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Henry S. Czauski, Deputy Director, Departmental Enforcement Center, CV

FROM: 
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SUBJECT: Orchard Court Multifamily Project, Located in Bath, Maine, Was Not Properly
Managed in Accordance with HUD Regulations

HIGHLIGHTS

What We Audited and Why

We audited the Orchard Court project, located in Bath, Maine, in response to a referral received by the Office of Inspector General's (OIG) Office of Investigation (Region 1). The referral indicated a potential inappropriate use of project funds by the Orchard Court Housing Corporation (project owner) and/or the management agent.

Our overall objective was to determine whether the project owner and/or management agents operated the project in accordance with U.S. Department of Housing and Urban Development (HUD) requirements.

What We Found

The project owner and/or prior management agents failed to operate the Orchard Court project in accordance with HUD regulations. The owner and/or prior management agents did not comply with HUD requirements with regard to

maintaining vacancies at a reasonable rate; making payments that were eligible, reasonable, adequately supported; following proper procurement procedures; maintaining the project in good physical condition; and ensuring that tenants qualified for subsidized rental housing. As a result, the project had \$265,226 in vacancy losses and incurred ineligible, unreasonable, and unsupported costs of \$511,727.

The project owner and a prior management agent executed two interest-bearing promissory notes in violation of the regulatory agreement, and a “Letter of Agreement” that may have violated the Project Owner’s/Management Agent’s Certification (Certification). The two notes allowed for the inappropriate accrual of interest in the amount of \$56,086.

Further, accounting records were incomplete, inaccurate or unavailable. The project’s current certified public accounting firm refused to prepare the project’s 2007 financial statements because it considered the project’s records not auditable. The project also lacked controls over the calculation of management fees and bad debts.

What We Recommend

We recommend that the Director of the Office of Housing require the project owner to reimburse or require the responsible management agents to reimburse the project \$49,270 for ineligible administrative, site supervisor, HUD 202, and site management fees paid to management agents; eliminate from the project’s accounting records \$151,436 in accrued administrative, maintenance, site management, other administrative, and HUD 202 fees that are ineligible project costs; and request from responsible management agents supporting documentation for the \$265,412 in unsupported costs charged to the project so that the eligibility of these costs can be determined. For any amounts determined to be ineligible, the project owner should repay or seek reimbursement from responsible management agent to pay the project from non-project funds; and remove \$56,086 in interest accrued on the notes payable of \$303,653 from the accounting records. In addition, HUD should consider pursuing administrative sanctions against the project owner and three prior management agents, including recovering management fees paid and removing payables representing unpaid management fees from the project’s accounting records.

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

Auditee's Response

We provided the auditee the draft report on October 2, 2008, and requested a response by October 17, 2008. We held an exit conference on October 10, 2008, attended by the Chairman of Orchard Court's Board of Directors and HUD staff. The auditee requested and we granted a one week extension to submit a response. We received the auditee's response on October 24, 2008. The auditee generally agreed with the facts, conclusions and recommendations in Finding 3 of this report. The auditee partially agreed with certain comments and conclusions contained in Findings 1 and 2.

The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

Orchard Court is a scattered-site duplex project with 70 two-bedroom units and one unit used as an on-site office. The project is located in Bath, Maine, and is operating under the provisions of Section 236 of the National Housing Act. The Section 236 program was established to facilitate the construction and substantial rehabilitation of affordable multifamily rental housing for lower income households. For projects assisted under Section 236, the U. S. Department of Housing and Urban Development (HUD) provides mortgage insurance and a monthly interest reduction payment subsidy to reduce the effective mortgage interest rate paid by the project to 1 percent. This subsidy helps the owner maintain the rental affordability of the project. In addition to Section 236, the project receives financial assistance for eight units under a rent supplement contract.

The project was built in 1945 and 1946 and is owned by the Orchard Court Housing Corporation (project owner), a 501(c) (3) corporation formed by the York-Cumberland Housing Development Corporation. The project was previously named Lambert Park in the early and middle 1990s before being renamed Orchard Court. Orchard Court underwent substantial rehabilitation in 1995 and 1996, and later improvements include the installation of new roofs and siding.

The previous Board of Directors including the President of the Orchard Court Housing Corporation resigned as of March 31, 2006 and a totally new Board of Directors and a new President were appointed.

Throughout its 60-year history, the project has gone through several bankruptcies, workout agreements, and transfers of ownership and management. Although the project is not delinquent on its mortgage payments, it has been in a non-surplus-cash position for the past three years and experienced vacancy losses of \$265,226 over the 41-month period October 2004 to February 2008. Orchard Court was managed by four different management agents throughout our audit period.

Management company	Period managed
Avesta Housing Management Corporation	October 1, 2004, to March 31, 2006
Chartwell Management Corporation	April 1, 2006, to August 31, 2007
Affordable Housing of New England	September 1, 2007, to March 15, 2008
C and C Realty Management	March 21, 2008, to present

HUD determined that the Chartwell Management Company (Chartwell) was not an acceptable manager for Orchard Court, and on August 16, 2007, HUD notified the project's owner of its desire to terminate the management agreement. The termination was based on Chartwell's failure to address outstanding findings from an unsatisfactory HUD management review completed on February 16, 2007. Affordable Housing of New England (Affordable Housing) was hired to manage the project on a short-term basis. After a considerable search, the project owner, with HUD approval, selected C and C Realty Management (C and C Realty), located in Augusta, Maine, to manage the project.

HUD provided \$3.2 million to Orchard Court in 1994 via a flexible subsidy residual receipts loan. By design, this loan may only be paid back from residual receipts of the project. Since the inception of this loan, the project has not made a payment. Due to low occupancy, ineligible expenses, and other poor management practices of prior management companies, this project has not generated sufficient income to have any residual receipts. The current management company, C and C Realty, has met with HUD to discuss a feasible financial plan to address the viability of the project.

The Bath, Maine, area can support a higher occupancy level than exists at the project. We found that the prior management agents did not make a sufficient effort to fill the vacancies. However, C and C Realty has taken the initiative and filled 7 of the 20 vacant units since it assumed management duties on March 21, 2008. The seven units required only minimal work to prepare them for occupancy. The prior management companies did not make on-site staff available to assist tenants, accept leasing applications, and show units. However, C and C Realty changed this practice and are staffing Orchard Court's on-site office on a regular basis.

To further address the vacancies, as well as the lack of income, C and C Realty increased marketing efforts and made adjustments to reduce cash outflow. Specifically, the management agent has

- Expanded outreach, including advertising and notifying housing authorities in the area of the availability of units;
- Reduced unnecessary maintenance;
- Applied for a real estate tax exemption, which is allowed for nonprofit-owned real estate in the state of Maine;
- Applied for a rent increase;
- Contacted the Maine State Housing Authority to discuss additional sources of funds or capital; and
- Considered applying for a subsidized rental contract (such as Section 8).

The overall objective of our audit was to determine whether the project owner and/or the management agents managed and operated the project in accordance with HUD requirements. Specifically, our objectives were to (1) determine the reasons for excessive vacancies and identify any unsupported, ineligible, and unreasonable expenses, particularly payments made to identity-of-interest companies; (2) obtain supporting documentation and determine the basis for the \$315,076 in notes/loans payable; and (3) determine if the project's financial and accounting controls were adequate.

RESULTS OF AUDIT

Finding 1: The Project Was Not Properly Managed in Accordance with HUD Requirements

The project owner and/or prior management agents of the Orchard Court project did not comply with the applicable HUD requirements to (1) maintain project vacancies at a reasonable rate; (2) make payments for project expenses that were eligible, reasonable, and adequately supported; (3) follow proper procurement procedures; (4) maintain the project in good physical condition; and (5) ensure that potential project tenants qualified for rental housing. These deficiencies occurred, in large part, because the management agents failed to properly manage the project in accordance with HUD requirements. As a result, the project incurred \$265,226 in vacancy losses and \$511,727 in ineligible, unreasonable, or unsupported project costs. In addition, project tenants were living in units that did not always meet health and safety standards, and qualified tenant applicants may have been deprived of housing.

