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	October 20, 2006
Audit Report Number	
	2007-LA-1001

TO: William F. Bolton, Director, Los Angeles Multifamily Housing, 9DHMLA
Margarita Maisonet, Director, Departmental Enforcement Center, CV
R. Faye Austin, Regional Counsel, 9AC

FROM: Joan S. Hobbs, Regional Inspector General for Audit, Region IX, 9DGA

SUBJECT: The Associates Group Pioneer Pines Park, Bakersfield, California, Did Not Follow the Provisions of the Regulatory Agreement

HIGHLIGHTS

What We Audited and Why

We audited The Associates Group Pioneer Pines Park (Pioneer Pines), located in Bakersfield, California, in response to a request from the U.S. Department of Housing and Urban Development's (HUD) Departmental Enforcement Center. Our audit objectives were to assess HUD's concerns about potential equity skimming and to determine whether the project was administered in compliance with the regulatory agreement and HUD rules and regulations.

What We Found

Pioneer Pines failed to collect $195,202 in rental payments from its mobile home dealers; paid $133,049 in unsupported wages; made payments of $373,827 for ineligible expenses, of which $27,515 remains outstanding; commingled funds and repaid advances while in a non-surplus-cash position; failed to maintain its vacant spaces in good repair and condition; and failed to make required mortgage payments.

We attribute the deficiencies to the president of Pioneer Pines' insufficient understanding and in some cases disregard of HUD and regulatory agreement requirements and the lack of adequate internal controls and procedures. As a result, project funds were used improperly, which unnecessarily increased the risk to HUD. Furthermore, Pioneer Pines' failure to properly maintain the vacant lots in a rent-ready condition may have adversely impacted potential homeowners' decisions to move to Pioneer Pines, and thus, hampered its ability to maximize its occupancy rate.

What We Recommend

We recommend that the director of HUD's Los Angeles Multifamily Hub require The Associates Group for Affordable Housing, Inc. (owner), to develop and implement new procedures and lease agreements to collect full rent from affiliated companies once spaces are leased, which will result in $195,202 in funds to be put to better use. In addition, we recommend that HUD require the owner to repay Pioneer Pines' project account from non-project funds for the $195,202 in uncollected rent, the $133,049 in unsupported salary expenses related to non-project activities, and the $27,515 in ineligible expenses. Further, we recommend that HUD require the owner to correct the deficiencies relating to the vacant spaces we inspected. We recommend that the president discontinue commingling funds and repaying advances while in a non-surplus-cash position and attend training on HUD's regulatory agreement and other pertinent rules to assure future compliance with the requirements. We also recommend that HUD's Regional Counsel, in conjunction with HUD's director of the Los Angeles Multifamily Housing HUB and HUD's Office of Inspector General (OIG), pursue double damages remedies against the owner for the inappropriate disbursements that were used in violation of the regulatory agreement.

In addition, we recommend the director of the Departmental Enforcement Center pursue action under the Program Fraud Civil Remedies Act against the president, impose civil money penalties and pursue administrative sanctions against the president for his part in the regulatory violations cited in this report, and impose administrative sanctions against Pioneer Pines and its owner for the inappropriate disposition of project assets cited in this report.

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 Pioneer Pines a draft report on September 5, 2006, and held an exit conference with Pioneer Pines' president on September 18, 2006. Pioneer Pines provided written comments on September 25, 2006. Pioneer Pines generally disagreed with our report findings.

The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

Built originally in 1973, The Associates Group Pioneer Pines Park (Pioneer Pines) is a 336-space mobile home park located in Bakersfield, California, and is insured by the U.S. Department of Housing and Urban Development (HUD) (project number 122-00225) for $7.83 million under the Section 207(m) program of the National Housing Act. This federal mortgage program is for new construction and substantial rehabilitation and insures lenders against loss on mortgage defaults. The project is also funded by the Housing Authority of the County of Kern with $350,000 Series 2002 B and $1,517,677 Series 2002 C tax-exempt bonds.

The Associates Group for Affordable Housing, Inc. (owner), was formed in 1988 as a California nonprofit corporation dedicated to providing persons and families of low and moderate income with affordable housing. The owner's initial purchase of Cedar Hill, a 281-space condominium conversion park, in 1999 was a success. In November 2002, the owner purchased Pioneer Pines with the intention of mirroring that success. In September 2002, the owner's board of directors unanimously agreed to create a supporting organization, The Associates Group Pioneer Pines Park, to manage the operations of the park. The Internal Revenue Service did not designate the nonprofit status of the new entity until December 2002 and thus forestalled the transfer of the project to the new entity. It was held in abeyance until the transfer was made in December 2004. In the meantime, the owner assumed the role as the supporting organization and stripped itself of its assets and liabilities to enable it to act as the single asset entity for the park. The former entity's assets and liabilities were transferred to another non-HUD-related organization, The Associates Group Cedar Hill, LLC (The Associates Group Cedar Hill). In February 2004, The Associates Group Cedar Hill transferred all of its rights and title in the park to Pioneer Pines. Before HUD's limited management review, the president shared the managing responsibilities with management company La Cumbre Management, which was hired in November 2002 and also manages The Associates Group Cedar Hill.

Pioneer Pines has not achieved the success of The Associates Group Cedar Hill. As of April 2006, Pioneer Pines had a 34 percent vacancy rate and is currently in default on its mortgage obligation, with the last payment received on July 14, 2006, for the November 1, 2005 loan payment. As of January 13, 2004, Pioneer Pines has struggled to pay its mortgage obligation and has requested disbursements from the working capital and operating deficit reserves.

The Los Angeles HUD Multifamily Hub conducted an on-site limited management review of Pioneer Pines in October 2004, which resulted in nine findings and one observation.

Shortly after meeting with HUD staff in March 2005, the president employed a certified public accountant to examine the backup documentation (invoices, checks, and vouchers) for all of Pioneer Pines' bank accounts to reconcile the questionable items and determine the amount due back to the project. The accountant identified $346,312 in unauthorized distributions of project funds relating to the purchase, refurbishment, installation, and transport of mobile home units and questionable salary, tax, and travel expenses. The total amount was repaid to the project in the form of home sale proceeds, The Associates Group Cedar Hill loans/advances, and intercompany transfers.

In a February 2006 memorandum, the Departmental Enforcement Center recommended we review the operations of Pioneer Pines for potential equity skimming. The project was an elective financial referral from the Los Angeles Multifamily Hub for unauthorized distribution of project funds. HUD's Real Estate Assessment Center also referred the project to the Departmental Enforcement Center for review as a result of the bank accounts not being in the name of the project, unauthorized distribution of project funds, an unauthorized loan, and collection of receivables on behalf of an affiliate.

Our audit objectives were to assess HUD's concerns about potential equity skimming and to determine whether Pioneer Pines was administered in compliance with the regulatory agreement and HUD rules and regulations.

RESULTS OF AUDIT

Finding 1: Pioneer Pines' Owner Failed to Administer the Project in Compliance with the Regulatory Agreement and HUD Rules and Regulations

Pioneer Pines' owner failed to administer the project in accordance with requirements relating to the receipt and expenditure of project funds and did not properly maintain the project. Pioneer Pines

- Failed to collect $195,202 in rental income and utilities for the project,
- Paid $133,049 in unsupported payroll charges for grounds worker wages,
- Inappropriately used $373,827 in project funds for ineligible expenses,
- Commingled project and non-project funds,
- Failed to properly maintain 90 of the 114 vacant lots on the premises, and
- Failed to make required mortgage payments.

We attribute these deficiencies to the president's insufficient understanding and in some cases disregard of HUD and regulatory agreement requirements and the lack of effective internal controls and procedures. As a result, project funds were used improperly, which unnecessarily increased the risk to HUD. Furthermore, Pioneer Pines' failure to properly maintain the vacant lots in a rent-ready condition may have adversely impacted potential homeowners' decisions to move to Pioneer Pines, and thus, hampered its ability to maximize its occupancy rate.

Pioneer Pines Failed to Collect $195,202 in Rental Income and Utilities

The president of Pioneer Pines failed to collect $195,202 in rental income for spaces used by 17 new homes that were brought into the park and 46 used homes that were purchased and rehabilitated by two of the president's affiliated companies, Homes of the West and The Associates Group Cedar Hill. Homes of the West is a home dealership located on the Pioneer Pines premises and owned by the president's son. The Associates Group Cedar Hill operates like a home dealership, except that it purchases, rehabilitates, and resells used homes rather than new homes, as does Homes of the West.

According to the accommodations lease agreement between Pioneer Pines and the two dealers, they would lease a space on the park for the purpose of rehabilitating and selling the mobile home unit located on the space. Monthly rental for the space would be $1 (plus utilities) until the mobile home located on the space was

rehabilitated to the president's satisfaction, at which time, the monthly rent would increase to $350 per month plus utilities.

Paragraph 18(b) of the regulatory agreement requires that rent paid by dealers for a space shall be a set rate and no special consideration will be given to any specific dealer (see appendix C). While there is no evidence showing that the two dealers actually paid the $1 monthly rent plus utilities, the other home dealers were not given the same benefit. Other dealers, like Accent Homes, Wall Street Capitol, LLC, and Rimer Homes, were required to pay the full rent amount while they rehabilitated the used homes on the lot.

The president contended that Pioneer Pines could not charge rent for homes that were not ready for occupancy (i.e., homes that had not been properly installed with electricity and inspected). He also stated that once the homes were habitable, Pioneer Pines would charge rent to the dealer or third parties and would continue to do so until the home was sold to an interested homebuyer. The owner's contention is obviously not true, as evidenced by the fact that Pioneer Pines charged non-affiliated dealers full rent while they rehabilitated the used homes on the lots. Therefore, it is apparent that the owner disregarded the regulatory agreement to give preferential treatment to its affiliated dealers. We also noted that a majority of the homes might sit on their respective lots for a period of time before being inspected. For instance, a home was placed on space 86 in January 2004, yet it was not inspected until January 2006, which prolonged the period before rent was paid. After homes were inspected, the president did not require the two dealers to pay the monthly rent; rather, rental payments were received only when the home was sold to a homebuyer. Pioneer Pines stood to gain a substantial amount of rental income had it properly charged the dealers the full rent. Appendixes D and E list the affected spaces, separated by new and used homes on the lot, and the corresponding amounts of uncollected rents.

Pioneer Pines Paid $133,049 in Unsupported Payroll Charges

Pioneer Pines paid $133,049 in unsupported payroll charges related to grounds worker wages because it failed to log work activities that supported the time spent on maintaining and operating the park versus other non-project activities.

Two currently employed grounds workers told us they did some work on mobile home units a couple of years ago, but they were not specific on which units and how much time was spent on those units. The April 2004 to December 2005 payroll journals, time sheets, and time cards sent to La Cumbre Management for review did not adequately disclose the number of hours spent on each work activity. As a result, we could not determine the number of hours these and past grounds workers expended on non-project-related activities.

The former manager stated that logging work activities and related hours were a waste of time and he abandoned the entire process. It was partly for this reason that the president terminated the manager from his position. The current manager, however, told us that Pioneer Pines has been logging work for the past four years, but the logs are destroyed after a year and are not sent to La Cumbre Management for review before payroll is processed. Although the manager was not able to locate the 2004 grounds maintenance reports, she provided samples of the 2005 reports. The reports listed the activities; however, they did not accurately record and report the time spent on each task. Also, they did not appear to have been reviewed by the supervisor in charge, although the current manager assured us that she verified the work reported once a week. For the rest of the week, she relied on her foreman to supervise. She also told us that the former foreman and manager consistently supervised the crew, yet according to the president, another reason the former manager was terminated from his duty was because he fraternized too much with the grounds workers and would not insist that they complete their work.

