Issue Date
June 29, 2006

Audit Report Number
2006-KC-1012

TO: Herman Ransom, Director, Office of Multifamily Housing, Kansas City Hub, 7AHM

Margarita Maisonet, Director of the Departmental Enforcement Center, CV

//signed//
FROM: Ronald J. Hosking, Regional Inspector General for Audit, 7AGA

SUBJECT: The Owner of HDC Retirement Village in St. Louis, Missouri, Violated Its Regulatory Agreement

HIGHLIGHTS

What We Audited and Why

We audited HDC Retirement Village, a 48-unit project located in St. Louis, Missouri. We selected this project for audit based on a request from the U. S. Department of Housing and Urban Development's (HUD) Office of Housing. Our audit objective was to determine whether the managing owner (owner) complied with regulatory agreement provisions when expending project funds.

What We Found

HDC Retirement Village's owner did not use project funds in compliance with the regulatory agreement. It also violated several other terms of the agreement. The owner violated the regulatory agreement because it viewed its projects as interdependent and not individually viable. These violations, totaling $209,716, adversely affected the project's financial stability.

What We Recommend

We recommend that HUD take appropriate actions to correct deficiencies and ensure that these violations will not occur in the future.

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

The owner generally disagreed with our findings. We provided the draft report to the owner on May 24, 2006. The owner provided written comments on June 12, 2006 . The complete text of the owner's response, along with our evaluation of that response, can be found in appendix B of this report.

TABLE OF CONTENTS

BACKGROUND AND OBJECTIVES

HDC Retirement Village is an elderly housing project consisting of 48 Section 8 units located in St. Louis, Missouri. The U.S. Department of Housing and Urban Development (HUD) insures this project under its Section 221(d)(3) mortgage insurance program.

Human Development Community Development Corporation (owner), a not-for-profit entity, owns and manages the project. It has managed two other HUD-insured projects (Wellston Townhouses and Grandview Heights), one of which was assigned in 2004.

HDC Retirement Village's operations are governed by a regulatory agreement, which was signed by the owner in 1981. Our audit objective was to determine whether the owner complied with regulatory agreement provisions when expending project funds.

RESULTS OF AUDIT

Finding: Owner's Actions Violated the Regulatory Agreement

HDC Retirement Village's owner did not use project funds in compliance with the regulatory agreement. It also violated several other terms of the agreement. The owner violated the regulatory agreement because it viewed its projects as interdependent and not individually viable. These violations, totaling $209,716, adversely affected the project's financial stability.

Managing Owner Violated Regulatory Agreement

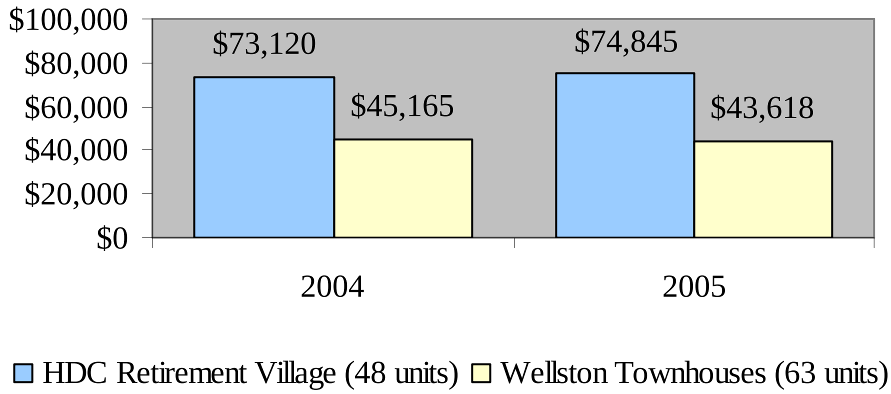
The owner did not follow the regulatory agreement requirements (see appendixes C and D). The owner

- Improperly allocated shared expenses,
- Made unauthorized distributions,
- Allowed liens,
- Underfunded tenant security deposits,
- Retained tenant rent credits, and
- Withheld required financial reports.

<u>Expense Allocation</u>

The owner did not properly allocate expenses for payroll, office utilities, and office maintenance. Its three projects share employees and office space; however, the owner did not have an allocation plan and did not require employees to track time spent performing duties for each project. While our review of Wellston Townhouses did not identify any payments for office maintenance or utilities, HDC Retirement Village paid $13,306 toward these expenses during the audit period. Further, although HDC Retirement Village was an elderly project with fewer units and fewer maintenance needs than Wellston Townhouses, it paid approximately $59,000 more than Wellston Townhouses in payroll expenses during the audit period.