Vacancies Were Excessive

The project owner failed to ensure that prior management agents, including Avesta Housing Management Corporation (Avesta), Chartwell Management Company (Chartwell), and Affordable Housing, made sufficient effort to reduce vacancies at Orchard Court. The project incurred \$265,226 in vacancy losses over the 41-month period October 2004 to February 2008. One of the primary reasons for the high vacancy rate was the management agents' failure to make regular on-site staff available to accept and process tenant applications, and show units to prospective tenants. Additionally, the owner of Affordable Housing informed us that addressing the vacancy problem was not a priority. On February 28, 2008, 17 of the 20 vacant units had been vacant 90 days or longer.

Orchard Court is located in an area that can support a higher occupancy level than existed at the project. However, the prior management agents failed to take advantage of this potential market. We evaluated four projects in the immediate area of the Orchard Court project and found that two projects had only a small number of two-bedroom units with rents that greatly exceeded the rents at Orchard Court. Two other properties we evaluated were more comparable to the Orchard Court project, and both were 100 percent occupied and had extensive waiting lists. The rents for two-bedroom units at both of these projects exceeded the two-bedroom rents charged at Orchard Court.

The current management agent, C and C Realty, began addressing the vacancy problem immediately after assuming management duties on March 21, 2008. C and C Realty is making onsite staff available at specific times to accept and process tenant applications and to show units to prospective tenants.

**\$511,727 In Project Expenses
Were Ineligible, Unreasonable
or Unsupported**

We identified ineligible payments totaling \$15,331 made by Chartwell from the project's operating account. These payments included an unexplained payment of \$6,167 to another project owned/managed by Chartwell; a payment to a manufacturer for \$4,000, which the check register indicated was for interest on a notes payable; and a payment to Chartwell for \$3,200, which represented a payment on the notes payable. These payments violated the regulatory agreement which prohibit payments other than for necessary expenditures. We also identified two payments totaling \$1,964¹ that were ineligible because the charges were not related to the Orchard Court project but represented storage charges incurred by an affiliate company of Chartwell (see appendix C).

We identified various fees of \$49,270 paid to management agents that were ineligible project costs. The management agents were only authorized to charge a management fee and did not receive HUD approval to charge other service fees. Chartwell was paid \$25,000² for \$21,000 in administrative fees and \$4,000 in site supervisor fees which are ineligible. In addition, Avesta was paid \$24,270³ for \$16,173 in HUD 202 fees and \$8,097 in site management fees which are also ineligible (see appendix D). Some of the above services were included as part of the management fees paid.

Avesta's general ledger showed that a \$214,995 notes payable (see finding 2) represented \$82,337 in management fees⁴ and \$132,658 comprised of ineligible maintenance, site management, other administrative, and HUD 202 fees owed to Avesta. The fees charged covered the period April 28, 2003, to October 1, 2005. In addition to the \$132,658 in fees, another \$18,778⁵ owed to Avesta was accrued for administrative, maintenance, and site management fees, all of which were

¹ \$670 + \$1,294 = \$1,964.

² Covering the period November 8, 2006, to November 12, 2007.

³ Covering the period January 20, 2005, to March 9, 2006.

⁴ The management fees covered services, such as site supervisor and site management services.

⁵ Covering the period November 2005 to March 2006.

ineligible project costs. The total amount of \$151,436⁶ reportedly owed to Avesta is an ineligible cost.

Chartwell and Affordable Housing's poor performance in reducing vacancies and failure to pay their bills on time resulted in \$11,294 in late charges owed to a fuel company and \$12,205 in sewer liens owed to the Bath, Maine, Water District. C and C Realty paid \$5,643 of the \$12,205 owed on sewer liens over a period from April 28 to May 21, 2008. The \$86,283 in outstanding fuel bills covered the period January 28, 2007 to June 30, 2008, and the \$26,053 in outstanding charges from the Water District covered the period June 29 to December 31, 2007. As a result of Chartwell and Affordable Housing's failure to take advantage of the favorable rental market and fill vacant units, the project sustained \$127,627 in vacancy losses over the period April 2006 to February 2008. Had these management agents properly addressed project vacancies, the project would have had sufficient funds to pay the fuel and water bills totaling \$112,336,⁷ thereby avoiding late charges and the sewer lien penalties. The \$23,499⁸ in late charges and sewer liens was unreasonable and unnecessary.

Chartwell paid \$20,417 for mowing and trimming of the lawns for the project's 70 units for the five-month period from May to September 2006. However, Chartwell's use of the lawn care company for Orchard Court was not the most efficient use of funds, particularly since the project was in a non-surplus-cash position and the contract included unnecessary work items for the Orchard Court project. A contractor recently solicited by the current management agent for mowing and trimming lawns efficiently met the project's needs and would have saved the project \$6,779 for a five-month period. The new lawn care company agreed to a rate of \$7 per unit for the 70 units, which would total \$10,780 for the 22-week period, compared to the \$17,863 charged by the previous lawn company. Therefore, the potential savings was \$6,779. We consider the difference of \$6,779 in costs to be unreasonable, and the project owner and/or Chartwell should reimburse the project that amount. Chartwell's use of the more expensive lawn company was not an economical use of funds, particularly since the contract included unnecessary work items for the Orchard Court project. For example, the prior lawn company's work items included keeping walks, drives, and parking areas clean of debris. However, there were no walks or parking areas requiring attention and minimal work would be required on driveways, since most tenants' cleaned debris off their driveways. In our opinion, the work outlined in the more recent contract would be more consistent with this scattered site neighborhood. In addition, the prior lawn company was not procured properly as described below.

⁶ \$132,658 plus \$18,778.

⁷ \$86,283 + \$26,053 = \$112,336.

⁸ \$11,294 + \$12,205 = \$23,499.

There was a payable of \$100,081 that includes \$88,658 later converted to a Note (see finding 2) owed to Avesta and a loan of \$11,423 made to the project by Avesta in fiscal year 2007 that were unsupported. We reviewed the management agent's records and contacted Avesta for documentation to determine the basis for these payables, but Avesta was unable to provide adequate supporting documentation.

Chartwell could not provide adequate supporting documentation to demonstrate that disbursements from the project's operating account totaling \$105,695⁹ were for reasonable and necessary operating expenses. The unsupported charges included payments to management agent companies, affiliated projects, and various vendors for construction, lawn care, cleaning, maintenance supplies, and seal coating/paving. For example, an identity-of-interest company hired to clean vacant tenant units started billing monthly at a flat rate of \$100 per unit and later began billing \$620 monthly without explaining the basis for the change in price or identifying the number of units cleaned. Therefore, the charges billed at \$620 totaling \$7,440 were unsupported (see appendix E for details).

Chartwell failed to provide supporting documentation for \$26,382 in payroll expenses in 2006 and \$33,254 in 2007 reported in the project's annual financial statements. The owner/management agent is responsible for providing documentation to support expenditures charged to the project. These costs were unsupported since the management agents could not provide adequate supporting documentation to substantiate that these expenses were reasonable and necessary.

Management Agents Did Not Follow HUD Procurement Regulations

Chartwell did not follow proper procedures for seven separate procurements and Avesta did not follow proper procedures for one procurement. In accordance with HUD requirements, management agents are expected to solicit written or verbal cost estimates, including making a record of any verbal estimates obtained, to ensure that the project was obtaining services at the lowest possible cost. There was no documented evidence to substantiate that management agents adhered to these requirements. For the procurements reviewed, supporting documentation and records were available for only two, and we found deficiencies and irregularities with both of these procurements. We identified three bids received by Chartwell for procurement of lawn care services submitted in October 2006 and learned that the lowest bidder had been receiving payments from Orchard Court for the same services since June 2006. Avesta made available a request for proposal for waste

⁹ Covering the period April 19, 2006, to December 12, 2007.

removal and a list including the names and addresses of five bidders, but there was no evidence of the actual bid prices having been submitted by the companies. Therefore, there was no assurance that the waste company selected submitted the lowest bid. Also, the owner and Chartwell Management certified on the Project Owner's/Management Agent's Certification that no identity-of-interest exists among the owner, agent, and any individuals or companies that regularly do business with the project. However, Chartwell actually had identity-of-interest with three of the companies it hired. Only one company entered into a written agreement/contract with the respective management agent. The current management agent, C and C Realty, is not utilizing the services of any of these companies subject to our review of procurement.