Based on our review of the grounds reports, we could not identify the number of hours that were spent by the grounds workers on non-project expenses and, therefore, question their wages and related Social Security and Medicare costs. A breakdown of the 2004 and 2005 unsupported payroll charges is as follows:

April to December 2004 Pioneer Pines ground workers wages and taxes				
Employee	Total earnings	Employer Social Security	Employer Medicare	Total
1	$ 12,504	$ 775	$ 181	$ 13,460
2	$ 13,871	$ 860	$ 201	$ 14,932
3	$ 8,306	$ 515	$ 120	$ 8,941
4	$ 14,226	$ 882	$ 206	$ 15,314
5	$ 1,676	$ 104	$ 24	$ 1,804
6	$ 3,713	$ 230	$ 54	$ 3,997
Subtotal	$ 54,296	$ 3,366	$ 786	$ 58,448
2005 Pioneer Pines ground workers wages and taxes				
1	$ 13,226	$ 820	$ 192	$ 14,238
2	$ 19,988	$ 1,239	$ 290	$ 21,517
3	$ 3,676	$ 228	$ 53	$ 3,957
4	$ 11,663	$ 723	$ 169	$ 12,555
5	$ 20,747	$ 1,286	$ 301	$ 22,334
Subtotal	$ 69,300	$ 4,296	$ 1,005	$ 74,601
Total	$ 123,596	$ 7,662	$ 1,791	$ 133,049

Pioneer Pines Spent $373,827 in Ineligible Expenses

Between November 2002 and December 2004, Pioneer Pines paid $373,827 in non-project-related expenses as follows:

	Questionable costs						
Description	Salary	Payroll tax	Travel	Other entity expenses	Mobile home purchase	Removal and installation of homes	Total
Balance of accounts as of December 31, 2003	$ 42,796	$ 12,347	$ 5,808	$ 6,477	$ 11,040	$ 60,501	$ 138,969
Balance of accounts as of February 28, 2004	$ 49,410	$ 13,346	$ 7,954	$ 7,982	$ 11,040	$ 95,168	$ 184,900
Balance of accounts as of March 1 to December 31, 2004	$ 26,735	$ 4,708	$ 5,772	$ 20,164	$ 57,000	$ 47,033	$ 161,412
Balance of accounts as of December 31, 2004	$ 76,145	$ 18,054	$ 13,726	$ 28,146	$ 68,040	$ 142,201	$ 346,312

We verified that $346,312 was repaid through proceeds derived from the sale of mobile home units, intercompany transfers, and loans/advances given by The Associates Group Cedar Hill. However, based on our independent review of invoices, checks, and vouchers, we identified $27,515 in ineligible expenses that was not repaid as follows:

Pioneer Pines ineligible expenses identified by OIG	
Description	Amount
October 2003 - January 2006 invoices	$ 8,793
Total advertising expense	$ 18,722
Total	$ 27,515

Between October 2003 and January 2006, $8,793 was spent on expenses such as electric bills, supplies, and termite fumigation for mobile home units; cable charges for the manager's unit; and other ineligible expenses that should have been paid by the individual mobile home owners. In addition, $18,722 was spent on advertising consulting fees (supplies, hotels, meals, telephone) incurred by a couple who resided on the premises. During HUD's review, HUD identified the same items as questionable and stated that it had not resolved the matter with Pioneer Pines. HUD contended that the president did not provide documentation to substantiate the nature of the relationship or provide any documentation to show the services that were rendered. We were only provided a copy of the checks and pay stubs for review.

Pioneer Pines Inappropriately Commingled Funds and Repaid Advances While in a Non-Surplus-Cash Position

Contrary to paragraph 6(e) of the regulatory agreement, Pioneer Pines inappropriately commingled project and non-project funds and repaid them while in a non-surplus-cash position (see appendix C). At the president's request, funds were transferred from The Associates Group Cedar Hill to Pioneer Pines to meet operating cash shortfalls. Similarly, Pioneer Pines' mortgage funds were transferred into an account the president maintained (now closed) and used for both project and non-project expenses. Both types of transactions contributed to the mortgage default and unnecessarily increased the risk to HUD's insurance fund. Some examples are as follows:

- Between 1999 and November 2002, Pioneer Pines' expenses were primarily funded by The Associates Group Cedar Hill. In November 2002, Red Mortgage Capital, Pioneer Pines' lender, transferred $288,487 from escrow to its project account, of which $278,487 was used to repay The Associates Group Cedar Hill advances. Pioneer Pines used the remaining $10,000 for operating expenses. (We could not determine whether Pioneer Pines was in a non-surplus-cash position since a financial report was not required for 2002.) Since the funds were fully expended, The Associates Group Cedar Hill was again required to cover Pioneer Pines' operating expenses through additional advances.

- On October 20, 2003, Pioneer Pines repaid The Associates Group Cedar Hill $47,527 for advances while in a non-surplus-cash position. Pioneer Pines used the remainder of its operating funds to pay its November 2003 mortgage obligation but then defaulted on its December 2003 payment.

- Between March 11, 2003, and July 16, 2004, La Cumbre Management made several fund transfers from the project account it maintained to the account maintained by the president. The combined amount of $365,487 was spent on project and non-project expenses. By April 7, 2004, the funds were fully expended, and The Associates Group Cedar Hill again covered Pioneer Pines' operating expenses. While we are not taking issue with the expenditures for project expenses, the transfer and use of project funds for non-project expenses was improper.

Between January and July 2005, The Associates Group Cedar Hill transferred a total of $108,333 into the current Pioneer Pines operating account that La Cumbre Management maintains. Based on the work prepared by the certified public accountant, The Associate Group Cedar Hill still owed Pioneer Pines $27,237 for non-project expenses incurred. Therefore, the outstanding advance still owed to

The Associates Group Cedar Hill for advances made was $81,096. Details are as follows:

Deposits made into La Cumbre Management account in 2005	
Deposit slip date	**Deposits made by The Associates Group Cedar Hill**
July 11, 2005	$ 9,502
June 10, 2005	$ 25,000
May 11, 2005	$ 21,830
March 7, 2005	$ 25,000
February 2, 2005	$ 30,000
Trustee fees	$ (3,000)
Total	**$ 108,333**
Less nonproject expenses incurred	**$ 27,237**
Net balance of advances still outstanding for The Associates Group Cedar Hill	**$ 81,096**

Collectively, the equity skimming that occurred when the advances were repaid precluded Pioneer Pines from making required mortgage payments.

Pioneer Pines Failed to Ensure the Project Was in Good Repair and Condition

Paragraph 7 of the regulatory agreement requires the owner to maintain the mortgaged premises, accommodations, and the grounds and equipment in good repair and condition (see appendix C). The owner disregarded this requirement. Our on-site review performed in April 2006 determined that 90 of the 114 vacant spaces observed contained at least one deficiency. We devised a rating schedule to assist us in quantifying the number of identified deficiencies and established a rating scale to measure the gravity of the deficiencies. A summary of the results follows.

Rating	Number of spaces	Percentage
Excellent condition (0 to 1 deficiency)	29	25
Good condition (2 deficiencies)	32	28
Fair condition (3 deficiencies)	22	19
Marginal condition (4 deficiencies)	14	12
Poor condition (5 or more deficiencies)	17	15
Total	**114**	**100**
*Percentages do not add up to 100 percent due to rounding.		

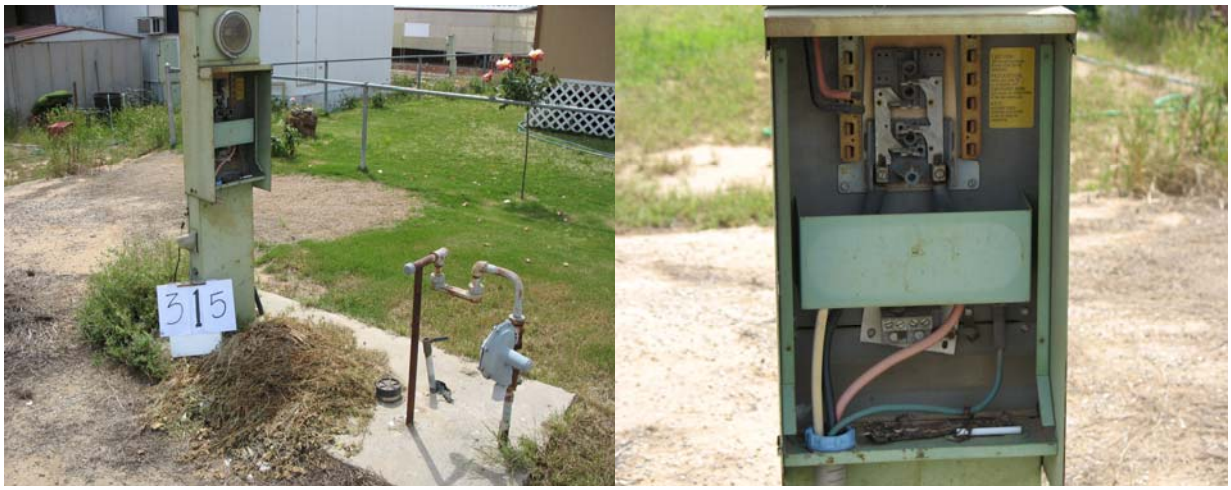
Of the 114 spaces inspected, 17 (15 percent) were in poor condition and contained five or more deficiencies. The most common deficiencies identified relate to the pedestal, utility hook-ups, and spaces that had uncapped sewer lines; needed

repainting; were missing pedestal panels; had exposed wiring, rusted pipes, uneven surrounding surfaces, missing or cracked base, or overgrown weeds/bushes; and needed cleaning.

A majority of spaces with poor conditions were located within the block of spaces from 285 to 334. The photographs below illustrate a few examples of spaces that received a rating of poor condition.

- Space 306 - The pedestal needed painting, the pipes had large rusted sections, and the sewer line was uncapped. In addition, the entire space needed to be cleaned.

- Space 315 - The pedestal needed painting and was missing a cover panel. The gas and water pipes had rusted sections, and the surrounding area needed to be cleared of weeds.



- Space 327 – The entire top section of the pedestal was missing, while the bottom half needed painting. There was some exposed wiring, and the gas

and water pipes had rusted areas. There were also trash and debris around the pedestal.

Pioneer Pines Failed to Make Required Mortgage Payments

Pioneer Pines failed to make its required mortgage payments in a timely fashion and as of April 2006, is currently in default on its mortgage obligation, with the last payment received on July 14, 2006, for the November 1, 2005 loan payment. Due to the loan advancements made during the early part of the loan term, mortgage payments were made timely until January 13, 2004, the date of Pioneer Pines' first default. The loan is paid up through October 2005 through disbursements from the working capital reserve or operating deficit reserve funds. After HUD withdrew permission to draw from these funds in June 2004, the loans were paid through a series of rolling defaults. That is, once a loan is past 30 days late it is in default and to reinstate the loan to current, Pioneer Pines would need to make any outstanding payments due by the current month they are paid in. Since Red Mortgage Capital has requested extending the election to assign the loan to HUD several times due to Pioneer Pines' failure to pay its mortgage, they appear to be satisfied with the efforts of the owner to try and make the project viable.

Pioneer Pines Failed to Establish an Adequate Internal Control Environment

Pioneer Pines lacked an adequate internal control environment, which contributed to the deficiencies found during our audit. Pioneer Pines failed to segregate work duties and provide adequate supervision as discussed below.

Failure to Segregate Duties

- La Cumbre Management was not independent of the president's control and could not assure that the president would not circumvent any controls it had in place. Also, La Cumbre Management was unaware of the provisions of the regulatory agreement and did not know that mobile home unit expenses were non-project-related until told by the president, who was also unaware until after the results of HUD's limited management review. During our review, we determined that

  - La Cumbre Management paid for non-project expenses related to air conditioning repairs, paint and supplies for the mobile home units, door locks for the units, etc.

  - While Pioneer Pines was in a non-surplus-cash position between 2003 and 2004, La Cumbre Management transferred $365,487 in project funds to the account maintained by the president. These funds went to pay for project and non-project expenses at the president's discretion. When asked whether La Cumbre Management ever refused to cut a check for the president, the bookkeeper stated, "they could have refused, but he was the president so they just wrote the check and believed him."

  - The bookkeeper incorporated expenses incurred by the president through the bank account he maintained into Pioneer Pines' general ledger based on the check register amounts that were faxed to La Cumbre Management. La Cumbre Management's bookkeeper neglected to determine whether those transactions were proper and for the purpose of maintaining and operating the property.

Lack of Adequate Supervision

- The president failed to provide adequate oversight on the premises to ensure that the work was being completed and documented as required.

  - A week before we inspected the park, the managers, a husband and wife team hired in April 2005, were dismissed. The president claimed that they were let go because they failed to complete their managerial duties

competently. The husband fraternized too much with employees, which ultimately reduced his ability to get the employees to accomplish their tasks. The husband also did not have adequate organizational skills and eliminated the process of logging the work completed. The wife was unable to use the computer software and relied heavily on the aid of the assistant manager. Contrary to the president's claim of visiting the park at least once a week, the assistant manager stated that he visited the park infrequently. Had there been adequate supervision, the president would have been aware of the problems with the managers. With inadequate oversight and poor record keeping on the part of the grounds workers (see Failure of Pioneer Pines Employees to Log Work Activities section above), we cannot be assured that the grounds workers were performing their duties as required (see Failure to Ensure Project Was in Good Repair and Condition section above).

- Based on our discussion with the president and our inspection of the park, it appears that the former manager did not closely supervise the grounds workers as required. As evidenced by our site review, maintenance work was not sufficient to satisfy the conditions of the regulatory agreement. The current assistant manager stated that she reviewed the work completed once a week and had deferred most of the supervisory responsibility to the foreman. We were told that Pioneer Pines hired another grounds worker who started on June 21, 2006, to assist the current manager in this task.

Conclusion

We attribute the deficiencies noted to the president's insufficient understanding and in some cases disregard of HUD and regulatory agreement requirements. Another contributing cause was the lack of adequate internal controls and procedures. As a result, the president failed to collect $195,202 in rental income and utilities, paid $160,564 in ineligible and unsupported expenses, and inappropriately commingled funds and repaid advances while in a non-surplus-cash position. These deficiencies resulted in fewer project funds being available for mortgage repayment, which unnecessarily increased the risk to HUD. Further, the president failed to adequately maintain the Pioneer Pines property in good repair and promptly pay its mortgage payments.

Recommendations

We recommend that the director of HUD's Los Angeles Multifamily Housing Hub require the owner to

1A. Repay Pioneer Pines project account for the $195,202 (funds to be put to better use) in uncollected rental income (appendixes D and E) from non-project funds.

1B. Develop and implement new procedures and lease agreements to collect the full rent from affiliated companies (dealers) once the spaces are leased or terminate all work with its affiliated companies.

1C. Provide documentation to support the portion of the $133,049 in grounds workers' wages that was related to non-project activities and repay the Pioneer Pines project account from nonfederal funds for that amount.

