
AUDIT REPORT



SAVANNAH TRACE APARTMENTS MULTIFAMILY EQUITY SKIMMING

KALAMAZOO, MICHIGAN

2005-CH-1012

AUGUST 4, 2005

OFFICE OF AUDIT, REGION V
CHICAGO, ILLINOIS



Issue Date	August 4, 2005
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Audit Report Number	2005-CH-1012
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TO: Barbara Chiapella, Director of Detroit Multifamily Housing Hub, 5FHMLA
Margarita Maisonet, Director of Departmental Enforcement Center, CV

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

SUBJECT: Management Agents and/or Owner of Savannah Trace Apartments in Kalamazoo,
Michigan, Improperly Used Project Funds

HIGHLIGHTS

What We Audited and Why

We reviewed the books and records of Savannah Trace Apartments (project), an 80-unit multifamily housing project in Kalamazoo, Michigan. We initiated the review based on a request from the Detroit Field Office of Multifamily Housing Hub for the U.S. Department of Housing and Urban Development (HUD). The review was also part of our efforts to combat multifamily equity skimming on HUD's Federal Housing Administration insurance fund. Our objective was to determine whether the owner/management agents used project funds in compliance with the regulatory agreement and HUD's requirements.

What We Found

Maplegrove Property Management, LLC (Maplegrove), the project's former identity of interest management agent; Keystone Property Management, Inc. (Keystone), the project's current management agent; and/or Richland Housing Partners, LLC (Richland), the project's owner, inappropriately used \$5,576 in project funds from January 2002 through April 2005 when the project was in a non-surplus-cash position and/or had defaulted on its HUD-insured mortgage. The inappropriate disbursements included \$3,156 in excessive management fees, \$1,488 for late fees/finance charges, \$776 for lawn service, and \$156 in office supplies/equipment. Further, Maplegrove charged the project an additional

\$2,044 in excessive management fees that were not paid as of April 30, 2005. Maplegrove and/or Richland also lacked documentation to support that an additional \$1,045 in project funds were properly used. We provided Maplegrove, Keystone, and/or Richland schedules of the inappropriate disbursements and unsupported payments.

What We Recommend

We recommend that HUD's director of Detroit Multifamily Housing Hub ensure that Richland, Keystone, and/or Maplegrove (1) reimburse the project's reserve for replacement account and/or HUD's Federal Housing Administration insurance fund for the inappropriate expenses, (2) provide documentation to support the unsupported payments or reimburse the appropriate amount to the project's reserve account and/or HUD's Federal Housing Administration insurance fund that cannot be adequately supported, and (3) implement procedures and controls. We also recommend that HUD's director, in conjunction with HUD's Office of Inspector General, pursue double damages remedies if Richland, Maplegrove, and/or Keystone do not make the reimbursement.

We also recommend that HUD's director of Departmental Enforcement Center impose civil money penalties against Richland, Maplegrove, Keystone, and/or their principals/officers for the inappropriate use of project funds.

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

Auditee's Response

We provided our discussion draft audit report to Richland's managing member, Maplegrove's managing member, Keystone's president, and HUD's staff during the review. We held an exit conference on July 11, 2005.

We asked Richland's managing member, Maplegrove's managing member, and Keystone's president to provide comments on our discussion draft audit report by July 15, 2005. Richland's managing member, Maplegrove's managing member, and Keystone's president (representatives) provided written comments dated July 14, 2005, July 14, 2005, and July 1, 2005, respectively. The representatives generally agreed with our finding. However, the representatives did not agree with our recommendations regarding the pursuit of double damages remedies and the imposition of civil money penalties. The complete text of the written responses, along with our evaluation of those responses, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVE

Savannah Trace Apartments (project) is an 80-unit multifamily housing project in Kalamazoo, Michigan. The project is insured under section 221(d)(4) of the National Housing Act, and its regulatory agreement was executed on January 20, 1999. The project's owner is Richland Housing Partners, LLC (Richland). Maplegrove Property Management (Maplegrove) is the project's former identity of interest management agent. Keystone Property Management (Keystone) is the project's current management agent. The project was in default on its Federal Housing Administration-insured mortgage from November 2003 through February 2005.

We initiated the review based on a request from the Detroit Field Office of Multifamily Housing Hub for the U.S. Department of Housing and Urban Development (HUD). The review was also part of our efforts to combat multifamily equity skimming on HUD's Federal Housing Administration insurance fund.