Physical Deficiencies Found in Rental Units Were Not Corrected in a Timely Manner

Chartwell failed to address physical deficiencies reported by tenants, and Affordable Housing did not follow up on deficiencies found in annual physical inspections that it conducted in October 2007. We performed inspections on seven units and identified serious deficiencies requiring immediate attention in three of those seven units. One unit had a seriously damaged kitchen ceiling caused by a leak from the upstairs tub/shower. A second unit had a large number of boxes scattered throughout the unit and these boxes were blocking access to the heating unit, and there was evidence of significant insect infestation. The third unit was unsanitary due to extreme untidiness and bad odor, and was unsafe due to a loose railing in the stairway to upstairs, and items blocking access to the boiler. Both the tenant with the damaged kitchen ceiling and the tenant requiring immediate storage of boxes reported the conditions to Chartwell, but the company failed to respond.

The current management agent, C and C Realty, stated that it planned to address these deficiencies. Several other tenants stated that, with the exception of C and C Realty, none of the management agents made on-site staff available to assist tenants. Further, a former tenant, who resided at the project from February 2006 to April 2008, stated that a contact phone number was removed from the door of the on-site office several months after she moved in, and a new phone number was never posted until C and C Realty assumed management duties in March 2008. Our review of 48 outstanding work orders generated from the physical inspections performed by Affordable Housing during October 2007 showed that none of the deficiencies had been addressed by Affordable Housing as of March 2008.

Tenants May Not Have Been Eligible for Subsidized Housing

A review of files for 17 tenants who moved into Orchard Court during May and June of 2006 found concerns with seven of the tenants. Under the Section 236 program, a tenant's income is verified for the purpose of determining the tenant's rent which is the greater of thirty percent (30%) of the tenant's adjusted gross income or the basic rent, but not greater than the fair market rent. For projects assisted under Section 236, HUD provides mortgage insurance and a monthly interest reduction payment subsidy to reduce the effective mortgage interest rate paid by the project to 1 percent.

In four of the tenant files, social security numbers and proof of income had not been included for all household residents. The remaining tenant files showed that single persons were improperly allowed to occupy two-bedroom units. HUD regulations state that a single person must not be permitted to occupy a unit with two or more bedrooms, except for the following persons: (1) a person with a disability who needs a larger unit as a reasonable accommodation, (2) a displaced person when no appropriate-size unit is available, (3) an elderly person who has a verifiable need for a larger unit, and (4) a remaining family member of a resident family when no appropriate-size unit is available. The tenant files did not show that any of the above conditions were present. Three of the seven tenants considered ineligible continue to reside at Orchard Court.

Conclusion

The Orchard Court project had difficulty generating sufficient income to remain a financially and physically viable project. Since 2004, the project had experienced cumulative vacancy losses totaling \$265,255 and was beginning to show signs of physical deterioration. In addition, the project had deferred payments to vendors/suppliers, including \$112,336 in fuel and water bills. The project was not managed in a manner that maximized rental income because prior management companies did not comply with the requirements with regard to maintaining vacancies at a reasonable rate. During the audit period, the prior management agents did not always pay costs that were eligible, reasonable, and adequately supported; follow proper procurement procedures; maintain the project in good physical condition; and ensure that tenants qualify for subsidized rental housing. As a result, some tenants were living in units that did not meet health and safety standards because unit deficiencies were not corrected in a timely fashion, and qualified tenant applicants may have been deprived of housing. These deficiencies

were the result of poor management and resulted in the project's incurring ineligible, unsupported, and unreasonable costs totaling \$511,727.

Recommendations

We recommend that the Director of the Office of Housing require the owner of Orchard Court to

- 1A. Implement controls to ensure vacancies are monitored and maintained in accordance with HUD requirements.
- 1B. Reimburse or require the responsible management agent(s) to reimburse \$64,601 to the project for ineligible project costs of \$15,331 and for ineligible administrative, site supervisor, HUD 202 and site management fees of \$49,270.
- 1C. Eliminate from the project's accounting records \$151,436 in accrued administrative, maintenance, site management, other administrative, and HUD 202 fees that are ineligible project costs.
- 1D. Reimburse or require the responsible management agent(s) to reimburse \$30,278 to the project for unreasonable late charges on fuel bills and sewer lien penalties of \$23,499 and for unreasonable lawn care payments of \$6,779.
- 1E. Request from responsible management agents supporting documentation for the \$265,412 in unsupported costs charged to the project so that the eligibility of these costs can be determined. For any amounts determined to be ineligible, the project owner should repay or seek reimbursement from responsible management agent to pay the project from non-project funds or remove payables from the project's accounting records.
- 1F. Develop and implement controls to ensure expenses are eligible and adequately supported.
- 1G. Require the current management agent to address the deficiencies noted from the physical inspections performed by Affordable Housing in October 2007.
- 1H. Require the current management agent to review the eligibility status for all the tenants of the project, and ensure that adequate supporting documentation is maintained in the tenant files to support and justify the eligibility of each tenant.
- II Consider taking sanctions against the three prior management companies

including recovery of management fees paid and the removal of payables representing unpaid management fees from the accounting records.

We also recommend that the Director of the Departmental Enforcement Center

- 1J. Pursue against the project owner and three prior management agents appropriate administrative and/or civil monetary or criminal penalties for the regulatory agreement violations and the other discrepancies disclosed in this report.¹⁰

¹⁰ In implementing this recommendation, the Deputy Director should consider all of the issues discussed in this report.

RESULTS OF AUDIT

Finding 2: Promissory Notes and an Agreement Violate HUD Regulations

An individual who served as president of both Avesta (former management agent) and Orchard Court (project owner) executed two interest-bearing promissory notes totaling \$303,653, without HUD authorization and assigned the notes to third parties. In addition, the same individual representing Avesta and the project owner entered into a “Letter of Agreement” with the owner of Chartwell (former management agent after Avesta) that may have been in violation of the Project Owner’s/Management Agent’s Certification. The president of Avesta and the ownership entity stated that he was not aware that HUD approval was required for the two notes or that the Letter of Agreement was in violation of any specific regulations or requirements. The two notes were inappropriate because they did not have HUD approval and the interest of \$56,086 attached to the notes was not a valid project expense. In addition, the project owner and Avesta failed to follow the provisions of the Project Owner’s/Management Agent’s Certification.

Owner and Management Agent Executed Notes Without HUD Approval

There were two interest-bearing promissory notes executed by Avesta, one for \$214,995 and another for \$88,658. The first note for \$214,995 was executed on October 15, 2005, and assigned to a company owned/managed by relatives of the president of Chartwell, who became the management agent for Orchard Court on April 1, 2006. The second note for \$88,658 was executed on March 30, 2006, and assigned to Chartwell. The two notes were in violation of the regulatory agreement which states that owners shall not encumber or assign any personal property of the project without prior written approval of HUD. HUD never gave its approval for the two notes. The individual serving as president of Avesta and Orchard Court stated that he was not aware that HUD approval was required because the notes were based on existing debt and were a method of formalizing this debt.

\$56,086 in Interest Accrued on the Notes Was Ineligible

The promissory notes for \$214,995 and \$88,658 accrued interest at the rate of 8 percent annually. As reported on the 2007 financial statements, \$45,966 in interest

had been accrued. In addition, \$10,120 in interest accrued during the first five months (October to February) of fiscal year 2008. The notes were an inappropriate encumbrance of the project, and the interest accrued totaling \$56,086 (\$45,966 plus \$10,120) was ineligible.

