audit report
OFFICE OF INSPECTOR GENERAL

Issue Date
January 26 , 1999
Audit Case Number
99-AT-211-1003

TO: Paula Carruth, Acting Director, Multifamily Housing Division, 4GHM

FROM: Nancy H. Cooper
District Inspector General for Audit-Southeast/Caribbean, 4AGA

SUBJECT: Eastover Apartments
Multifamily Mortgagor Operations
Indianola, Mississippi

We completed an audit of Eastover Apartments multifamily mortgagor operations. We conducted the audit at the request of the Multifamily Housing Division, Mississippi State Office. Our objectives were to determine whether Eastover Apartments, Ltd. used project funds in accordance with the Regulatory Agreement and in compliance with the Department of Housing and Urban Development (HUD) requirements.

Eastover did not adequately manage the project's maintenance and finances. Due to the mismanagement of the project's operations, the project had deferred maintenance and needed improvements exceeding $900,000. As a result, tenants were deprived of decent, safe, and sanitary housing, and the value of the project used to secure the mortgage has depreciated at an accelerated rate. In addition, excessive Section 8 subsidies were paid by HUD. Therefore, tenants paid less rent than required, while HUD paid increased subsidies.

Within 60 days, please furnish us, for each recommendation in this report, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Also, please furnish us copies of any correspondence or directives issued because of this report.

If you have any questions, please contact Sonya D. Lucas, Assistant District Inspector General for Audit, or Narcell Stamps, Senior Auditor, at (404) 331-3369. We are providing a copy of this report to Eastover Apartments, Ltd.

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Executive Summary

We completed an audit of the multifamily mortgagor operations of Eastover Apartments. We conducted the audit at the request of the Multifamily Housing Division, Mississippi Office. The objectives of the audit were to determine if Eastover used project funds in accordance with the Regulatory Agreement and in compliance with the Housing Assistance Payments (HAP) Contract and other HUD requirements.

We determined that Eastover did not comply with the project's Regulatory Agreement, Section 8 HAP Contract, and other HUD requirements.

Specifically, the audit disclosed:

- Eastover Apartments and Intervest Corporation needed to improve its management over the project's maintenance operations. The apartments were not properly maintained and required repairs were not completed. Specifically, the project was allowed to deteriorate to dilapidated condition and inaccurate Section 8 certifications were provided regarding the condition of units. Due to the mismanagement of the project's operations, the project has deferred maintenance and needed improvements exceeding $900,000. As a result, tenants were deprived of decent, safe, and sanitary housing and the value of the project used to secure the mortgage has depreciated at an accelerated rate. Also, Eastover and Intervest breached their obligation to HUD under the Regulatory Agreement, HAP Contract, and the project's Management Contract.

- Intervest Corporation inappropriately disbursed $116,388 of Eastover Apartment's funds. The management agent disbursed $1,194 for ineligible and unnecessary expenses, $1,070 in duplicate payments, and $114,124 of questioned and unsupported costs. Therefore, HUD cannot be assured the costs charged to the project were reasonable and necessary.

- HUD paid or received claims for payment of $26,508 in excessive Section 8 subsidies based on improper rent calculations. The management agent understated tenant incomes in the rent calculations. As a result, tenants paid less rent than required, while HUD paid or was billed for increased subsidies.

We recommend HUD enforce administrative sanctions against Eastover and Intervest for violating program requirements. We also recommend HUD require Eastover Apartments, Ltd. to repay the project for all ineligible costs and resolve unsupported costs, and recalculate rent subsidies and reimburse excess subsidy payments by HUD.

We presented our findings to Eastover and HUD's Mississippi State Office officials during the audit. We held an exit conference on November 24, 1998. Eastover provided written comments to our findings on December 11, 1998. Eastover generally disagreed with the findings in the report. HUD's Mississippi State Office of Multifamily Housing also provided written comments and suggested recommendations to our findings. We considered the comments and suggested recommendations in preparing our final report. We included excerpts from Eastover's comments in each finding and the complete comments as Appendix E.

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Abbreviations

HAP	Housing Assistance Payments
HUD	Department of Housing and Urban Development
SDRHA	South Delta Regional Housing Authority

Introduction

Background

Eastover Apartments is a 56 unit multifamily complex located in Indianola, Mississippi. The project is owned by Eastover Apartments, Ltd., a Mississippi Limited Partnership. Eastover has two general partners: J. Steve Nail, managing general partner, and Charles Craig. Intervest Corporation, an identity-of-interest firm, was the management agent for the project. Eastover's managing general partner, J. Steve Nail, was the President of Intervest Corporation. Eastover Apartments entered into a Regulatory Agreement with HUD and signed a 40 year mortgage note in the amount of $1,343,200 on September 1, 1980. The mortgage is insured by HUD under Section 221 (d)(4) of the National Housing Act. On March 23, 1998, the mortgage was assigned to HUD with an unpaid balance of $1,238,121. In July 1998, Eastover transferred the project to HUD who then became the Mortgagee-In-Possession. HUD took control of the project and transferred the management from Intervest to a contract management firm.

Additionally, Eastover Apartments received 100 percent Section 8 rental assistance under the terms of an Annual Contributions Contract entered into with South Delta Regional Housing Authority (SDRHA). SDRHA is the Contract Administrator for the project's Section 8 HAP contract. In June 1997, SDRHA declared Eastover in default of its HAP contract and suspended the housing assistance payments to the project effective July 1997.

Audit Objectives

The audit objectives were to determine whether Eastover Apartments, Ltd. used project funds in accordance with the Regulatory Agreement and in compliance with HUD requirements.

Audit Scope and Methodology

To accomplish the objectives we tested compliance with the Regulatory Agreement and HUD requirements, interviewed appropriate HUD staff, Eastover, Intervest and South Delta Regional Housing Authority officials. We reviewed HUD, Intervest, and SDRHA records. Our review methodology included a judgmental selection of disbursements and tenant rent subsidies. We also inspected 100 percent of the project's interior, exterior, and the surrounding grounds.

Our audit covers the period January 1997 to March 1998. However, we extended the audit period as necessary. We performed the audit field work between February and October 1998. We conducted the audit in accordance with generally accepted government auditing standards for performance audits.

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The Management Of Eastover's Maintenance Needed Improvement

Eastover Apartments and Intervest Corporation needed to improve its management over the project's maintenance operations. The apartments were not properly maintained and required repairs were not completed. Specifically, the project was allowed to deteriorate to dilapidated condition and inaccurate Section 8 certifications were provided regarding the condition of units. Due to the mismanagement of the project's operations, the project has deferred maintenance and needed improvements exceeding $900,000. As a result, tenants were deprived of decent, safe, and sanitary housing and the value of the project used to secure the mortgage has depreciated at an accelerated rate. Also, Eastover and Intervest breached their obligation to HUD under the Regulatory Agreement, Housing Assistance Payment Contract, and the project's Management Contract.

Suspension of housing assistance payments

The conditions noted during our review followed a period of about 10 months in which the project did not receive housing assistance payments. The project's contract administrator, South Delta Regional Housing Authority (SDRHA), suspended the housing assistance payments in July 1997. The suspension occurred because the owner defaulted on its obligation under the HAP contract to properly maintain the project. The suspension followed a history of failures by the owner and the management agent to provide the tenants decent, safe, and sanitary housing. The project's physical condition was unsatisfactory when the suspension took effect. After the suspension, the owner did not complete the necessary actions to allow resumption of the housing assistance payments. The housing assistance payments were the primary source of income used to operate and maintain the project. Therefore without the housing assistance payments, the project's rate of deterioration accelerated. The project's mortgage went into default in January 1998. The mortgage was assigned to HUD on March 23, 1998, with an unpaid balance of $1,238,121.

