Issue Date	July 18, 2006
Audit Report Number	2006-DE-1004

TO: Marcia D. LaPorte, Director, Denver Multifamily Hub, 8AHML

FROM: //signed//
Ronald J. Hosking, Regional Inspector General for Audit, 8AGA

SUBJECT: Juniper Communities, Bloomfield, New Jersey, Did Not Comply with Its Regulatory Agreement or HUD Regulations in Managing Its Federal Housing Administration-Insured Projects

HIGHLIGHTS

What We Audited and Why

In January 2006, we received a referral from the U.S. Department of Housing and Urban Development's (HUD) Departmental Enforcement Center for Wellspring at Louisville and Wellspring at Aurora, two Section 232 projects owned and managed by Juniper Communities (Juniper). The Departmental Enforcement Center claimed that the projects took cash distributions when in a non-surplus-cash position, made loans to affiliates, and commingled funds between projects.

Our audit objectives were to determine whether the projects made inappropriate disbursements to the owners and/or loaned project funds to other projects.

What We Found

For Wellspring at Louisville, Juniper did not make inappropriate distributions to the owners or loan project funds to other projects. The Departmental Enforcement Center based its claim on data that contained reporting errors made by Juniper's independent public accountant.

For Wellspring at Aurora, Juniper made unauthorized cash distributions totaling more than $165,000, prematurely withdrew more than $912,000, and had loans outstanding from other Federal Housing Administration-insured projects totaling almost $127,500 as of December 31, 2005.

Juniper also accrued unallowable asset management fees totaling almost $130,000 and improperly allocated corporate expenses to Wellspring at Aurora.

What We Recommend

We recommend that the Denver multifamily Hub director require Juniper to repay Wellspring at Aurora for the unauthorized cash distributions, develop and implement management controls to ensure that unauthorized cash distributions do not recur, repay Wellspring at Aurora for the unauthorized loans to other Federal Housing Administration-insured projects, develop and implement management controls to ensure that unauthorized loans do not recur, eliminate all asset management fee accrual accounts, develop and implement management controls to ensure that expenses accrued and/or charged to Federal Housing Administration-insured projects are legitimate project-related expenses, and properly allocate its corporate expenses.

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 the discussion draft of the audit report to Juniper on July 10, 2006, and requested its comments by July 25, 2006. Juniper provided its written response on July 13, and agreed with the findings. The complete text of the auditee's response is in appendix B of this report.

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BACKGROUND AND OBJECTIVES

The U.S. Congress established the U.S. Department of Housing and Urban Development's (HUD) Section 232 Nursing Home Program in 1969 to accomplish three purposes:

1) Conserve and increase the supply of nursing homes, intermediate care facilities, and board and care homes;
2) Provide credit enhancement through insurance of mortgages for new or substantially rehabilitated projects; and
3) Purchase or refinance existing Section 232 insured projects with or without repair.

Owners of projects insured by HUD under Section 232 of the National Housing Act enter into a regulatory agreement. The regulatory agreement, among other things, restricts the owner's ability to withdraw or disburse project assets.

Juniper Communities (Juniper), located in Bloomfield, New Jersey, owns and manages Wellspring at Aurora and Wellspring at Louisville. Juniper does the majority of accounting for its projects. It owns and manages seven Federal Housing Administration-insured Section 232 projects and eight non-Federal Housing Administration-insured projects.

Wellspring at Aurora is a Delaware general partnership formed on January 16, 1998, to develop and operate a 48-unit, 52-bed assisted living facility housing project for Alzheimer's patients. The facility is located at 11901 East Mississippi Avenue, Aurora, Colorado.

Wellspring at Louisville is a Delaware limited partnership formed on March 24, 1999, to develop and operate a 52-unit, 52-bed assisted living facility housing project for Alzheimer's patients. The facility is located at 1078 South 88th Street, Louisville, Colorado.

In January 2006, we received a referral from HUD's Departmental Enforcement Center claiming that Wellspring at Aurora took cash distributions when in a non-surplus-cash position, made loans to affiliates, and commingled funds between projects. In addition, the Departmental Enforcement Center claimed that Wellspring at Louisville took unauthorized distributions from the project when the project was in a non-surplus-cash position.

The objectives of the audit were to determine whether the projects made inappropriate disbursements to the owners and/or loaned project funds to other projects.

RESULTS OF AUDIT

Finding 1: Juniper Made Unauthorized Distributions and Premature Withdrawals and Loaned Project Funds from Wellspring at Aurora

Juniper did not comply with HUD's regulatory agreement or regulations in managing its Federal Housing Administration-insured project. It took unauthorized cash distributions, made premature withdrawals, and loaned monies from Wellspring at Aurora to other Federal Housing Administration-insured projects. Juniper's management lacked knowledge of HUD requirements for Section 232 Federal Housing Administration-insured mortgages. Juniper placed Wellspring at Aurora at risk financially, thus placing HUD at risk for the Federal Housing Administration-insured mortgage.