1D. Repay the Pioneer Pines project account for the $27,515 in ineligible expenses from non-project funds.

1E. Correct the deficiencies related to the conditions of the spaces with poor ratings so they comply with the regulatory agreement, and develop an inspection process and controls to ensure the inspection process is working effectively.

1F. Implement procedures and controls to ensure that future disbursements for project expenses comply with the regulatory agreement and HUD requirements.

1G. Discontinue commingling of funds and seek HUD's approval before making a repayment of loan advances to an affiliated company.

1H. Attend training on HUD's regulatory agreement and other pertinent rules to assure future compliance with the requirements.

We also recommend that HUD's regional counsel, in coordination with the director of HUD's Los Angeles Multifamily Housing Hub and HUD's Office of Inspector General (OIG),

1I. Pursue double damages remedies against the responsible parties for the inappropriate disbursements that were used in violation of the project's regulatory agreement.

We also recommend that the director of HUD's Departmental Enforcement Center

1J. Pursue civil money penalties and administrative sanctions, as appropriate, up to and including debarment, against responsible parties for their part in the regulatory violations cited in this report.

SCOPE AND METHODOLOGY

We performed our audit work at Pioneer Pines, Bakersfield, California, and La Cumbre Management, Santa Barbara, California. We conducted our fieldwork from March 20 through July 21, 2006. Our review generally covered the period from April 9, 1999, through February 28, 2006. We expanded the scope of the audit as necessary.

To accomplish our objectives, we

- Reviewed the HUD requirements and regulations and the regulatory agreement.
- Obtained an understanding of Pioneer Pines' procedures, including its controls to ensure that the project was properly managed.
- Interviewed Pioneer Pines' president, park staff, certified public account, and construction and management company staff to acquire an understanding of the operation's procedures.
- Reviewed Pioneer Pines' loan, operating deficit fund, working capital, and reserve accounts provided by the lender.
- Interviewed HUD multifamily and Departmental Enforcement Center personnel.
- Reviewed the work of Pioneer Pines' certified public accountant, including the invoices, bank statements, and checks related to the financial activities of the park.
- Reviewed the timesheets, time cards, and payroll journals for Pioneer Pines employees between 2004 and 2005.
- Reviewed January 2003 through April 2006 rent rolls, monthly traffic reports, additions to income reports, deductions to income reports, deposit slips, and the president's collection reports pertaining to the new and used homes that were purchased and placed on the lots.
- Performed a site review to determine whether the park was adequately maintained as required by the regulatory agreement.
- Reviewed HUD's October 2004 limited management review report to determine whether the monitoring identified any findings or concerns that pertain to the scope of our audit work.
- Reviewed Pioneer Pines' audited financial statements for years ending 2004 through 2005 to determine whether the independent auditor identified any findings that pertain to the scope of our audit work.

  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 audit objectives:

- Policies and procedures that management implemented to reasonably ensure that the HUD-insured project is administered in conformity with the regulatory agreement and HUD requirements.

We assessed the relevant controls identified above.

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:

- Pioneer Pines lacked effective internal controls and procedures to ensure that the project was administered in compliance with the regulatory agreement.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

Recommendation number	Ineligible 1/	Unsupported 2/	Funds to be put to better use 3/
1A			$195,202
1B		$133,049	
1C	$27,515		

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 polices or regulations. The $27,515 represents ineligible costs that are unnecessary to the project's operation or disallowed because they were incurred contrary to the regulatory agreement.

2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of audit. Unsupported costs require a 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. The $133,049 represents unsupported payroll charges related to grounds worker wages.

3/ "Funds to be put to better use" are quantifiable savings that are anticipated to occur if an OIG recommendation is implemented, resulting in reduced expenditures at a later time for the activities in question. This includes costs not incurred, deobligation of funds, withdrawal of interest, reductions in outlays, avoidance of unnecessary expenditures, loans and guarantees not made, and other savings. The $195,202 represents rental income for spaces the park failed to collect for the 17 new homes that were brought into the park and 46 used homes that were purchased and rehabilitated by two of the president's affiliated companies, Homes of the West and The Associates Group Cedar Hill.

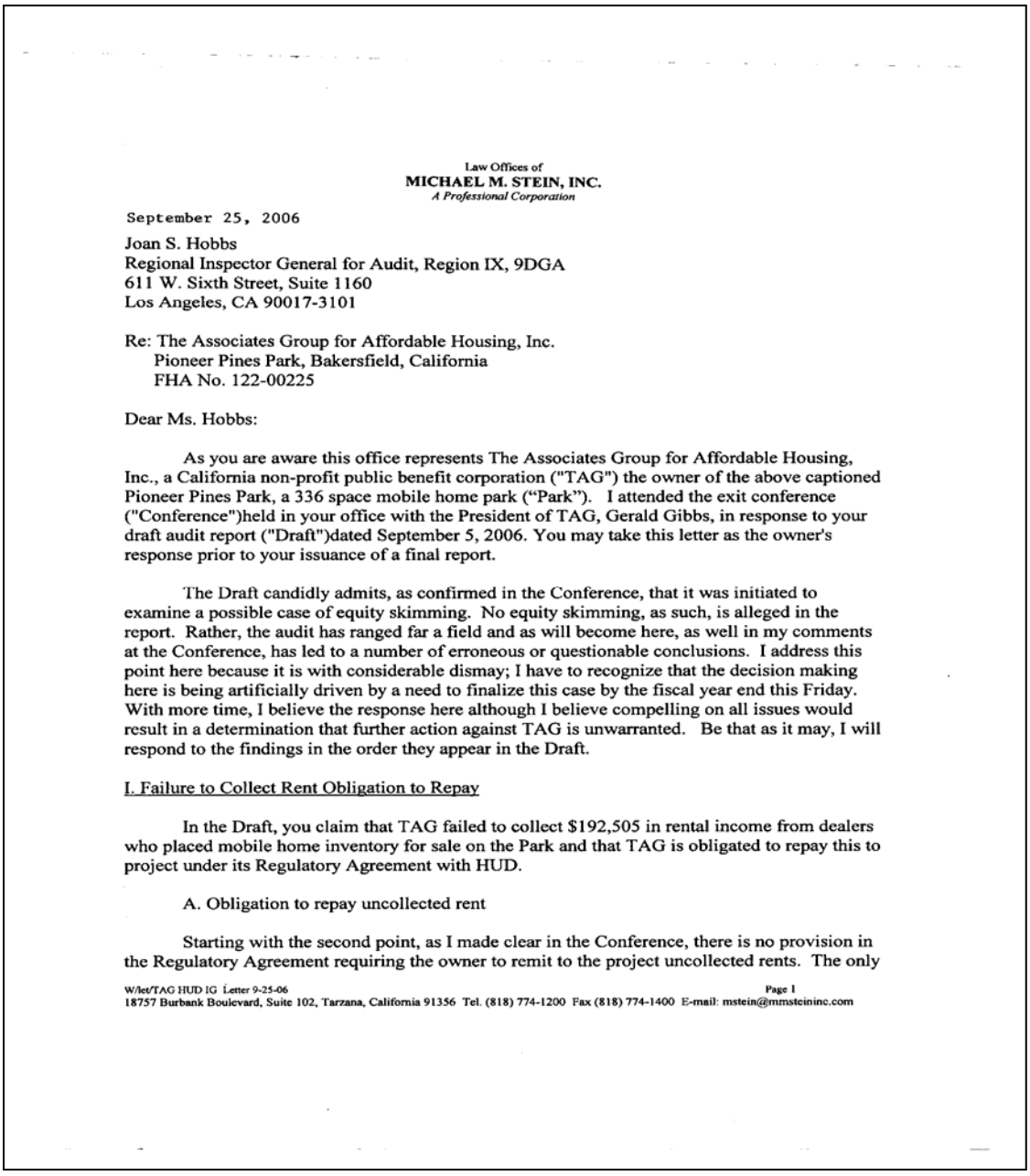
8,793 was spent on expenses such as electric bills, supplies, and termite fumigation for mobile home units; cable charges for the manager's unit; and other ineligible expenses that should have been paid by the individual mobile home owners. In addition, $18,722 was spent on advertising consulting fees (supplies, hotels, meals, telephone) incurred by a couple who resided on the premises.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

Comment 1



Law Offices of
MICHAEL M. STEIN, INC.
A Professional Corporation

September 25, 2006

Joan S. Hobbs
Regional Inspector General for Audit, Region IX, 9DGA
611 W. Sixth Street, Suite 1160
Los Angeles, CA 90017-3101

Re: The Associates Group for Affordable Housing, Inc.
Pioneer Pines Park, Bakersfield, California
FHA No. 122-00225

Dear Ms. Hobbs:

As you are aware this office represents The Associates Group for Affordable Housing, Inc., a California non-profit public benefit corporation ("TAG") the owner of the above captioned Pioneer Pines Park, a 336 space mobile home park ("Park"). I attended the exit conference ("Conference")held in your office with the President of TAG, Gerald Gibbs, in response to your draft audit report ("Draft")dated September 5, 2006. You may take this letter as the owner's response prior to your issuance of a final report.

The Draft candidly admits, as confirmed in the Conference, that it was initiated to examine a possible case of equity skimming. No equity skimming, as such, is alleged in the report. Rather, the audit has ranged far a field and as will become here, as well in my comments at the Conference, has led to a number of erroneous or questionable conclusions. I address this point here because it is with considerable dismay; I have to recognize that the decision making here is being artificially driven by a need to finalize this case by the fiscal year end this Friday. With more time, I believe the response here although I believe compelling on all issues would result in a determination that further action against TAG is unwarranted. Be that as it may, I will respond to the findings in the order they appear in the Draft.

I. Failure to Collect Rent Obligation to Repay

In the Draft, you claim that TAG failed to collect $192,505 in rental income from dealers who placed mobile home inventory for sale on the Park and that TAG is obligated to repay this to project under its Regulatory Agreement with HUD.

A. Obligation to repay uncollected rent

Starting with the second point, as I made clear in the Conference, there is no provision in the Regulatory Agreement requiring the owner to remit to the project uncollected rents. The only

18757 Burbank Boulevard, Suite 102, Tarzana, California 91356 Tel. (818) 774-1200 Fax (818) 774-1400 E-mail: mstein@mmsteininc.com

monetary obligation arises from funds improperly **received and retained** by the owner. No one at the meeting could cite any provision that negated my view.

Accordingly, your proposed finding that the owner is obligated to remit this amount to the project accounts and that HUD should consider legal action to recover these funds is without any legal basis whatsoever. If HUD wishes to pursue this theory, the proper course is to follow existing procedures for revision of HUD loan forms, so individual owners would be put on notice of potential liabilities **before** entering in a HUD insured loan.

B. Failure to Collect Rents Due

Comment 2

The backbone of this matter is two erroneous conclusions. First, that dealers placing inventory for sale on the Park should have paid rent in all cases from the date of placement and second, the preferential treatment was given to so called "affiliated" dealers in not requiring rent payments collected from affiliated dealers. Neither contention is true. In my review of your Draft and comments by your audit staff, it became clear there is a major lack of understanding of the business conducted by my client at the Park. The Park is a space lease tenant owned homes mobile home park in a poor market area in a low median income city. The Park has a running vacancy level of about 50% due to market conditions. In the Conference it became clear that the dichotomy between full rental (space and mobile home units leased) and space rental was not understood or appreciated by the audit staff. Nor was there any appreciation of the different marketing burdens of an owner trying to bring tenant or third party for sale units on a highly vacant park versus as a near or full occupancy park. This has led to a series of misconceptions that form the unstable foundation of your findings and recommendation.

The audit staff acknowledged that the Regulatory Agreement does not address even the issue of when or under what circumstances rent is payable by dealers placing inventory on the Park. Instead they imported an implied obligation to collect rent from dealers from the date a unit is placed on a park based on a common or industry practice. In support, they contacted for four Orange County park owners to support his position. A detailed review (to be discussed below) shows none of these contacts support the auditors' contention. Even if they did, as matter of contract law industry practice only becomes an implied contract term when the practice is settled industry practice, evidenced by common language in trade industry forms and publications. While this implied rule applies between private parties, implied terms in government (including HUD) contracts are disfavored by the courts. A summary of these legal principles will be proved on request.

Joan S. Hobbs
Regional Inspector for Audit
September 25, 2006

In any event, the implied obligation to collect rent from dealers disintegrates on analysis of the relevant facts. First, Orange County is an affluent market where residential rents, in contrast to Bakersfield, are way above national and California median income levels. Also, the rental market is very strong in Orange County. As a result, when the auditors asked the park owners the question when they start collecting rent, they received meaningless answers. First, one or more of the parks involved, park owner leased homes and spaces in contrast to third party dealer owned units. Second none of the parks had the high vacancy rates of the Park. As Mr. Gibbs can explain, parks with large vacancies have great difficulty attracting tenants. This is hardly surprising. Therefore, of necessity, concessions must be offered to dealers to bring inventory onto a park. The most obvious incentive is a rent waiver while the dealer is attempting to market inventory. Mr. Gibbs has provided an affidavit for a dealer that supports his contention that waivers of rents for units placed on a park with less than high (95%) occupancy is a standard practice. A copy is attached to this letter. He can obtain more affidavits if required. In short, the only industry standard is no rent is due under the circumstances described here. I am attaching a more descriptive narrative prepared by Mr. Gibbs that adds depth to what is summarized here

C. Discrimination between So called Affiliated and Unaffiliated Dealers.

Comment 3

As a subordinate argument in support of a rent obligation from dealers, the audits cite what they believe is a disparity in treatment between certain third party dealers and dealers that should be treated as "affiliated" with TAG. Mr. Gibbs disputes the evidence for this and I am attaching commentary and a narrative from him addressing this point. It establishes a uniform practice not to change rent to dealers under equivalent circumstances. This material should receive serious consideration before you determine what took place here.