The owner stated that after the housing assistance payments were suspended in 1997, funds were not available to maintain the property and make repairs. The owner further stated that its attorney met with SDRHA's attorney in an attempt to resolve the matter, but was unsuccessful.

Scope of our review

Starting in May 1998, our Construction Analyst inspected 100 percent of the units (occupied and vacant), the exterior of the buildings, the grounds, and the general surroundings of the project. The Analyst identified dilapidated conditions coupled with significant health and safety violations that endangered the tenants. The project has 56 units, of which 43 were occupied at the time of our inspection. The project, including all buildings, and occupied and vacant units, failed to meet the program's standards for decent, safe, and sanitary housing. The Analyst estimated a cost totaling over $900,000 to repair the property.

Because of the project's substandard conditions, we met with HUD officials to initiate measures to protect the interest of the tenants. As a result, HUD obtained status as Mortgagee-In-Possession on July 29, 1998, and took control of the project.

Dilapidated physical condition

The Regulatory Agreement, Section 10 requires the owner to maintain the project in good repair and condition. *The Management Agreement, Section 4* requires the management agent to abide by the Regulatory Agreement and the HAP contract.

We identified 539 violations from inspecting the interior of the units. The table below shows the conditions noted during the unit inspections.

TYPES OF VIOLATION	NUMBER
Deteriorated ceilings	20
Deteriorated windows	20
Lead paint hazards	21
General safety and health hazards	24
Various categories of violations	24
Defective refrigerator	25
Defective bathroom equipment	26
Deteriorated walls	41
Food preparation space was not suitable	59
Electrical hazards	84
Inadequate security	85
Deteriorated floors	110
TOTAL	**539**

The violations were counted by room.

Many of the conditions noted during our inspection could have been avoided if Eastover and Intervest had properly managed the project's maintenance operations and related financial affairs. Between 1993 and 1996, as much as $52,000 in surplus cash sat idle in the project's bank account, while the project deteriorated. The funds could have been used to make repairs. In addition, with HUD's approval, funds were available from the reserves for replacement account. We noted many instances where low cost deferred maintenance items such as water leaks, caulking, and painting were not timely or properly completed. As a result, the project experienced high cost structural damage and health and safety violations that endangered the tenants. Examples of the structural damage and health and safety hazards follow.

Structural damage (exterior)

The siding and trim on all buildings were in bad condition and needed replacing. In an April 6, 1992, memo to HUD, the management agent stated that all of the buildings' damaged trim and siding had been replaced at a cost of $6,415. The agent requested reimbursement from the project's reserves for replacement account. Now 6 years later, the project has deteriorated siding and trim that needs to be replaced.

The rotted siding and trim existed throughout the project. In some instances, the decay showed as blistering paint or bulges in materials. In other instances, the decay was visible with small or large holes and/or pieces of siding and trim that had fallen off or was in the process of falling off due to decay. Despite the deterioration, in 1997, the agent paid an identity-of-interest firm $8,650 to paint over the defective material at three buildings. The following pictures are examples of siding and trim conditions identified. See Appendix A for additional photographic examples of defective conditions.

Unit 48 - The siding was rotted due to water leaking from the air conditioner.

Building 70 - The fascia is rotted.

We also noticed defective sections of roofing at some buildings (e.g., buildings 20, 40, and 60). The shingles were coming loose from the decking material. The decking appeared to be decaying or rotted. The roofs were replaced in 1994.

Structural damage (interior)

The project needed major interior repairs to correct structural damage caused by deferred maintenance, defective floor construction, and tenant unit abuse.

We noticed deferred maintenance structural damage that could have been avoided or the extent of repairs reduced by early preventive measures. For instance, throughout the units, cabinets were damaged, floors were badly stained, decaying or rotted out, and ceilings were badly stained or deteriorated from plumbing leaks. The following pictures are examples of conditions noted. See Appendix B for additional photographic examples of defective conditions.

Unit 55 - The kitchen cabinet was damaged by water and tenant abuse.

Unit 74 - The bath ceiling was damaged by leaking water.

We also noticed structural conditions related to tenant unit abuse and construction defects in the floors throughout the units.

- **Tenant unit abuse** - In one instance, a tenant had severely abused the unit. The agent's unit inspection reports had documented the problems for over a year. The management agent did not take action to evict the tenant. This unit was the worst occupied unit in the project.

- **Flooring** - Eastover and Intervest were aware of the defective flooring located throughout the project. They repaired the floors in five units. They described the problem as a construction flaw and attempted to resolve the issue. HUD was aware of the defective flooring, but the issue was not corrected.

Hazards to health and safety

Many violations involved severe conditions that posed immediate danger to the health, safety, and welfare of the tenants. In some cases, the conditions had existed for long periods with no corrective action. The violations included the following:

- Six vacant units had been vandalized. The doors were open and the windows were not secured. The interior walls had holes knocked through them. The exterior windows were broken out with jagged glass hanging from the window frames. The broken glass was on the floor and outside on the grounds where children play.

- One unit used an extension cord to provide electricity to the bathroom.
- Metal steps had rusted out pans, including some with jagged edges on or along the walking surface.
- A manhole cover was left half open, and a 4 x 8 sheet of plywood with protruding nails was lying face up in the yard where children play.

The following pictures are examples of conditions noted. See Appendix C for additional photographic examples of defective conditions.

Unit 22 - The unit was vandalized with broken glass still in the window frame.

Buildings 50 and 60 - Yard hazard from a sheet of plywood with protruding nails facing up.

False certifications

The Housing Assistance Payments Contract, Section 2.4(h) requires project owners to certify on each monthly request for housing assistance payments that to the best of their knowledge and belief the dwelling units are in decent, safe, and sanitary condition.

False Section 8 certifications were made regarding the condition of units for which the owner or management agent requested housing assistance payments. Many of the violations observed during our May 1998 inspection had existed for a long time. We interviewed several tenants who stated some of the violations had existed for several years. They also stated the problems were reported but no action was taken. We compared certain deficiencies noted during our inspection with those reported in HUD's 1995 and 1996 inspections and the inspections performed by the agent for 1996, 1997, and 1998. The reports for subsequent years often repeated the deficiencies cited in prior year reports.

For instance, HUD prepared an inspection report dated April 29, 1996, which gave Eastover an unsatisfactory rating for the project's physical condition and its maintenance policies and practices. The report cited specific repairs. We noted that most of the requested repairs had not been made at the time of our May 1998 inspection. However, the agent continued to claim housing assistance payments, even after SDRHA suspended the payments in July 1997. The repeated violations noted during our review included:

- Repair/replace all defective siding and trim
- Repair defective areas of asphalt and parking areas
- Replace missing window screens
- Upgrade landscaping in rear of three buildings
- Replace stairs on a building
- Replace leaking water faucets in two units
- Replace kitchen cabinets in four units
- Replace all defective subfloors and floor tiles
- Replace defective bathroom and kitchen exhaust fans in a unit
- Replace missing or defective window locks in four units
- Replace defective attic fans in two units
- Paint interior of a unit

The owner stated that they were aware of problems with the units, but continued to bill for the housing assistance payments. The owner also stated that they continued the billings because they did not realize they should not file the claims since HUD did not abate the rents. The owner believed if the deficiencies were serious HUD should have abated the rents, which was not done. The owner did not acknowledge its HAP contractual responsibility to request payments for units that meet decent, safe and sanitary standards. Eastover and its agent should have known the condition of all units at the project and only requested payments and provided certification for units that meet the program's decent, safe, and sanitary standards.