Payroll expenses for shared employees
of HUD-insured projects



HDC Retirement Village's books and records did not show that the $161,271 paid for payroll, office utilities, and office maintenance was reasonable and necessary for project operations.

Asset Distributions

The owner, without prior HUD approval, distributed $28,971 in project assets. The owner

- Purchased $16,388 in supplies and services for other projects, $5,900 of which was later repaid to the project;
- Paid $3,486 for owner legal expenses not related to project operations;
- Loaned $3,000 to another project;
- Transferred $4,229 to another project to correct an unsupported deposit error; and
- Paid $1,868 for ineligible or unsupported miscellaneous expenses.

Appendix E provides details of each unauthorized distribution.

The owner also failed to keep sufficient records of credit card activity. During our audit period, the project made several payments toward its Visa account and toward another project's Office Depot account. The project's books and records did not show the payments were charges of the project or that they were reasonable and necessary.

Liens

The owner allowed the sewer district to place liens on the project. As of December 31, 2005, the owner had not paid $10,844 in service fees, penalties, and interest. The sewer bill consisted of $8,601 for service and $2,243 for penalties and interest. The penalties and interest accumulated because the owner did not pay the project's sewer expense in a timely fashion. Penalties of this type are not ordinary or necessary for the project's operation.

Security Deposits

The owner improperly used tenant security deposits. In November 2005, the owner transferred tenant security deposit funds to the project's operating account. As of December 31, 2005, the tenant security deposit account was underfunded by $6,836.

Rent Credits

The owner improperly retained tenant rent credits. When retroactive changes at recertification created rent credits, the project manager did not issue refunds to tenants. As of December 31, 2005, the project owed $1,794 to 20 tenants. Seven of the tenants were owed between $100 and $400.

Financial Reports

The owner did not submit all required monthly accounting reports. In March 2005, HUD advised the owner that it was required to submit these reports each month, beginning with February 2005. HUD uses these reports to monitor the project's revenues, disbursements, and obligations. As of December 31, 2005, the project had only submitted two monthly account reports.

Owner's Reasoning

The owner viewed its projects as interdependent and not individually viable. The owner did not establish effective written procedures and controls because it wanted fiscal flexibility to meet expenses. The owner

- Believed it was too time consuming and costly to accurately track employee time between projects,
- Thought it was reasonable to financially support other entities by paying their expenses and advancing funds,
- Thought it was allowable to repay other entities without obtaining HUD approval,
- Did not pay the sewer bills because this service could not be shut off like other utilities,
- Had a standard practice of using security deposits for operating expenses and then reimbursing the account upon receipt of reserve for replacement funds, and

- Thought it was allowable to delay notifying tenants who were due rent reimbursements.

Financial Stability Affected

The owner allowed the project's financial stability to deteriorate through these regulatory agreement violations totaling $209,716, including unsupported payroll and liens on the property. The owner also denied HUD access to financial reports needed to monitor the project's condition. These reports would have indicated to HUD that the owner used project funds for unauthorized purposes and allowed the project's financial stability to deteriorate. For example, from August 31, 2004, to August 31, 2005, the project's negative surplus cash doubled to more than ($27,000).

Conclusion

Due to the frequency and significance of these regulatory agreement violations, HUD should consider terminating the self-management arrangement and requiring independent management of the project. This action would put $1,500 monthly project funds to better use, or $18,000 annually. The self-management certification provides for this type of action when owners fail to follow regulatory agreement requirements.

Recommendations

We recommend that the director of HUD's Kansas City Multifamily Housing Hub require the owner to

1A. Obtain independent management to put $18,000 to better use annually.

1B. Develop and implement procedures and controls to ensure that future disbursements of project assets comply with the regulatory agreement and HUD's requirements, including a cost allocation plan to maintain adequate books and records.

1C. Provide documentation to support the $166,812 in unsupported distributions for payroll, office utilities, office maintenance, and miscellaneous expenses or reimburse the project's reserve for replacement account the applicable portion that cannot be supported as necessary to the project.

1D. Deposit $17,530 for improper distributions into the project’s reserve for replacement or a restricted capital account, which requires HUD approval for release of the funds.

1E. Pay $2,243 in sewer fees and interest from nonproject funds and initiate action to pay $8,601 from project funds to resolve sewer liens.

1F. Properly fund the tenant security deposit account with $6,836.

1G. Reimburse tenants from project funds $1,794 for their rent credits.