II. Unallowable Expenditures

A. Maintenance Personnel

Comment 4

The auditors in the Draft and in our Conference took the rather bizarre position that as it appeared a portion of the time spent by the grounds crew was not for project allowable expenses (e.g. items related to tenant unit maintenance). Unless the owner could establish a proper allocation, the entire grounds crew expenditures were not allowable. Frankly, this position borders on or crosses over to the ridiculous. In any event, the owner has canvassed the employees in question, obtained to affidavits and can provide a clear breakdown. As to the amounts due for the rather minor work done on tenant and non-Park owned units this would appear to be classic good marketing practice and but for the circumstances of this case would not be questioned by anyone. Excluding these items leaves an adjustment in potential unallowable

Joan S. Hobbs
Regional Inspector for Audit
September 25, 2006

expenditures as set forth in the attached schedule. To put this matter to rest, it would be a good idea to refer this back to the Housing staff to discuss with the owner and come up with a meaningful number. In disallowing **all** of the staff time for the period involved HUD alleges that some form of task by task time keeping is required by contract or statute. Please note that HUD Handbook 4381.5 at 6.38 states: "Weekly timesheets are an acceptable method of documenting hours spent on front-line tasks."

B. Other Unallowable Expenses

Comment 5

The auditors found two other categories of unallowable expenses. Other costs for individual tenant units and expenses of consultants hired to develop a sales program. Mr. Gibbs has evaluated the first category and has come up with a revised schedule of expenses totaling he feels are allowable which is attached. I am particularly struck, as was he, with the disallowance of a small amount spent for a Christmas tree. While as a general point, this would fall into an allowable case of normal marketing expense, the idea that HUD would disallow this item conjures up notions of the "Grinch Who Stole Christmas". I highly recommend this item not appear in your final report.

The second item involves a classic misunderstanding of the Park operation. At the Conference it was suggested that this expense should not be allowed because it was the function of the property management company who were paid for such services. Not so!! Their contract does not involve mobile home **sales** but operating the Park and normal leasing activities. Mr. Gibbs was presented with a high vacancy park with a history of drug activity, (which he eliminated by an aggressive eviction policy), and a reluctance of local dealers, even with concessions, to attempt to sell homes on the Park. Again, it would be best for all concerned to have this issue reexamined by Housing staff in light of the facts before a final determination is made.

III. Commingling of Funds

Comment 6

The auditors found that in the past TAG improperly utilized project funds for unallowable purposes in advancing a sales program. At the Conference Mr. Gibbs acknowledged this. What is important here is that the auditor findings reflect all alleged improper expenditures were paid back when the project auditors called this to TAG's attention. What is material here is that, based on your auditors own findings all such expenditures were paid back last year and there is actually a net advance to the project (the exact amount being between approximately $81,000 to $108,000 depending on the resolution of additional alleged unallowable expenses, see Item II.B. above). At this point, this history is informative but irrelevant to any action item under your

consideration. In this regard, TAG objects to the characterization of these fund transfers as "equity skimming" (see page 12 first paragraph). Equity skimming is defined as the **willful** payment of project funds to non-project authorized purposes (in practice it has been limited to direct pecuniary benefit to the owner). TAG admits and no one is contending otherwise that Mr. Gibbs authorized payments he did not realize were not permitted under the Regulatory Agreement in attempting to resolve the vacancy problems at the Park. This is not equity skimming and the reference here in the Draft is pejorative and should be removed from the final report.

IV. Project Condition

Comment 7

The auditors conducted an onsite inspection finding in their view numerous physical deficiencies in the Park. I am attaching a point by point response by Mr. Gibbs which establishes that (a) corrective action has since been taken on items in need of repair and (b) items the auditors thought were in need of repair were in acceptable working order. Whatever the exact resolution of this issue, it is clear that the auditors have deviated from the HUD regulatory format in physical review of an insured project. As you know, HUD has in place the REAC inspection system to monitor compliance with physical requirements. The last REAC inspection, addressed primarily to interior units was the absolute maximum 100 points, meaning no further inspection will be required for 2 years. As pointed out at the Conference, this inspection was comprehensive for the project. However, one key feature of the REAC system is that no penalties or other action is taken against an owner unless with adequate notice, i.e., the REAC report, no effort is made to address the deficiencies. Your Draft makes no mention of any effort to provide this information to TAG or to conduct a follow up inspection to evaluate repairs undertaken. TAG did receive a draft of the findings on last month, but with the caution that it was all subject to review and revision. There was no invitation to comment or request that any action be taken by TAG. As such until a reinspection is undertaken and the points made by Mr. Gibbs addressed, it provides no useful information in making a recommendation in your final report or in evaluating any actions you recommend.

V. Mortgage Default

Comment 8

The project is admittedly in arrears of its mortgage debt service. However, the mortgagee apparently satisfied with the efforts of the owner to try and make the project viable has not made an insurance claim but has requested on a continuing basis an extension of time to make a claim. The Draft fails to address this point and in at Page 16 misstates that the project's physical condition has resulted in the lack of funds to pay the mortgage. Not so. The market conditions

that have lead to the inability to attract home purchasers and corresponding vacancy rates of about 50% are the cause of the problem.

VI. Lack of Internal Controls

Comment 9

The Draft points to lack of internal controls condition that existed in the past as confirmed by Mr. Gibbs. These conditions involved a former manger and misunderstandings on Mr. Gibbs part as to the obligations and responsibilities of an owner under the HUD regulatory agreement. However, the bulk of the objections relate to the conclusion that there were uncollected rents and large ineligible expenses. TAG, as noted above, disputes these conclusions as well as that its failure to maintain the physical condition of the park is leading to an increased risk of a mortgage insurance claim (the only risk in this regard would be if HUD cease to grant extensions of time to Red Capital assign the mortgage). A final assessment of internal controls cannot be made in the absence of a resolution of items I through IV above and an assessment of current management practices.

VII. IG-Audit Recommendations

Comment 10

The Draft makes a number of recommendations for sanctions as well as requesting repayment to the project of the alleged unpaid rent and improper expenditures. As to the latter, it would appear that a determination, by a referral back to Housing is warranted to determine what if anything is due and legally recoverable by HUD. In this respect, as per your agreement at the Conference the excess in advances to the project would be netted against your claimed disallowable payments producing a net payable by the project and not an amount due back to the project.

As to the various sanctions proposed, they do not appear warranted or justified here. The sanctions you propose are traditional aimed at one or more of three purposes: (a) compelling the cessation of material violations of HUD agreements or requirements and deterring future violations (b) punishing serious past violations that are willful and (c) to recover funds due HUD that cannot be collected otherwise. First, the degree of past violations of the Regulatory Agreement remains in dispute. Second, the amounts owing to or from the project remains in dispute. Certainly, having these proposals in a report will have a serious adverse impact on TAG pending a final decision here. It would be appropriate to have the issues resolved before not after recommendations for punitive action are made. As to the recommendation for training (Item 1H) no objection is made here.

VII. Conclusions

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Joan S. Hobbs
Regional Inspector for Audit
September 25, 2006

On behalf of TAG, let me express our thanks for the courtesies shown in the Conference that made it possible to prepare this response. However, it is with some dismay TAG submits this response whose timing has been dictated by your or your Headquarters requirement that this audit be "closed" by Friday. TAG has raised substantial and material objections to each key element of your Draft. It would be both arbitrary and unfair to have the final report go out without adequate time for you and your staff as well as Housing to consider these points. In the meantime, if you have any questions or need any further information, please contact me at your earliest convenience. Once again thank you for you courtesy in this matter.

Sincerely,

MICHAEL M. STEIN

MMS: bzs
Enclosures
cc: Gerald Gibbs, Tanya Schulze, William F. Bolton, William Christiansen

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HISTORICAL PERSPECTIVE OF PIONEER PINES PARK

When TAG first purchased Pioneer Pines Park, it had done all of its due diligence based upon 216 current residents. Because the non-profit had not worked under a HUD program, most of the due diligence and fiscal analysis was accomplished by paid consultants. When escrow closed and collections started, it became obvious that not all tenants were able to pay regular rent and that some residents were incapable of living in an environment which included complying with rules. In this latter category, there existed both drug users and suspected drug dealers.

During the construction phase, it was difficult to weed out the rule violators due to the condition of the park. As construction progressed and we were able to get our hands around certain violators and certain non-paying individuals, the park population dwindled to a low point of 175 paying tenants.

This process was also accompanied by natural attrition. Unfortunately, the resale of homes had decreased to a bare minimum, and because of conditions and reputation, the park was not attracting qualified buyers for homes being sold by tenants. As a further result of these problems the resales of homes were at extremely low prices and many of the persons available to buy the homes were not really qualified to live in the park.

In order to fill spaces in a semi-depressed park, a decision was made that we should not only solicit outside dealers to sell homes in the park, but that we should: (1) capture all homes that were abandoned or on which a lien was achieved as we removed the non-paying tenant, (2) evaluate the condition of such homes and determine if they could be repaired and resold or, if they were beyond repair be removed from the park, and (3) a course of action was taken to acquire other used homes capable of rehabilitation for movement into the park for resale. The management contract approved by HUD did not call for the management firm to accomplish any marketing and in fact state law discourages managers from doing so on a regular basis.

Comment 5

Initially, all of the effort for the foregoing was paid from project funds. The non profit was experienced in mobilehome park operations where the rule was to save all homes possible and the park owner was totally responsible for the assurance that the park was kept full of qualified resident home owner/tenants. As shown later this very logical rule was totally incompatible with the HUD guidelines for 207 program financing. The non-profit and its staff were not reading the requirements in that fashion as a result of its prior experience with operations of mobilehome parks. In fact, during the application period the non-profit had to prepare a marketing plan which was presented and utilized the normal methods for attracting persons and homes into the park by the park owner. That process was accomplished without any objections from the consultants retained or the HUD consultants analyzing the proposed marketing approach.

Comment 5

Comment 4

The park then undertook a course which resulted in acquiring homes for rehabilitation and resale to fill the empty spaces. The rehabilitation was done by outside contractors and independent contractors. No park employees were involved in the rehab process. Park employees were utilized to remove abandoned homes, which were incapable of retention. The latter activity is a project

expense as it was the park's responsibility to hold spaces in a rentable condition and abandoned homes in poor condition were a sign of blight that had to be removed.

The park did not have sufficient funds to fund the foregoing activity, although by any reasonable standards, a park owner and operator would have done the same thing to fill the park, which was not receiving at this time rent from 40-plus additional spaces.

The used homes came in three categories:

1. Those which were imported solely by and paid for solely by the non-profit corporation out of other non-profit project funds.

2. Those that were acquired as contingent purchases or donations from other park owners, with payment due upon resale, and

3. Those which were recovered at lien sales as being abandoned in the park.

It was determined that by acquiring these homes and rehabilitating and selling them in place, the park population could be increased and thus make up the dramatic loss of revenue due to reduction in tenancy.

Not all of the foregoing homes remained in the park. At some point, a number of these homes were determined to be incapable of salvage or found unacceptable by the state inspector of homes. Those home were later removed or scrapped. Generally, these removed or scrapped homes were the result of in-park foreclosure, but some were imported homes. Additionally, at least one home was resold, recaptured and rented out for a short time to an employee and subsequently determined to be not capable of further use.

All of the foregoing was done in the context of what a prudent park operator would do to fill a desperately difficult park with a bad reputation in a poor neighborhood by community standards.

Comment 10

When the 2004 audit was performed, the outside auditor determined that a number of costs incurred would not be acceptable under the HUD guidelines for a leasehold park operation. While not agreeing with the conclusion and given the reality of the situation of this park, the corporation had no choice but to agree to separate all of the foregoing activity from the project. This was done in as detailed a fashion as possible and by the end of the revised audit it was determined that the project was still owed $27,000.00 plus from corporate funds. These funds were repaid in 2005 and an additional $87,000.00 plus was advanced by the corporation to the project to continue paying its bills and pay current loan payments. This is according to the HUD guidelines which state that any funds spent for non-project activities are held in trust and must be returned. That has been done and if the amount set forth in the audit as additional disallowed costs is deducted from the additional funds advanced, those funds have also been returned and there is still a balance owing to the corporation, by the project as of this date

During this entire period, HUD has also retained in excess of $97,000 which the project was paying interest on and which HUD has refused to release to this day. Accounting for those funds

means that the interest arrearages that resulted from insufficient project income should also be reduced.

In order to further sell the park to potential home buyers, two dealers were retained to bring models into the park and market homes. In both cases, the dealers failed miserably. The result was that no new homes were sold. Elsewhere in this report you will see that we were able to prevail on Mr. Gibbs' son to form a dealership and import, at his sole cost, new homes for sale.