Auditee comments

Excerpts from Eastover's comments on our draft findings follow. Appendix E contains the complete text of the comments.

The finding claims that the Eastover Apartments, as of May 1998, were in need of over $900,000 of improvements due to a failure of Eastover Apartments, Ltd. and Intervest Corporation to perform maintenance and repairs in a timely fashion. You claim that this resulted from too much idle cash remaining in the operating fund and the performance of inadequate repair work that, you say, has caused conditions to prematurely fall again into disrepair. Intervest performed timely repairs and upkeep to the extent that monies were available. Repair monies were not misspent on quick fixes. The real problem was HUD's inadequate funding of the Eastover Apartments and circumvention of our attempts to infuse more funds into the apartments.

A. <u>Restructuring the indebtedness</u>

In January 1992, Intervest proposed a plan for the sale of the Eastover Apartments and refinancing of the underlying debt. If approved and implemented, this plan would have resulted in a new loan at a much lower interest rate, creating about $5,000 of loan proceeds per unit for renovation. The local HUD office notified us that our application for refinancing could not be processed because a policy had not been established to allow the refinancing program. This was contrary to a letter we have from Nick Retsinas, Assistant Secretary for HUD.

Nevertheless, HUD, having refused to process our application, proceeded to allow a refunding of the Bond Issue on the property by the South Delta Housing Authority ("South Delta"). The refunding by South Delta placed all of the savings from the debt restructuring into the pockets of South Delta and HUD for use in projects other than Eastover. In particular, financial bankers and attorneys were paid over $150,000. Even as part of South Delta's refunding plan, South Delta was supposed to return $50,000 to the Eastover Apartments in January of 1996. This did not occur.

<u>OIG's response</u>

The finding addresses the failure by the owner and Intervest to properly perform deferred maintenance and to timely use available cash for needed repairs. The finding does not address whether HUD should or should not have accepted Intervest's re-financing proposal. However, even if the proposal had been approved, that would not have resolved our concerns about inadequate deferred maintenance that contributed to an accelerated rate of deterioration and the need to infuse cash for repairs. Furthermore, the bond refund, which Intervest takes exception to, was done pursuant to HUD's national policy directive (Housing Notice H-94-95).

B. <u>Violations noted in the May 1998 inspection report</u>

We are still awaiting receipt of a copy of your May 1998[1] inspection report. That report and site photographs contained in your draft report address conditions 10 months after the HAP's for Eastover, its lifeblood for funding, was terminated. Nevertheless, you conclude that these defects could have been avoided if the Eastover Apartments had been properly managed. In particular, you assert that excess surplus cash and reserves remained idle

[1] We expressed mailed the report to Intervest on November 25, 1998, and received confirmation that delivery occurred on November 27, 1998. We received Intervest's written comments by fax on December 11, 1998.

while the project deteriorated. The conditions observed by your May 1998 inspection were not the fruition of neglect from previous years when HAPs were being paid.

The OIG inspection report cited problems with inadequate security and the lack of attention to the repair or replacement of ceilings, windows, lead paint hazards, refrigerators, walls, food preparation spaces, and electrical hazards. We did not neglect these conditions when they were brought to our attention by HUD inspections. In some instances, the need for more response resurfaced after we did the work (e.g., repairs to walls).

OIG's response

The owner and Intervest stressed that they made the repairs HUD brought to their attention. Independent of HUD, they had a contractual obligation to know the condition of the project and to initiate repairs whether or not HUD inspections identified a need for the work. Many of the repairs noted by our May 1998 inspection resulted from progressive damage that resulted from a failure to perform routine maintenance (e.g., repair leaks, caulk seams, and paint surfaces).

C. Excess cash

The claim that as much as $52,000 in surplus cash sat idle in the project's bank account is not totally accurate. All "surplus" operating and reserve moneys were earmarked for use by a MIO plan that was submitted to HUD for approval in 1994. This MIO plan was revised as the needs of the property changed. Each revision earmarked significant amounts of the operating account as the funding source for repairs.

OIG's response

As cited in the finding, the funds sat idle in the account while needed repairs (including those cited in the MIO plan) went undone.

D. <u>Funds spent on quick fixes</u>

We disagree that Intervest wasted repair money on trim and siding that was short-lived and had to be performed a second time at additional cost.

<u>OIG's response</u>

The replacement of siding and trim was intended to be a long term fix to all defective materials. That is what Intervest indicated to HUD when they made the repairs. However, we recognize that some pieces of siding and trim may be in good enough condition to not require replacement. Thus, we revised the finding to state the audit showed substantial instances of deteriorated and or rotted materials 6 years after the owner informed HUD these conditions had been fixed.

E. <u>Major interior repairs neglected</u>

The report states that major interior repairs were needed to correct structural damage to cabinets and defective floors caused by neglected maintenance. We made repairs to cabinets and floors. Furthermore these items were included in the 1995 and the revised 1997 MIO plans sent to HUD. We repaired kitchen cabinets in many units and, based on our January 1998 inspection, kitchen cabinets were needed in 11 units. HUD was aware of the defective floor problem. We performed repairs on some units but discontinued the repairs due to the high cost pending HUD's approval to proceed on the remaining units.

<u>OIG's response</u>

The finding points focus on damage to cabinets caused by the lack of deferred maintenance (e.g., repair water leaks) and tenant abuse that unnecessarily increased the cost of any subsequent repair. We recognize that the flooring problem is an issue HUD was aware of and of your claim the problem stemmed from a construction flaw. We never attributed the problem with the floors to neglected maintenance.

F. Health and safety violations

Your report also states that health and safety violations have been ignored. You list four conditions, none of which were cited in HUD's April 1996 inspection report. In particular, you mention that six vacant units were vandalized, "with doors open, windows not secure and exterior windows broken out with jagged glass on floor and outside." When the HAPs ceased, our limited funds were used to correct deficiencies in occupied units. Therefore, vacant units fell victim to vandalism. These units were constantly broken into and management had to board up the units.

OIG's response

The owner and Intervest were obligated to know the condition of the project and to initiate repairs without regard to whether HUD inspected the project. We visited the project several times during the course of the audit. During each visit we noticed that vacant units were not secured and/or boarded up.

G. False certifications

The report states that Intervest falsely certified that the apartment units were in decent, safe, and sanitary condition. In support of the conclusion, the report claims that the May 1998 inspection revealed many repairs that had not been made over a long period of time. The deficiencies regarded by the Inspector General as repeat deficiencies were not repeat violations.

Between October 1996 and the time of HAP termination in July 1997, Intervest was working with HUD to establish an allowable MIO plan. In the interim, however, for Intervest to fund the corrective action plan or MIO, it had to submit the monthly requests for payment containing the required certification. The contract contains no modified or alternative procedure for requesting monthly HAPs in the event that the management agent is in the process of fulfilling the terms of a corrective action plan or MIO. HUD was aware of the physical condition of the apartment units and approved, expressly or tacitly, with Intervest's proposed plans to correct those deficiencies and to pay for the corrective measures with future HAPs. Intervest signed the vouchers to facilitate continued operation of the apartments and the funding of the corrective action plans.