HUD's Regulatory Agreement and Regulations Not Followed

Juniper made more than $165,000 in unauthorized cash distributions from Wellspring at Aurora in fiscal year 2001. Unauthorized cash distributions are cash distributions greater than the surplus cash calculation allowed each year, plus any surplus cash distributions not taken in previous years. Juniper made more than $912,000 in premature withdrawals from Wellspring at Aurora over the period 2000 through 2005. Premature withdrawals are taking cash distributions before the computation of surplus cash at the end of the reporting period, less any remaining surplus cash not distributed in prior years. Juniper had also loaned almost $127,500 from Wellspring at Aurora directly to other Federal Housing Administration-insured projects as of December 31, 2005. According to Juniper officials, the loans kept another Federal Housing Administration-insured project financially stable.

Lack of Knowledge of HUD Regulatory Agreement and Regulations

Juniper's management lacked knowledge of its HUD regulatory agreement and regulations. For example, it did not understand that it could take funds from a property only if the surplus cash computation resulted in excess cash. It also did not understand that it could take surplus cash only as of and after a semiannual or annual fiscal period.

In addition, Juniper's management was not aware that all borrowers under Section 232 must be single asset borrowers. One of the main purposes of this requirement is to keep Federal Housing Administration-insured properties from making loans to other Federal Housing Administration-insured properties. HUD only allows Juniper, as owner, to take surplus cash distributions. Then it can lend those monies to other projects if it chooses.

Wellspring at Aurora and HUD Placed at Risk

By taking unauthorized cash distributions, making premature withdrawals, and loaning project funds to other projects, Juniper placed Wellspring at Aurora at risk of being in a deficit position had unexpected expenses occurred. This in turn put HUD at potential risk if Wellspring at Aurora defaulted on its mortgage or went into foreclosure.

Recommendations

We recommend that the Denver multifamily Hub director require Juniper to

1A. Repay Wellspring at Aurora for the unauthorized cash distributions of more than $165,000, and any other unauthorized cash distributions made from other Federal Housing Administration-insured projects.

1B. Develop and implement management controls to ensure that unauthorized cash distributions do not recur. This would have prevented the premature withdrawals of more than $912,000.

1C. Repay Wellspring at Aurora for the unauthorized loans to other Federal Housing Administration-insured projects of just under $127,500, and repay any other unauthorized loans made to or received by other Federal Housing Administration-insured projects.

1D. Develop and implement management controls to ensure that unauthorized loans do not recur.

Finding 2: Juniper Accrued Unallowable Asset Management Fees and Improperly Allocated Corporate Expenses to Wellspring at Aurora

Juniper did not comply with HUD regulations in managing its Federal Housing Administration-insured project. It accrued unallowable asset management fees to Wellspring at Aurora for a three-year period. In addition, it improperly allocated corporate expenses to Wellspring at Aurora. Juniper's management lacked knowledge of HUD requirements for Section 232 Federal Housing Administration-insured mortgages. As a result, Wellspring at Aurora had less money for its operations.

Accrued Unallowable Fees and Improperly Allocated Corporate Expenses

Juniper accrued unallowable asset management fees of almost $130,000 to Wellspring at Aurora in violation of HUD requirements. This occurred from 2003 through 2005. According to Juniper's management, the asset management fees are for costs associated with reporting to the board of directors, developing Juniper as a company, acquisition opportunities, and tax returns and audits of Juniper. These are owner-related expenses, not project-related expenses.

Juniper improperly allocated corporate expenses to Wellspring at Aurora in violation of HUD requirements. For example, Juniper employed a Colorado regional director of operations and allocated some of her travel and telephone expenses to Wellspring at Aurora. According to HUD regulations, HUD-insured properties must pay a management fee to the management agent for its services and only the person or entity approved by HUD to manage a HUD project can receive management fees. Management agents must cover the costs of supervising and overseeing project operations out of the fee they receive. Therefore, the monthly management fee paid to Juniper by Wellspring at Aurora already covered the Colorado regional director of operations' expenses.

Lack of Knowledge of HUD Requirements

Juniper's management lacked knowledge of HUD requirements for accruing and allocating corporate expenses to Wellspring at Aurora. As described by Juniper, the accrued asset management fees are unallowable owner expenses. In addition, Juniper lacked knowledge of management-related, project-related, and owner-related fees. The management agent fee already covered the corporate expenses allocated to Wellspring at Aurora.

Less Money for Wellspring at Aurora's Operations

Juniper accrued almost $130,000 in unallowable asset management fees and improperly allocated corporate expenses to Wellspring at Aurora. As a result, Wellspring at Aurora had less money for its operations.

Recommendations

We recommend that the Denver multifamily Hub director require Juniper to

2A. Eliminate almost $130,000 in asset management fee accruals for Wellspring at Aurora and any other asset management fee accrual accounts for other Federal Housing Administration-insured properties.

