AUDIT REPORT

IVAN WOODS SENIOR APARTMENTS
MULTIFAMILY EQUITY SKIMMING

LANSING, MICHIGAN

2005-CH-1013

AUGUST 5, 2005

OFFICE OF AUDIT, REGION V
CHICAGO, ILLINOIS

Issue Date	August 5, 2005
Audit Report Number	2005-CH-1013

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 Ivan Woods Senior Apartments in Lansing, Michigan, Improperly Used Project Funds

HIGHLIGHTS

What We Audited and Why

We reviewed the books and records of Ivan Woods Senior Apartments (project), a 90-unit multifamily housing project in Lansing, 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 Ivan Woods Limited Dividend Housing Association Limited Partnership (Partnership), the project's owner, inappropriately used $9,928 in project funds from June 2002 through April 2005 when the project was in a non-surplus cash position. Further, Maplegrove charged the project an additional $262 in excessive management fees that were not paid as of April 30, 2005. Maplegrove and/or the Partnership also lacked documentation to support that an additional $3,089 in project funds were properly

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used. We provided Maplegrove, Keystone, and/or the Partnership schedules of the inappropriate disbursements and/or unsupported payments.

What We Recommend

We recommend that HUD's director of Detroit Multifamily Housing Hub ensure that the Partnership, 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 the 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 the Partnership, 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 the Partnership, 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 the Partnership's agent, 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 the Partnership's agent, Maplegrove's managing member, and Keystone's president to provide comments on our discussion draft audit report by July 15, 2005. Maplegrove's managing member and Keystone's president provided written comments dated July 14, 2005, and July 1, 2005, respectively. The Partnership's agent did not provide any written comments as of July 28, 2005. Maplegrove's managing member and Keystone's president generally agreed with our finding. However, Keystone's president disagreed that expenses related to the Partnership's low-income housing tax credits were inappropriate. Further, Maplegrove's managing member and Keystone's president 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

Ivan Woods Senior Apartments (project) is a 90-unit multifamily housing project in Lansing, Michigan. The project is insured under section 223(f) of the National Housing Act, and its regulatory agreement was executed on June 12, 2002. The project's owner is Ivan Woods Limited Dividend Housing Association Limited Partnership (Partnership). 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.

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 Inappropriately Used or Lacked Supporting Documentation for the Use of More Than $13,000 in Project Funds

Maplegrove, Keystone, and/or the Partnership improperly used $9,928 of project funds from June 2002 through April 2005 when the project was in a non-surplus-cash position. The inappropriate disbursements included $2,279 in excessive management fees, $5,700 for expenses related to the Partnership's low-income housing tax credits, and $1,949 for late fees/finance charges. Further, Maplegrove charged the project an additional $262 in excessive management fees that were not paid as of April 30, 2005. Maplegrove and/or the Partnership also lacked documentation to support that an additional $3,089 in project funds were properly used. The problems occurred because the Partnership, Maplegrove, 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.

The partnership paid management agents $2,279 in excessive management fees

The Partnerhip paid Maplegrove and Keystone excess management fees of $2,279 from June 2002 through April 2005 when the project was in a non-surplus-cash position.

The Partnerhip paid Maplegrove management fees totaling $26,965 from June 2002 through September 2003. However, Maplegrove only earned $25,389 during this period. The following schedule summarizes the payments to Maplegrove.

Year	Management fees		Over(under) payment
	Paid	Earned	
2002	$16,779	$13,170	**$3,609**
2003	10,186	12,219	**(2,033)**
Totals	**$26,965**	**$25,389**	**$1,576**

The underpayment of $2,033 during 2003 occurred because Maplegrove reduced its management fees for February and March 2003 by $3,218 to offset excessive management fees paid during 2002 and 2003.

Maplegrove also charged the project $5,193 in management fees for August, October, and November 2003. Maplegrove only earned $4,921 of the fees. The

Partnership has not paid Maplegrove for these fees. However, the $262 in excess fees are carried on the project's books as an accounts payable to Maplegrove. The accounts payable to Maplegrove as of April 30, 2005, was $52,477.