OIG's response

The certification is clear and speaks for itself. To the extent project units did not meet required standards, they should have been excluded from the monthly request.

Recommendations

We recommend that you:

1A. Assure the tenants are relocated to decent, safe and sanitary housing.

1B. Pursue enforcement action, including but not limited to administrative sanctions, against Eastover and Intervest for the reported violations.

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Project Funds Were Inappropriately Disbursed

Intervest Corporation inappropriately disbursed $116,388 of Eastover Apartments' funds. The management agent disbursed $1,194 for ineligible and unnecessary expenses, $1,070 in duplicate payments, and $114,124 of questioned and unsupported costs. This occurred because the management agent mismanaged the project's cash and procurement operations. Therefore, HUD cannot be assured the costs charged to the project were reasonable and necessary.

Inappropriate disbursements of project funds

Sections 8(b) and (e) of the Regulatory Agreement provide that the owner shall not without the prior approval of HUD:

- assign, transfer, dispose of, encumber any personal property of the project, including rents, or pay out any funds, other than from surplus cash, except for reasonable operating expenses and necessary repairs; or,

- make, receive and retain, any distribution of assets or income of any kind of the project, except surplus cash and only then if the project is in compliance with all outstanding notices of requirements for proper maintenance of the project.

HUD Handbook 4370.2 REV-1, Financial Operations and Accounting Procedures for Insured Multifamily Projects, paragraph 2-10 defines a distribution as any withdrawal or taking of cash or any asset of the project other than for the payment of reasonable expenses necessary to the operation and maintenance of the project.

Intervest inappropriately disbursed $6,534 of project funds to refinance the project's mortgage. The disbursements included: (1) $5,340 paid for refinancing application fees; (2) $750 of refinancing fees; and (3) $444 for a title search. However, the $5,340 paid for refinancing application fees was reimbursed because the refinancing deal was not completed. The disbursements were owner entity expenses that were not necessary for the operations and maintenance of the project. As a result, $1,194 of project funds were used for ineligible expenses. The owner stated that if the refinancing effort was successful he would have used the extra funds to make repairs needed at the project. Therefore, he believed that the costs were reasonable and necessary for the project's operations.

In addition, Intervest made a duplicate payment of $1,070 to repair and paint the stairs of a building. We advised the Bookkeeper of the duplicate payment. The Property Manager stated that the duplicate payment was a mistake.

Thus, project funds totaling $2,264 were inappropriately disbursed.

Criteria

Section 4 of the Management Agreement requires the agent to comply with pertinent requirements of the Regulatory Agreement, the Housing Assistance Payment Contract, and the directives of the Secretary in performing its management duties. *Section 11 of the Management Agreement* requires the agent to give special attention to preventive maintenance, contract for repairs that exceed the capability of regular maintenance workers, and to receive and service emergency requests on a 24 hour basis.

Section 18 of *the Management Agreement* requires written quotes from at least three contractors or suppliers for any contract, or ongoing supply or service which is expected to exceed $5,000 per year.

HUD Handbook 4370.2, Rev-1, Financial Operations and Accounting Procedures for Insured Multifamily Projects, paragraph 2-6, (B) states that all disbursements from the regular operating account must be supported by approved invoices/bills or other supporting documentation.

Breach of management contract

Intervest breached its contractual obligation to properly maintain the project's physical condition and finances. Due to the project's poor physical condition, HUD took over management of the project in July 1998. HUD notified the owner and management agent about the project's failing physical condition. The notifications, as shown below, started before and continued after the project acquired extra cash that the management agent could have, but did not, use for the critically needed repairs.

Inspection Date	Physical Rating	Surplus cash at December 31	Amount
6/24/92	Below Average	1992	$ 7,423
3/24/93	Below Average	1993	52,028[2]
3/11/94	Below Average	1994	41,652
2/21/95	Unsatisfactory	1995	35,858
4/29/96	Unsatisfactory	1996	16,352

Intervest failed to use available project cash for deferred maintenance and to assure the tenants were provided decent, safe, and sanitary housing. From 1994 through 1995 large amounts of surplus cash sat idle in the project's bank accounts while the project deteriorated at an accelerated rate. This was in addition to the reserve for replacement account funds that were available. The account had balances ranging from $29,000 to $37,000 for 1994 to 1997. The management agent performed some repairs and routine maintenance during the period in question. However, the extent and adequacy of the work was far less than what the project needed and could afford. The owner and management agent stated that they did not use the cash so the project would have funds available for emergencies. Also, they were considering the availability of cash from other sources. The other sources included an unsuccessful effort in 1994 to refinance the project and a 1995 bond refund[3] by the project's contract administrator, South Delta Regional Housing Authority. The owner did not adequately consider the immediate need of the tenants for decent, safe, and sanitary housing, and the availability of funds for that purpose.

In addition, we are concerned about the adequacy of the agent's management of two large repairs. The repairs should have been long lasting, but now need to be patched or redone. In 1994 the agent paid $16,812 to replace the roofs on project buildings and in 1992 it paid $6,415 to replace all rotted and deteriorated siding and trim. However, during our inspection, we found loose and improperly installed roofing and a major problem with rotted siding and trim throughout the project.

2 The primary source of the surplus cash for 1993-1996 was a $43,536 rent adjustment paid 4/93.

3 During the course of the audit, we performed a separate review of the 1995 bond refund. We issued an audit memorandum, dated June 24, 1998 (number 98-AT-211-1807), which detailed the results of the review. Basically, we concluded that SDRHA failed to obtain and provide the project $50,000 due from the bond refund for use in making repairs.

Therefore, we question Intervest's management fees of $84,823 from January 1, 1994, through July 31, 1998.

Intervest failed to assure contract costs were reasonable

Intervest did not assure the project costs paid to various firms were reasonable and appropriate. Also, Intervest lacked sufficient documentation to support costs paid to contractors.

The management agent paid Delta Flooring $19,255 for work without obtaining adequate written quotes to document the reasonableness of costs. The contractor was paid $14,075 for floor repairs. Delta was the only contractor to bid on the work. Also, Delta was paid $5,180 for various work in which no bids were obtained.

In addition, the management agent paid Delta $422 without obtaining adequate supporting documentation. The payments were supported by photocopied invoices. The Bookkeeper stated that they used the copies because the original invoices were not available.

The management agent paid Affordable Apartment Services, an identity-of-interest firm, $8,650 to paint certain project buildings. However, the bids and supporting invoices were from a different firm named Affordable Services and Products. Affordable Services and Products submitted bids to paint three buildings, but Affordable Apartment Services did not submit any bids for the work. Also, Affordable Apartment Services was paid $974 for paint and related supplies. The purchases were inadequately supported by computer generated invoices from Affordable Services and Products.

We examined Affordable Services and Products' bank records and determined that the checks were deposited into the company's account. The account was maintained by one of the management agent's bookkeepers. The checks were made payable to Affordable Apartment Services in care of Intervest.

Intervest's President stated that Affordable Services and Products was not an identity-of-interest firm, and the checks were incorrectly made payable to Affordable Apartment Services. The management agent shared office space with Affordable Services and Products. The President said they provided Affordable Services and Products administrative and accounting support to help the company get started.

As a result, $19,255 paid to Delta and $8,650 paid to Affordable Apartment was not supported by proper competition to document the reasonableness of the costs. Also, Delta was paid $422 and Affordable Services was paid $974 without proper supporting invoices.