2B. Develop and implement management controls to ensure that expenses accrued and/or charged to Federal Housing Administration-insured projects are legitimate project-related expenses.

2C. Develop and implement management controls to ensure the proper allocation of corporate expenses as project-related, owner-related, or management-related expenses.

SCOPE AND METHODOLOGY

To accomplish the audit objectives, we

- Became familiar with the applicable program requirements and project regulatory agreement;
- Interviewed HUD multifamily officials;
- Reviewed HUD multifamily project files;
- Performed site work at Wellspring at Aurora in Aurora, Colorado, reviewed financial records, and performed testing of account payables;
- Performed site work at Wellspring at Louisville in Louisville, Colorado, reviewed financial records, and performed testing of account payables;
- Performed site work at Juniper in Bloomfield, New Jersey, and obtained and reviewed audited financial statements, general ledgers, bank statements, and various other documentation for the Federal Housing Administration-insured projects; and
- Interviewed officials and staff of Wellspring at Aurora, Wellspring at Louisville, and Juniper.

Our audit period covered January 1, 2000 through December 31, 2005.

We relied on computer-processed data maintained by Juniper in its Quick Book accounting system. We assessed the reliability of these data by corroborating the data with other sources. Based on our assessment, we concluded that in meeting our objectives, the data are sufficiently reliable.

In an effort to make appendix A more understandable, we explained those amounts categorized as “funds to be put to better use.” Based on the audited financial statements (specifically, the surplus cash calculation in the notes to the audited financial statements and cash distributions reflected in the statement of cash flows), Juniper made $912,519 in premature withdrawals from Wellspring at Aurora. Based on Wellspring at Aurora’s general ledger, account number 590-08, Juniper accrued $129,996 in asset management fees.

We performed the audit work from February to June 2006. We conducted the audit 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:

- Juniper's policies and procedures for making cash disbursements to the project owners and
- Juniper's policies and procedures for ensuring project funds are used exclusively for project-related expenses.

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:

- Management lacked controls to ensure that unauthorized cash distributions do not recur. [Finding 1]
- Management lacked controls to ensure that Federal Housing Administration-insured projects do not loan monies to other Federal Housing Administration-insured projects. [Finding 1]
- Management lacked controls to ensure that expenses accrued to Federal Housing Administration-insured projects are legitimate project-related expenses, and to ensure the proper allocation of corporate expenses. [Finding 2]

APPENDIXES

Appendix A

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

Recommendation number	Ineligible 1/	Funds to be put to better use 2/
1A	$165,900	
1B		$912,519
1C	$127,487	
2B		$129,996

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/ Funds to be put to better use are quantifiable savings that are anticipated to occur if an Office of Inspector General (OIG) recommendation is implemented, resulting in reduced expenditures at a later time for the activities in question. This includes costs not incurred, deobligation of funds, withdrawal of interest, reductions in outlays, avoidance of unnecessary expenditures, loans and guarantees not made, and other savings.

For recommendation 1B, we determined that HUD requires that the management agent maintain the funds identified in the project's operating account until they are available for distribution. If Juniper had controls over cash disbursements, it would have followed its regulatory requirement. For recommendation 2B, we determined that Juniper accrued the asset management fees and therefore encumbered assets of Wellspring at Aurora. If Juniper had controls to ensure that expenses accrued were legitimate project-related expenses, this would not have occurred.

Appendix B

AUDITEE COMMENTS

JUNIPER COMMUNITIES

July 13, 2006

Mr. Fred Smith
Ms. Lara Gustafson
HUD OIGA, UMB Plaza Building
1670 Broadway, 24th Floor (8AGA)
Denver CO 80202-4801

Re: Discussion Draft Report for
Wellspring at Aurora and Wellspring at Louisville

Dear Fred and Lara,

Thank you for taking the time to come out to New Jersey for our "exit" conference today. As I mentioned during our meeting, we generally agree with the two findings you cited in your draft discussion report dated July 11, 2006.

We truly hope you found us to be cooperative, open, and accommodating in all our interactions. As you know, we strove to be forthcoming with all information requests in a timely manner (vacations and travel aside!) and met with you directly and openly instead of working through an intermediary such as an attorney.

As you alluded to in your report, the cash draws from Wellspring at Aurora were part of our ongoing efforts to improve the financial fortunes of a different HUD-insured facility. (As an aside, those efforts have been largely successful.) We were also happy with your conclusions on Wellspring at Louisville, the issue that, in our minds, prompted this entire process.

Per today's conversation, we will now work with the HUD Multifamily Denver team to work through some of the technical details and implement their specific recommendations. My August 14 trip to meet with Nancy Stutz in Denver will be the first step in that process. Thank you again for your help and understanding throughout the process.

Sincerely,

Chuck Hastings