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

1H. Pursue civil money penalties and administrative sanctions, up to and including debarment, as appropriate against the owner, management agent, and/or their principals/owners for their part in the regulatory violations cited in this report.

SCOPE AND METHODOLOGY

Our review generally covered the period from January 1, 2004, through December 31, 2005. To achieve our objective, we conducted interviews with the project's management staff, HUD Departmental Enforcement Center staff, and HUD multifamily housing staff. We also reviewed federal laws, regulations, and requirements. We also reviewed sewer district records.

To determine whether the owner complied with regulatory agreement provisions when expending project funds, we reviewed the project's

- Monthly accounting reports,
- Cash disbursements ledger,
- Bank statements,
- Check stubs,
- Supporting documentation,
- Audited financial statements, and
- Regulatory agreement.

We reviewed all disbursements of more than $250. Because we identified problems with shared expenses, we also reviewed all disbursements for office rent, utilities, and maintenance; payroll expenses; and credit card accounts. During our review of the monthly accounting files, we also noted four miscellaneous questionable disbursements under our threshold; therefore, we included them in our sample.

As a result of this review, we identified the regulatory agreement violations addressed in the finding. We discussed our results with the owner, as well as HUD staff, to obtain clarification and agreement.

We performed audit work from February through March 2006 at Human Development Community Development Corporation's office, 6046 Delmar Boulevard, St. Louis, Missouri. The audit was conducted in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

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

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

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined the following internal controls were relevant to our audit objectives:

- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

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 item is a significant weakness:

- The owner did not have adequate procedures in place to ensure project assets were distributed in compliance with the regulatory agreement (see finding).

APPENDIXES

Appendix A

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

Recommendation number	Ineligible 1/	Unsupported 2/	Funds to be put to better use 4/
1A			$18,000
1C		$166,812	
1D	$17,530		
1E	$2,243		$8,601
1F	$6,836		
1G			$1,794

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

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.

3/ "Funds to be put to better use" are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. This includes reductions in outlays, deobligation of funds, withdrawal of interest subsidy costs, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings which are specifically identified. Our estimate reflects only the initial year of these recurring benefits.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Auditee Comments

June 12, 2006

Ronald J. Hosking
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Region 7 office of Audit
Gateway Tower II
Kansas City, Kansas 66101-2406

SUBJECT: HDC Retirement Village

Dear Mr. Hosking:

Response to an audit report of HDC Retirement Village, issued by the Regional Office of the Inspector General on regulatory agreement violations.

Comment 1

1. Payroll Allocation of shared expenses – Management disagrees with the improper assessment of payroll allocation. Management believes that work performed is proof that all needed repairs and administrative duties required were provided to the project on an as needed daily basis and that employees of the project provided equal time to each project. This can be certified by employee work records. Personnel was allocated based on the agreed budget and workers were on each project according to the budget. If special needs were needed on another development efforts were made to allocate the cost back to that development. Statements made by the inspectors concerning the staff are false and should not be in the report. The audit finding does not suggest that any lack of care was evident or that time cards were not maintained for each employee. Management does not believe that time cards would have changed any of the service received by the project. Time card allocation alone does not substantiate proper allocation and is not currently used in many business practices. Staff assignments and allocation of resources is the responsible of the management agency and does not violate the management agreement. Management also disagrees with any outside parties trying to define the best method of allocating the use of staff and the way it is reported. It should be noted that the cost of HDC Retirement Village is higher than one of the other developments because we have an employee that has been with us on that payroll for over seventeen years and is more skilled than some of the other workers, that employee was compensated accordingly. Any other charges of supplies or payment that have been incorrectly charge will be corrected.

We strongly disagree of any inclusion of any employee wages being in this report and believe that the statements by the inspectors are false and an effort to discredit the management in order to have it appear that the development had some problems that did no exist...

Comment 2

2 Unauthorized Distributions – Management admits that prior approval was not always obtained from HUD, but does not agree that this action put the project at risk. The correction of a banking error and the repayment of obligation of the development in our reading of the regulation do not require approval of HUD. We did not distribute any assets of the project to any outside parties and disagree with the implied implication of wrong doing by the office of the inspector general. Management believes the success of the HDC Retirement Village is in its best interest and has worked hard to insure its continuation to provide housing to low-income seniors. We want to commit to HUD that we will take steps to ensure compliance with any regulatory requirements...

Comment 3

3. It is true that a lien was filed by MSD on the HDC Retirement Village. We are making payments on the sewer bill and have requested release of replacement reserve to bring the bill up to date. We are in contact with MSD to resolve any outstanding balances.