Our objective was to determine whether the owner/management agents used project funds in compliance with the regulatory agreement and HUD's requirements.

RESULTS OF AUDIT

Finding: Management Agents and/or Owner Improperly Used or Lacked Supporting Documentation for the Use of More Than \$6,500 in Project Funds

Maple Grove, Keystone, and/or Richland inappropriately used \$5,576 of project funds from January 2002 through April 2005 when the project was in a non-surplus-cash position and/or had defaulted on its HUD-insured mortgage. The inappropriate disbursements included \$3,156 in excessive management fees, \$1,488 for late fees/finance charges, \$776 for lawn service, and \$156 in office supplies/equipment. Further, Maple Grove charged the project an additional \$2,044 in excessive management fees that were not paid as of April 30, 2005. Maple Grove and/or Richland also lacked documentation to support that an additional \$1,045 in project funds were properly used. The problems occurred because Richland, Maple Grove, and Keystone lacked effective procedures and controls over the use of project funds. As a result, fewer funds were available for debt service, and project funds were not used efficiently and effectively.

Owner paid management agents \$3,156 in excessive management fees

Richland paid Maple Grove and Keystone excess management fees of \$3,156 from January 2002 through April 2005 when the project was in a non-surplus-cash position and/or in default of its HUD-insured mortgage.

Richland paid Maple Grove management fees totaling \$34,289 from January 2002 through July 2003. However, Maple Grove only earned \$33,154 during this period. The following schedule summarizes the payments to Maple Grove.

Year	Management fees		Over(under) payment
	Paid	Earned	
2002	\$18,753	\$19,862	\$(1,109)
2003	15,536	13,292	2,244
Totals	\$34,289	\$33,154	\$1,135

The underpayment of \$1,109 during 2002 occurred because Maple Grove reduced its management fees for March 2002 by \$2,589 to offset part of the excessive management fees paid during 2001 and 2002.

Maple Grove also charged the project \$27,483 in management fees for 11 months, September 2002 through January 2003 and August 2003 through January 2004. Maple Grove only earned \$25,439 of the fees. Richland has not paid Maple Grove

for these fees. However, the \$2,044 in excess fees is carried on the project's books as an accounts payable to Maplegrove. The accounts payable to Maplegrove as of April 30, 2005, was \$79,914.

The overpayments occurred because Richland paid Maplegrove a flat monthly rate of \$2,589 per month rather than 4.032 percent of the project's residential income collected as required by the management agent's certification, dated March 5, 2001. Maplegrove's accounts payable clerk said she followed the instructions provided by Maplegrove's former chief accountant to pay the flat monthly fee.

Richland paid Keystone management fees totaling \$30,068 from February 2004 through April 2005. However, Keystone only earned \$28,047 during this period. The following schedule summarizes the payments to Keystone.

Year	Management fees		Over payment
	Paid	Earned	
2004	\$21,853	\$20,355	\$1,498
2005	8,215	7,692	523
Totals	\$30,068	\$28,047	\$2,021

The overpayments occurred because Keystone determined its management fee based on 4.382 percent of the project's total monthly income. Keystone's vice president said Keystone followed its management agreement with Richland. She did not know Keystone included income HUD does not consider residential income. Keystone repaid the \$2,021 in excessive management fees on June 30, 2005, by depositing \$2,021 in the project's operating account.

Management agents inappropriately used \$2,420 of project funds

Maplegrove and Keystone inappropriately disbursed \$2,420 in project funds for late fees/finance charges, lawn service, and office supplies/equipment. Maplegrove's disbursements of \$1,568 of the \$2,420 occurred from March 2003 through November 2003. Keystone disbursed the remaining \$852 from February 2004 through December 2004. The late fees/finance charges were for maintenance supplies and services, pest control, lawn service, advertising, specialty retail stores, utilities, resident screening, computer software, and a late mortgage payment. The late fees/finance charges, lawn service, and office supplies/equipment were not reasonable and necessary expenses of the project. The following table identifies the inappropriate disbursements.