Auditee Comments

Excerpts from Eastover's comments on our draft findings follow. Appendix E contains the complete text of the comments.

A. <u>Were monies inappropriately disbursed?</u>

> According to your second finding, Intervest "inappropriately disbursed" $116,388. Half of this questioned amount is the $84,823 in total management fees Intervest received over the 55-month period from January 1, 1994 through July 31, 1998. The report claims that Intervest's fee for that period are questioned because we did not properly maintain the project's physical condition and finances.
>
> In particular, you present a chart showing "surplus cash" on hand at the end of calendar years 1992-1996, ranging from $7,423 to $52,028 while the project was receiving "below average" or "unsatisfactory" physical condition ratings. Your deduction is that use of the cash balance to make more repairs would have improved the condition of the project.
>
> At the best, this would have resulted in a one-time infusion of $50,000 of cash into the repairs of the project in 1993. Your inference from this that the magnitude of improvements needed according to your May 1998 report, $900,000 would have been avoided

or greatly reduced by spending $50,000 extra dollars is unsupportable. HUD is well aware that a more realistic, meaningful solution was to allow a refinancing in 1994 that would have infused funds tenfold this amount.

According your own report and logic, South Delta is equally at fault. In a footnote, you say that with respect to South Delta's 1995 bond refund, South Delta "failed to obtain and provide [Eastover] $50,000 due from the bond refund for use in making repairs."

You also question our entitlement to our $1,500 per month management fee because you say we should not have disbursed $6,534 to process the refinancing package in 1994. We were following our best judgment to spend $6,534 to obtain $500,000 for Eastover. We stand by this management decision.

In addition, you question a $1,070 duplicate payment to paint stairs. Intervest did appear to make an accounting error and process a duplicate payment of $1,070 to repair and paint a set of stairs on a building. The vendor involved applied the duplicate payment to an outstanding balance due them by Eastover. These funds should not be required to be reimbursed by Intervest.

B. <u>Substandard roof repairs</u>

The March 1994 inspection directed Intervest to install new roofing for Buildings 30, 40, and 60 with an estimated completion time of 180 days. By May, roof repair had been completed on Buildings 20 and 30 with the roofing on Buildings 40 and 60 expected to be completed later in May.

It is our belief that the roof repair in 1994 is not the same roofing your inspector concluded was in need of repair in May 1998. We would like to supplement our response on this point once we have reviewed that report.

C. Payments to Delta Flooring

According to our records, Delta Flooring was selected as the contractor to repair fire-damaged units in Building 60. Since Delta Flooring was already on site, we thought it was a good management decision to keep them on-site to perform the additional flooring work at issue.

Intervest rejected the original quotes from Delta Flooring as being too expensive. Intervest negotiated with Delta Flooring as to the work to be performed and the cost. The final cost was lower than the negotiated price.

D. Payments for painting

According to our documentation, three quotes were obtained for exterior painting of buildings. The bid was let to the low bidder, Affordable Services and Products. Affordable Services and Products is not an identity-of-interest firm and did not paint over defective materials at these buildings. Again, we would like to review your May 1998 inspection report.

OIG's response

The finding does not state the cash that was available would have fixed and/or prevented all or most of the problems identified by the audit. The finding states that the owner did not consider the immediate need of the tenants for decent, safe, and sanitary housing, and the availability of funds for that purpose. We disagree with Intervest's claim that there was no identity of interest between it and Affordable Services and Products. The two companies shared office space and staff.

Recommendations

We recommend that you:

2A. Require Eastover and Intervest to reimburse the project $2,264 of ineligible costs and provide supporting documentation or reimburse $114,124 of unsupported costs.

2B. Pursue enforcement action, including but not limited to administrative sanctions, against Eastover and Intervest for the reported violations.

Excessive Section 8 Subsidies Were Paid or Claimed for Payment

HUD paid or received claims for payment of $26,508 in excessive Section 8 subsidies based on improper rent calculations. The management agent understated tenant incomes in the rent calculations. The management agent did not implement the established controls to verify the accuracy of the rent calculations. As a result, tenants paid less rent than required, while HUD paid or was billed for increased subsidies.

Criteria

The Management Agreement provides that the agent is responsible for calculating subsidy amounts and for hiring, supervising, and terminating project employees, including the project manager.

Miscalculations identified by the contract administrator

The project's contract administrator, South Delta Regional Housing Authority discovered the understatement of a tenant's income and informed the owner and management agent. The management agent performed a limited review of tenant rent calculations. The review revealed that $17,221 in excessive subsidies were claimed for 14 tenants. This occurred because the tenant incomes were understated. As a result, on January 5, 1998, the management agent submitted a claim to its fidelity bond company to recover the loss. The claim noted that further related claims were possible. At the completion of our review, the bonding company had not paid the claim.

Scope of our review

We recalculated the HUD subsidies for six tenants, whose files contained conflicting information, to verify the accuracy of tenant incomes. We selected the six tenants because their income information was verifiable.

As shown by the chart below, $26,508 of excessive subsidies was paid or claimed for the six tenants. The subsidies included $22,606 in payments and $3,902 was claimed for payment.

Tenant	Excessive Subsidy Amount	Period Reviewed
A	$ 9,445	1/95 - 12/97
B	6,246	1/96 - 9/97
C	5,816	1/96 - 8/97
D	4,122	1/96 - 6/98
E	713	1/96 - 4/98
F	166	1/96 - 3/98
Total	$26,508	

The excessive subsidies resulted from the prior site manager understating tenant incomes. The Section 8 tenants were required to pay 30 percent of their income toward rent, net of various deductions and exclusions, and HUD subsidized the difference.

The management agent did not exercise proper oversight in the certification and re-certification process. The management agent did not properly complete the site manager's performance review. The performance review checklist contained a section for the management agent to verify the accuracy of tenant rent calculations. We reviewed the two performance reviews conducted, and determined the management agent omitted the verification of rent calculations portion of the checklist.

We interviewed one of the six tenants whose income was understated. The tenant stated that she informed the site manager of her household income. We noticed that some tenant files contained altered documents or documents created to support the understated incomes.

We performed a limited review of 81 tenant files and noted discrepancies involving income in 40 cases, including 6 sample cases. The owner needs to conduct follow-up for the other 34 cases.

Auditee Comments

Excerpts from Eastover's comments on our draft findings follow. Appendix E contains the complete text of the comments.

Your draft report claims that excessive subsidies were paid on the Eastover property because Intervest did not verify the accuracy of rent calculations. A control was in place to insure that housing assistance payments are requested properly. The site manager was trained to verify all household members' income and accurately process certifications and HAP vouchers. The site manager, along with residents, participated in cheating the government by falsifying income verifications, tenant certifications and HAP vouchers. Billy Kozielski, district manager for Intervest Corporation, discovered other discrepancies and terminated the site manager. As soon as we discovered these income understatement discrepancies, Billy Kozielski and his assistant spent days on site to correct the current tenant files.

OIG's Response

Intervest has established procedures to check the accuracy of rent calculations made by its on site manager. However, as cited in the finding, Intervest omitted the related review steps for the two reviews we found in the files.

Recommendations

We recommend that you require Eastover and Intervest to:

3A. Reimburse the project for ineligible costs of $26,508.

3B. Hire, at non-project expense, an independent third party to determine the extent of the Section 8 subsidy overpayments and reimburse HUD that amount.