The overpayments during 2002 occurred because Maplegrove included 1 percent of total monthly income for consulting fees along with 4 percent of total monthly income for management fees. Beginning April 2003, the Partnership paid Maplegrove a flat monthly rate of $1,731. Maplegrove's accounts payable clerk said she followed the instructions provided by Maplegrove's former chief accountant to pay the flat monthly fee.

The Partnership paid Keystone management fees totaling $31,977 from December 2003 through April 2005. However, Keystone only earned $31,274 during this period. The following schedule summarizes the payments to Keystone.

	Management fees		Over
Year	**Paid**	**Earned**	**payment**
2003	$1,941	$1,900	**$41**
2004	22,163	21,667	**496**
2005	7,873	7,707	**166**
Totals	**$31,977**	**$31,274**	**$703**

The overpayments occurred because Keystone determined its management fee based on 4 percent of the project's total monthly income. Keystone's vice president said Keystone followed its management agreement with the Partnership. She did not know Keystone included income HUD does not consider residential income. Keystone repaid the $703 in excessive management fees on July 1, 2005, by depositing $703 into the project's operating account.

Management agents inappropriately used more than $7,500 in project funds

Maplegrove and Keystone inappropriately disbursed $7,649 in project funds for expenses related to the Partnerhip's low-income housing tax credits and late fees/finance charges. Maplegrove's disbursements of $5,664 of the $7,649 occurred from July 2002 through November 2003. Keystone disbursed the remaining $1,985 from December 2003 through June 2004. The low-income housing tax credits and late fees/finance charges were not reasonable and necessary expenses of the project. The following table identifies the inappropriate disbursements.

Inappropriate	*Maplegrove*		*Keystone*		
disbursements	*2002*	*2003*	*2003*	*2004*	*Totals*
Tax credits	$3,000	$1,350		$1,350	$5,700
Fees/charges	531	783	$179	456	1,949
Totals	$3,531	$2,133	$179	$1,806	$7,649

The disbursements for the Partnership's low-income housing tax credits included annual compliance monitoring fees to the Michigan State Housing Development Authority and tenant compliance fees to a certified public accounting firm. The late fees/finance charges were for utilities, pest control, glass repair, heating and cooling, specialty retail stores, and advertising.

Maplegrove's accounts payable clerk said she did not know the expenses related to the Partnerhip's low-income housing tax credits and 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 expenses related to project owners' low-income housing tax credits and late fees/finance charges were not eligible project expenses. Keystone repaid the $635 in late fees/finance charges on July 1, 2005, by depositing $635 into the project's operating account.

Maplegrove and/or owner lacked documentation for the use of more than $3,000 in project funds

Maplegrove and/or the Partnerhip also lacked documentation to support that an additional $3,089 in project funds was properly used. The unsupported disbursements included $1,062 and $2,027 to Maplegrove in 2002 and 2003, respectively. Maplegrove's director of accounting could not explain why Maplegrove lacked supporting documentation for the unsupported payments.

The Partnership has fewer project funds to make vendor and reserve payments

The Partnership 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 $38,897 from the project's reserve fund for replacement account to pay for vendor payments. 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 as of May 25, 2005, was $94,702, $294,939 below HUD's minimum requirement of $389,641 for the project.

Recommendations

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

1A. Reduce the project's accounts payable to Maplegrove by $1838 ($262 for the excessive management fees charged but not paid and $1,576 for the excessive management fees paid).

1B. Transfer $1,338 ($703 for excessive management fees paid to Keystone and $635 for late fees/finance charges) from the project's operating account to its reserve for replacement and/or reimburse HUD's Federal Housing Administration 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 $7,014 ($5,700 for the Partnership's low-income housing tax credits and $1,314 for late fees/finance charges) for the inappropriate expenses.

