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96-BO-214-1001

TO: Luisa G. Osborne, Director, Multifamily Division,
Office of Housing, Rhode Island State Office, 1GHM

FROM: William D. Hartnett, District Inspector General,
Office of Audit, New England, 1AGA

SUBJECT: National Investments, Ltd.
Management Agent
Johnston, Rhode Island

We performed an audit of National Investments, Ltd., an Identity-of-Interest Management Agent, located in Johnston, Rhode Island. The primary audit objective was to assess the ability of the Management Agent to initiate and complete required repairs at Evergreen and Riverbend Apartments. Specifically, our objective was to evaluate the projects' physical and financial condition, and identify the best method for the Management Agent to optimize cash flow, restore and maintain the projects' physical condition, and protect HUD's interests.

Due to a shortage of available funds, the projects need more than \$3.5 million in substantial repairs. Rents at both projects are well under the Fair Market Rent for existing housing and market rents in the locality. The Rhode Island State Office is currently processing project rent increases and Section 241(a) loans to address the physical and economic health of these projects. Such approach will protect HUD's interests, while aiding in the restoration and maintenance of the physical condition of the projects. Based on your office's actions, no recommendations are needed at this time.

Please furnish us copies of any correspondence or directives issued because of the audit.

Please note that a copy of the report has been provided to the Management Agent. Should your staff have any questions, please contact our office at (617) 565-5259.

Executive Summary

Our primary audit objective was to assess the ability of National

Investments, Ltd., an Identity-of-Interest Management Agent, to initiate and complete required repairs at Evergreen and Riverbend Apartments located in East Providence and Cranston, Rhode Island, respectively. We also evaluated the projects' physical and financial condition, and reviewed actions of the Management Agent and Rhode Island State Office to optimize cash flow, restore and maintain their physical condition and protect HUD's interests.

The two projects have deteriorated to a point where substantial funds are needed to make repairs. These funds are not readily available. Funds exceeding \$3.5 million are needed to correct the deficiencies (more than \$1.7 million at each project). Rents at both projects are well under the Fair Market Rent for existing housing and market rents in the locality. The Rhode Island State Office is currently processing project rent increases and Section 241(a) loans to address the physical and economic health of these projects. These actions should protect HUD's interests, while aiding in the restoration and maintenance of the physical condition of the projects.

HUD's latest inspections show that more than \$3.5 million (\$1,772,665 at Evergreen Apartments and \$1,797,865 at Riverbend Apartments) are needed to correct project deficiencies.

In order to obtain funds to make necessary repairs, the Rhode Island State Office is processing project rent increases and Section 241(a) loans to obtain funds to address the projects' physical needs. The Section 241(a) loan applications, submitted by the Management Agent, request \$2.1 million for Evergreen Apartments and \$2.3 million for Riverbend Apartments to be used exclusively for project repairs and capital needs. The projects' rent increase is to be provided by the State Office in coordination with the Section 241(a) loans. Project rent increases are feasible and beneficial to the projects while not harming the tenants.

HUD is currently processing the project rent increases and Section 241(a) loans to protect HUD's interests and provide for the restoration of each project. Therefore, no additional recommendations are necessary.

We have discussed our concerns with the Management Agent and your staff during the course of our review. The

Management Agent was provided a draft report for comment on October 10, 1995. The Management Agent's comments were received on October 20, 1995 and were considered this report. A copy of the Management Agent's comments are included in Appendix A.

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Abbreviations

CPA	Certified Public Accountant
FMR	Fair Market Rent
HAP	Housing Assistance Payments
HUD	Department of Housing and Urban Development
LTD	Limited

Introduction

National Investments Ltd. is an Identity-of-Interest Management Agent of the owner and General Partner, Alfred Carpionato. The Management Agent manages four HUD insured projects:

Project Name	Project Number
Evergreen Apartments	016-44067
Riverbend Apartments	016-44011
1890 House	016-44066
Carties Health Center	016-43018

Evergreen Apartments is located at 15 Evergreen Drive, East Providence, Rhode Island, and Riverbend Apartments is located at 517 Dyer Avenue,

Cranston, Rhode Island. The projects have been 100 percent Section 8 subsidized since October 1992. Both projects are Section 236 family projects of 10 wooden two-story buildings each, consisting of 168 (one, two and three bedroom) rental units. The projects' mortgages are current but have been recently added by the Rhode Island State Office to their list of projects which are "potentially troubled."

The 1890 House is a 52-unit elderly Section 236 project located at 254 Washington Street, Providence, Rhode Island, which is also 100 percent Section 8 subsidized. Carties Health Center is a 213-bed Section 232 nursing home project located at 21 Lincoln Avenue, Central Falls, Rhode Island. Both 1890 House and Carties Health Center are in good physical condition. However, Evergreen and Riverbend Apartments have physical deficiencies which require corrective action.

National Investment Ltd., also manages eight non-HUD insured projects having Section 8 subsidies administered by the Rhode Island Housing Mortgage Finance Corporation.