Comment 4

4. The Tenant Security Deposits – We agree that security deposits were temporarily used to meet the every increasing demands of the project, while we waited for the release of funds from HUD of our reserves. It should be noted that request for funds out of the replacement reserve were often delayed by the department of Housing and Urban Development without any explanation. We have repaid them and steps taken to insure their protection in the future.

Comment 5

5. Prepaid Rents –We disagree with the finding. Management conducted an annual review of each tenants account and made any adjustments needed to balance tenant rents with amounts due. Also when a tenant moved out the final adjustment in terms of rent due or owed was balanced against damage claims and or outstanding factors in their rental agreement. Management never used or misused tenants accounts. Most of the funds in this account were owed to the development when the tenant moved out or was refunded if it was due to the tenant.

Comment 6

6. Financial Reporting – We disagree with the finding. We had no knowledge of requirement for addition financial reports for the Retirement Village. Additional HUD reports are required if a project is listed as troubled. We were current on our payment on the mortgage and received high marks on our inspection both by Missouri Housing Development and the Department of Housing and Urban Development. If the request was send to Mr. Brown, he was too ill to notify the staff of the request for additional reports. Financial reports were prepared and forwarded to the holder of the projects mortgage and we were not aware that these reports were not being received by HUD as well. Monthly reports and accounting

records were prepared and maintained by the management agency and submitted to HUD upon their request at the annual inspections.

The owners have taken steps to dispose of the property and the HDC Board of Directors no longer wish to manage it or any other HUD projects once the sell is completed. HUD'S interest in the project will be protected and any outstanding obligation of the development will be disposed of.

We request that no action be taken that could jeopardize the sell of the project and result in the sale not be completed which will truly jeopardized HUD'S security interest and put the welfare of the tenants of the HDC Retirement Village at risk.

Sincerely,

Herman Noah

Herman Noah,
Chairman of the Board

OIG's Evaluation of Auditee Comments

Comment 1 The owner indicates that "... employees of the project provided equal time to each project." This is representative of our concerns. When the owner does not properly allocate employee time between projects, HUD has no assurance that any of the projects' expenses are reasonable and necessary or accurate. The owner has a contractual obligation under the regulatory agreement to only incur reasonable and necessary expenses. Expenses which benefit another project are not reasonable or necessary to HDC Retirement Village. The owner has previously indicated to OIG that they

- Do not keep timesheets or record the amount of time spent on each project,
- Employ three maintenance men and each project pays the salary of one maintenance man who works on all projects,
- Have a work order system, but it does not track which man performed the work, time spent, supplies used or the project charged, and
- Allocate employee time based on what the project can afford rather than how much time or supplies it requires.

The owner should be required to properly allocate employee time and shared expenses to the project receiving the benefit. If the owner had properly allocated these expenses, the owner would have met its contractual obligation to only incur reasonable and necessary project expenses and avoided violating the regulatory agreement.

Comment 2 The owner's statement that the correction of a bank error and the repayment of obligation of the development do not require HUD approval is incorrect. The owner's statement that assets were not distributed to any outside parties is also incorrect. Once funds have been deposited into the project's bank account they become assets of the project and any distributions of assets made to outside entities, including disbursements that benefit other projects or the owner, require prior HUD approval.

The owner should be required to obtain HUD approval before project assets are distributed to either the owner or to related entities. If the owner had requested HUD approval prior to making disbursements for the owner's or related entity's benefit, the owner would have met its contractual obligation and avoided violating the regulatory agreement. Requesting HUD's approval and not getting it would have kept project funds for the project's use and benefit.

Comment 3 The owner should have prevented local sewer company liens by properly paying the project's sewer bill. It is the owner's responsibility to properly pay the sewer bill. If the owner had paid this expense, the owner would have met its contractual obligation to keep the property free of liens and avoided violating the regulatory agreement.

Comment 4 The owner should have kept security deposit funds separate and apart from all other funds of the project in a trust account. The amount in this account should have always been equal to or more than the aggregate of all outstanding obligations under said account. Tenant security deposits should not, for any reason, be used for demands of the project. If the owner had maintained the tenant security deposit in the proper manner, the owner would have met its contractual obligation and avoided violating the regulatory agreement. The owner has not provided us with information that would verify repayment of the underfunded amount.

