auditee Comments**

included that denied our request. Nevertheless, the inclusion of this amount hardly qualifies as an active effort to deceive HUD for our gain.

The finding that Limited, LLC paid operating expenses inappropriately is confusing. What expenses? Where did Limited, LLC get the money to pay these expenses except from LP, Inc? Again, we assume there was an accounting action that recorded expenses in a way that appeared as you state in your finding.

4. ***HUD Incurred a Loss of Over $1 million On The Sale of Wood Hills Limited Partnership's Mortgage Loan***

As the Resident Agent of Wood Hills Limited Partnership, LLC since October, 2003, I do not have any record of the letter in question. Any request of information to me from Midland or HUD has been responded to in a timely and complete manner. On behalf of Limited, LLC I have provided information about operations both requested and not requested. I have attempted to keep HUD informed of our efforts to correct the financial problems that resulted in the default.

HUD may have lost some money and we regret that loss. We have lost a project we developed as one of the first assisted living projects in Kalamazoo. Personally, as the developer of this project, I have lost a 17 year effort to create a business that would serve elders and their families and make me proud.

Frankly, given the situation of assisted living projects at this time, especially those designed like ours, HUD did well by selling the loan for $1,595,171. Two appraisals I have had conducted a few months ago by national senior housing real estate brokers placed the value at between $800,000 and $1 million. The change in the assisted living market is national in nature. Rather than the national occupancy level of 90-93% we enjoyed during the 1990's, the level of occupancy for assisted living nationally is 82-85%. Wood Hills has been in the mid to upper 80% during this period.

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Comment 3

As to the ***Recommendations***, we think that there is no basis for civil or criminal action since we did not engage in behavior that supports the recommended actions.

We think HUD's review of the loan application and their conclusion that his loan was good and that Wood Hills Limited Partnership, LLC had the financial strength to repay loan at the monthly level was flawed. It is an incomplete conclusion to suggest that we should not have signed the loan. We provided all information requested by HUD for their review prior to making the loan. We understand that these type of loans have experienced a high number of defaults nationally. Possibly our situation is not so unique and HUD needs to review its practices.

We regret that our efforts over the past 17 years have come to the current situation. We regret that HUD lost money on this loan. To point a finger at us is short sighted, incorrect and fails to include HUD as part of the problem.

We trust that fairness will prevail. We request that your findings be modified based on our comments and that the recommendations be eliminated.

Thank you for your civil treatment of us during a difficult time.

Sincerely,

Dick Fink, MSW
Resident Agent

C: Shareholders
Freedman & Goldberg

OIG Evaluation of Auditee Comments

Comment 1 In a September 5, 2002, letter, HUD's Chicago Regional Office of Departmental Enforcement Center requested that Wood Hills Limited Partnership's General Partner have Wood Hills Limited Partnership's owners or Wood Hills LP, Inc., pay $212,075 ($197,480 in delinquent lease payments and $14,595 in operation advance receivables), written off as bad debt as of December 31, 2001, into the Project's operating and escrow accounts. HUD's Departmental Enforcement Center also requested the General Partner to submit a payment plan between Wood Hills Limited Partnership and Wood Hills LP, Inc., for the $245,067 in delinquent lease payments as of August 1, 2002. Wood Hills LP, Inc., benefited from the write off of the delinquent lease payments.

Comment 2 HUD's receipt of annual financial statements does not constitute approval and/or knowledge of the Project's financial position and actions. Further, HUD does not approve annual financial statements.

Comment 3 Wood Hills Limited Partnership did not operate the Project according to its Regulatory Agreement. Wood Hills Limited Partnership's General Partner inappropriately certified in the Project's fiscal year 2001 audited financial statements that the Project had $210,241 in furnishings. HUD's loan approval process is not a guarantee the Project will succeed and following the Regulatory Agreement is a requirement for the Project's owner.

Appendix C

FEDERAL REQUIREMENTS

Wood Hills Limited Partnership's Regulatory Agreement, paragraph 6, mandated that the owner may not, without the prior written approval of the Secretary of Housing and Urban Development assign, transfer, dispose of, or encumber any personal property of the project, including rents, or pay out any funds except from surplus cash, except for reasonable operating expenses and necessary repairs, and make or receive and retain any distribution of assets or any income of any kind of the Project except surplus cash.

Paragraph 13(g) of the Regulatory Agreement defines distribution as any withdrawal or taking of cash or any assets of the project, excluding payment for reasonable expenses incident to the operation and maintenance of the project.

Paragraph 9 of Wood Hills Limited Partnership's Rider to Note, Mortgage, and Regulatory Agreement requires all signatories to the Rider to be liable for a) funds or property of the Project coming into their hands that they are not entitled to retain and b) their own acts and deeds or acts and deeds of others, which they have authorized, in violation of the provisions.
HUD Handbook 4370.2, REV-1, CHG-1, "Financial Operations and Accounting Procedures for Insured Multifamily Projects," paragraph 2-10, section A, states that if the owner takes distributions when the project is in default or when the project is in a nonsurplus cash position, the owner is subject to criminal and/or civil penalties.

According to 24 Code of Federal Regulations, part 24.110, HUD is permitted to take administrative sanctions against employees or recipients under HUD assistance agreements that violate HUD's requirements. The sanctions include debarment, suspension, or limited denial of participation and are authorized by parts 24.300, 24.400, or 24.700, respectively. HUD may impose administrative sanctions based upon the following conditions:

- Failure to honor contractual obligations or to proceed in accordance with contract specifications or HUD regulations (limited denial of participation);

- Deficiencies in ongoing construction projects (limited denial of participation);

- Violation of any law, regulation, or procedure relating to the application for financial assistance, insurance, or guarantee or to the performance of obligations incurred pursuant to a grant of financial assistance or pursuant to a conditional or final commitment to insure or guarantee (limited denial of participation);

- Violation of the terms of a public agreement or transaction so serious as to affect the integrity of an agency program such as a history of failure to perform or unsatisfactory performance of one or more public agreements or transactions (debarment);

- Any other cause so serious or compelling in nature that it affects the present responsibility of a person (debarment); or

- Material violation of a statutory or regulatory provision or program requirements applicable to a public agreement or transaction, including applications for grants, financial assistance, insurance, or guarantees, or to the performance of requirements under a grant, assistance award, or conditional or final commitment to insure or guarantee (debarment).

Title 12, United States Code, section 1715z-4a, "Double Damages Remedy for Unauthorized Use of Multifamily Housing Project Assets and Income," allows the U.S. Attorney General to recover double the value of any project assets or income that was used in violation of the Regulatory Agreement or any applicable regulation, plus all cost relating to the action, including but not limited to reasonable attorney and auditing fees.

Title 12, United States Code, section 1735f-15, "Civil Money Penalties Against Multifamily Mortgagors," allows the Secretary of Housing and Urban Development to impose a civil money penalty of up to $25,000 per violation against a mortgagor with five or more living units and a HUD-insured mortgage. A penalty may be imposed for any knowing and material violation of the Regulatory Agreement by the mortgagor, such as paying out any funds for expenses that were not reasonable and necessary project operating expenses or making distributions to owners while the project is in a nonsurplus cash position.

Title 31, United States Code, section 3801, "Program Fraud Civil Remedies Act of 1986," provides Federal agencies which are the victims of false, fictitious, and fraudulent claims and statements with an administrative remedy to recompense such agencies for losses resulting from such claims and statements; to permit administrative proceedings to be brought against persons who make, present, or submit such claims and statements; and to deter the making, presenting, and submitting of such claims and statements in the future.