1D. Provide documentation to support the $3,089 in unsupported payments or reimburse the project's reserve for replacement 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. Pursues double damages remedies if the Partnership and/or Keystone do not reduce the project's accounts payable to Maplegrove and/or the Partnership, 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 the Partnership, 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; 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

- The Partnership'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,
- The Partnership's audited financial statements for the years ending December 31, 2002, and 2003,
- The Partnership's management agreements with Maplegrove and Keystone, and
- The State of Michigan's Department of Labor and Economic Growth concerning ownership information for 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 207; 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 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 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:

- The Partnership, 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	$1,838	
1B	1,338	
1C	7,014	
1D		$3,089
Totals	$10,190	$3,089

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**

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MAPLEGROVE
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: Ivan Woods Limited Dividend Housing Association Limited Partnership

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 Ivan Woods. This package includes our summary response intended to correspond to the comments, or "results of audit" on pages five through nine of the discussion draft.

With our summary response are three exhibits we prepared to expand on various items included therein:

Memorandum on insurance payments – exhibit "A"
Schedule of hospitalization billings – exhibit "B"
Listing of unsupported disbursements – exhibit "C"

The bulk of this package consists of copies of respective items listed in exhibit C with the supporting documents attached.

We trust that all questions about disbursements and expenses raised in your discussion draft have been answered satisfactorily with the supporting documentation included in this response.

–

Mr. Brent Bowen
July 14, 2005
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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 enclosed documentation.

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 an future projects.

We are hopeful there will be no subsequent report required when you have finished reviewing this documentation.

Very truly yours,

James F. Anderton IV

James F. Anderton IV
Managing Member

Ref to OIG Evaluation **Auditee Comments**

RESPONSE TO RESULTS OF AUDIT
IVAN WOODS LIMITED DIVIDEND HOUSING ASSOCIATION LIMITED PARTNERSHIP
HUD – OIG DISCUSSION DRAFT DATED JUNE 16, 2005

OWNER PAID MANAGEMENT AGENTS $2,279 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 $1,838, comprised of the $262 not yet paid and $1,576 paid by the project. Maplegrove charged the project for management fees in accordance with instructions (which have been shown to be incorrect) received from the office of Managing General Partner. There was no intent to charge inappropriate fees.

MANAGEMENT AGENTS INAPPROPRIATELY USED OVER $10,000 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. The absence of capital calls made it very difficult to manage this property.

Comment 1

MANAGEMENT AGENTS AND/OR OWNER LACKED DOCUMENTATION FOR THE USE OF MORE THAT $32,000 OF PROJECT FUNDS (page 8) – 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 were 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

Of the amount shown in the report ($32,915.15), $32,434.65 is attributed to the period of Maplegrove's management. The major portion ($23,814.77) of those in the Maplegrove era is focused on three areas of expense: property casualty insurance ($9,307.14), hospitalization insurance ($4,507.63), and a wire transfer made in March of 2003 ($10,000.00). The following relates to those large items -

PROPERTY CASUALTY INSURANCE – A currently reconstructed pro-rata allocation of the premiums ($150,479) based on property values results in an allocation of 10.26%, or $15,434, of the annual premiums to Ivan Woods. A memorandum describing that allocation is attached and demonstrates the reasonableness of the $1,551.19 payments. (See exhibit "A")

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HOSPITALIZATION INSURANCE – Maplegrove contracts for hospitalization insurance through the Lansing Regional Chamber of Commerce, and the Chamber bills the premiums monthly. Maplegrove then bills each of the client properties for the premium relating to the people working at the respective sites. In 2002 the properties paid Maplegrove, and in 2003 the practice was changed so that each property paid the Chamber directly. The list includes various payments, and the respective billings from the Chamber are enclosed. They may not have been paid in the same order as the Chamber issued its bills.

7/9/02	chk #441	$ 449.40	(see item #1 in file of support data)
9/18/03	chk #211	1,128.03	(see schedule of Lansing Regional
10/3/03	chk #223	1,128.03	Chamber of Commerce – Blue
11/7/03	chk #248	1,128.03	Cross/Blue Shield invoices)
11/20/03	chk #258	674.14	

The schedule titled "Lansing Regional Chamber of Commerce – Blue Cross/Blue Shield" is attached – see exhibit "B" (In the package prepared for Savannah Trace, this same schedule has copies of the invoices from the Chamber attached.)