Comment 5 The owner's comments are not responsive to the issue at hand. Tenants are owed refunds of rent they have over paid. The regulatory agreement requires that only the proper amount of rent be collected. If the owner collects excess rent, the owner should notify the tenant and refund the rent. Maintaining rent credits for use at move out to cover damages violates the regulatory agreement.

Comment 6 HUD was very clear in its instructions to the owner. The owner did not comply with HUD's request for monthly accounting reports. Forwarding the financial reports to the mortgage holder and the Board of Directors and Mr. Brown's health has no bearing on these issues. The owner's actions have violated the regulatory agreement.

Appendix C

SCHEDULE OF REGULATORY AGREEMENT VIOLATIONS

Regulatory agreement violations	Funds improperly used	Applicable Sections
Improperly allocating shared expenses	$161,271	8(f),12(c),12(d)
Making unauthorized asset distributions	$28,971	8(b),8(f)
Allowing liens	$10,844	8(a)
Underfunding tenant security deposits	$6,836	8(g)
Retaining tenant rent credits	$1,794	5(b)
Withholding required financial reports	$0	12(f)
Total funds improperly used	$209,716	

Appendix D

REGULATORY AGREEMENT PROVISIONS

Paragraph 5 -

(b) The maximum rent for each Section 8 unit is stated in the Housing Assistance Payments Contract and adjustments in such rents shall be made in accordance with the terms of the Housing Assistance Payments Contract.

Paragraph 8 -

Owners shall not without the prior written approval of the Secretary:

(a) Convey, transfer, or encumber any of the mortgaged property, or permit the conveyance, transfer, or encumbrance of such property.

(b) Assign, transfer, dispose of, or encumber any personal property of the project, including rents, or pay out any funds except from surplus cash [residual receipts], except for reasonable operating expenses and necessary repairs.

(f) Engage, except for natural persons, in any other business or activity, including the operation of any other rental project, or incur any liability or obligation not in connection with the project.

(g) Require, as a condition of the occupancy or leasing of any unit in the project any consideration or deposit other than the prepayment of the first month's rent, plus a security deposit in an amount not in excess of one month's rent (the gross family contribution in Section 8 units) to guarantee the performance of the covenants of the lease. Any funds collected as security deposits shall be kept separate and apart from all other funds of the project in a trust account the amount of which shall at all times equal or exceed the aggregate of all outstanding obligations under said account.

Paragraph 12 -

(c) The mortgaged property, equipment, buildings, plans, offices, apparatus, devices, books, contracts, records, documents, and other papers relating thereto shall at all times be maintained in reasonable condition for proper audit and subject to examination and inspection at any reasonable time by the Secretary or duly authorized agents of the Secretary. Owners shall keep copies of all written contracts or other instruments which affect the mortgaged property, all or any of which may be subject to inspection and examination by the Secretary or duly authorized agents of the Secretary.

(d) 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.

(f) At request of the Secretary, or duly authorized agents of the Secretary, the Owners shall furnish monthly occupancy reports and shall give specific answers to questions upon which information is desired from time to time relative to the income, assets, liabilities, contract, operation, and condition of the property and the status of the insured mortgage.

Appendix E

SCHEDULE OF UNAUTHORIZED DISTRIBUTIONS

Check number	Cash disbursements journal month	Ineligible costs	Ineligible costs later reimbursed (as of December 31, 2005)	Unsupported costs
The owner purchased $16,388 in supplies and services for other projects, $5,900 of which was later repaid to the project.				
5583	July 2004	$600		
5586	July 2004	$389		
5611	August 2004	$2,000		
5616	September 2004	$716		
5642	November 2004	$2,223		
5669	November 2004	$150		
5672	November 2004	$386		
5682	December 2004	$1,852		
5690	December 2004	$5,592	$4,800	
5735	February 2005	$900		
5761	April 2005	$153		
5772	April 2005	$327		
5778	April 2005	$1,100	$1,100	
		$16,388	$5,900	$0
The owner paid $3,486 for owner legal expenses not related to project operations.				
5661	November 2004	$750		
5747	March 2005	$236		
5826	August 2005	$2,500		
		$3,486	$0	$0
The owner loaned $3,000 to another project.				
DM	April 2005	$3,000		
		$3,000	$0	$0
The owner transferred $4,229 to another project to correct an unsupported deposit error.				
5554	May 2004			$4,229
		$0	$0	$4,229
The owner paid $1,868 for ineligible or unsupported miscellaneous expenses.				
5469	February 2004	$350		
5525	April 2004			$307
5589	July 2004			$180
5646	November 2004			$825
5667	November 2004	$206		
		$556	$0	$1,312