U.S. Department of Housing and Urban Development
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OFFICE OF INSPECTOR GENERAL FOR AUDIT

Audit Memorandum
No. 00-DE-212-1801

July 26, 2000

MEMORANDUM FOR: Larry Sidebottom, Director, Office of Multifamily Housing, 8AHMLA

Robert C. Gwin

FROM: Robert Gwin, District Inspector General for Audit, 8AGA

SUBJECT: Review of Project Operations
Village 88 Apartments
Thornton, Colorado

We have completed a review of the program operations for Village 88 Apartments. The objectives were to evaluate the management controls for cash, residual receipts, occupancy, and Section 8 Housing Assistance Payments for Village 88 Apartments, and to evaluate compliance with HUD requirements.

BACKGROUND

Village 88 Apartments, located in Thornton, Colorado, was established in 1972 as a limited partnership to obtain an interest in real property and to develop and operate 180 units under Section 236 of the National Housing Act. Under Section 236, HUD provides subsidy to reduce mortgage interest payments. In May 1995, Village 88 Apartments entered into a Preservation Recapitalization Use Agreement with HUD, in which HUD agreed to provide certain initiatives in exchange for the Partners' agreement to continue the low-income affordability restrictions on the Project for the remaining useful life of the project. The Preservation Recapitalization subjects Village 88 Apartments to provisions of Subtitle A of Title VI of the National Affordable Housing Act, the Low Income Housing Preservation and Resident Homeownership Act of 1990 (LIHPRHA) with a Section 241 (f) loan. Village 88 Apartments receives a rental supplement from HUD. The owner agreed by executing two HAP Contracts, contract number CO99M000077 and CO99L000017 for Section 8 Housing Assistance Payments for a total of 180 units. Effective March 1, 2000, contract number CO99M000077 for 36 units became inactive, and contract number CO99L000017 was adjusted to cover all 180 units.

Village 88 Apartments is owned by Village 88, a Limited Partnership. The management agent, Hadley-Mendel Management Company, is an identity of interest entity to Village 88, a Limited Partnership. The accounting records and Section 8 Housing Assistance Payment records of Village 88 Apartments are located at Hadley-Mendel Management Company. Village 88 Apartments maintains the resident files onsite at the project.

RESULTS OF REVIEW

To accomplish our objectives, we reviewed Village 88 Apartments procedures for cash receipts and other income, petty cash, cash disbursements and allocations of costs, surplus cash and residual receipts, occupancy, and Section 8 Housing Assistance Payments. We also interviewed Village 88 Apartments, Hadley-Mendel Management Company, and HUD's Office of Multifamily Housing staff, and examined accounting records and other documents of these organizations.

The original audit period was January 1, 1998 through December 31, 1999; however the audit period was expanded to include the most current data available while performing the site work at the Project. Therefore, where applicable the audit period was expanded to include current data through March 7, 2000. We conducted field work during March and April 2000. Our review was conducted in accordance with generally accepted government auditing standards.

Overall, we noted the management controls of Village 88 Apartments were good. We determined that the management controls over petty cash, cash disbursements and allocations of costs, surplus cash and residual receipts, occupancy, and Section 8 Housing Assistance Payments were adequate. The management controls over cash receipts were adequate, except for the controls over laundry revenue. The finding for the laundry revenue is discussed below.

FINDING - LAUNDRY REVENUE IS NOT RECEIVED BY VILLAGE 88 APARTMENTS

The Regulatory Agreement requires any income of any kind of the project to be deposited in the name of the project. Therefore, revenue generated by the project's laundry facilities is to be deposited into the project account.

Revenue generated by the project's laundry facilities is not deposited into the project bank account as required. Instead laundry revenues are deposited into a non-project account titled "Village 88 Laundry". The revenues and expenses associated with the laundry facilities are controlled by a separate identity of interest partnership entity called "Village 88 Laundry". However, Village 88 Laundry does not pay the project for any rental of space for the laundry equipment, nor does Village 88 Laundry reimburse the project for the utilities used for the laundry equipment.

The identity of interest entity was established to provide the laundry machines and operate the laundry facilities for the project, because the project was unable to afford the laundry equipment at the time the project had the idea of having laundry facilities. The project officials stated that this arrangement has been operating with the knowledge of HUD officials.

As a result, the project is granting free space for the laundry facilities and is paying for the laundry utilities, but the project is not receiving any benefit from the laundry revenue. Approximately $12,000 of laundry revenue is collected a year. In our opinion, the revenues from the operation of the laundry facilities need to be received and deposited into the project's operating account.