The Letter of Agreement Did Not Have HUD Approval

In accordance with a “Letter of Agreement,” Avesta ceased managing Orchard Court and Chartwell assumed management duties of the project. In consideration of Avesta relinquishing its right to manage the project, and upon assignment to Chartwell of all receivables (currently in excess of \$200,000) due to Avesta with respect to the project, Chartwell paid Avesta \$100,000.

In our opinion, this transaction may have violated the terms of the Project Owner’s/Management Agent’s Certification which require the project owner and the management agent to certify that they will comply with HUD requirements and contract obligations, and agree that no payments have been made to the owner in return for awarding the management contract to the agent. There are obvious concerns including the fact that Chartwell paid for the receivables before being chosen as the management agent. This transaction presents the appearance that Chartwell’s designation as management agent was contingent on Chartwell making the \$100,000 payment to Avesta. Had Chartwell not made this payment, it probably would not have been selected as the management agent. The president of Avesta stated that he was not aware that the Letter of Agreement was in violation of any rules or regulations.

HUD was not aware of the Agreement, and there was no clear evidence that the project’s board of directors were adequately informed of the transaction. Considering the amount of money involved, a board resolution should have been declared to address the Agreement, and HUD should have been informed before the terms of the Agreement were carried out.

Conclusion

The two promissory notes with the provision to accrue interest is an encumbrance of the project and is not a valid project expense. In addition, the owner and Avesta did not follow provisions of the Project Owner’s/Management Agent’s Certification when executing the “Letter of Agreement.” The president of Avesta

stated that he was not aware that the related parties were required to obtain HUD approval for the two notes and was not aware that the “Letter of Agreement” violated any specific rules or regulations.

Recommendations

We recommend that the Director of the Office of Housing require the owner of Orchard Court to

- 2A. Remove \$56,086 in interest accrued on the notes payable of \$303,653 from the accounting records and ensure that no further interest is accrued or paid on the notes.
- 2B. Ensure that all future notes and agreements are approved by HUD.
- 2C. Obtain a legal opinion regarding whether the Letter of Agreement violates the Project Owner’s/Management Agent’s Certification.

RESULTS OF AUDIT

Finding 3: The Project's Financial and Accounting Controls Were Inadequate

The owner of the Orchard Court project and/or prior management agents did not adequately monitor the project's financial and accounting records. The audit found that (1) vital financial and accounting records for the project were unreliable, incomplete, or unavailable, (2) management fees were calculated incorrectly, (3) controls over tenant receivables/bad debts were inadequate, and (4) one of the previous management agents inappropriately paid sales tax on fuel bills. These deficiencies occurred because of a lack of adequate controls. Without accurate and reliable financial and accounting records for the project, the project owner and/or the management agent could not provide adequate assurance that the project was properly managed.

Financial Records Were Unreliable, Incomplete, or Unavailable

The certified public accounting firm that prepared the 2006 financial statements and was to prepare the 2007 financial statements declined to perform the financial audit because it considered the accounting records unauditible. The 2007 financial statements were certified by the project owner and later submitted to the HUD Real Estate Assessment Center. However, the statements were not considered a certified public accountant-audited submission, and the project was given a six-month extension for a complete audit.

Vital records for the project were unreliable, incomplete, or unavailable. For example, a complete general ledger for fiscal year 2006 was not made available during our audit. In addition, balances of certain accounts in the 2007 certified financial statements were not in agreement with the project's general ledger accounts, as shown below:

Account	Account number	2007 general ledger	2007 certified financial statements
Tenants receivable	1130	\$35,090	\$4,294
Heating and cooling	6546	\$17,975	\$6,475
Snow removal	6548	\$7,333	\$12,583

The previous management agents failed to maintain adequate documentation to support the amount of excess income reported for fiscal years 2006 and 2007. We could not reconcile excess income from project records to the annual financial statements because supporting data were missing, inaccurate, or inconsistent. In addition, Chartwell failed to submit to HUD the required annual narrative description, which identifies the amount of excess income available, and the purpose(s) for which this excess income was used during the prior fiscal year.

We attempted to reconcile \$65,603 in reserve for replacement withdrawals from the 2007 financial statements to funding authorizations (HUD-9250). However, the funding authorization, required for all replacement withdrawals, could not be located in the records. In addition, written policies and procedures for procurement and general accounting procedures were not readily available. The only written policies and procedures that were available were the occupancy requirements and tenant selection criteria. Because of these and similar conditions, we have limited confidence in the accuracy of the financial and accounting records for the project.

Management Fees Were Calculated Incorrectly

Management controls were not adequate to ensure that Chartwell charged the project the correct amount of management fees. Based on our review of invoices and checks in fiscal year 2007, we determined that Chartwell undercharged for management fees. For example, the management agent improperly calculated fees in October 2006 and January to May 2007 based on a rate used by another government agency in lieu of the HUD rate. In addition, we found several instances where the monthly management fees were not posted to the general ledger and supporting documentation for fees was missing or not available.

Controls over Tenant Receivables, Including Collection and Write-Offs, Were Inadequate

Chartwell did not establish adequate controls and procedures regarding the management of tenant receivables, including collections and write-offs of receivables from prior tenants. Therefore, we could not be assured that all rent

receivables due from tenants had been properly accounted for because the management agent failed to maintain a reliable tenant receivable subsidiary ledger. In addition, there was no evidence that Chartwell initiated collection efforts on behalf of the project or turned over debts to a collection agency for collection. The owner of Affordable Housing stated that a collection company had not been used to collect past-due amounts for approximately a year and a half. Additionally, Chartwell had not established an “allowance for doubtful account” to record the amount of the tenants receivables considered to be uncollectible. A journal entry should be made crediting the “allowance for doubtful account,” as well as, debiting bad debt expense for the estimated amount of uncollectible tenant receivables; and the allowance for doubtful account would be decreased when the receivables are formally written off. The write-offs should occur only after all collection efforts have failed. Consequently, bad debts were 9 percent and fifteen percent of gross rents in fiscal years 2006 and 2007, respectively. HUD considers bad debts in excess of 1 percent as excessive.

The Project Was Inappropriately Charged Sales Tax on Fuel Bills

A fuel company consistently charged Orchard Court a sales tax for materials on repair work. This charge was an oversight on the part of Chartwell because nonprofit organizations are exempt from paying sales tax.

HUD determined that the Chartwell was not an acceptable manager for Orchard Court, and on August 16, 2007, HUD notified the project’s owner of its desire to terminate the management agreement primarily because of Chartwell’s failure to address outstanding findings from an unsatisfactory HUD management review completed on February 16, 2007. To further address the vacancies, as well as the lack of income, the current management agent, C and C Realty, increased marketing efforts and made adjustments to reduce cash outflow. Specifically, the management agent has

- Expanded outreach, including advertising and notifying housing authorities in the area of the availability of units;
- Reduced unnecessary maintenance;
- Applied for a real estate tax exemption, which is allowed for nonprofit-owned real estate in the state of Maine;
- Applied for a rent increase;
- Contacted the Maine State Housing Authority to discuss additional sources of funds or capital; and

- Considered applying for a subsidized rental contract (such as Section 8).

Conclusion

The owner and/or previous management agents of Orchard Court did not ensure that adequate controls were maintained over the project's financial and accounting records. The project's current certified public accounting firm declined to prepare the project's 2007 financial statements because it considered the records unauditible. Consistent, reliable, and accurate records were not maintained because several prior management agents over the past four years failed to exercise due diligence in managing the project. Without accurate and reliable financial and accounting records for the project, the project owner and/or the management agent could not provide adequate assurance that the project was properly managed.