The Management Agent's staff consists of three full-time corporate employees and eight on-site employees for the three Section 236 projects (Carties Health Center employees are all leased through a Leasing Company). All employees, including the senior property manager, are under the direction of John Kokot, Vice President of Development.

Financial and accounting records for the Section 236 projects are maintained at the corporate offices located at 1414 Atwood Avenue, Johnston, Rhode Island. Records for Carties Health Center are maintained at the Health Center Office located at 21 Lincoln Ave, Central Falls, Rhode Island.

Our audit objective was to assess the ability of National Investments, Ltd. to initiate and complete required repairs at Evergreen and Riverbend Apartments. We also evaluated each projects' physical and financial condition and reviewed actions of the Management Agent and Rhode Island State Office to optimize cash flow, restore and maintain their physical condition and protect HUD's interests.

Audit work was performed between October 1994 and May 1995 and covered the period from October 1, 1991 through September 30, 1994. Where appropriate, the audit period was extended.

We focused our review on the financial operations and physical condition of the Evergreen and Riverbend Apartment projects. To accomplish the audit objectives, we:

- o Reviewed the Regulatory Agreements and Section 8 Housing Assistance Payment Contracts.
- o Reviewed audited Financial Statements for the Fiscal Years 1991 to 1994.
- o Reviewed the Certified Public Accountant's (CPA) working papers.
- o Analyzed Project Replacement Reserve Accounts.
- o Reviewed the latest HUD and Mortgagee Physical Inspections.
- o Analyzed deficiencies cited in the Physical Inspection Reports performed by HUD.
- o Conducted site inspections at Evergreen and Riverbend Apartments.
- o Analyzed funding sources cited in Evergreen and Riverbend Apartments' Corrective Action Plans.
- o Reviewed HUD's Rhode Island State Office appraisals for Evergreen and Riverbend Apartments.
- o Evaluated the potential cost of the Section 241(a) loan applications if approved by HUD.
- o Analyzed Market Rents for unassisted housing projects located around Evergreen and Riverbend Apartments.
- o Conducted interviews with the Management Agent's staff, the projects' CPA, and personnel of HUD's Rhode Island State Office of Housing, Multifamily Division.

We conducted the audit in accordance with generally accepted government audit standards.

Projects Require Substantial Repairs

Evergreen and Riverbend Apartments have deteriorated to a point where over \$3.5 million is needed to correct physical deficiencies at both projects. A shortage of available funds has left the Management Agent, National Investments Limited, incapable of making the required repairs. As a result, tenants are living in projects where substantial repairs are required, and the deferred maintenance is jeopardizing HUD's overall interests. The Rhode Island State Office is currently processing rent increases and Section

241(a) loans to obtain funds to complete the required repairs.

The Regulatory Agreements for Evergreen and Riverbend Apartments provide that the projects must be maintained in good repair or condition. The Section 8 Housing Assistance Payments (HAP) Contracts for both projects require the owners to operate and maintain decent, safe, and sanitary housing, to maintain the property and grounds, and to make repairs with reasonable promptness.

To assure projects are adequately maintained, HUD performs inspections and reports deficiencies which need to be corrected. Time frames for corrective action are specified by the HUD State Office.

Since 1993, the Management Agent, HUD, and the projects' Mortgagees have identified significant physical deficiencies at both projects. HUD inspections identified weak maintenance practices as the cause for the extensive repairs now required at both projects. The Management Agent believes lack of funds was the main cause for the current conditions.

Evergreen Apartments

A 1993 Capital Needs Survey identified 26 items with a total cost estimate of \$2,742,900 to be repaired over a five year period. The most urgent first year (1994) replacement or repair items totalled \$1,794,713. The five highest cost first year repair items were: Kitchen Cabinets(\$282,000); Vinyl Siding (\$262,000); Asphalt Paving (\$200,000)

Window Replacement (\$183,000), and Roofing Shingles (\$166,000). Safety was cited as a concern for the asphalt paving.

HUD's June 8, 1993 Physical Inspection Report for Evergreen Apartments identified \$1.1 million (65 percent) of \$1.7 million in repairs requiring correction within the first year. First year repairs consisted of: Exterior Walls & Foundations (\$280,000); Roofs, Flashing & Vents (\$126,000); Walks, Steps & Guardrails (\$76,000); Floors, Carpets and Tiles (\$115,599); Refrigerators and Ranges (\$62,895), and thirteen other repairs (ranging from \$2,000 to \$60,000 each). Since the inspection, roof replacement, to prevent deterioration of the units, has become one of the most urgent priorities at the project. As of February 1995, corrective action on urgent deficiencies had been limited. Roofs on only three of the fourteen buildings have been replaced.

Evergreen Apartments' Mortgagee performed an inspection on July 20, 1994, a year after the HUD inspection which also concluded the project physical condition was "unsatisfactory." The Mortgagee's report indicated that the

project buildings were over 20 years old and showing signs of wear on the exterior and interior.