<i>Inappropriate disbursements</i>	<i>Maple Grove 2003</i>	<i>Keystone 2004</i>	<i>Totals</i>
Fees/charges	\$636	<u>\$852</u>	\$1,488
Lawn service	776		776
Office supplies/equipment	<u>156</u>		<u>156</u>
Totals	<u>\$1,568</u>	<u>\$852</u>	<u>\$2,420</u>

Maple Grove’s accounts payable clerk said she did not know late fees/finance charges were not eligible project expenses. She said she has not received training or been provided HUD handbooks regarding eligible project expenses. Keystone’s regional property manager said she was not aware that late fees/finance charges were not eligible project expenses. Keystone repaid the \$852 in late fees/finance charges on June 30, 2005, by depositing \$852 in the project’s operating account.

Maple Grove and/or owner lacked documentation for the use of \$1,045 in project funds

Maple Grove and/or Richland also lacked documentation to support that an additional \$1,045 in project funds were properly used. The unsupported disbursements included \$982 for utilities, \$48 to Maple Grove, and \$15 of office supplies/equipment in 2003. Maple Grove’s director of accounting could not explain why Maple Grove lacked supporting documentation for the unsupported payments.

Richland has fewer project funds to make vendor and reserve payments

Richland has fewer project funds to make vendor and reserve fund for replacement payments due to the inappropriate disbursements. HUD’s staff for the Detroit Field Office of Multifamily Housing Hub were not aware of the inappropriate and unsupported payments. HUD approved the use of \$41,629 from the project’s reserve fund for replacement account to pay for vendor payments. In addition, HUD approved the suspension of the project’s reserve payments from July through December 2004 and from February through July 2005. HUD’s director of asset management for the Detroit Field Office of Multifamily Housing Hub said HUD would not have approved the use of the project’s reserve if it had known about the inappropriate and unsupported disbursements. As a result, the project’s reserve account as of May 25, 2005, was \$37,265, \$182,465 below HUD’s minimum requirement of \$219,721 for the project.

Recommendations

We recommend that HUD's director of Multifamily Housing Hub, Detroit Field Office, ensure that Richland, Maplegrove, and/or Keystone

- 1A. Reduce the project's accounts payable to Maplegrove by \$3,156 (\$2,044 for the excessive management fees charged but not paid and \$1,135 for the excessive management fees paid).
- 1B. Transfer \$2,873 (\$2,021 for excessive management fees paid to Keystone and \$852 for late fees/finance charges) from the project's operating account to its reserve for replacement and/or reimburse HUD's Federal Housing Administration insurance fund for the inappropriate expenses cited in this report that Keystone repaid to the project's operating account.
- 1C. Reimburse the project's reserve for replacement and/or HUD's Federal Housing Administration insurance fund \$1,568 for the late fees/finance charges, lawn service, and office supplies/equipment Maplegrove inappropriately disbursed from project funds.
- 1D. Provide documentation to support the \$1,045 in unsupported payments or reimburse the project's reserve for replacement account and/or the Federal Housing Administration insurance fund for the applicable portion.
- 1E. Implement procedures and controls to ensure project funds are used according to the regulatory agreement, the project owner's/management agent's certifications, and HUD's handbooks.

We also recommend that HUD's director of Multifamily Housing Hub, Detroit Field Office, in conjunction with HUD's Office of Inspector General (OIG),

- 1F. Pursue double damages remedies if Richland and/or Keystone do not reduce the project's accounts payable to Maplegrove and/or Richland, Maplegrove, and/or Keystone do not reimburse the project's reserve for replacement and/or the Federal Housing Administration insurance fund for the inappropriate expenses.

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

- 1G. Impose civil money penalties against Richland, Maplegrove, and/or Keystone for the payment of inappropriate expenses that violated the project's regulatory agreement.

SCOPE AND METHODOLOGY

We performed the review at HUD's Detroit and Grand Rapids Field Offices, Maplegrove's and Keystone's offices, and the project from February through April 2005. To accomplish our objective, we interviewed HUD's staff; employees from the project, Maplegrove, and Keystone; Richland's managing member; and Maplegrove's managing member.

To determine whether the owner/management agent used project funds in compliance with the regulatory agreement and HUD's requirements, we reviewed

- Richland's regulatory agreement with HUD;
- HUD's files and correspondence related to the project;
- HUD's Real Estate Management System and Financial Assessment Subsystem information related to the project;
- The project's financial records;
- Richland's audited financial statements for the years ending December 31, 2000, 2001, 2002, and 2003;
- Richland's management agreements with Maplegrove and Keystone; and
- The State of Michigan's Department of Labor and Economic Growth concerning ownership information for Richland, Maplegrove, and Keystone.