WIRE TRANSFER – 3/31/03 - $10,000.00 – We are including the transfer slip with this packet of information. Attached to that is the detail of the items intended to be covered by that payment, even though that detail only totals $9,999.65. The details of those items can be traced to the general ledger detail as of 1/31/03, the first xx items in the ledger.

Also enclosed (attached to another copy of the notice of wire transfer) is a composite displaying the detail of accounts payable at Ivan as of 2/28/03 and 3/31/03. Observe that that detail shows the amounts due to Maplegrove - $27,888.79 at 2/28 and $17,288.79 at 3/31/03. The balance has been reduced by $10,000.00 by the wire transfer on 3/31/03, the item (#13) listed in your list of unsupported expenses.

If we had the list of open items comprising the 3/31/03 balance, that list might show a "partial" payment of $10,000.00 (a payment in round numbers, not applied to specific open invoices) because of the wire transfer. The 3/31/03 payables list might just as well (or better) have shown the payment as an unapplied entry rather than to apply it to the large carryover balance.

As of February 1,2003, the accounts for Ivan Woods were installed on new software, YARDI. We had been using AMSI software. As an expedient to the installation (which now seems ill-advised), we merely picked up the balance due Maplegrove, rather than re-enter the plethora of individual transactions previously recorded, but not liquidated. This transaction represents a partial payment on the balance.

We have prepared and enclosed a list of the items included in the $32,915.15 attributed to Maplegrove, exhibit "C." Supporting details are included for the items in the list and are cross referenced to the list numerically, 1 through 29.

–

To require that Maplegrove reimburse the escrow account is to suggest that Maplegrove received or otherwise misappropriated the funds rather than 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 time under consideration. In some cases we could not identify, from the auditor's lists, which transactions or items were thought by the auditor 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 is striving to continually improve its accounting procedures.

THE PARTNERSHIP HAS FEWER PROJECT FUNDS TO MAKE VENDOR AND RESERVE PAYMENTS (page 8) – We do not concur that there have been "inappropriate disbursements." The fact that we cannot locate supporting documentation for particular disbursements does not mean the payment was inappropriate.

A comment at the top of page eight of the report makes reference to HUD authorized use of replacement 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 for operating expenses.

OTHER RECOMMENDATONS (page 9)

We do not concur with the recommendation (1E, page 9) 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. Also, it is our understanding that once Maplegrove no longer managed the property, some owners of the property sought and secured permission fro HUD to use reserve funds for payment of operating expenses. Only after these funds were expended did those owners agree to capital calls.

7/14/05

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102 South Main Street
Mt. Pleasant, MI 48858
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KMG Housing
KMG Southeast
KMG Services

KMG
KEYSTONE
MANAGEMENT GROUP

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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

RE: IVAN WOODS

Dear Mr. Wolfe:

This letter is in response to the Discussion Draft Audit Report for Ivan Woods Apartments (hereinafter Ivan) 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 Ivan Woods Limited Partnership and Keystone. This document refers to the management fee calculation as "computed and payable monthly in an amount equivalent to 4.0 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 Ivan Woods Limited Partnership 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.

   Comment 3
   Comment 5

   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 Ivan a check in the amount of $703.00 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.

Comment 4
Comment 5
Comment 7

2. Keystone inappropriately disbursed $634.68 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 spite of the situation

TDD 800-649-3777

Mr. Heath Wolfe
Regional Inspector General for Audit – Region V
U.S. Department of Housing and Urban Development
July 1, 2005
Page Two

Keystone inherited, Keystone is willing to take responsibility for the $634.68 as noted in the audit report.

Comment 4
Comment 5
Comment 7

Keystone has, as of June 30, 2005, deposited into the operating account of Ivan a check in the amount of $634.68 as noted above. A copy of the check and the deposit receipt has been attached to this letter as addendum A.