Laundry revenue is required to be deposited in the project account

The Regulatory Agreement requires that the owners shall not without the prior written approval of the Commissioner make, or receive and retain, any distribution of assets or any income of any kind of the project. All rents and other receipts of the project are required to be deposited in the name of the project in a bank. Such funds shall be withdrawn only in accordance with this agreement for expenses of the project, and for distributions of surplus cash as limited by the Use Agreement and Amendment of Existing Regulatory Agreement. Any owner receiving funds of the project other than by such distributions of surplus cash shall immediately deposit such funds in the project bank account.

The Regulatory Agreement requires commercial facilities to be rented at not less than the rental approved by the Commissioner. The Use Agreement further requires that if there is any approved commercial space, the rents from the units receiving Section 8 assistance shall not be used to pay any expenses incurred with respect to the commercial use.

Therefore, revenue generated by the project's laundry facilities is to be received and deposited into the project's bank account. If the project has commercial space, the commercial space must be approved by the Commissioner and rented at not less than the rental approved by the Commissioner. The rents from the units receiving Section 8 assistance shall not be used to pay any expenses incurred with respect to the commercial use.

Laundry revenue is not deposited into the project bank account

Revenue generated by the project's laundry facilities is not deposited into the project bank account as required. Instead laundry revenues are deposited into a non-project bank account titled "Village 88 Laundry".

The laundry equipment used at the project is owned by a separate identity of interest partnership entity called “Village 88 Laundry”. Four of the five partners of the Village 88 Laundry entity are also partners of the project. Revenues generated from the laundry equipment are deposited into a separate bank account controlled by the identity of interest entity. Expenses in connection with the equipment are paid by the entity from laundry revenues. Any profit from the Village 88 Laundry is distributed twice a year to the partners of Village 88 Laundry.

The project is granting free space for the laundry facilities and is paying for the laundry utilities, but receives no benefit from the laundry revenues

However, Village 88 Laundry does not pay the project for any rental of space for the laundry equipment, nor does Village 88 Laundry reimburse the project for the utilities used for the laundry equipment. As a result, the project is granting free space for the laundry facilities and is paying for the laundry utilities, but the project is not receiving any benefit from the laundry revenues.

The resident manager of Village 88 Apartments estimates that about $1,000 is collected each month, or $12,000 annually, from the laundry equipment. The balance in the Village 88 Laundry bank account as of December 31, 1999, was $6,788.62. The operation of the laundry facilities by Village 88 Laundry is made without the benefit of any written contract with the project.

An identity of interest entity provided the laundry machines, because the project was unable to afford them, and HUD was aware of this arrangement

Project officials apprised us that when the idea of installing laundry equipment into the project was made, the project was unable to afford the laundry equipment. As a result, the identity of interest entity was established to provide the laundry machines and operate the laundry facilities for the project. The project officials added that this arrangement has been in existence for approximately twenty five years and has been operating with the knowledge of HUD officials. The project officials also commented that information on the laundry facilities was disclosed to HUD during the project’s Low Income Housing Preservation and Resident Homeownership Act of 1990 application process. HUD did not express any concern about the operation of the project’s laundry facilities.

Laundry operation revenues need to be received and deposited into the project account

In our opinion, the revenues from the operation of the laundry facilities need to be received and deposited into the project’s operating account. Since the laundry equipment is not owned by the project, some contract arrangement needs to be established for the equipment usage. Ideally, the project could procure for a fixed monthly fee, through open bidding, the leasing of the project laundry facilities to an independent laundry service vendor. The vendor would be responsible for providing, operating, and maintaining the laundry equipment. This would allow the project to receive income from the laundry and to provide funds to pay for the use of utilities by the laundry. Another option would be for the project to purchase and maintain the laundry equipment.

Specific instructions from HUD need to be provided to the project

In any case, specific instructions from HUD need to be provided to the project on exactly how the laundry revenues are to be received by the project and reflected on the project's books of account. Also, instructions need to be given on the project's recovery and recording of the laundry monies that have been received and used by the identity of interest partnership, Village 88 Laundry.

Auditee Comments

The owner does not believe that the net funds generated by the laundry facilities are funds of the project. There were not sufficient funds remaining after completion of the construction to complete and install a laundry facility, and the partners of Village 88 Apartments chose not to contribute additional capital for the purpose of the laundry facilities. Village 88 Laundry, a separate entity, was formed to complete the room, install equipment, and operate the laundry facilities.

The owner contends that the Village 88 Laundry entity has provided a much needed amenity to the project's tenants with no capital or other operating cost to the project, in exchange for use of the laundry room space and utilities. Under these terms, the rental of this commercial space was orally approved by HUD in 1974 and reaffirmed in 1995. The Auditee's entire response is attached as Appendix 1.