We also reviewed Title 12, *United States Code*, sections 1715 and 1735; Title 31, *United States Code*, section 3801; 24 CFR [*Code of Federal Regulations*], parts 24 and 221; and HUD Handbooks 2000.06, REV-3; 4350.1, REV-1; 4370.2, REV-1; and 4381.5, REV-2.

The review covered the period January 1, 2003, to December 31, 2004. This period was adjusted as necessary. We performed our review in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

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

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

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:

- Program operations - Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Validity and reliability of data - Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.
- Compliance with laws and regulations - Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Safeguarding resources - Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

We assessed the relevant controls identified above.

A significant weakness exists if internal 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:

- Richland, Maplegrove, and Keystone lacked effective procedures and controls over the use of project funds (see finding).

Appendixes

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/	Unsupported 2/
1A	\$3,179	
1B	2,873	
1C	<u>1,568</u>	
1D		<u>\$1,045</u>
Totals	<u>\$7,620</u>	<u>\$1,045</u>

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

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

JUL-15-2005 11:02 P.02/03

 **Mallory,
Cunningham,
Lapka & Scott, P.L.L.C.**

SUSAN L. MALLORY
JANICE K. CUNNINGHAM
THOMAS L. LAPKA
KELDON K. SCOTT
TODD S. SELIN
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605 South Capitol Avenue • Lansing, Michigan 48933 • Telephone (517) 482-0222 • Facsimile (517) 482-9019

June 14, 2005

Mr. Brent Bowen
Assistant Regional Inspector General for Audit
U. S. Department of Housing and Urban Development
77 West Jackson Blvd, Suite 2646
Chicago IL 60604-3507

RE: Savannah Trace

Dear Mr. Bowen:

This letter is our response on behalf of Richland Housing Partners, LLC, a Michigan limited liability company ("Richland"), the ownership entity of Savannah Trace Apartments. For your information, the members of the limited liability company are as follows:

Anderton Family Limited Partnership James Anderton, General Partner	50%
Yellow Ball Investments, LLC Kenneth T. Brooks, Thomas L. Lapka and Frank Bustamante, Members	25%
Oakwood Kalamazoo, LLC Thomas J. Kostosky and Craig Moulton, Members	25%

With respect to your Draft Audit Report and findings, we offer the following response:

1A. We agree with reducing Richlands accounts payable to Maplegrove by \$2,044.00 for the excessive management fee's charged but not paid in the amount of \$2,044.00; as to the excessive management fees' paid, we take the position that those should be reimbursed, (not reduce accounts payable) and paid directly into the operating account. Verification of same by Maplegrove should be provided, e.g. copy of check delivered to Keystone for deposit into the operating account.

1B. We agree with findings, except rather than reimburse the projects replacement reserve, that those moneys be deposited in the operating account. It appears that these corrective actions have been implemented pcr Keystone's letter dated July 1, 2005.

Comment 1

JUL-15-2005 11:03

P.03/03

Mr. Brent Bowen
June 15, 2005
Page Two

The reason for requesting funds in 1A and 1B be paid to the operating account is to assist us in meeting current and ongoing expenses incurred. The project is making positive strides and improving every month since Keystone took over management but it is still in a operating deficit mode.

1C. Agree with findings and to extent that Maplegrove or Keystone cannot adequately document these payments, any unaccounted expenses should be reimbursed to the operating account.

1D. We agree with the findings and based on Keystones letter dated July 1, 2005 it appears that Keystone has implemented the appropriate procedures. We will also schedule an owners meeting with representatives of Keystone to discuss and have the owners become familiar with HUD compliance issues.

1E. We agree with reducing the payables to Maplegrove and Keystone to reflect any overpayment. We disagree with double damage assessment as well.

1F. We disagree that any penalties be assessed against Richland. Richland hired and retained professional property managers and relied upon their expertise to properly manage accounts and the property. Further, if the position of HUD is to disregard the issue of Maplegrove commingling funds on Savannah with other projects, which have now been accounted for, e.g. "No harm no foul" then that thinking should prevail on the defaults of excessive management fees and undocumented payments as well.

Should penalties be assessed they should be attributable to Keystone and to Maplegrove. Further, if penalties are assessed, for the benefit of Savannah, they should be paid to the operating account. This would have a dual purpose of penalizing the mistakes of the professional managers and assisting the party most injured by their actions, Savannah Trace.