Comment 6
Comment 7

3. Central Office Employee Salary. The following is from the HUD 4370.2 REV-1 for account descriptions, particularly account 6310, with emphasis added. "This account records salaries paid to office employees (other than the resident manager) responsible for the front-line operation of the project regardless of whether the employee works on site or in the agent's office. Front-line responsibilities include for example, taking applications, verifying income and processing maintenance request." Also, under paragraph 6.38 MANAGEMENT COSTS CHARGED TO THE PROJECT'S OPERATING ACCOUNT, it is noted that "front-line activites include:...screening, certifying, and recertifying residents". And finally the handbook notes that a "management agent employing generalist staff members specifically designated to assume front-line responsibilities on an as-needed basis may bill the project's operating account for time spent on front-line activities ...". It was also noted in the draft audit report that the "low-income housing tax credits ...were not reasonable and necessary expenses of the project."

We find the conclusion of "not reasonable and necessary" as a complete stretch. The very existence of this housing development is inextricably tied to the tax credit program. Additionally, we are unable to find the appropriate reference in the HUD manual where tax credits are specifically delineated as not necessary and request that this information be provided before further determination on this matter. However, if correct, we would look to the ownership of Ivan to take proper corrective action and repay these funds to the operating account.

We have attached a copy of the job description for this position to this response letter and feel strongly that this position qualifies as a site expense. This staff position performs no management agent functions and serves strictly as an addition to the site management staff in approving tenants for occupancy. Our internal designation of "central office employee" may have been misleading to the field audit staff and therefore resulted in the conclusions noted in the audit report.

Mr. Heath Wolfe
Regional Inspector General for Audit – Region V
U.S. Department of Housing and Urban Development
July 1, 2005
Page Three

Comment 2

4. "Maplegrove, Keystone, and/or the partnership also lacked documentation to support that an additional $32,915 in project funds were properly used." Of this total $480.50 has been identified with the time period of Keystone management. The accounting staff was given the task of locating said documentation and was able to retrieve from our materials as returned by the HUD field audit staff.
   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 to 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. In addition, disbursements from the reserve fund for replacement require HUD approval; therefore, HUD can ensure that the use of the funds is for eligible project expenses.

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, Keystone, and/or the Partnership lacked documentation to support that project funds were properly used by $29,826. 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 the Partnership, Maplegrove, and/or Keystone provide documentation to support the $3,089 in unsupported payments or reimburse the project's reserve for replacement and/or the Federal Housing Administration insurance fund the applicable portion.

Comment 3 We adjusted our report by adding Keystone repaid the $703 in excessive management fees on July 1, 2005, by depositing $703 in the project's operating account.

Comment 4 We adjusted our report by adding Keystone repaid the $635 in late fees/finance charges on July 1, 2005, by depositing $635 in the project's operating account.

Comment 5 We added a recommendation for the Partnership, Maplegrove, and/or Keystone to transfer $1,338 ($703 for excessive management fees paid to Keystone and $635 for late fees/finance charges) from the project's operating account to its reserve for replacement and/or reimburse HUD's Federal Housing Administration for the inappropriate expenses cited in this report that Keystone repaid to the project's operating account.

Comment 6 We adjusted our report by reducing the amount of project funds Maplegrove, Keystone, and/or the Partnership improperly used by $2,415. We also deleted the disbursements for the Partnership's low-income housing tax credits that included salary expenses for Keystone's tax credit specialist.

Comment 7 We adjusted our report to recommend the Partnership, Maplegrove, and/or Keystone reimburse the project's reserve for replacement and/or HUD's Federal Housing Administration insurance fund $7,014 ($5,700 for the Partnership's low-income housing tax credits and $1,314 for late fees/finance charges) for the inappropriate expenses.

Appendix C

FEDERAL REQUIREMENTS

The Partnership'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.

The Partnership and Maplegrove certified in their project owner's/management agent's certification, dated November 16, 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 percent of residential and commercial income collected. The Partnership 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 all expenses of the project are reasonable and necessary.

The Partnership and Keystone certified in their project owner's/management agent's certification, dated December 24, 2003, 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 percent of residential income collected. The Partnership 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 all expenses of the project are reasonable and necessary.

HUD Handbook 4370.2, REV-1, CHG-1, page 2-6, requires that all disbursements must 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.