Recommendations

We recommend that the Director of the Office of Housing require the owner of Orchard Court to

- 3A. Initiate the appropriate procurement actions to hire independent accounting firms, one to prepare the 2007 financial statements for audit and one to audit the statement for submission of audited financial statements to HUD.
- 3B. Develop and implement controls to ensure the current management agent properly calculates its management fees.
- 3C. Ensure that a policy for collection of prior tenant accounts is established and implemented, including procedures to analyze each account, determine collection activities necessary, and determine when an account should be written off.
- 3D. Require the current management agent to determine the amount of sale tax paid on repair bills from the fuel company and request reimbursement from the fuel company.

SCOPE AND METHODOLOGY

We performed an audit of the Orchard Court project, owned by the Orchard Court Housing Corporation. Our fieldwork was completed at the office of C and C Realty located at 219 Capitol Street, Augusta, Maine, from March through July 2008. Our audit generally covered the period October 1, 2004, through September 30, 2007, and was expanded to cover other periods as needed. To accomplish our objectives, we

- Evaluated the management company's procurement practices by selecting for review all companies, excluding utility companies, providing services and showing two or more payments throughout the audit period. In addition, for those companies selected, we evaluated the reasonability or necessity of charges related to these procurements.
- Using the check register covering the audit period, we selected for review all (100 percent) expenditures, excluding utility companies, of \$1,000 and up, verifying that costs were eligible, reasonable, and supported.
- Reviewed supporting documentation for management fees to ensure that they were properly supported, calculated, and within HUD approved limits.
- Requested and reviewed supporting documentation related to maintenance fees, other administrative fees, site management fees, HUD 202 fees, and site supervisor fees. In addition, we reviewed supporting documentation for certain payroll and contract charges.
- Determined the basis for \$315,076 on notes/loans payable owed by Orchard Court to Avesta and determined whether HUD authorized the notes/loans. In addition, we calculated the interest accrued on the notes/loans.
- Determined the reasons for the vacancy problem by reviewing marketability, maintenance, vacancy turnover, and on-site staffing.
- Randomly selected a sample of eight tenant files for review to ensure tenants were qualified and/or were eligible for housing.
- We inspected a sample of units. The sample of units selected for inspection was the same as those selected for review of tenant files.
- Evaluated the management the agents' controls and procedures regarding tenant receivables, including collection and write-off of receivables from prior tenants.

We performed our review in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

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

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, 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:

- Advances and execution of notes and loans involving related party transactions;
- Requirements that project costs be eligible, supportable, and reasonable;
- Payment of management fees;
- Procurement and purchasing procedures when awarding contracts to identity-of-interest companies;
- Tenant eligibility;
- Maintaining units in decent, safe, and sanitary condition; and
- Tenant receivables.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weaknesses

Based on our review, we believe the following items are significant weaknesses:

- The owner and management agent did not have an adequate system to ensure that resources were properly safeguarded in its recordkeeping when it

charged ineligible, unsupported, and unreasonable expenditures to the project (findings 1 and 3).

- The owner and management agent did not have adequate controls to ensure that vacancies were monitored and maintained at minimum levels (finding 1).
- The owner and management agent did not have adequate controls to ensure management fees were accurately calculated (finding 3).
- The owner and management agents did not establish adequate policies and procedures over the management of tenant receivables, including collections and write-offs of receivables from prior tenants (finding 3).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

The audit identified questioned costs totaling \$567,813 as follows:

Recommendation number	Ineligible <u>1/</u>	Unsupported <u>2/</u>	Unreasonable or unnecessary <u>3/</u>
1B	\$64,601		
1C	\$151,436		
1D			\$30,278
1E		\$265,412	
2A	\$56,086		

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

2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.

3/ Unreasonable/unnecessary costs are those costs not generally recognized as ordinary, prudent, relevant, and/or necessary within established practices. Unreasonable costs exceed the costs that would be incurred by a prudent person in conducting a competitive business.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

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Auditee Comments

OCT-24-2008 FRI 03:07 PM COAN & LYONS FAX NO. P. 02

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October 24, 2008

Mr. Kevin Smullen
Assistant Regional Inspector General for audit
U.S. Department of Housing and urban development
10 Causeway Street
Room 370
Boston, MA 02222

Dear Mr. Smullen:

This firm represents Orchard Court Housing Corporation (the "Corporation"), the owner of Orchard Court, a multifamily housing rental Project located in Bath, Maine (the "Project"). The Project is assisted under HUD's 236 Program. On behalf of the Corporation, we hereby submit the following comments in response to the draft Audit Report ("Report") by your office on the management and operation of the Project.

INTRODUCTION

On March 31, 2006, the Corporation replaced all five members of the Corporation's Board of Directors with five new directors (the "New Board"). However, by the time the New Board took control of the Corporation, many of the questionable expenditures and transactions had already occurred. For example, all of the allegedly ineligible fees paid to Avesta identified in the Report were made before the New Board took control. In addition, the two Promissory Notes and Letter Agreement questioned by the Report were executed before the New Board took control. So too was Chartwell's Management Agreement which was presumably the basis for the fees paid to Chartwell that have been questioned in the Report.

The overarching theme of the Corporation's response is that upon taking control, the New Board reasonably relied on Chartwell to manage the Project in accordance with HUD requirements. The New Board was unaware of the problems identified in the Report. Moreover, as stated in the Summary of Audit Results contained in the Corporation's Audited Financial Statement for the fiscal year ending September 30, 2006:

2. No material weakness were identified during the audit of the financial statements.

Comment 1

Comment 2

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Auditee Comments

Comment 2

3. No instances of noncompliance material to the financial statements... were disclosed during the audit.

4. No material weaknesses were identified during the audit of the major federal award program of Orchard Court Housing Corporation.

8. Orchard Court Housing Corporation qualifies as a low-risk auditee.

In addition, the April 23, 2007 letter from Jim grimes to the New Board, a copy of which is enclosed, essentially stated that all was well. Therefore, the New Board had no reason to question Chartwell's management of the Project.

COMMENTS

The Report has three Findings. Under each Finding there is discussion of the issues on which each Finding is based. Each of these issues are addressed separately.

In addition, the Report contains recommendations for dealing with each Finding. Each recommendation will also be addressed.

Finding 1 – The Project Was Not Managed in Accordance With HUD Requirements

Comment 3

a. Vacancies Were Excessive – The Corporation agrees that vacancies were excessive. The amount of vacancies for the past few years is unacceptable to the Corporation. However, since the Corporation's previous management agents never informed the Corporation of this problem, the Corporation was unaware of the problem.

The Corporation first became aware of this problem when the Corporation began its search for a company to replace Affordable Housing as the Project's management agent. As noted on page 8 of the Report, "The current management agent, C and C Realty, began addressing the vacancy problem immediately after assuming management duties on March 21, 2008." Therefore, the Corporation believes that this problem has been resolved and will not recur.

Comment 4

b. \$507,227 In Project Expenses Were Ineligible, Unreasonable or Unsupported – The Report discusses a multitude of expenditures that are alleged to have been improper. The Corporation does not have sufficient documentation to agree or disagree whether the specified expenditures were improper. However, all these expenditures were made by the previous management agents without the knowledge of the New Board.

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Comment 5

The Corporation acknowledges that under paragraph 7(b) of the Regulatory Agreement¹ the Corporation may not, without HUD's permission, "pay out any funds, except for reasonable operating expenses and necessary repairs." Moreover, the Corporation firmly believes that under the current Board and management agent, all relevant requirements regarding expenditures of Project funds are being adhered to.

c. Management Agents Did Not Follow HUD Procurement

Regulations – The Corporation is without sufficient information to agree or disagree with the assertion that Chartwell and Avesta did not follow proper procedures for several procurements or whether Chartwell had an identity-of-interest with three vendors. However, the Corporation acknowledges its obligation to follow proper procurement procedures and to notify HUD whenever an identity-of-interest exists.

Comment 6

d. Physical Deficiencies Found in Rental Units Were Not Corrected in a Timely Manner – The Corporation agrees that there was a problem in addressing physical deficiencies in a timely manner. However, as noted by the Report, C and C Realty plans on addressing all current physical deficiencies and it has provided on-site personnel to assist tenants when they report any deficiencies.