Riverbend Apartments

A 1993 Capital Needs Survey identified 24 items with a total cost estimate of \$2,531,400 to be repaired over a five year period. The most urgent first year (1994) replacement or repair items totalled \$2,104,566. The five highest cost first year repair items, were: kitchen cabinets (\$399,000); asphalt paving (\$390,000); step replacement (\$312,000); entrance Doors (\$203,000), and vinyl siding (\$192,000). Safety was cited as the reason for asphalt paving and step replacement.

HUD's August 4, 1994 Physical Inspection Report for Riverbend Apartments identified \$851,000 of \$1.7 million (50 percent) as repairs requiring correction

within the first year. The only two first year high priority items, smoke alarms and exterminating have been addressed. Among the low priority items was \$99,575 for "roofs, flashing and vents". Since the inspection, roof replacement has become one of the most urgent priorities at the project. Aside from the two first year high priority items, corrective action on other deficiencies was limited. As of February 1995, roofs on only two of the fourteen buildings, had been replaced.

Riverbend Apartments' Mortgagee performed an inspection on July 29, 1994 which also concluded that the project's physical condition was "below average". Prior repairs required by HUD had not been completed.

Current project rents at both projects are well under the Fair Market Rent (FMR) which could be charged, and in the case of Riverbend Apartments, substantially below the market rents for the surrounding area, as identified by HUD's Office of Economic and Market Analysis.

Evergreen Apartments

Unit Size	Project Rents	Fair Market	Market Rent
	Effec. 9/94	Rent 9/95	2/95
1 BR	\$476	\$534	\$555
2 BR	\$550	\$642	\$663
3 BR	\$612	\$805	\$825

Riverbend Apartments

Unit Size	Project Rents Effec. 8/94	Fair Market Rent 9/95	Market Rent 2/95
1 BR	\$463	\$534	\$628
2 BR	\$561	\$642	\$805
3 BR	\$634	\$805	\$924

HUD has approved several rent increases during the last three years. However, one rent increase in August 1993 for Riverbend Apartments was insignificant. Two subsequent rent increases at each of the projects, granted in October 1993 and August 1994, have produced substantial increases in rental income. From 1993 to 1994, annual net rental income increased at Evergreen by \$97,458, and at Riverbend by \$190,298. However, these increases are still insufficient to address major repair needs in a timely manner.

As of August 1995, Evergreen and Riverbend Apartments each have available from a source of three Section 8 HAP contracts, committed contract authority totalling \$5,991,960 and \$5,083,985 respectively. Available Section 8 funds remaining at August 16, 1995 were \$2.7 million for each project. At the projects' prevailing rents, it is estimated that each project will have at least 20 percent of their contract authority remaining at the expiration of the HAP Contract. Considering an average monthly draw down, Evergreen and Riverbend will have undisbursed contract authority of \$1.1 and \$1.3 million respectively at the HAP contracts' expiration.

In order to obtain funds to make necessary repairs, the Rhode Island State Office is simultaneously processing project rent increases and Section 241 (a) loan applications submitted by the Management Agent. The Section 241 (a) loan applications requested \$2.1 million for Evergreen Apartments and \$2.3 million for Riverbend Apartments to be used exclusively for project repairs and capital needs. These applications were submitted on February 24, 1995, however due to incomplete application packages, the State Office temporarily suspended processing.

On September 20, 1995 the State Office advised that complete 241(a) loan application packages have been received and processing would take approximately two months, with four to six months for construction, and four months after construction completion for commencement of amortization. HUD will establish a final hierarchy of replacement and repair needs pursuant to their approval of the 241(a) loans.

The State Office has advised that project rents will be increased to support the 241(a) loans. On September 20, 1995, the State Office estimated that

it will be a minimum of 61 days before the increases are approved and implemented. Once approved, the increase will be deposited into the reserve for replacement specifically to make required repairs. When the 241(a) loan is approved, budget modifications will be executed to reduce the reserve for replacement deposit in the amount of the debt service. In addition a plan has been developed that identifies and prioritized capital repairs.

* * * * *

Based upon the results of our review, we are not making any specific recommendation. The Rhode Island State Office is initiating the appropriate actions to optimize cash flow necessary to restore and maintain the projects' physical condition, and protect HUD's interest.

Internal Controls

In planning and performing our audit, we considered the internal control systems of the Management Agent.

Internal control is the process by which an entity obtains reasonable assurance as to achievement of specified objectives, such as to ensure that: its goals and objectives are met; 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.

Internal control consists of interrelated components, including integrity, ethical values, competence, and control environment which includes establishing objectives, risk assessment, information systems, control procedures, communication, managing change, and monitoring.

We determined that internal controls were not relevant to our audit objectives and accordingly we did not review the internal control systems of the Management Agent.

Appendix A

Auditee Comments

Appendix B

Distribution

Secretary Representative, 1AS

Director, Office of Housing, 1AH
Audit Liaison Officer, New England, 1AAI
Office of Comptroller, 1AFF
Rhode Island State Coordinator, 1GS
Comptroller/ALO, Housing, HF, Room 5132
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