If you have any questions, please do not hesitate to call me.

Very truly yours,

RICHLAND HOUSING PARTNERS, LLC



Thomas L. Lapka, Managing Member

cc: Kenneth T. Brooks
Frank Bustamante
Tom Kostosky
Craig Moulton
James Anderton

E:\TLL-Civil\Yellow Ball\ud.tr.vpd

TOTAL P.03

MAPLE GROVE
Property Management, LLC
A quality property management company and licensed broker
330 West Lake Lansing Road, Suite 2
East Lansing, MI 48823
Tel: 517 333-9622
Fax: 517 333-9677

July 14, 2005

Mr. Brent Bowen, Assistant Regional
Inspector General for Audit
United States Department of HUD
Office of Inspector General
77 West Jackson Boulevard, Suite 2646
Chicago, Illinois 60604-3507

RE: Richland Housing Partners, LLC

Dear Mr. Bowen:

Pursuant to your letter of June 16, 2005, and the discussion at the "Exit Conference" on Monday, July 11, 2005, we are enclosing our response to the discussion draft of the audit report for Richland Housing Partners, LLC (aka Savannah Trace). This package includes a two page summary response intended to correspond to the comments or "results of audit" on pages five through nine of the discussion draft.

We have also included two items to facilitate the response to the list of "Unsupported Expenses" attached to your draft audit report:

An enlarged copy of that list (to facilitate reading) to which we have added reference numbers to identify corresponding documentation we are submitting for the related disbursements (see exhibit "A")

A schedule titled "Lansing Regional Chamber of Commerce – Blue Cross/Blue Shield" which summarizes the billings for hospitalization insurance and relates those billings to payments by Savannah Trace for that coverage (exhibit "B"). Copies of the billings for the hospitalization coverage are attached to that schedule.

Mr. Brent Bowen
July 14, 2005
Page 2

A major portion of the transactions questioned has to do with hospitalization insurance. Maplegrove contracts for that coverage through the Lansing Regional Chamber of Commerce and allocates those premiums to the respective properties. In some cases (through August, 2003) the payments by the properties were made to reimburse Maplegrove for their payment. After that date the properties paid the Chamber directly. Those payments are scheduled on the work paper titled "Lansing Regional Chamber of Commerce – Blue Cross/Blue Shield" with the identification of Kalamazoo employees. The allocation between Savannah Trace and The Meadows (geographically contiguous properties both managed by Maplegrove at the time of these transactions) is shown on that schedule. That schedule is referenced several times in satisfaction of the unsupported items.

As we mentioned in the exit conference, we would appreciate the opportunity to meet with you and/or your staff if there are any remaining questions after you have reviewed the documentation supplied.

Maplegrove is new to the management of HUD properties. We have learned much through the experience of managing Ivan Woods and Savannah Trace. We have also learned from the questions submitted to us by HUD auditor Judith Storrs and are respectful and appreciative of her professionalism throughout this process. We look forward to working with HUD on future projects.

We are hopeful there will be no reason to issue a subsequent report at the conclusion of your review of this response.

Very truly yours,



James F. Anderton IV
Managing Member

RESPONSE TO RESULTS OF AUDIT
RICHLAND HOUSING PARTNERS, LLC (SAVANNAH TRACE APARTMENTS)
HUD – OIG DISCUSSION DRAFT DATED JUNE 16, 2005

OWNER PAID MANAGEMENT AGENTS \$3,156 IN EXCESSIVE MANAGEMENT FEES (page 5) – We concur with this finding as it relates to Maplegrove Property Management. We concur with the recommendation (1A, page 8) to “Reduce the project’s accounts payable to Maplegrove . . .” by \$3,179, comprised of the \$2,044 not yet paid and \$1,135 paid by the project. Maplegrove believes it had charged the project for management fees in accordance with documented instructions received from the project’s auditors, Reznick, Fedder and Silverman, CPAs. There was no intent to charge fees inappropriately.

MANAGEMENT AGENTS INAPPROPRIATELY USED \$1,488 OF PROJECT FUNDS (page 6) – We now understand that late fees ought not be paid by the project, and concur with the recommendation (1B, page 8) that those fees ought to be reimbursed to the escrow accounts. We do not concur that those reimbursements should be paid by the management company, but instead should be paid by the owners because those late fees were paid in the absence of capital calls that would have provided funds for the operation of the project and for mortgage payments. Without capital calls, this property was very difficult to operate.