Comment 7

e. Tenants may Not Have Been Eligible For Subsidized Housing – The Corporation does not have sufficient information to know whether the tenants whose files were examined were eligible. However, it should be noted that under the 236 program, tenants are not required to meet income eligibility requirements. Rather, a tenant's income is verified for the purpose of determining the tenant's rent which is the greater of 30% of the tenant's adjusted gross income or the basic rental, but not greater than the fair market rental. Nonetheless, the Corporation and C and C Realty, will follow all applicable eligibility requirements.

Finding 1– Recommendations

1A. Agree – The Corporation will work with C and C Realty, and any future management agent, to this end.

Comment 5

1B. Disagree – The previous management agents should be provided an opportunity to justify the propriety of these expenditures.² To the extent they can't, or won't, HUD should seek reimbursement from the agents who made the expenditures. The Corporation did not authorize any of these expenditures. Therefore, it should bear no liability for them.

Comment 5

1C. Disagree – Avesta should be given an opportunity to justify the propriety of these charges which are currently shown as being owed to Avesta. To the extent Avesta can't, or won't, the Corporation agrees to notify Avesta that the Corporation has canceled

¹ It should be noted the Project's Regulatory Agreement does not contain a provision that prohibits expenditures when the Project is in a non-surplus cash position.

² The reference to HUD 202 fees is puzzling. The Project is not a 202 Project.

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**Comment 5
Comment 8**

these charges.³ Since all these charges were incurred before the New Board took control of the Corporation, the Corporation should bear no liability for the charges.

1D. Disagree – There is no Regulatory, contractual or administrative basis for requiring reimbursement to the Project for late fees incurred in paying valid Project expenses. In addition, comparing the previous lawn care contract with the current lawn care contract is an exercise in hindsight that does not justify reimbursement for the difference in price between the two contracts. However, to the extent it is determined that any of these costs must be reimbursed it is Chartwell and/or Avesta, not the Corporation, that should be required to reimburse the Project. The Corporation did not authorize, nor was the Corporation aware of, these charges.

**Comment 5
Comment 8**

1E. Agree and Disagree – The Corporation agrees to seek documentation from Chartwell and Avesta to try to determine whether these charges identified in the Report were eligible Project expenses. The Corporation disagrees, however, that to the extent that any of these charges are determined to be ineligible, that the Corporation should repay them to the Project; the Corporation did not authorize, nor was it aware of, any of these charges. Instead, if any of these charges are determined to be improper, the Corporation will seek reimbursement from the responsible previous management agent.

1F. Agree – The Corporation will work with the Project's management agent to implement this recommendation.

1G. Agree – As noted in the Report, C and C Realty is already in the process of doing this.

**Comment 5
Comment 9**

1H. Agree and Disagree – The Corporation will have C and C Realty review the eligibility status of the seven tenants identified by the Report. However, it should be noted that unless any of these tenants are receiving assistance under the Project's Rent Supplement Contract, the only reason to verify a tenant's income under the 236 program is to determine whether the tenant will pay 30% of the tenant's adjusted gross income, the basic rental or the fair market rental. However, if it is determined that any of the seven tenants received assistance to which they were not entitled, the Corporation does not agree that it should reimburse HUD. There is no Regulatory, contractual or administrative basis for requiring the owner to reimburse HUD. Instead, it is the tenant who should reimburse HUD. The Corporation will seek any improper payment of subsidy from the tenant.

**Comment 5
Comment 10**

1I. Disagree – There is no basis for any enforcement action against the Corporation. As stated in paragraph 18 of the Regulatory Agreement, the Corporation is not liable for "matters not under their control."

In essence, the die was cast for most of the improprieties identified in the Report by the time the New Board took control on March 31, 2006. Moreover, the New Board was deceived by the former President of the Corporation who, in an April 23, 2007 letter

³ Again, the reference to 202 fees is puzzling.

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Auditee Comments

Comment 5

to the Board, essentially told the Board that everything at the Project was copacetic. Therefore, the matters identified by the Report were not under the control of the Corporation.

Paragraph 18 of the Regulatory Agreement does impose liability on the Corporation "for funds or property of the Project coming into their hands which... they are not entitled to retain." Since there is no such allegation in the Report, this provision is not applicable.

Paragraph 18 also imposes liability on the Corporation "for their own acts or deeds or acts and deeds of others which they have authorized in violation of the provisions hereof." As discussed previously, since the New Board took control, the Corporation did not authorize any of the alleged improprieties identified by the Report. Nor did the Corporation violate any provisions of the Regulatory Agreement. Rather, any improper actions were authorized by the previous Board of Directors and/or Jim Grimes, a former President of the Corporation. Therefore, any enforcement action pertaining to the Corporation should be limited to the previous Board and/or Mr. Grimes.

**Comment 11
Comment 5**

Finding 2 – Promissory Notes and an Agreement Violate HUD Regulations

a. Owner and Management Agent Executed Notes Without HUD Approval – These Promissory Notes were executed before the New Board took control. Therefore, the Corporation should not be held liable for their execution, if, in fact, these Notes are improper. Although the Regulatory Agreement does prohibit the Corporation from encumbering or assigning any personal property of the Project without HUD approval, a Promissory note would not ordinarily constitute an encumbrance or assignment of personal property.

Comment 12

b. The Letter of Agreement Did Not have HUD Approval – The Report states that the Letter Agreement "may have violated the terms of the Project Owner's/Management Agent's Certification" in which an owner and management agent "agree that no payments have been made to owner in return for awarding the management contract to the agent." However, as noted in the Report, the Letter Agreement required payment by Chartwell to Avesta, neither of which is the owner of the Project. Therefore, since the Letter Agreement does not involve a payment to the Corporation, it does not constitute a violation of the Certification by the Corporation.

Comment 5

As noted in the Report, "[T]here was no clear evidence that the Project's board of directors were adequately informed of the transaction." This is consistent with the basic point made repeatedly herein that the Corporation was unaware of the problems identified by the Report.

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Comment 11

Finding 2 – Recommendations

2A. Disagree – Absent specific language in the Promissory Notes stating that the Notes encumber or assign personal property of the Project, the Corporation does not believe that the Notes violated the Regulatory Agreement. The real issue is whether the debts for which the Promissory Notes were executed are valid debts of the Project. If they are, the Corporation believes that the interest accrued and paid thereunder is a valid Project expense.

2B. Agree – The Corporation will seek HUD approval of any notes and agreements that require HUD approval.

2C. Disagree – The Corporation is not a party to the Letter Agreement, it is between Avesta and Chartwell. If the Letter Agreement violates the Project Owner's/Management Agent's Certification, the violation is by Avesta and/or Chartwell. Therefore, it is HUD, not the Corporation, that should make the determination whether the Letter Agreement constitutes a violation of the Certification by the management agent.

Comment 13
Comment 5

Finding 3 – The Project's Financial and Accounting Controls Were Inadequate

a. Financial Records Were Unreliable, Incomplete, or Unavailable – The Corporation reasonably relied on the Project's management agents to maintain the financial records of the Project in accordance with HUD requirements. The Corporation also relied on the management agents to submit all required Reports to HUD and obtain HUD's approval of any withdrawals from the Replacement Reserve. Therefore, to the extent that there is a problem with the Corporation's financial records, the responsibility lies with the previous management agents, not the Corporation.

Comment 5
Comment 14

b. Management Fees Were Calculated Incorrectly – The Corporation will review this finding and take whatever action is appropriate based on its review.

Comment 5

c. Controls over Tenant Receivables, Including Collection and Write-offs, Were Inadequate – As Noted in the Report, the responsibility for this problem lies with Chartwell and Affordable Housing. However, the Corporation will work with C and C Realty to ensure adequate controls over tenant receivables are implemented.

d. The Project Was Inappropriately Charged Sales Tax on Fuel Bills – The Corporation agrees that the Corporation should not pay sales tax, or any other tax, from which it is exempt. The Corporation will instruct C and C Realty to apply for an exemption from paying taxes wherever it is appropriate.