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Management Controls

In planning and performing our audit, we considered the management controls of Eastover Apartments in order to determine our auditing procedure and not to provide assurance on the controls. Management controls include the plan of organization, methods and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant management controls

We assessed the following management controls we determined were relevant to our audit objectives:

- Maintenance and security.
- Financial management.
- Section 8 subsidy amounts.

It is a significant weakness if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet an organization's objectives. Based on our review, significant weaknesses existed in the management controls we tested as discussed in the findings.

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Follow Up On Prior Audits

This was the first Office of Inspector General audit of Eastover's mortgagor operations.

The latest independent audit of Eastover's operations was for the fiscal year ended December 31, 1997. The report contained three findings which affected our audit objectives. The findings discussed problems pertaining to tenant files and HUD inspections (unsatisfactory ratings). These findings were not resolved and conditions similar to those reported by the independent auditor were also detected by our work and are reported as findings 1 and 3 of this report.

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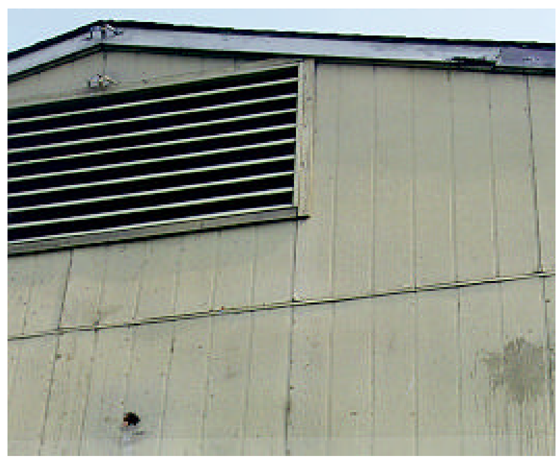
Examples of Exterior Structural Damage

Building 20 - The siding is rotted and shows a lack of caulking.

Building 60 - New roofing was installed over deteriorated decking and is coming loose.

Building 50 - The siding is starting to rot and the trim is not painted.



Building 70 - The siding and trim are starting to rot. There is also a hole in the siding.

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Examples of Interior Structural Damage

Unit 74 - The trim and floor near the commode were damaged.

Unit 51 - The kitchen ceiling was damaged by leaking water.

Unit 42 - The counter top on the bathroom vanity was separating from the wall.

Unit 41 - The kitchen cabinet was deteriorated with signs of water damage.

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Examples of Health and Safety Violations

Building 50 - The trim is rotted, and hazardous broken glass is still in the window frame.

Building 30 - The stair pans are rusted out.

Unit 35 - The bathroom had no electricity. The tenant used an extension cord to provide power.

Unit 37 - The unit was vacant and vandalized.

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Schedule Of Ineligible and Unsupported Costs and Cost Efficiencies

Recommendation	Ineligible [4]	Unsupported [5]	Efficiencies[6]
2A	$ 2,264	$ 114,124	
3A	26,508		$ 3,902
Totals	$ 28,772	$ 114,124	$ 3,902

[4] Ineligible amounts violate law, contract, HUD or local agency policies or regulations.

[5] Unsupported amounts are not clearly eligible or ineligible but warrant being contested because they lack satisfactory documentation to support eligibility.

[6] Efficiencies are an estimate of future savings from recommendations which prevent improper obligations, avoid more unneeded expenditures, or increase revenues.

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Auditee Comments

INTERVEST

December 14, 1998

VIA FEDERAL EXPRESS

Ms. Sonya Lucas
Office of Inspector General
U.S. Department of Housing and
Urban Development
Richard B. Russell Federal Building
75 Spring Street, SW, Room 330
Atlanta, Georgia 30303

Re: Response to Inspector General's Draft Audit Findings on Eastover Apartments, Ltd.

Dear Ms. Lucas:

I am in receipt of your draft audit findings regarding Eastover Apartments in Indianola, Mississippi and our response is provided below. We appreciate your giving us an additional week to provide a response. Below, we are providing the most complete and accurate responses possible with the amount of time we had to investigate the facts that cover a four-year period. We would like to reserve our right to amend and supplement our responses as needed.

I. RESPONSE TO FINDING NUMBER 1

The first finding in your report claims that the Eastover Apartments, as of May 1998, were in need of over $900,000 of improvements due to a failure of Eastover Apartments, Ltd. and Intervest Corporation to perform maintenance and repairs in a timely fashion. You claim that this resulted from too much idle cash remaining in the operating fund and the performance of inadequate repair work which, you say, has caused conditions to prematurely fall again into disrepair.

We will demonstrate below that Intervest performed timely repairs and upkeep to the extent that monies were available. We will show that repair monies were not misspent on quick fixes and that the real problem was HUD's inadequate funding of the Eastover Apartments and circumvention of our attempts to infuse more funds into the apartments.

A. Restructuring The Indebtedness

For example, in January 1992, Intervest proposed a plan for the sale of the Eastover Apartments and refinancing of the underlying debt. If approved and implemented, this plan would have resulted in a new loan at a much lower interest rate, creating about $5,000 of loan proceeds per unit for renovation. This plan was rejected by HUD.

P.O. Box 12791 • Jackson, MS 39236-2791 • 5750 I-55 North Frontage Road • Jackson, MS 39211-2638 • (601) 956-6000 • Fax (601) 956-2350

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In 1994, HUD, without cause, rejected a viable refinancing plan. Our refinancing plan would have allowed a renovation of the property, placing almost $500,000 into the property as improvements. Our plan was to utilize the differences between the original interest rate of 11½% and the current rate of 6¾% to repay the debt and renovate the complex.

HUD notified us that our application for refinancing could not be processed because a policy had not been established allowing the processing of applications under this refinancing program. However, we are in the possession of a letter from Nick Retsinas, Asst. Secretary for HUD, which shows that our refinancing plan was compatible with refinancings he proposed for these types of properties. We believe that this missed opportunity contributed significantly to conditions resulting in HUD's foreclosure on the property.

Nevertheless, HUD, having refused to process our application, proceeded to allow a refunding of the Bond Issue on the property by the South Delta Regional Housing Authority ("South Delta"). The refunding by South Delta placed all of the savings from the debt restructuring into the pockets of the South Delta and HUD for use in projects other than Eastover. In particular, financial bankers and attorneys were paid over $150,000. Even as part of South Delta's refunding plan, South Delta was supposed to return $50,000 to the Eastover Apartments in January of 1996. This did not occur.

While the owner and managing agent have responsibilities to properly use the Housing Assistance Payments (HAP) and rental payments to provide decent, safe and sanitary housing for the Eastover residents, HUD has a duty to assure that the subsidy amount or funds from secondary sources are sufficient to maintain the property at these standards. With a few relatively small exceptions, the Inspector General and HUD must agree that all of the funds available for the operation of the Eastover Apartments was properly spent. This of itself shows that the disrepair of the apartments is due in large part of the inadequacy of the funding HUD permitted to be used for these apartments.

B. Violations Noted In The May 1998 Inspection Report

During our November 24 conference with you, we requested a copy of the May 1998 inspection referenced in your audit report. We have not yet received a copy of the report. We would like to reserve our rights to supplement our response to your draft audit findings after we have had an opportunity to review that inspection report. Also of significance is that the May 1998 inspection and site photographs contained in your draft audit report address conditions 10 months after the HAP's for Eastover, its lifeblood for funding, was terminated.