Comment 1

MANAGEMENT AGENTS AND/OR OWNER LACKED DOCUMENTATION FOR THE USE OF ALMOST \$40,000 OF PROJECT FUNDS (page 7) – We understand that the auditor did not find documentation of all the disbursements they examined. We concur with the recommendation (1C, page 8) that documentation be provided, but do not concur that undocumented funds should be reimbursed to the escrow accounts because deposits have been made to the mortgage escrow accounts as required and all disbursements from those accounts have been authorized as required. The escrow accounts were not “shorted” by any of these transactions.

Comment 2
Comment 3

Of the amount shown in the report (\$39,465), \$33,864 is attributed to Maplegrove. Our subsequent file search yielded support for a major portion of those items, and a separate set of work-papers details that documentation. (See the magnified copy of your “Savannah Trace Apartments Unsupported Expenses” and our list titled “Documentation for Use of Project Funds.”)

To require that Maplegrove reimburse the escrow account is to suggest that Maplegrove received or otherwise misappropriated the funds rather than to use them for the benefit of the property, and that is not the case. The absence of documentation might be attributed to misfiling or mishandling the supporting paper work during the course of the involved period of time. In some cases we could not identify, from the auditors lists, which transactions or items were thought to be not supported. Typically that was the case with parts of payments on vouchers that listed varied items to one vendor – often Maplegrove.

Recommendation 1D, page 8, suggests that accounting procedures should be revised. Because Maplegrove no longer manages the property, this recommendation is not applicable. However, Maplegrove continually seeks to improve its accounting procedures.

RICHLAND HAS FEWER PROJECT FUNDS TO MAKE VENDOR AND RESERVE PAYMENTS (page 7) – We do not concur that there have been “inappropriate disbursements.” The fact that we cannot locate the support for particular disbursements does not presume that the payment was inappropriate.

A comment at the top of page eight of the report makes reference to HUD authorized use of reserve funds to pay vendors for operating expenses. Those payments were made after Maplegrove ceased managing the project, and are not germane to Maplegrove. Maplegrove never used replacement reserve funds to pay operating expenses.

OTHER RECOMMENDATIONS (pages 8 & 9) –

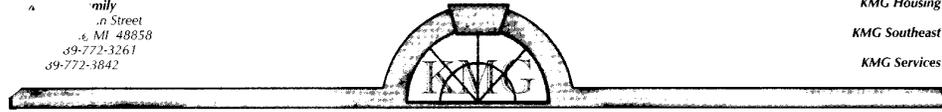
We do not concur with the recommendation (1E, page 8) that “double damage remedies” be imposed if Maplegrove does not reimburse the reserves for expenses paid on behalf of the project because there has been no demonstration that any funds expended were spent for anything other than reasonable operating expenses or necessary repairs of the project. Also we believe the documentation of those expenses have been maintained in reasonable condition for proper audit, and good faith efforts have been made to recreate accounting schedules where appropriate.

We do not concur with the recommendation (1F, page 9) that civil money penalties be imposed for expenses incurred on behalf of the project. Maplegrove did not know that advances made to the property to support its operations were contrary to the U. S. Code. In fact, Maplegrove made these advances because some of the partners in the project were unwilling to participate in capital calls. This is exemplified by the fact that once Maplegrove no longer managed the property, some owners of the property sought and secured permission from HUD to use reserve funds for payment of operating expenses. Only after these funds were expended did those owners agree to capital calls.

7/13/05

Family
in Street
e, MI 48858
39-772-3261
39-772-3842

KMG Housing
KMG Southeast
KMG Services



**KEYSTONE
MANAGEMENT GROUP**

July 1, 2005

Mr. Heath Wolfe
Regional Inspector General for Audit – Region V
U.S. Department of Housing and Urban Development
77 West Jackson Blvd, Suite 2646
Chicago, IL 60604-3507

2005 JUL -5 PM 1:43
RECEIVED
HUD - OIG
OFFICE OF AUDIT
CHICAGO, ILLINOIS

RE: SAVANNAH TRACE

Dear Mr. Wolfe:

This letter is in response to the Discussion Draft Audit Report for Savannah Trace Apartments (hereinafter Savannah) as those findings relate to Keystone Property Management, Inc (hereinafter Keystone).