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Comment 2
Comment 5

Finding 3 – Recommendations

3A. Agree – The Corporation will endeavor to hire an independent accounting firm to prepare an Audited Financial Statement for the Corporation's fiscal years that ended on September 30, 2007 and September 30, 2008.

3B. Agree – The Corporation will work with C and C Realty to develop and implement controls to ensure that the management agent's fees are calculated properly.

3C. Agree – The Corporation will work with C and C Realty to establish and implement a policy for the collection of tenant receivables.


3D. Agree – The Corporation will instruct C and C Realty to seek reimbursement of any taxes paid from which the Corporation was exempt.

CONCLUSION

The questioned expenditures were made without the Corporation's knowledge or an authorization. The Promissory Notes and Letter Agreement questioned in the Report were also executed without the Corporation's knowledge or authorization. Moreover, based on the Corporation's Audited Financial Statement for the fiscal year that ended September 30, 2006, and the April 23, 2007 letter from Jim Grimes to the New Board, the Corporation had no reason to question the management of the Project. Therefore, there is no basis for seeking reimbursement from the Corporation for any of the improper expenditures. For the same reason, there is no basis to seek any enforcement action against the Corporation beyond the implementation of the recommendations to which the Corporation has agreed.

Thank you for the opportunity to provide this response on behalf of the Corporation to the Report.

Sincerely,



Carl A.S. Coan, III

CASCIH/sb

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CHARTWELL MANAGEMENT

4/23/2007

Orchard Court Apartments Board Members Update

To: Board Members of Orchard Court Housing Corporation
69 Apartments in Bath, Maine
From: Jim Grimes President

It has been a year since Chartwell has taken over Management of Orchard Court. Here are some issues / changes that have been made in the overall performance and stability of the Property.

Currently we have had an average of 3 vacancies from the 27 initial vacancies that we acquired when taking over.

We have torn down and removed all dilapidated sheds from the site and removed all junk cars that have been an eyesore for years. We had some resistance from these residents; some moved out or gave notice to move. This created another period where vacancies increased. Every unit that was vacated had to be painted out and some were in need of new flooring and appliances. Furnaces in five units needed immediate replacement. The cost was significant.

Evictions were issued for non-payment and non-compliance. This process was time consuming for Chartwell Staff and Attorney fees added up quickly. We basically cleaned house and now have good tenants.

Combining the turnover costs and furnace replacement, the reserve account was depleted. HUD advised that we must increase the monthly deposit for the reserve account from \$1490.00 to \$2000.00 and to hold off replacing other failing furnaces until it became an emergency situation. Two more furnaces failed and were replaced.

A rent increase was submitted along with the 2007 budget for Orchard Court back in August. Unfortunately HUD was in the middle of staff changes and our rent request along with the budget was tabled for two months. When HUD assigned a new Project Manager to Orchard Court, Chartwell was informed by HUD that they had to start the entire rent increase process over again. This became a financial burden with the property because Chartwell had met the



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CHARTWELL MANAGEMENT

requirements for the rent increase and anticipated the increase would take place before the Winter Season. Chartwell had set up the property so heat and hot water would be included in the rent along with having the snow removal done by contractors, not the tenants. HUD finally approved a portion of the requested rent increase in May 2007.

Effective May 1st the rent increase for including heat and hot water has been approved. The snow removal and lawn care was not approved. Chartwell has appealed HUD's decision and will reapply for another rent increase that includes the grounds work being done by a contractor. The grounds contractor is a significant factor as far as reducing insurance premiums. Chartwell has been paying for the heat and hot water and the grounds all winter.

With all of the above issues occurring, Chartwell took the following actions:

- Chartwell loaned the property \$36,000.00 to cover operating costs
- Deferred in taking March and April administrative fees
- Deferred in taking February, March, and April management fees
- Paid for the last two furnace replacements

A recent physical inspection of Orchard Court was conducted by HUD. Although they seemed pleased with the property, the final report indicated several issues that needed immediate attention by Management. Most of the findings indicated that a weatherization plan had to be implemented.

Chartwell received a Grant for a weatherization plan from Maine Housing. This Grant will take care of the majority of findings by HUD. The cost averaged out to be \$2000.00 per unit. With work coming to a close, the final amount of the Grant will be around \$150,000.00.

Overall, within the short time Chartwell has taken over, the Property has improved physically and vacancies are way down.

Also, we need to have an annual Board Member meeting (conference call) this Spring. I would like to schedule this for the end of May. Please email me on which of the 3 days best works. (May 29th, 30th, or 31st) in the afternoon @2:00pm. Email: jgrimes@chartwell.biz

Sincerely yours,


Jim Grimes
President Orchard Court Housing Corporation



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Comment 1 The report was revised to note that the current Board has been in place since March 31, 2006. However, the auditee's response on questionable expenditures is incorrect and many of the questionable expenditures occurred after the Board was appointed on March 31, 2006.

Comment 2 The report did not address whether the Corporation was aware of the problems identified in the report or its reliance on the management agent to manage the project as required. However, regardless of what the Corporation was aware of or its reliance on its management agent, we emphasize that the primary responsibility for managing the Orchard Court project rests with the owner, and it is the owner that is held accountable by HUD. We did not perform a financial audit and did not evaluate the financial audit that was performed, therefore, we cannot attest to the statements made in the financial audit or on what basis they were made. It is clear our audit, which is more in depth than a financial audit, found material instances of non compliance.

The letter referred to from Mr. Jim Grimes, former president and management agent, was cited as evidence that the Board had no reason to question Chartwell's management of the project. As emphasized above the primary responsibility for managing the Orchard Court project rests with the owner, and it is the owner that is held accountable by HUD. Therefore, it is the Orchard Court Housing Corporation as the owner that was ultimately responsible for the actions or inactions of its management agents. The project's Regulatory Agreement between the owner (Orchard Court Housing Corporation) and HUD stipulates that the owner will comply with the requirements of Section 236 of the National Housing Act and regulations adopted by HUD, and that the owner is responsible for providing for the management of the project in a manner satisfactory to HUD. Our audit concluded that the project generally was not operated in accordance with HUD requirements. As noted, the primary responsibility for management and operation of the project rests with the Orchard Court Housing Corporation.

Comment 3 We acknowledge that the current management agent is addressing the vacancy problem, but we do not agree that the problem has been entirely resolved yet. The owner is required to monitor the management agent's efforts and ensure that vacancies are maintained at a reasonable rate, going forward. We advise that the owner report to HUD on a continuing basis as to the status of vacancies for the project until HUD is satisfied that this is no longer a problem.

Comment 4 Many of the improper expenditures occurred after the Board was appointed on March 31, 2006. We also provided details of the improper expenditures so the board would be able to further evaluate the propriety of the charges. The current management agent is aware of all questioned costs after March 31, 2006. Also, the Regulatory Agreement does not contain a provision that prohibits expenditures when the project is in a non-surplus cash position as indicated in the comments and the report was revised accordingly. The Corporation must immediately reimburse the project from non-federal funds regardless of whether they recover any funds from previous management agents.

Comment 5 The Corporation is the owner of the project, regardless of the board members seated at the time, and entered into a Regulatory Agreement with HUD stating they would comply with HUD's regulations and the terms of the Agreement. The owner contracts with a management agent to act on their behalf but this does not allow the owner to delegate this responsibility to the agent. The owner remains responsible to HUD under the Regulatory Agreement.

During our audit work we worked diligently to obtain as much documentation as was available from the previous management agents. We reported all questioned costs we were unable to resolve with the management agents. The Corporation must immediately reimburse the project from non-federal funds regardless of whether they recover any funds from previous management agents.

Comment 6 The Corporation acknowledged that the project's physical deficiencies were not being corrected in a timely manner, and stressed that this should not continue to be a problem under the current management agent. However, the owner should report to HUD on a continuing basis as to the physical condition of the project until HUD is satisfied that the physical deficiencies were addressed and resolved, and that any newly reported deficiencies are also addressed and resolved in a timely manner.