The used home sales failed in that the homes were generally not financeable in the regular lending market place, and the corporation was forced to accept partial payment and carry back paper on the majority of its resold homes. The total venture of acquisition, retention and rehabilitation of homes has not been in any way profitable to the corporation, but it did produce twenty-five of the home sales in the park to date, which has enabled the park to bring its population back to over 200 spaces.

In addition to the foregoing, the park has been required to scrap or pay to have removed from the park, at least twenty-one homes. Some of the payment to defaulting residents was to prevent further legal costs and some were for the fact that the homes were required to be destroyed and taken to the dump. In addition, twenty-six homes were removed from the park either voluntarily or involuntarily by the owner or subsequent buyer from the former owner.

The level of occupancy today is 207 with two being used by management as a part of payroll. The net difference between purchased or retained used homes, and the moved out or scrapped homes, has been made up by new home sales or persons moving in new homes or in three cases newer used homes from outside the park.

The project is still facing difficulties with marketing homes by dealers and individuals selling in the park. The difficulties are generally due to the inability to finance buyers with little or no credit.

The corporation did make application for and obtained a grant from the State of California, at no cost to the project, to accommodate up to 50 grants to Farmworkers in need of adequate housing. Those grants provide a $30,000.00 silent second from which the new home owner is able to purchase with a commercial loan for the balance. In order to sell the Farmworker Grant homes, the corporation has had to search out private lenders and the selling dealer, and TAG must guarantee such loans. If those were all sold, there would be fifty such residents in the park. There are now at least seven new farmworkers in residence in new homes.

Comment 10

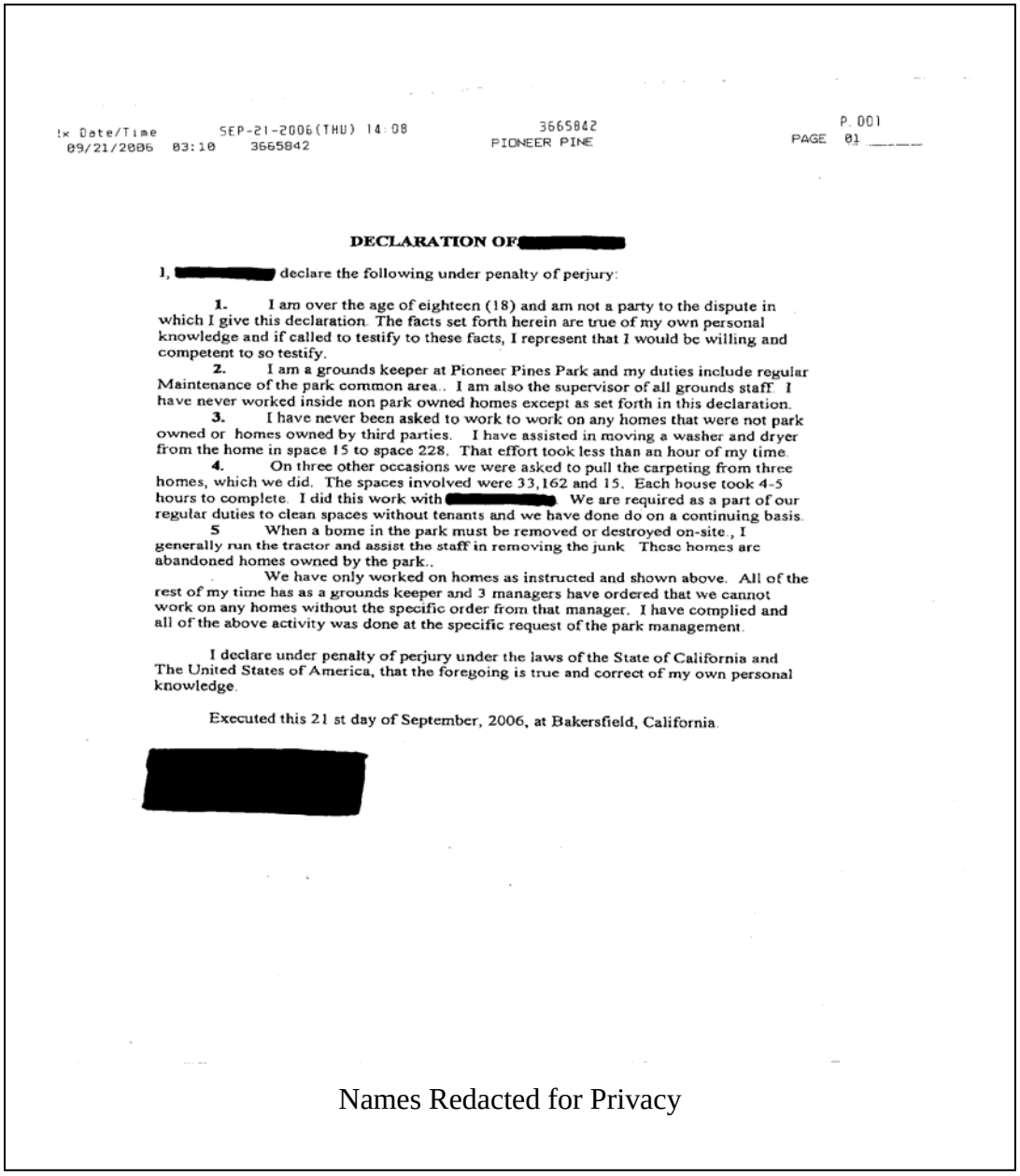
I hope this will assist you in your search for a way to resolve the difficulty involved with the very harsh recommendations contained in the draft audit. Certainly the corporation and its officers did not realize that it was not complying with the HUD regulations which as mentioned are counter intuitive to normal park operations by profit making or non profit entities. These are not apartments that are available for ready rental. A person moving into a mobilehome park must be able to buy a new home and place it on someone else's land and pay rent for the land. Again, that is not generally the way the ordinary citizen visualizes buying a home.

Comment 7

The final issue raised by the Auditors has to do with the conditions of spaces in the park. Frankly a new resident is not concerned with the looks of the lot and whether it has weeds or not,

but we agree that some lots have a need for maintenance and we have taken the steps previously outlined to correct the conditions, but contrary to the assertions made, none of the conditions presented serious health and safety issues. The vast majority were a question of aesthetics and some noted as serious were not connected to power sources which would present a danger. Regardless of this, the lots are being finalized as we write this to you. It should be noted that we have also taken steps to remove all concrete surfaces except the required driveways. This will make maintenance much easier in the future, but it has been a very expensive frolic and detour to resolve a non-safety related problem.

Comment 11



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DECLARATION OF [redacted]

I, [redacted] declare the following under penalty of perjury:

1. I am over the age of eighteen (18) and am not a party to the dispute in which I give this declaration. The facts set forth herein are true of my own personal knowledge and if called to testify to these facts, I represent that I would be willing and competent to so testify.

2. I am a grounds keeper at Pioneer Pines Park and my duties include regular Maintenance of the park common area.. I am also the supervisor of all grounds staff. I have never worked inside non park owned homes except as set forth in this declaration.

3. I have never been asked to work to work on any homes that were not park owned or homes owned by third parties. I have assisted in moving a washer and dryer from the home in space 15 to space 228. That effort took less than an hour of my time.

4. On three other occasions we were asked to pull the carpeting from three homes, which we did. The spaces involved were 33,162 and 15. Each house took 4-5 hours to complete. I did this work with [redacted]. We are required as a part of our regular duties to clean spaces without tenants and we have done do on a continuing basis.

5 When a home in the park must be removed or destroyed on-site., I generally run the tractor and assist the staff in removing the junk. These homes are abandoned homes owned by the park..

We have only worked on homes as instructed and shown above. All of the rest of my time has as a grounds keeper and 3 managers have ordered that we cannot work on any homes without the specific order from that manager. I have complied and all of the above activity was done at the specific request of the park management.

I declare under penalty of perjury under the laws of the State of California and The United States of America, that the foregoing is true and correct of my own personal knowledge.

Executed this 21 st day of September, 2006, at Bakersfield, California.

[redacted]

Names Redacted for Privacy

DECLARATION OF [redacted]

I, [redacted], declare the following under penalty of perjury:

1. I am over the age of eighteen (18) and am not a party to the dispute in which I give this declaration. The facts set forth herein are true of my own personal knowledge and if called to testify to these facts, I represent that I would be willing and competent to so testify.

2. I have been a park owner and operator since 1967. I have personally been involved in building and operating 16 Mobile Home Parks in my career. I am still a principal in a series of entities which own and operate four very large Parks.

3. As a matter of policy we have, while filling our parks, allowed homes to be moved into the parks and would normally only cause rent to be paid by the new tenant when the home is fully inspected and ready for tenant occupancy.

4. During my career we have also owned and operated Mobile Home dealerships and continue to sell homes in parks we own. In spite of that ownership, we allow other dealers to deliver homes in our parks and must do so according to the law governing our dealer's license.

5. When a park is full or nearly full, we normally do not have a question of who pays rent and for how long, as the homes generally get sold and the newly-accepted tenant carries on from the prior tenant.

6. It should also be noted that persons in our industry often offer rent consideration to new tenants, depending upon the condition of the park and its occupancy at the time as well as local competition.

I declare under penalty of perjury under the laws of the State of California and the United States of America, that the foregoing is true and correct of my own personal knowledge.

Executed this 21st day of September, 2006, at Rancho Santa Fe, California.

[redacted]

DECLARATION OF [redacted]

I, [redacted] declare the following under penalty of perjury:

1. I am over the age of eighteen (18) and am not a party to the dispute in which I give this declaration. The facts set forth herein are true of my own personal knowledge and if called to testify to these facts, I represent that I would be willing and competent to so testify.

2. I do not recall that I told the HUD auditors that I worked on homes or in what way it was said

3. I am a grounds keeper at Pioneer Pines Park and my duties include regular Maintenance of the park common area. I do not work on home and have not done so except as ordered by the park manager and set forth below.

4. I have never been asked to work on any park owned or other homes owned by third parties. I did however spend approximately two hours or less assisting Steve Green in putting up the awnings on space 110 as he was unable to do the installation without another hand. I have also assisted in moving a washer and dryer from the home in space 15 to space 228. That effort took less than an hour of my time.

5. On three other occasions we were asked to pull the carpeting from three homes, which we did. The spaces involved were 33,162 and 15. Each house took 4-5 hours to complete. I did this work with [redacted]

6. We have only worked on homes as instructed and shown above. All of the rest of my time has as a grounds keeper and 3 managers have ordered that we cannot work on any homes without the specific order from that manager. I have complied and all of the above activity was done at the specific request of the park management.

I declare under penalty of perjury under the laws of the State of California and The United States of America, that the foregoing is true and correct of my own personal knowledge.

Executed this 21 st day of September, 2006, at Bakersfield, California.

[redacted]

Comment 12

Comments as to Claimed Ineligible Expenses

The audit has produced a total of $29,019.00 in costs that are, in the opinion of the auditors, improperly charged to the project.

Whatever the final results of this discussion, none of the charges were made with an intent to improperly use project funds.

Because some of the alleged charges are "lumped" together without any identity as to check number or a specific space number, we have a real problem refuting the allegations. Where there are specifics, we have done our best to sort out the charges and allocate the responsibility.

No matter what the final conclusion, the corporation has advanced sufficient additional funds to the project to more than cover these alleged mischarges.

We would like to address the charges in reverse order as the major portion of the charges are in the last category of "advertising" expenses, reflecting a total of $18,722.00. All of those charges relate to the use of contract employees and their per diem expenses. See the Part II chart enclosed.

In late 2003, the construction had been delayed and the attempt at marketing the park had been less than successful. We had spent much of our efforts in getting the park in proper working order and getting the non-paying and non-performing tenants removed, together with some homes that were not compliant with Health and Safety regulations imposed by the State of California.. We had one dealer who ventured to place models in the park during construction and that entity placed many advertisements and used new signage and other media to create attention to the park as a place to put new or used homes.

The dealer had failed to sell one home and was critical of the park condition due to the rehabilitation and other conditions. The non-profit owner was charged with the responsibility for filling the park to enable sufficient cash flow to pay all costs of operation and the debt service.

It should be noted here that the management contract did not contain any requirement for marketing the park or attempting to cause persons to come to the park as a place to live.

Manufactured housing community managers are not in the business of selling homes or marketing the park. They operate the park, interview prospective tenants and account for and pay all bills. This is not like an apartment complex where the manager can show a "door" and the tenant can accept and move in. In a mobile home park the manager can only show a barren lot and give the dimensions and monthly rental fee. In this environment, you must enable someone to either bring in a home they own or purchase a new or used home that may be in the park.

The non-profit had done its job in park operations but was frankly stymied as to the local market and the negative attitude as to the park history and location.

Based on research of local mobile home parks, the non-profit was able to find a similar situation as to a park with empty spaces and a need to fill those spaces. After some rather touchy negotiations, the non-profit was able to retain the services of the couple who had turned around the other park and had almost filled it to capacity.

An arrangement was made to pay the couple to travel from their home in Solvang, California to the park and attempt to turn around its image and work with the non-profit to fill the park. In that process, the

non-profit had spent $18,722.00 of project funds to attempt to fill the park and amend its image for purpose of attracting new homeowners.

These people were not licensed dealers or brokers and could not sell homes, nor were they charged with that duty. That duty must be left to outside dealers, but the non-profit had the obligation to fill the park and legitimately retained these persons to assist in that effort to advertise the park.