1. Excessive Management Fees. There are two documents that reference the management fee calculation. The first such document is entitled "Management Agreement" and is an agreement between Richland Housing Partners, LLC and Keystone. This document refers to the management fee calculation as "computed and payable monthly in an amount equivalent to 4.382 percent of gross collections". The Keystone accounting staff failed to reference the definition of "gross collections", "amounts actually collected by the Agent as rents" and applied the percentage against all collections. The second document is the "Project Owner's & Management Agent's Certification" that is an agreement signed by Richland Housing Partners, LLC, Keystone and the U.S. Department of Housing and Urban Development. This document is a little more direct and clearer in the fee calculation. However, the Keystone staff failed to make use of this document and further lead to the error. We have subsequently provided training for the accounting staff and are satisfied that a proper understanding of the HUD regulations is now present.

It is noted herein that Keystone pays management fees earned in arrears so that at the end of any given month the excess management fees as calculated were less than the accrued fee from the previous month. This fact notwithstanding Keystone has, as of June 30, 2005, deposited into the operating account of Savannah a check in the amount of \$2,021 as noted in the audit report findings. A copy of the check and the deposit receipt has been attached to this letter as addendum A.

2. "Maplegrove and/or Keystone inappropriately disbursed \$1,488 of Project funds for late fees and/or finance charges". Keystone does recognize that errors were made with respect to late payment fees and/or finance charges disbursed from the project operating funds. However, Keystone inherited an untenable situation from Maplegrove Property Management, LLC in that due to the previous poor performance of the property Keystone was forced to pay these late fees in order to secure vendors to service the property. In

**Comment 4
Comment 6**



TDD 800-649-3777



Comment 5
Comment 6
Comment 7

spite of the situation Keystone inherited, Keystone is willing to take responsibility for the \$851.71 as noted in the audit report plus an additional \$44.86 not identified in the audit but discovered by Keystone when researching for documentation not located by the field audit staff.

Keystone has, as of June 30, 2005, deposited into the operating account of Savannah a check in the amount of \$896.57 as noted above. A copy of the check and the deposit receipt has been attached to this letter as addendum A.

3. "Maple Grove, Keystone, and/or Richland also lacked documentation to support that an additional \$39,465 in project funds were properly used." "Keystone's regional manager could not explain why...Keystone...lacked supporting documentation for the unsupported payments." Of this total \$5,601 has been identified with the time period of Keystone management. Quite frankly, we are surprised and dismayed by this finding. First of all, it is not noteworthy that a regional manager would not fully understand the file structures and record keeping functions performed by the accounting staff. The audit was performed remote from the accounting office of origination to accommodate the audit staff. Had the audit staff visited the Keystone office, the Keystone accounting staff would have had the opportunity to explain the file structure and procedures. This in all likelihood would have resolved all of the issues that led to the comment "lacked supporting documentation". Secondly, when the accounting staff was given the task of locating said documentation it was retrieved from our materials as returned by the HUD field audit staff. It was available all the while.

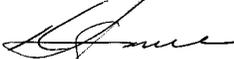
Comment 2

We have made copies of all the documentation and have attached to this letter as addendum B.

In conclusion, we feel that the recommendation to "impose civil money penalties" and the pursuit of "administrative sanctions" against Keystone to be far too severe given the level of infractions and willingness to take swift and corrective action

Sincerely,

KEYSTONE PROPERTY MANAGEMENT, INC.



Kenneth C. Bovee, CPM®

Enclosures.