Nevertheless, you conclude from your review of the May 1998 inspection that these defects could have been avoided if the Eastover Apartments had been properly managed. In particular, you assert that excess surplus cash and reserves remained idle while the project deteriorated. Category by category below, we address most of the classifications of violations noted in your May 1998

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inspection to demonstrate that the conditions observed by your inspectors in May 1998 were not the fruition of neglect from previous years when the HAPs were being paid. We base the responses below and throughout this letter on documents in our possession and, presumably, your possession at the time of your audit. If there is particular documentation you would like to see, we will provide it upon request.

Overall, it is important to note that, contrary to the report's statement that Intervest particularly neglected deficiencies noted in the April 1996 HUD inspection report, in mid-December 1996, Intervest assigned Billy Kozielski to be its new District Property Manager at Eastover. Kozielski hired five workers to form a maintenance support staff at Eastover which undertook and accomplished several major repairs at Eastover, beginning in January 1997 and ending in February 1997.

"Deteriorated Ceilings"

Our records do not indicate a history of Intervest neglecting the condition of the apartment ceilings. For example, Intervest's response to HUD's March 1994 inspection shows a record of prompt repairs.

PROBLEM	INSPECTION RESPONSE
Unit 28 - 6' x 8' area of bedroom ceiling needs repair.	5/13 - In process of repairing. Will be completed by 5/20.
Unit 51 - Repair 4' x 8' area in bath ceiling.	5/13 - In process of repairing bath ceiling with projected completion date of 5/20.
Unit 73 - Repair 4' x 8' area in living room ceiling.	5/13 - will be completed by 5/20.

HUD's April 1996 inspection makes no mention of any defective ceilings. HAPs were suspended in July 1997 and our inspection in January 1998 located 21 units in need of ceiling repairs.

"Deteriorated Windows"

Deterioration of windows is not listed as a deficiency in HUD's inspection of March 1994. HUD did not require any provision for window work in Intervest's MIO plan which HUD approved in February 1995. HUD's April 1996 inspection noted the need to replace window screens and six window locks but makes no mention that the windows themselves are showing signs of deteriorating condition.

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Our January 1998 inspection found 12 units in need of either window, window frame, or window glass replacement. This, of course, was six months after the HAPs were terminated.

"Lead Paint Hazards"

A lead paint hazard is not referenced in either HUD's March 1994 inspection, the MIO plan revision approved by HUD in February 1995 nor in HUD's 1996 inspection report.

"Defective Refrigerators"

No problems were noted with any refrigerators in HUD's March 1994 inspection. However, this item appears in the February 1995 Inspection Report.

On December 19, 1996, Intervest informed HUD that all units would have new refrigerators by February 1997. Over a six-week period beginning in January 1997, all refrigerators were checked out and repaired/replaced as necessary.

Our January 1998 inspection located 5 additional refrigerators needing replacement or repairs.

"Defective Bathroom Equipment"

Intervest's response to HUD's March 1994 inspection indicates Intervest's timely response to these problems:

PROBLEM	RESPONSE
Unit 28 - replace bath lavatory.	5/13 - replaced.
Unit 33 - repair/replace bath sink faucets.	5/13 - faucets have been repaired.
Unit 48 - repair/replace sink faucets, anchor commode.	5/13 - repaired sink faucet, commode has been anchored.
Unit 64 - Repair/replace tub faucets.	5/13 - tub faucet has been repaired.
Unit 81- replace lavatory sink.	5/13 - bath lavatory has been replaced.

Intervest's successful completion of these items is evidenced by the fact that the revised MIO plan, approved by HUD in February 1995, does not include bathroom equipment as an item to be addressed.

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HUD's April 1996 inspection finds 10 deficiencies in bathroom equipment, principally regarding bathtub or lavatory faucet leaks. Our January 1998 inspection shows that at least six of these deficiencies were fixed and, at most, four either re-occurred or had not been fixed.

"Deteriorated Walls"

Our District Manager's six-week project at Eastover fixed, by mid-February 1997, all holes in walls or ceilings and all missing baseboards were replaced. Nevertheless, our own inspection in January 1998 found 28 units again in need of repaired sheetrock.

"Food Preparation Spaces Not Suitable"

Our records show that kitchen counter top repairs were needed in 7 units, according to our January 1998 inspection. One of these units had been designated for counter top repairs in the April 1996 HUD inspection. We have not yet located records to indicate whether this counter top had been replaced prior to the January 1998 inspection. The other unit noted in the April 1996 HUD inspection as needing a counter top was fixed by the time of the January 1998 inspections.

"Electrical Hazards"

This item appears in the February 1995 Inspection Report. In a June 1995 letter to HUD, Intervest stated that missing cover plates and ceiling fans, which had been improperly installed by the tenants, would be corrected. We see no further documentation from HUD indicating that Intervest failed to complete this work.

Electrical repairs were completed in Buildings 50, 60, 70 and 80 during January 1997. By mid-February, all electrical problems in the remaining buildings were resolved.

"Inadequate Security"

HUD graded the Security Program "acceptable" in its April 1996 Management Review.

C. Did Intervest Hold Excess Idle Cash That Could Have Prevented The Project From Deteriorating?

The claim that as much as $52,000 in surplus cash sat idle in the project's bank account is not totally accurate. All "surplus" operating and reserve moneys were earmarked for use by a MIO plan that was submitted to HUD for approval in 1994. This MIO plan was revised as the needs of the property changed. Each revision earmarked significant amounts of the operating account as the funding source for repairs.

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D. Did Intervest Spend Repair Monies On Quick Fixes?

Also in Finding Number 1, you claim that Intervest wasted repair money on work which was short-lived and had to be performed a second time at additional cost.

The Inspection General's draft audit findings infer that $6,415 was wasted on trim and siding replacement in 1992 because the same siding and trim, according to the May 1998 inspection report, needed replacing only 6 years later.

In 1992, any siding and trim that was deemed damaged was repaired or replaced on buildings 10, 20, 30, 40, 50 and 60. It is our recollection that siding and trim was replaced as needed, both in 1992 and 1997. We have not seen your May 1998 report, but we do not believe it would reflect 1992 or 1997 work needing to be re-performed.

E. Were Major Interior Repairs Neglected?

The audit report states that major interior repairs were needed to correct structural damage. The audit report claims that these problems were caused by neglected maintenance. We respond to some of those problems below.

"Cabinets Damaged"

On January 20, 1997, Intervest reported to HUD that major cabinet repairs had begun in three buildings. On February 3, 1997, Intervest reported that major cabinet repairs had been completed in Buildings 20, 30, 40, 50, 60, 70 and 80.

In June 1997, Intervest submitted a revised MIO Plan to replace defective kitchen and bath cabinets, counter tops and medicine cabinets by using $50,000 from reserves. Under this plan, the work was projected for completion in October 1997. Over a six-week period beginning in January 1997, all kitchen and bath cabinets were repaired. According to our January 1998 inspection, kitchen cabinets needed work in 11 units.

"Defective Flooring Due To A Construction Flaw"

The January 1995 revision of the MIO Plan stated that by March 1995, defective sub-flooring in 20 units would be repaired at a cost of $33,000 drawn from the operating account. Copies of the bids to repair were forwarded to HUD. The bids were about double the costs estimated by Management Solutions. As of June 12, 1995, according to correspondence, Intervest was still awaiting HUD's approval.

In September 1995, HUD approved Intervest's proposed MIO Plan to repair subfloors in some of the 22 units with $45,000 from the operating account and $15,000 from the reserve account.