Ultimately, the non-profit decided to terminate the relationship for a number of good and valid reasons, but the effort was not wasted and a great deal of knowledge of the local marketplace was gleaned and put to valid use.

The anomaly of the 207 program is such that the mobile home park is treated like a multi-family "hard" structure which it is not. The rules drawn for apartments do not fit those required to properly operate and market an empty mobile home park.

If those costs are not allowable, then the type of action required of a park owner/operator to fill a park can never be accomplished within the project. That does not make any sense, and the project may as well be restricted to parks which are full and require no rehabilitation or repopulation.

Comment 13

The next item, although relatively small, is a $220.00 total charge for Brighthouse Cable to the manager's home. That is a part of the manager's housing costs paid for by the park. It is a severely discounted rate which is given for the manager's home as a part of the total park being wired for cable. These costs should not be disallowed. Space 89 has a park-owned home and all costs therefore are project costs.

The next category contains some charges which are only identified by date, vendor and purchase and dollar amount. The total of these amounts equals $3,629.00, and therefore, are relatively modest and could be absorbed by the corporation as non-project costs, except for the principal involved.

Those charges that are clearly for non-park owned homes of facilities are properly disallowed and will be deducted from the loan balance of the corporation to those points that could be investigated and assigns responsibility for payment.

Comment 14

There are four items that stand out as project expenses which should not be disallowed. The December 22, 2004 payment of $55.00 was to reimburse the corporation for mortgage payments received by the project in error. The Christmas trees are a traditional part of the clubhouse decorations, and have been a part of the community since the park was originally constructed by Mrs. Falk. If these costs are disallowed, can you then disallow floor polish used to make the floor look good?? It is not logical that the corporation should pay for those items that are an integral part of park operations.

Suffice it to say that sending flowers to one employee's wife who had a baby is good employee relations, and has nothing to do with the corporation. It is part of the cost of having employees, at least as a reasonable employer wishing to keep employees happy and working hard.

Comment 15

The question of trustees' fees has previously been addressed by the internal auditor and charged to the corporation, not the project. An accounting entry resolved that at year end.

We are attempting to sort out the remaining items, but everything for the homes in spaces 179 and 174 should be removed and reimbursed from the corporation's loans to the project. Based on some later information, we have annotated several items that were not clear.

The final portion of the enclosed charts involve the use of electricity at the park, which was assigned to certain spaces over time.

It should be noted that electrical and gas charges continued to accrue at minimum rates for as long as a meter or meters are attached and the utility provider not noticed as to a need to shut off service, or a change in service. In our examination of the list attached, we found:

1. Some charges continued to accrue after a tenant left and the park was charged for the service, since the tenant had left without service cut-off.

2. Some charges were incurred when subcontractors of the non-profit convinced the park manager that they needed power at the utility post to perform their construction duties.

3. Similarly, some homes being worked on by Homes of the West were consuming power and that was charged to the park.

4. In some cases, the new tenant failed to cause power to be transferred to his/her name on time, and that is a split responsibility of the non-profit and the tenant.

5. Finally, as to Spaces 180 – 181, the dealer should have been charged for the power on those two spaces. When it was discovered, the dealer was made to put the power in its' name, but the park paid minimum charges on five occasions.

Unfortunately, from February 2003 through October 2003, the auditors have failed to delineate which homes were involved and we have asked for the information to either agree or disagree with the finding.

Comment 5

Comment 3

Comment 16

TAG Response to Preferential Treatment of Certain Dealers

When the HUD auditors, staff counsel and, apparently management, reached the conclusion that the management company was to be charged with marketing spaces in a mobilehome park, it became clear that everyone was treating a mobilehome park the same as an apartment complex.

It is truly important that all levels of HUD be reminded that, in mobilehome parks there is a significant difference between the habitable structure and the space or lot on which the home is sited. I have also confirmed that the management contract entered into by the park owner and approved by HUD does not charge the management company with any marketing duties in any way, shape or form.

The homes and their owners that were cited by HUD auditors as not being given preferential treatment are four in number. Before I get to those, I would like to note that there were a number of other homes brought into the park by third party tenants or dealers, other than the LLC or HOW, that were treated the same as HOW and the LLC. If a dealer or a homeowner brings a home into the park for sale, he or she is not charged rent until the home is set and accepted by the state inspector, at which time utilities can be turned on and the home completed and accepted by the park for occupancy.

Only after the home is completed and a lease signed by the tenant preparing to move in as owner, is rent charged and collected. If a person from the outside brings in a home, it will not sit long as it has been paid for by the person and he or she intends to occupy the home.

If a dealer brings in a home, the dealer is not charged rent as a tenant for reasons stated above. If the dealer completes the home and uses it for a model, which is to say it can be occupied, rent is paid by that dealer. The other homes/dealers treated the same as TAG-LLC and HOW include Space 46, 105, 152, 212, 225 and 259, plus those discussed below.

Now, let us look at the examples given by the HUD auditors.

The spaces cited by the auditors as not being accorded the same treatment as TAG LLC and Homes of the West are as follows:

A. Space No. 73 – The dealer's agent took the home for rehabilitation and to sell. He was not performing and the park manager attempted to charge 2 months rent at $250.00 per month. When it was determined the agent was not going to perform, he was refunded the $500 paid and the home was removed from the park as it was a wreck. The

park manager should have charged the prior homeowner for the rent until the home was removed or title transferred to a third party.

Comment 17

B. Space No. 136 was a home owned by the aunt of one of our prior tenants. He said he could not continue to pay rent on an empty house and TAG-LLC did contract to purchase it for rehabilitation and resale. The contract was never finalized. A local dealer listed the home directly for the owner who was still responsible for rent under the original lease. Rimer Homes made a deal with the homeowner, not the park or LLC. The seller (Rimer apparently paid rent for the month of July after a tenant was approved, but who did not move in during that month). The new tenant paid rent for August forward.

The payment of one month's rent by Rimer was intended to stop a 3/60 Day Notice as to the seller who, living in the park, was under a lease to pay rent. The chart of used homes reflects a rent rate date of October 2005, but the rent receipt records reflect payment by the new tenant's name on the August 2005 rent roll. This was just like any in-park sale, whether involving a dealer or not. The reference to Rimer indicates they did handle the sale for the owner. If you look at the July 2005 collection report, you will note rent was collected and in Rimer's name. Rimer never took title and we cannot determine if they paid that month or if the seller paid. Also, the August rent roll reflects a new tenant made payment.

There was no Park contract with Rimer as it made its arrangement with the seller who owed the space rent.

Comment 18

C. Space Nos. 180 and 181 were both occupied by two different dealers who each installed two homes at different times. Initially Accent Homes moved in two homes and set-up models. Once inspected, the dealer was charged rent, but did not pay. When he later moved the home out, no rent was collected. The dealer did expend significant amounts on advertising for the benefit of the park, but the homes were listed at prices which were at least $20,000.00 over the then market

D. Space Nos. 180-181 were later occupied by Wall Street Capital with two new homes, and Wall Street Capital was not charged rent until they had been completely set, inspected and used as models. Even with the establishment as models, no rent was paid by the dealer but some back rent was collected when each home was sold. The rent came from the proceeds of the sales.

We have stated that if homes are used as models, rent should be paid, but that point in time is only after successfully passing the state inspection and then completion of the unit fit for either full-time occupancy or as a model home.

Comment 19

No rent was ever collected on Space Nos. 180-181 under Accent or from Wall Street Capital, only after they were completely inspected and approved by the State and the park for human occupancy and subsequent sales.

The foregoing does not reflect different treatment for different people or dealers. Please review the other homes noted as having been installed by other dealers or by individual new tenants. Those persons were all charged rent only after the home was installed, inspected by the state inspector and the park for human occupation. There was no differential treatment.

Comment 20

The Mobilehome parks contacted by HUD for verification of Industry standards regarding the payment of rent by dealers or new move-in tenants should be reviewed carefully.

If you look at the telephone numbers given for the parks surveyed, you will note they are all located in Orange County. There are virtually no vacancies in Orange County mobile home parks. We can provide data from a number of sources which indicate when considering a park closure in Orange County, the experts employed all say there are no vacancies where homes can be relocated.

Whenever comparisons are made, one must always look to comparable subject matter. In appraisals, comparables are a fact, but in that process there are degrees of similarity that must be accounted for by qualified persons. In the particular examples cited by the auditors, they have gone outside a depressed city/county that is just now achieving up to $220,000 for median priced homes. In Orange County, the median priced homes are well over $500,000 and a mobilehome park is a relatively good deal. Also, the conditions of the park are important. If it is a senior park, it is not the same as an open park and vice versa. If the park has no regular vacancies, it is also significantly different and should not be considered comparable.

Proceeding to the parks used by the auditors as comparables, each park was contacted by a person familiar with Mobilehome Parks and the following information obtained:

Anaheim Shores Mobilehome Estates is a 264-space mobilehome park in the City of Anaheim. The park was a senior park, but it is now an open park and it generally only has a vacancy upon a tenant death or an elderly tenant leaving the park. The manager stated that the park is full and the only vacancies are filled as soon as they can be listed for sale. The have no open (vacant) spaces.

Los Alisos Home Estates is really one of two parks located in Westminster. The park is listed by the State of California as Los Rubles with 103 spaces. Los Alisos is not on the state's list. The park is a family park and most of the homes in the park are owned by the park and rented out as apartments or rental homes. The park manager stated that only the park owner is allowed to

bring a new home into the park and those are not sold to outside tenant/homeowners. This sounds as if the park owner is preparing to close the park and use it for another purpose. It is a full park with serious controls on resales and is probably acting in an illegal fashion.

Cherokee is a resident-owned park which was originally a limited equity park, later converted to a corporate resident-owned park. The park has 173 spaces and is believed to be full, except for occasional vacancies. The Gibbs Law Firm has represented the park, and vacancies are only as created by death or movement of the person. When a home is sold, the person who buys must also purchase a membership. It is not comparable to the Pioneer Pines Park in any way, shape or form.

Palm Lodge is a 162-space park, also located in Anaheim, and advertises the availability of homes for rent, but no empty spaces for outside homes. This is once again a park in transition to a potential closure and not comparable

The four parks cited are located in the second most expensive county in the state and in two of the largest concentrations of population in Orange County. The demand for housing is such that spaces are only available upon tenant turnover, thus you either buy a home from a current tenant and live in it or you buy a home and replace it with a new home. None of the parks are comparable to a 342-space park that is approximately 50% vacant in a depressed community that is starting to grow, but the demographics in Orange County are not at all like Bakersfield.

Unfortunately, there are no parks in Bakersfield with this level of vacancy. The only park with significant vacancies for new homes is a new addition to another park that is the only place you can find a senior restricted community for new homes. It has no difficulty in attracting senior retirees and little need to incentivize dealers or others to move a home into the park as they are generally resold to persons looking for senior only home. The second park in Bakersfield with significant vacancies is a park which was foreclosed upon after the owner virtually emptied the park and the person purchasing from the foreclosure has allowed drug dealers and drug users to enter the park and it is considered a park to stay away from by the local population of home dealers, brokers.

Very truly yours,

TAG – PIONEER PINES PARK

GERALD R. GIBBS

GRG:lc

Comment 21

EXHIBIT D

The HUD IG audit team has taken exception to four items in its audit of Pioneer Pines Park which need to be addressed.

I would like to address these matters in reverse order, as they were presented.

Item D on the finding outline claims that 90 of 114 vacant lots were not properly maintained on the date they were inspected.

The audit team created separate categories of alleged problems for all spaces as follows:

1. No problems – We certainly accept that category, based upon the inspection date.

2. Exposed wiring/separate electrical wire conduit. This category encompassed 47 spaces, which were listed on the report.

   Upon review of the spaces questioned, it became obvious that the wires in question were not electrical, but rather cable TV and telephone wiring. Those two utilities own the wire in question and they pose no hazard as they do not carry any electrical current and the park has no ownership or control of those two systems. We cannot simply cut off cable or telephone wiring at ground level and expect the utility to set new boxes each time they install those utilities in a home. These are not health and safety violations.

3. Sewer lines uncapped. On the date of the inspection there were 8 such removals. The month prior they were all in place and they are again as of this date. I have little doubt that they will be stolen from some lots in the future, but we will continue to replace them as they are removed. There is no foolproof method of capping off the sewer lines as they are not threaded and anyone can remove the caps with little effort. The sewer line size is not large enough to present a hazard of someone stepping in them, but they can present odor and they become a source for persons to stuff foreign matter in and potentially plug the line.

4. Missing pedestal panel (covers). Once again, five of these were found by the audit staff and we have previously surveyed the problem, but we have had to conclude that we will have to have them manufactured, as replacement parts don't seem to be readily available. This is being accomplished and as soon as they are received they will be placed on the pedestals. In the interim, there is no health or safety problem as the electrical power has been turned off at all spaces not occupied by a tenant. We have also painted all pedestals that have covers in place.

5. Rust on pedestals. The audit team discovered four such instances of rust out of the 114 items inspected. We have a regular program of painting these pedestals and will be sure these four are resolved.