Auditor's Evaluation of Auditee Comments

We commend Village 88 Laundry for providing the laundry facilities for the residents of Village 88 Apartments. However, the commercial use and the rental of the commercial space was not approved in writing by HUD, as required by the Regulatory Agreement. Paragraph 6(h) of the Regulatory Agreement requires the owners to obtain the prior written approval of HUD to permit commercial use and paragraph 4(k) requires commercial facilities to be rented at not less than the rental approved by the Commissioner.

Furthermore, while Village 88 Apartments is paying the mortgage and the utilities for the project, which includes the laundry facility, the project is not receiving any income or rent from the laundry facility commercial space. Section 3 of the Use Agreement further requires that if there is any approved commercial space, the rents from the units receiving

Section 8 assistance shall not be used to pay any expenses incurred with respect to the commercial use.

Recommendations

We recommend that HUD's Office of Multifamily Housing:

1A. Provide specific instructions to the Owner on exactly how the laundry revenues are to be received by the project and reflected on the project's books of account.

1B. Provide instructions to the Owner on how the project will recover and record the laundry monies that have been received and used by the identity of interest partnership, Village 88 Laundry.

1C. Once the project has implemented recommendations 1A and 1B, review the project to ensure appropriate corrective action has been implemented and the project is properly receiving and recording laundry revenue in conformity with HUD requirements.

These recommendations will be controlled under the Departmental Automated Audit Management System. Within 60 days please furnish to this office, for each recommendation in this report, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered not necessary. Also, please furnish us copies of any correspondence or directives issued because of the audit.

We appreciate the courtesies and assistance extended by the personnel of Village 88 Apartments, Hadley-Mendel Management Company, and the HUD Office of Multifamily Housing. Should you have any questions please contact Ernest Kite, Assistant District Inspector General for Audit, at (303) 672-5452

APPENDIX 1

Auditee Response

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July 6, 2000

By Fax 303-672-5006

U.S. Department of Housing and Urban Development
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Re: Audit Memorandum No. 00-DE-212-1801
Village 88 Apartments
Thornton, CO

Attn: Robert Gwin, District Inspector General
for Audit, 8AGA

Dear Mr. Gwin:

This firm is legal counsel to the owner and manager of the above referenced complex. We have been asked to respond to the Audit Memorandum on our clients' behalf.

As the memorandum notes, the project was built and placed in service in 1974. There were not sufficient funds remaining after completion of the construction to complete and install a laundry facility, and partners of Village 88 Apartments chose not to contribute additional capital for the purpose of the laundry facility.

HUD was informed that the existing partnership could not provide this amenity for the tenants. A separate entity known as Village 88 Laundry was formed to complete the room, install equipment and operate the laundry facility. HUD was aware of and approved of this arrangement.

Operation of the laundry facility has remained the same since opening in 1974. In connection with entering into the Preservation Recapitalization Use Agreement with HUD in 1995, the operation of the laundry facility was discussed during the preservation process, and it was determined that it was acceptable to remain the same.

U.S. Department of Housing and Urban Development
July 6, 2000
Page 2

The owner does not believe that the net funds generated by the laundry facility are "funds of the project" as set forth in the audit memorandum. All equipment (and subsequent replacements thereto) were purchased by the Village 88 Laundry entity and the Village 88 Laundry entity completed the laundry room and has paid its own expenses incurred in the operation of the facility. The space used for the laundry would have remained unfinished and vacant if the laundry entity had not agreed to expend funds as it did. In exchange for use of the laundry room space and utilities, Village 88 Laundry entity has provided a much needed amenity to the project's tenants with no capital or other operating cost to the project. The "rental" of this commercial space on these terms was orally approved by HUD in 1974 and reaffirmed in 1995.

In conclusion, it was, at the time of development, the only way to provide what was deemed to be a necessary amenity which greatly enhanced the project and provided a needed service to its tenants. At the time of development, neither HUD or the project's partnership were willing and/or able to finance the amenity. The method of operating was fair to both the project and the laundry operator. The laundry facility has always been operated with the knowledge and approval of HUD.

Sincerely,
Moss & O'Dell, P.C.
Christopher C. O'Dell
Christopher C. O'Dell

cc: Lee S. Mendel (By Fax)
Carol Hadley (By Fax)

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APPENDIX 2

Distribution

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Director, Housing and Community Development Issue Area, United States General Accounting Office, 441 G Street, NW, Room 2474, Washington, DC 20548 (Attention: Judy England-Joseph)

Steve Redburn, Chief, Housing Branch, Office of Management and Budget, 725 17th Street, NW., Room 9226, New Executive Office Building, Washington, DC 20503

Ms. Carol Hadley, President/Property Manager, Hadley-Mendel Management Company, 1165 S. Pennsylvania Street, Suite 202, Denver, Colorado 80210

Mr. Lee Mendel, Owner, Hadley-Mendel Management Company, 1165 S. Pennsylvania Street, Suite 202, Denver, Colorado 80210