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Beginning in October 1996, sub-flooring in six of the 22 units were completed. At the completion of each unit, we requested that HUD come to the property, inspect the repairs and confirm whether the repairs were satisfactory. Finally, in April 1997, HUD inspected the property and Intervest received oral confirmation that the repairs were adequate. However, since subfloor repairs to date had been so costly, we did not want to proceed without HUD's approval. As of July 1997, we did not have HUD's approval to proceed on the remaining units.

F. Did Health And Safety Violations Exist For Long Periods Of Time Without Corrective Action?

Your report also states that health and safety violations have been ignored. You list four conditions, none of which were cited in HUD's April 1996 inspection report.

In particular, you mention that six vacant units were vandalized, "with doors open, windows not secure...exterior windows broken out with jagged glass on floor and outside." When the HAP's ceased, our limited funds were used to correct deficiencies in occupied units. Therefore, vacant units fell victim to vandalism. These units were constantly broken into and management had to board up the units.

We would like to supplement our responses to address the repair of the metal steps.

G. Did Intervest Make False Certifications?

The audit report states that Intervest falsely certified that the apartment units were in decent, safe and sanitary condition. In support of the conclusion, the report claims that the May 1998 inspection revealed many repairs that had not been made over a long period of time. As shown above, the deficiencies regarded by the Inspector General as repeat deficiencies on page 2 of Finding 1 were not repeat violations.

HUD's April 1996 inspection report was mailed to Intervest on June 3, 1996. On October 15, 1996, Intervest forwarded a proposed MIO plan to HUD. HUD commented on the MIO by letter dated November 27, 1996. On December 19, 1996, Intervest requested permission of HUD to submit a new MIO plan and gave updates of corrective actions. In January and February 1997, Intervest submitted updates on corrective actions taken and, on June 16, proposed a new MIO plan. Of course, the HAPs were terminated in July.

In the interim, in order for Intervest to fund the pending corrective action plan or MIOs, obviously, Intervest had to continue to submit monthly requests for payments. The contract provides, in Section 1.7f.(2), that "[e]ach of the Owner's monthly requests shall contain a certification by him that to the best of his knowledge and belief (i) the dwelling units are in decent safe, and sanitary condition. . . ." Intervest understood the inspector's conclusions that certain conditions required remedy. In the interim, however, for Intervest to fund the corrective action plan

Ms. Sonya Lucas
December 14, 1998
Page 8

or MIO, it had to submit the monthly requests for payment containing the required certification. The contract contains no modified or alternative procedure for requesting monthly HAPs in the event that the management agent is in the process of fulfilling the terms of a corrective action plan or MIO. HUD was aware of the physical condition of the apartment units and approved, expressly or tacitly, with Intervest's proposed plans to correct those deficiencies and to pay for the corrective measures with future HAPs. Intervest signed the vouchers to facilitate continued operation of the apartments and the funding of the corrective action plans.

II. RESPONSE TO FINDING NUMBER 2

A. Were Monies Inappropriately Disbursed?

According to your second finding, Intervest "inappropriately disbursed" $116,388. Half of this questioned amount is the $84,823 in total management fees Intervest received over the 55-month period from January 1, 1994 through July 31, 1998. The report claims that Intervest's fee for that period are questioned because we did not properly maintain the project's physical condition and finances.

In particular, you present a chart showing "surplus cash" on hand at the end of calendar years 1992-1996, ranging from $7,423 to $52,028 while the project was receiving "below average" or "unsatisfactory" physical condition ratings. Your deduction is that use of the cash balance to make more repairs would have improved the condition of the project.

At best, this would have resulted in a one-time infusion of $50,000 of cash into the repairs of the project in 1993. Your inference from this that the magnitude of improvements needed according to your May 1998 report, $900,000 would have been avoided or greatly reduced by spending $50,000 extra dollars is unsupportable. HUD is well aware that a more realistic, meaningful solution was to allow a refinancing in 1994 that would have infused funds tenfold this amount.

According to your own report and logic, South Delta is equally at fault. In a footnote, you say that with respect to South Delta's 1995 bond refund, South Delta "failed to obtain and provide [Eastover] $50,000 due from the bond refund for use in making repairs."

You also question our entitlement to our $1,500 per month management fee because you say we should not have disbursed $6,534 to process the refinancing package in 1994. We were following our best judgment to spend $6,534 to obtain $500,000 for Eastover. We stand by this management decision.

In addition, you question a $1,070 duplicate payment to paint stairs. Intervest did appear to make an accounting error and process a duplicate payment of $1,070 to repair and paint a set of stairs

Ms. Sonya Lucas
December 14, 1998
Page 9

on a building. The vendor involved applied the duplicate payment to an outstanding balance due them by Eastover. These funds should not be required to be reimbursed by Intervest.

B. Did Intervest Waste $16,812 On Substandard Roof Repairs?

The March 1994 inspection directed Intervest to install new roofing for Buildings 30, 40 and 60 with an estimated completion time of 180 days. By May, roof repair had been completed on Buildings 20 and 30 with the roofing on Buildings 40 and 60 expected to be completed later in May.

It is our belief that the roof repair in 1994 is not the same roofing your inspector concluded was in need of repair in May 1998. We would like to supplement our response on this point once we have reviewed that report.

C. Did Intervest Pay Delta Flooring $19,255 Without Adequate Quotes?

According to our records, Delta Flooring was selected as the contractor to repair fire-damaged units in Building 60. Since Delta Flooring was already on site, we thought it was a good management decision to keep them on-site to perform the additional flooring work at issue.

Intervest rejected the original quotes from Delta Flooring as being too expensive. Intervest negotiated with Delta Flooring as to the work to be performed and the cost. The final cost was lower than the negotiated price.

D. Did Intervest Pay An Identity of Interest Firm To Perform $8,650 Of Unnecessary Painting?

According to our documentation, three quotes were obtained for exterior painting of buildings. The bid was let to the low bidder, Affordable Services and Products. Affordable Services and Products is not an identity of interest firm and did not paint over defective materials at these buildings. Again, we would like to review your May 1998 inspection report.

III. RESPONSE TO FINDING NUMBER 3

Your draft report claims that excessive subsidies were paid on the Eastover property because Intervest did not verify the accuracy of rent calculations. A control was in place to insure that housing assistance payments are requested properly. The site manager was trained to verify all household members' income and accurately process certifications and HAP vouchers. The site manager, along with residents, participated in cheating the government by falsifying income verifications and tenant certifications and HAP vouchers. Billy Kozielski, district manager for Intervest Corporation, discovered other discrepancies and terminated the site manager. As soon as we discovered these income understatement discrepancies, Billy Kozielski and his assistant spent days on site to correct the current tenant files.

Very truly yours,

INTERVEST CORPORATION

By: Steve Nail
Steve Nail, President

Distribution

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Room 2474, Washington DC 20548
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Washington, DC 20024
HUD OIG Webmanager-Electronic format via cc:mail (Morris_F._Grissom@hud.gov)
Assistant to the Deputy Secretary for Field Management, SDF (Room 7106)
Assistant to the Secretary for Labor Relations, SLD (Room 7118)
Ranking Member, Committee on Governmental Affairs, United States Senate,
Washington DC 20515-6250
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United States Senate, Washington DC 20515-6250
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House of Representatives, Washington, DC 20510-4305
Ms. Cindy Sprunger, Subcommittee on General Oversight and Investigations, Room 212,
O'Neil Office Building, Washington DC 20515
J. Steve Nail, President, Intervest Corporation
Executive Director, South Delta Regional Housing Authority