6. Pedestal needs painting. The audit team has found 44 such pedestals. That number appears to be overstated or we have since painted these pedestals in our normal cause of maintenance. Unfortunately shortly before the audit team visit we terminated our on-site manager and the painting left undone was a part of our difficulty. All pedestals should now have been painted or touched up as required, with the exception of missing panels which must be manufactured. Please understand that the pedestals electric source has been deactivated and therefore presents no safety problems from that source.

7. Rusted pipes. The audit team has alleged that 50 such pipes are involved. As near as we can determine, the pipes in question are the water risers, to which the home are to be connected. These pipes will always rust over time and as they are galvanized they are not painted. Some gas pipes have also rusted and they are painted by the utility provider which owns the pipes. This is done when the space is activated and gas meters are placed on the site.

   These water risers are replaced as required, but not simply because they have corroded in some way on the exterior. The risers are still in operating condition and are only replaced as required. The galvanized risers are generally set in concrete at the pedestal and are up to six feet in length. All but 12 inches or so are underground. It takes two men at least four to six hours to replace one riser. Since they are rusted but serviceable, they only get replaced as required. Since we have owned the park we only have record of one such riser being replaced and that was because someone cross-threaded the riser and it finally cracked at the threads. The risers for water are galvanized and never painted.

Comment 22

8. Uneven surrounding surfaces. Since there are none of these we have no comment, except we didn't know what it means.

Comment 21

9. Missing or cracked areas on driveway. The team reported 10 such instances. We should explain that cement will always crack. It is our policy not to replace a full driveway unless it is necessary. A necessary replacement of a portion of the driveway is generally accomplished once a new home is located on a particular lot. In all instances, before a lot is occupied by a new home, the park must regrade the lot to ensure it meets the drainage requirement of the State inspector. After that is done and the home installed, the cement is once again inspected and if required replaced or repaired. The placement of a home or removal of a home can cause concrete to be broken and so there is no reason to do this twice. If a lot driveway has a trip point we do cause it to be ground down at the point or cut out and replaced. Again, this is done after the home is in place, unless there is some danger as an empty lot.

It should be noted that empty lots are not to be used by anyone or traversed regularly.

10. Concrete damage or base/slab has cracks or broken pieces. The audit team noted 12 such instances, but the definition is not meaningful. It should be noted that since the HCD inspector has ruled that all lots must be graded for drainage before a new home is installed, we have been forced to remove all concrete on all lots, except the driveway which will remain. This covers all vacant lots and lots which will become vacant. That is in process and the 12 in question will be included as are 100 lots where concrete is being removed.

11. Pieces of concrete on lot. Four such instances are reported and as a part of 10 above this has been resolved or will be soon. In fact, at the time of the review some lots were in fact being used to stockpile broken concrete until it could be removed from the park. That process continues.

12. Pad not completely flat or poorly maintained. Three such lots were noted. In one of the lots, the home had just been removed and the other two the homes had been removed some time ago and the hardscape not removed. This is being accomplished as a part of the removal of all concrete, except for driveways.

13. Overgrown with weeds. The audit team noted 25 such lots. As near as we can determine, all of the lots had been recently sprayed for weeds and there were in fact dead plants on the lot in questions. Our regular procedure involves active spraying twice a year and regular weed removal in between.

    Last winter Bakersfield had more than sufficient rain to grow a magnificent crop of weeds. Unless we were to retain special contract employees to continually chop off weeds as they came up, we have to routinely assign ground workers to task of weed removal. It is a 365 day a year task and we attempt to keep all lots clean, but there will always be weeds in some lots, some more than others. Before occupancy the lots are cleared and graded to remove all such impediments, but if it is raining, the weeds will come back in a matter of days.

14. Requires general cleaning. (dirt on pad or side by street needs cleaning, trash on pedestal). This was the largest complaint with 42 lots reflecting his problem. This becomes very subjective, but we attempt to remove trash from all lots on a regular basis. This is reviewed daily, but does not include daily removal of dirt on pads. If you look at the pads, they are 90+ percent dirt and the balance concrete. As we clean lots, dirt will get on the cement. As the wind blows, trash and dirt will arrive on a lot from who knows where. We even have to correct children in the park from throwing dirt clods from lots, as a form of fun.

The auditors could review the park on one day and find all well, but if the wind comes up there will be dirt on concrete, leaves in the street gutters as well as dirt in gutters. It happens, it is not dangerous and it is regularly maintained.

We do not have the capability to sweep the streets mechanically and we cannot prevent leaves and dirt form accumulating in gutters. In fact, as a lot is regularly maintained dirt does blow about and at times into the street. Until the park is fully occupied that will continue. Although part of our regular maintenance, it will not be perfect at all times and it is unreasonable to expect it to be perfect.

In addition to the items mentioned above, special note was made of the following spaces:

1. Space 316. There is a dangerous hole around one of the corners of the utility pad. The hole in question was as a result of an underground waterline problem and was actually being pursued at the time. It has since been resolved.
2. Space 324. Pedestal missing the entire top section. That pedestal had the meter cap removed at the time the meter was taken out when it was deactivated. The top is covered with a piece of aluminum, attached to the base. It does not represent a hazard. I have written to PG&E to request that they return the head for the meter. If they do not do so, we may have to replace the pedestal when a new home is installed. In the interim there is no present danger as there is no power present.
3. Space 327. Pedestal missing entire top section. This is very similar to Space 324, except the temporary cover will be made and reinstalled. Hopefully PG&E will return the TOP HAT soon. In spite of being missing, the pedestal is safe and presents no safety problem as no power is present.
4. Space 339. There is no concrete base. Area around pedestal is dangerously uneven with loose wires that pose a tripping hazard. The pedestal base was damaged at some point and new concrete will have been poured in place this week. The only wire that could present a tip hazard is the telephone ground wire which has been clipped off and removed. That wire in question was a ground wire and is not technically a part of the utility service and we have removed it as advised.
5. Space 42. Pedestal cover panel is on the ground and not on the pedestal. This has been inspected and the pedestal is not as described. There is a telephone utility box on the property which has a plastic cover that was titled off the standard, but that has been righted.

We believe this covers the problems as presented and invite a REAC inspection of the lots, if that is what is required. We would, however, appreciate notice of any such review so we can explain the situation to the inspectors who are generally not at all familiar with mobile home communities or the technical aspects therein.

We have rented several tractors for the past several months and are continuing to remove all concrete from each pad that is not to be used as a driveway. Recent requirements imposed by the State inspector of home installations makes it impracticable to have any sidewalks or concrete other than the present driveway on a lot that must now be graded for drainage as dictated by the State.

OIG Evaluation of Auditee Comments

Comment 1 We disagree. The rental income should have been collected by the owner pursuant to Paragraph 11(b) of the regulatory agreement. Since the rental income was not collected, the owner violated the regulatory agreement. Pursuant to Title 12 of the United States Code, Section 1715z-4a, the Secretary of Housing and Urban Development may request the Attorney General to bring an action in a United States district court to recover any assets or income used by any person in violation of a regulatory agreement that applies to a multifamily project whose mortgage is insured or held by the Secretary under Title II of the National Housing Act.

Comment 2 We acknowledge and empathize with the owner's marketing burdens and difficulty in increasing the occupancy rate. Based on the comments provided by the auditee, we have removed any references to our contacts with other mobile home parks in the Orange County area, since we agree they may not be similar to mobile home parks in Bakersfield. However, we disagree that the conclusions are erroneous. The underlying issue is the park's failure to collect rental income from two of the president's affiliated dealers. We also note that our position is consistent with HUD's position that it took when it raised the issue of uncollected rent in its monitoring review.

Comment 3 The auditee did not provide any information that changes our conclusion about the disparity between third party dealers and affiliated dealers. Comments 15 through 18 specifically address the attached commentary and narrative the president prepared in response to our report.

Comment 4 Any work performed related to the rehabilitation of mobile home units while being paid out of project funds is in violation of the regulatory agreement. When we interviewed two of the park's maintenance employees, we were given the impression that rehabilitating of the homes was a secondary part of their functions. Because the records did not document the hours spent and duties performed on specific tasks, we were compelled to question the entire grounds crew's salaries. We agree that a portion of the salaries is eligible; however, we were unable to determine what portion. During the audit resolution process, the owner can provide documentation evidencing the portion of the salaries that are eligible to resolve the issue. In addition, we noted that the written response did not include the entire relevant portion of HUD Handbook 4381.5, which states that an agent's generalist staff must document hours spent and duties performed

on front-line activities for each project and those spent on the central office functions. Weekly timesheets are an acceptable method of documenting hours spent on front-line tasks.

Comment 5 According to HUD's Multifamily Housing officials, advertising of the vacant spaces is a function incumbent on the management company, and the expenses should be borne by the management company. Although the Management Agent's Certification signed on April 1, 2002 by the president of The Associates Group and March 25, 2002 by the president of La Cumbre Management Company does not specifically state that advertising is a function of the management company, the management company agreed to "ensure that all expenses of the project are reasonable and necessary." Upon review of the $18,722 in advertising and consulting fees incurred within a two and a half month period (January 12 to March 23, 2004), we determined that these expenses were questionable because the auditee did not provide any documentation to substantiate the services provided in order to support that the expenses were reasonable and necessary to the project operations. Although The Associates Group claimed that La Cumbre Management Company's services did not involve mobile home sales, our review showed that La Cumbre Management performed the bookkeeping and collecting of the mortgage premiums of these mobile home sales. In November 2004 the president instructed the manager of Pioneer Pines to stop billing residents who owe The Associates Group Cedar Hill for payments not made.

Comment 6 By definition, equity skimming is the use of project funds for other than actual or necessary expenses when the mortgage is in default or the project is in a non surplus cash position. There is no required level of intent. Whether the owner willfully, negligently, or without knowledge, utilized project funds for other than actual or necessary expenses, it is still equity skimming. We agree that the $81,096 can be used to offset the ineligible expenses; however, this needs to be reflected in the general ledger before we can consider the issue resolved. The main purpose of this section of the report is to point out that there exists a pattern of requiring advances to be repaid while the park is in a nonsurplus cash position, which is considered equity skimming, and needs to be addressed so that the practice does not continue.

Comment 7 We acknowledge that our inspection was not a Real Estate Assessment Center inspection, nor was it meant to be in compliance with Real Estate Assessment Center requirements. The Real Estate Assessment Center inspection score differed from the results of our inspection because the scopes of the inspections were different. Real Estate Assessment Center inspected the common areas, but did not inspect the vacant spaces that we did. Had Real Estate Assessment Center inspected the vacant spaces then the score may have been different. As recommended in the report, the owner can provide information to HUD during the audit resolution process to demonstrate that corrective action has been taken.

Comment 8 We amended the report to state that the mortgagee was apparently satisfied with the efforts of the owner to try and make the project viable, and thus has requested extension of the loan's assignment to HUD. We also corrected the misstatement that the project's physical conditions resulted in the lack of funds to pay the mortgage.

Comment 9 Since the owner agreed that the internal controls were deficient, we have no further comment. Comments on the uncollected rent, ineligible expenses, and project condition are specifically addressed in comments 1 through 3, and 20.

Comment 10 We amended the report recommendation regarding the repayment of $29,015, to $27,515 (due to removal of trustee fee, see comment 14 below) as agreed upon at the exit conference. The recommendations we proposed were directed to the Los Angeles Office of Multifamily Housing and the Departmental Enforcement Center, thus the appropriateness of the recommendations can be addressed during the audit resolution process. We also want to point out that the owner was given 15 days to respond to the draft report, which is the same amount of time given to all our external auditees. The owner was given finding outlines back in July, nearly two months before the draft report, but chose not to provide us any comments at that time. We have given serious consideration to the written comments provided in finalizing the audit report. We agree that advances may be used to offset any ineligible expenses; however, this needs to be addressed with HUD during the audit resolution process. With regard to the $97,000 that HUD has not released, we have no comment on the issue since it was not within the scope of our audit.

Comment 11 As stated in Comment 4, these declarations conflict with information provided to us during our audit fieldwork and are insufficient to resolve the issue of unallowable expenses of maintenance personnel at this time. Documentation evidencing the amount of time spent on eligible activities can be provided to HUD during the audit resolution process to resolve this issue.

Comment 12 As discussed in Comment 10, we have reduced the ineligible expenses in response to your comments. We have provided comments on some of the specific expense items raised by the auditee in Comments 5, and 16 through 19.

Comment 13 While the cable expense may be relatively small, it is an unnecessary expense to the park operations, and thus, ineligible.

Comment 14 We removed the $1,500 in trustee's fees from the questioned costs, but we maintain that $27,515 should be repaid back out of non-project funds. Specific comments on some of the other ineligible expenses are as follows:

- December 22, 2004 $55 payment – This underpayment was the result of a balance carry forward for rental of space number 135. The balance forward as of November 2004 was $952.46 and a payment of $620 was received, bringing the balance to be carried forward down to $332.46 in January of 2005. However, only $277.46 was carried over to January 2005, which was an understatement of $55. The president explained to us that the renter was to receive a renter's credit of $105 per month and had been inadvertently (due to clerical error) been given a $160 renter's credit, which is an overstatement of $55 and should be repaid back to the project.

- Christmas Trees and Flowers – As with the cable expenses, these expenses are unnecessary to the project operations, and thus, are ineligible.

- Trustee Fees – We verified with the internal auditor that this trustee fee was reversed as an accounting entry and resolved. We have removed this from the ineligible expenses.