OIG Evaluation of Auditee Comments

- Comment 1** Reimbursement to the project's reserve fund for replacement will return funds used from the reserve fund for replacement to pay for vendor payments.
- Comment 2** We adjusted our report by removing Keystone lacked supporting documentation to support project funds were properly used. We also reduced the amount Maplegrove and/or the Partnership lacked documentation to support that project funds were properly used by \$38,420. We also removed that Keystone's regional property manager could not explain why Keystone lacked supporting documentation for the unsupported payments. We adjusted our report to recommend Richland, Maplegrove, and/or Keystone provide documentation to support the \$1,045 in unsupported payments or reimburse the project's reserve for replacement account and/or the Federal Housing Administration insurance fund for the applicable portion.
- Comment 3** The supporting documentation Maplegrove provided contained \$932 in inappropriate disbursements. The inappropriate disbursements were for lawn service and office supplies/equipment. We adjusted our report by increasing the amount Maplegrove and Keystone inappropriately disbursed in project funds to \$2,420 including lawn service and office supplies/equipment in the list of inappropriate disbursements. We also increased the amount of Maplegrove's inappropriate disbursements to \$1,568.
- Comment 4** We adjusted our report by adding Keystone repaid the \$2,021 in excessive management fees on June 30, 2005, by depositing \$2,021 in the project's operating account.
- Comment 5** We adjusted our report by adding Keystone repaid the \$852 in late fees/finance charges on July 1, 2005, by depositing \$852 in the project's operating account.
- Comment 6** We added a recommendation for Richland, Maplegrove, and/or Keystone to transfer \$2,873 (\$2,021 for excessive management fees paid to Keystone and \$852 for late fees/finance charges) from the project's operating account to its reserve for replacement and/or reimburse HUD's Federal Housing Administration insurance fund for the inappropriate expenses cited in this report that Keystone repaid to the project's operating account.
- Comment 7** We adjusted our report to recommend Richland, Maplegrove, and/or Keystone reimburse the project's reserve for replacement and/or HUD's Federal Housing Administration insurance fund \$1,568 for the late fees/finance charges, lawn service, and office supplies/equipment Maplegrove inappropriately disbursed from project funds.

Appendix C

FEDERAL REQUIREMENTS

Richland's regulatory agreement, paragraph 6, mandates that the owner may not, without prior written approval of the secretary of HUD, assign, transfer, dispose of, or encumber any personal property of the project, including rents, or pay out any funds except for surplus cash, except for reasonable operating expenses and necessary repairs, and make or receive and retain any distribution of assets or any income of any kind of the project except surplus.

Paragraph 9(d) of the regulatory agreement states the books and accounts of the operations of the mortgaged property and of the project shall be kept in accordance with the requirements of the secretary. Paragraph 13(g) of the regulatory agreement defines a distribution as any withdrawal or taking of cash or any assets of the project, excluding payment for reasonable expenses incident to the operation and maintenance of the project.

Richland and Maplegrove certified in their project owner's/management agent's certification, dated March 5, 2001, that they have executed or will execute, within 30 days after receiving approval(s), a management agreement for the project. The management agreement provides or will provide that the management agent will manage the project for 4.032 percent of residential income collected. Richland and Maplegrove agreed to comply with the project's regulatory agreement; HUD handbooks, notices, or other policy directives relating to the management of the project; and HUD requirements regarding payment and reasonableness of management fees. Maplegrove agreed to assure that all expenses of the project are reasonable and necessary.

Richland and Keystone certified in their project owner's/management agent's certification, dated January 28, 2004, that they have executed or will execute, within 30 days after receiving approval(s), a management agreement for the project. The management agreement provides or will provide that the management agent will manage the project for 4.382 percent of residential income collected. Richland and Keystone agreed to comply with the project's regulatory agreement; HUD handbooks, notices, or other policy directives relating to the management of the project; and HUD requirements regarding payment and reasonableness of management fees. Keystone agreed to assure that all expenses of the project are reasonable and necessary.

HUD Handbook 4370.2, REV-1, CHG-1, page 2-6, requires that all disbursements be supported by approved invoices/bills or other supporting documentation. Page 2-6 also requires that all disbursements be used to make mortgage payments and required deposits, and pay reasonable expenses necessary for the operations and maintenance of the project and pay distributions of surplus cash.

HUD Handbook 4381.5, REV-2, paragraph 1.6(a), states the property owners are ultimately responsible for a project's compliance with HUD's regulations and requirements. HUD expects owners to oversee the performance of their management agents and take steps to correct deficiencies that occur.

Title 12, *United States Code*, section 1715z-4a, “Double Damages Remedy for Unauthorized Use of Multifamily Housing Project Assets and Income,” allows the attorney general to recover double the value of any project assets or income that were used in violation of the regulatory agreement or any applicable regulation, plus all costs relating to the action, including but not limited to reasonable attorney and auditing fees.

Title 12, *United States Code*, section 1735f-15, “Civil Money Penalties Against Multifamily Mortgagors,” allows the secretary of housing and urban development to impose a civil money penalty of up to \$25,000 per violation against a mortgagor with five or more living units and a HUD-insured mortgage. A penalty may be imposed for any knowing and material violation of the regulatory agreement by the mortgagor, such as paying out any funds for expenses that were not reasonable and necessary project operating expenses or for making distributions to owners while a project is in a non-surplus-cash position.