Comment 15 We cannot provide the space numbers that were involved with the disallowed electrical and gas charges dated between February to October 2003 because the documentation did not clearly delineate those charges as did the other Pacific, Gas, and Electric bills. This is the reason why we questioned those expenses. During the audit resolution process, the owner can provide documentation to HUD to show the break down of the costs and the proper allocation towards each mobile home unit.

Comment 16 As stated in Comment 3, the owner did not provide any additional information that changed our conclusion. Between the dates December 2003 and March 2004, the rent roll shows that space number 73 was occupied by Accent Homes. The same information appears on the president's collection report. During Accent Homes' occupation of this space, two deposits in the amount of $350 were made, one on January 13, 2004 and another for $350 on February 4, 2004. It was not until March of 2004 did the dealer stop paying its rent and incurred a balance forward of $350. The March 2004 Delinquency report even shows that Accent Homes has an amount due of $350 and it's "on its way out." Accent Homes was required to pay rent while it was rehabilitating the home while it sat on space number 73. The Associates Group's response even admits that Accent Homes was required to pay rent while it was rehabilitating the home, although the rent was refunded back to the dealer due to non performance, which is irrelevant.

Comment 17 In the spreadsheet provided by the president, he stated that the home on space #136 "was under contract to LLC and turned over to an outside dealer who later sold the home after some remodel." The response contradicts that statement and states the contract for the home was never finalized and Rimer Homes made a deal with the homeowner and not the park or LLC. Our review of the dated March to July 2005 rent rolls and collection report shows space 136 to be occupied by Rimer Homes. It was not until the August 2005 rent roll and collection report did the name change to reflect the current tenant. A rent receipt record shows rent to have been paid in April 8, 2005, May 9, 2005, and July 8, 2005. Also, according to the spreadsheet, the park received the tenant application in July 2005 and signed the lease agreement on August 2005, which leads us to conclude that Rimer Homes was required to make rental payments for the time they spent rehabilitating the home.

Comment 18 According to the spreadsheet provided by the owner, homes were moved into space number 180 and 181 on January 2005 and passed its inspection on January 7, 2005. Also, these homes were certified habitable on September 2005 and June 2005, respectively. We acknowledge that no rent was collected for these spaces until the homes were sold; however, our position is that other dealers were required to pay the full rent amount. It is evidenced by the balance in the balance and credit forward reports that these dealers are required to pay the full rent amount. The December 2004 and January 2005 balance and credit forward reports show an increasing balance in the amount of rent expected to be collected from Wall Street Capital for utilizing spaces 180 and 181. In The Associates Group's response, they openly admitted to collecting back rent when each home was sold. Even before the homes were certified as habitable and suitable for occupancy, rent was expected from Wall Street Capital. By June 2005, the balance forward owed by Wall Street Capital for homes on space number 180 and 181 amounted to $2,172 each. So although The Associates Group's claims to charge rent after a home passes state inspection and is fit for full-time occupancy, the treatment for homes on space numbers 180 and 181 illustrates that they either do not follow the policy or do not adhere to it consistently.

Comment 19 As requested by the auditee, we reviewed other homes noted as having been installed by other dealers. Based on the spreadsheet provided by the president, only two other spaces were occupied by another dealer, Visalia Homes. Given that the home was occupied immediately by a tenant or the park's records conflicted with one another, we could not make a determination whether differential treatment was made with regard to Visalia Homes. Therefore, we were unable to support the auditee's contention that there was no disparate treatment between the affiliated and non-affiliated dealers.

According to the rent roll and collection report, space number 225 was vacant between January 2003 and November 2005. In the month of December 2005, as evidenced by the Pioneer Pines Changes for the Month of December 2005 report and December 2005 rent roll and collection report, a new tenant moved into the space and paid rent on January 4, 2006.

According to the rent roll report, space number 259 was vacant between January 2003 and August 2005; however the collection report shows the space as vacant between January 2003 and December 2005. In such a case, we can not make an accurate determination because the records seem to conflict with one another.

Comment 20 As discussed in Comment 2, the underlying issue is the park's failure to collect rental income from two of the president's affiliated dealers. Based on the auditee's comments, we have removed all references to our contacts with other mobile home parks. However, we noted that based on our analysis above in Comments 16 through 19, the owner was indeed charging rent to non-affiliated dealers during the rehabilitation phase, and in other cases it was unclear whether there was disparate treatment or not.

Comment 21 As recommended in our report, the owner can provide evidence of the corrective action taken to resolve the issues during the audit resolution process. Specifically with regard to the wiring, we are aware that the exposed wiring is not electrical wiring and does not pose a health violation; however, we identified it as a deficiency due to the fact that the exposed wires may be a safety hazard. Children who may play in the vacant lots or even residents may trip over them.

Comment 22 With regard to the deficiency on the uneven surrounding surfaces, these are situations where there is a pile of dirt and debris on the front end of the slab and the ground surface beside it is dangerously uneven (see space number 328)

Appendix C

CRITERIA

Regulatory Agreement

We extracted the pertinent paragraphs from the executed regulatory agreement.

Paragraph 6(e):

The owner shall not without the prior written approval of the Secretary [of HUD] make, or receive and retain, any distribution of assets or any income of any kind of the project except surplus cash and except on the following conditions: 1) all distributions shall be made only as of and after the end of a semiannual or annual fiscal period, and only as permitted by law of the applicable jurisdiction; 2) no distribution shall be made from borrowed funds, before the completion of the project or when there is any default under the regulatory agreement or under the note or mortgage; 3) any distribution of any funds of the project, which the party receiving such funds is not entitled to retain hereunder, shall be held in trust separate and apart from any other funds; and 4) there shall have been compliance with all outstanding notices of requirements for proper maintenance of the project.

Paragraph 7:

The owner shall maintain the mortgaged premises, accommodations, and the grounds and equipment in good repair and condition.

Paragraph 11(b):

The owner will collect all rents and charges in connection with the operation of the project and use such collections to pay the owners' obligations under the regulatory agreement and under the note and mortgage and the necessary expenses of preserving the property and operating the project.

Paragraph 15:

The owner warrants that he has not, and will not, execute any other agreement with provisions contradictory of, or in opposition to, the provisions hereof, and that, in any event, the requirements of the regulatory agreement are paramount and controlling as to the rights and obligations set forth and supersede any other requirements in conflict therewith.

Paragraph 18 and 18(b):

The mortgagor shall not use or permit the use of any portion of the mortgaged premises for demonstrating mobile home models or for other sales purposes, except the mortgagor may rent up to 10 percent of the total number of spaces in the project to mobile home dealers for the purpose of demonstrating their sales model providing:

The rental paid by dealers for a space shall be the rate set forth on Form HUD 92458, and no special consideration will be given to any specific dealer.

24 CFR [*Code of Federal Regulations*] Part 24

According to 24 CFR 24.305, 24.411, 24.700, and 24.1110, HUD is permitted to take administrative sanctions against recipients of HUD assistance who violate HUD's requirements. The sanctions include limited denials of participation, suspensions, and debarments.

An authorized HUD official may issue a limited denial of participation against a person based upon adequate evidence of any of the following causes:

- Failure to honor contractual obligations or to proceed in accordance with contract specifications or HUD regulations;

- Failure to satisfy, upon completion, the requirements of an assistance agreement or contract; and

- 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.

An authorized HUD official may issue a debarment or suspension against a person based upon adequate evidence of any of the following causes:

- Violation of the terms of a public agreement or transaction so serious as to affect the integrity of an agency program, such as

  (1) A willful failure to perform in accordance with the terms of one or more public agreements or transactions,

  (2) A history of failure to perform or of unsatisfactory performance of one or more public agreements or transactions, or

  (3) A willful violation of a statutory or regulatory provision or requirement applicable to a public agreement or transaction.

- HUD may debar a person from participating in any HUD programs or activities for material violation of a statutory or regulatory provision or program requirement 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.

- **Title 12, *United States Code*, section 1715z-4a**

Section 421 of the Housing and Community Development Act of 1987, 12 *United States Code*, section 1715z-4a, contains double damages remedy for unauthorized use of multifamily housing project assets and income. The double damages remedy is a civil remedy rather than an administrative remedy. It permits the secretary of HUD to request that the attorney general bring an action in a United States district court to recover any assets or income used by any owner or agent of the owner in violation of a regulatory agreement that applies to a multifamily project whose mortgage is insured or held by the secretary under Title II of the National Housing Act and any applicable regulations.

Appendix D

SCHEDULE OF UNCOLLECTED RENTAL INCOMEAND UTILITIES – NEW HOMES

Count	Space number	Potential rent from dealer	Trash, sewer & water (utilities)	Number of months rental income not collected from Homes of the West	Period
1	4	$3,615	$355	10 1/2	March 2005 to first half of January 2006
2	5	$2,445	$241	7 1/2	April to part of November 2005
3	18	$2,800	$273	8	July 2005 to February 2006
4	32	$4,140	$406	12	March 2005 to February 2006
5	36	$1,340	$133	4	March to June 2005
6	49	$1,690	$166	5	March to July 2005
7	51	$1,050	$101	3	June to August 2005
8	53	$2,780	$271	8	May to December 2005
9	55	$3,110	$304	9	April to December 2005
10	82	$2,450	$240	7	August 2005 to February 2006
11	93	$1,750	$171	5	October 2005 to February 2006
12	99	$2,100	$205	6	September 2005 to February 2006
13	103	$1,750	$171	5	October 2005 to February 2006
14	110	$863	$85	2 1/2	August to first half of October 2005
15	168	$2,100	$205	6	September 2005 to February 2006
16	189	$3,600	$353	10 1/2	April 2005 to first half of February 2006
17	358	$1,050	$103	3	August to October 2005
	Total	$38,633	$3,783		$ 42,416

The highlighted items indicate that the space was occupied initially by a used home, then a new home.

Appendix E

SCHEDULE OF UNCOLLECTED RENTAL INCOME AND UTILITIES– USED HOMES

Count	Space number	Potential rent	Trash, sewer & water (utilities)	Number of months rental income not collected from The Associates Group LLC or Homes of the West	Period
1	1	$ 6,580	$ 672	20	August to December 2003, June to August 2004, and March 2005 to February 2006
2	15	$ 3,750	$ 370	11	January to November 2005
3	16	$ 2,450	$ 240	7	August 2005 to February 2006
4	18	$ 3,470	$ 366	11	January and March to December 2004
5	19	$ 290	$ 33	1	Apr-04
6	22	$ 660	$ 67	2	June to July 2004
7	28	$ 1,050	$ 103	3	October to December 2004
8	33	$ 7,400	$ 739	22	May 2004 to February 2006
9	37	$ 990	$ 100	3	August to October 2004
10	46	$ 1,400	$ 137	4	August to November 2005
11	53	$ 1,160	$ 133	4	July to October 2003
12	60	$ 4,170	$ 433	13	March 2004 to March 2005
13	61	$ 2,110	$ 233	7	January to July 2004
14	65	$ 4,170	$ 433	13	March 2004 to March 2005
15	67	$ 7,980	$ 805	24	March 2004 to February 2006
16	71	$ 1,860	$ 200	6	March to August 2004
17	72	$ 3,335	$ 349	10 1/2	March 2004 to first half of January 2005
18	73	$ 580	$ 67	2	November to December 2003
19	78	$ 8,560	$ 872	26	January 2004 to February 2006
20	83	$ 2,110	$ 233	7	January to July 2004
21	85	$ 8,270	$ 839	25	February 2004 to February 2006
22	86	$ 8,210	$ 838	25	January 2004 to January 2006
23	88	$ 870	$ 100	3	January to March 2004
24	90	$ 2,450	$ 240	7	August 2005 to February 2006
25	97	$ 700	$ 68	2	August to September 2005
26	100	$ 4,090	$ 433	13	January 2004 to January 2005
27	110	$ 1,740	$ 200	6	July to December 2003
28	136	$ 1,320	$ 133	4	November 2004 to February 2005
29	139	$ 7,280	$ 737	22	March 2004 to November 2005 and February 2006
30	154	$ 6,450	$ 639	19	August 2004 to February 2006
31	154	$ 2,970	$ 300	9	November 2004 to July 2005
32	158	$ 5,460	$ 539	16	November 2004 to February 2006
33	158	$ 2,970	$ 300	9	November 2004 to July 2005
34	159	$ 580	$ 67	2	November to December 2003
35	162	$ 2,520	$ 266	8	March to October 2004
36	173	$ 3,400	$ 336	10	January to October 2005
37	174	$ 870	$ 100	3	March to May 2004
38	179	$ 580	$ 67	2	April to May 2004
39	212	$ 1,900	$ 233	7	April to October 2003
40	228	$ 3,810	$ 373	11	April 2005 to February 2006
41	230	$ 2,125	$ 266	8	March to October 2003
42	236	$ 1,900	$ 233	7	April to October 2003
43	303	$ 330	$ 33	1	Feb-05
44	311	$ 1,940	$ 200	6	May to October 2004
45	344	$ 990	$ 100	3	September to November 2004
46	350	$ 700	$ 68	2	January to February 2006
	Total	$ 138,500	$ 14,286		$ 152,786

The highlighted spaces (18, 46, 53, 73, 110, and 212) indicate the space was occupied initially by a used home, then a new home.

The highlighted spaces (16 and 90) indicate that it was a space identified in new home list the owner provided; however, it appears to have had a used home sitting on the lot.