Comment 7 Upon request, the information regarding these tenants can be provided again including the three tenants who continue to reside at Orchard Court. The current management agent is aware of these tenants. Also, the report was changed to clarify that income data needed for the purpose of determining the tenant's rent was missing.

Comment 8 During the audit, Avesta was given the opportunity to justify the propriety of the fees in question (see Comment 5). The Corporation can contact Avesta to allow them the opportunity again to justify these fees. The audit also questioned the HUD 202 fees and why the owners would have allowed the management agent to identify any charges as HUD 202 fees. Regardless, the Corporation does bear the liability for the ineligible project costs. The Corporation must immediately reimburse the

project from non-federal funds regardless of whether they recover any funds from the previous management agent.

Comment 9 The recommendation was revised to require the current management agent to review the eligibility status for all of the tenants, and to ensure that adequate supporting documentation is maintained in the tenant files to support the eligibility of each tenant.

Comment 10 The Corporation has misinterpreted the Regulatory Agreement when it states the Corporation is not liable for matters not under their control. The agreement actually states that the project's *individual owners are not personally liable* for matters not under their control. Therefore, this stipulation does not include the Corporation as the owner, and the Corporation should have controls in place to ensure it has these matters under its control. The primary responsibility for managing Orchard Court rests with the owner and the Corporation as the owner is accountable to HUD. Therefore, the Corporation is subject to any administrative and/or civil monetary or criminal penalties for the regulatory agreement violations and the other discrepancies disclosed in this report regardless of the board seated at the time.

We do not agree with the auditee's position that it is not responsible since many of the improper expenditures occurred after the Board was appointed on March 31, 2006. Regardless of the letter to the Board by the former President of the Corporation, the auditee's comment that matters identified by the Report were not under control of the Corporation is incorrect. If the Corporation acknowledges that its former President may have engaged in deception with the Board, then the Corporation cannot also now claim that matters addressed in the Report were not under their control. The President of the Corporation represents the project's ownership entity to HUD as the owner. Therefore, the Corporation is subject to any administrative and/or civil monetary penalties for the regulatory agreement violations and the other discrepancies disclosed in this report.

We do not agree with the auditee's position since many of the improper expenditures occurred after the Board was appointed on March 31, 2006. The Corporation as the owner is subject to any administrative and/or civil monetary or criminal penalties for the regulatory agreement violations and the other discrepancies disclosed in this report. The Corporation through its agents authorized the actions identified in the Report and through acts of its agents violated provisions of the Regulatory Agreement. Lack of proper controls by the owner to oversee the management agent and prevent improper transactions does not relieve responsibility.

Comment 11 The Promissory Notes with the provision to accrue interest is an encumbrance of the project and without HUD's approval, the interest is not a valid and reasonable operating expense of the project.

Comment 12 The Letter of Agreement was enacted under unusual circumstances because one of the parties involved in the transaction simultaneously represented both the management agent and the ownership entity. Therefore, because this individual was the president of the Corporation and executed the relevant documents in his capacity as President, the Corporation (the owner) did authorize the \$100,000 payment made by Chartwell.

The Corporation as the owner has the primary responsibility for the management and operation of the Orchard Court project, and as such, it is accountable to HUD.

Comment 13 The Corporation was in fact party to the Agreement because the Agreement was enacted by the President of the ownership entity, namely the Orchard Court Housing Corporation.

Comment 14 Provisions under the regulatory agreement between the owner and HUD state in paragraph 9(c) the requirement that books and records be maintained in reasonable condition for proper audit. The Corporation has primary responsibility for managing the Orchard Court project as the owner, and it is the owner that is held accountable by HUD for the requirement regarding the maintenance of the accounting records.

Appendix C

SCHEDULE OF INELIGIBLE PAYMENTS MADE BY CHARTWELL

Amount	Check number	Date of check	Invoice number	Date of invoice	Business or payee	Comments
\$3,200.00	1840	Sept 18, 2007	12149	Jan. 1, 2007	Chartwell	Payment on Notes Payable
\$670.30	001580	Aug. 21, 2006	10784	Aug. 1, 2006	Chartwell	Storage cost should be charged to affiliated company of mgt agent
\$1,293.60	001632	Oct. 23, 2006	10874	Sept. 7, 2006	Chartwell	Storage cost should be charged to affiliated company of mgt agent
\$6,166.66	001602	Sept. 25, 2006	Not known	Not known	Barron Hills 1	Payment made to another project owned/managed by Chartwell
<u>\$4,000.00</u>	1791	June 12, 2007	Not known	Not known	Manufacturing	Check register shows payment represents interest on notes payable
Total \$15,331 (rounded)						

Appendix D

SCHEDULE OF INELIGIBLE FEES PAID TO CHARTWELL

Check number	Date of check	Invoice number	Date of invoice	Administrative fee	Site supervisor fee	Overall totals
001639	Nov. 8, 2006	10984	Oct. 19, 2006	\$2,625.00	\$0.00	\$2,625.00
001650	Dec. 12, 2006	11124	Dec. 1, 2006	\$2,625.00	\$0.00	\$2,625.00
001655	Dec. 12, 2006	11042	Nov. 1, 2006	\$2,625.00	\$0.00	\$2,625.00
1886	Nov. 12, 2007	2134	Oct. 30, 2007	\$2,625.00	\$0.00	\$2,625.00
001752	Apr. 10, 2007	11237	Dec. 27, 2006	\$0.00	\$2,000.00	\$2,000.00
001737	Mar. 19, 2007	11430	Mar. 2, 2007	\$2,625.00	\$0.00	\$2,625.00
001721	Mar. 9, 2007	11344	Feb. 2, 2007	\$2,625.00	\$0.00	\$2,625.00
001681	Jan. 23, 2007	11197	Dec. 27, 2006	\$0.00	\$2,000.00	\$2,000.00
1776	May 21, 2007	11555	Apr. 2, 2007	\$2,625.00	\$0.00	\$2,625.00
<u>1823</u>	<u>Aug. 10, 2007</u>	<u>12017</u>	<u>May 3, 2007</u>	<u>\$2,625.00</u>	<u>\$0.00</u>	<u>\$2,625.00</u>
Totals				\$21,000.00	\$4,000.00	\$25,000.00

SCHEDULE OF INELIGIBLE FEES PAID TO AVESTA

Check number	Date of check	Invoice number	Date of invoice	Site mgt fees	HUD 202 fees	Overall totals
5516	Jan. 20, 2005	4852	None	\$771.50	\$0.00	\$771.50
5516	Jan. 20, 2005	646	None	\$0.00	\$2,107.89	\$2,107.89
5516	Jan. 20, 2005	648	None	\$1,445.78	\$0.00	\$1,445.78
5598	June 10, 2005	405	None	\$0.00	\$451.83	\$451.83
5598	June 10, 2005	104	None	\$0.00	\$2,107.89	\$2,107.89
5608	June 22, 2005	1250	None	\$0.00	\$966.26	\$966.26
5608	June 22, 2005	1252	None	\$1,445.78	\$0.00	\$1,445.78
5618	July 13, 2005	1452	None	\$0.00	\$2,107.89	\$2,107.89
5654	Sept. 22, 2005	1454	None	\$1,445.78	\$0.00	\$1,445.78
5654	Sept. 22, 2005	1740	None	\$0.00	\$2,107.89	\$2,107.89
5691	Dec. 15, 2005	1742	None	\$1,445.78	\$0.00	\$1,445.78
5691	Dec. 15, 2005	1937	None	\$0.00	\$2,107.89	\$2,107.89
5717	Jan. 27, 2006	1939	None	\$771.50	\$0.00	\$771.50
5727	Feb. 8, 2006	2141	None	\$771.50	\$0.00	\$771.50
5743	Mar. 9, 2006	2139	None	\$0.00	\$2,107.89	\$2,107.89
<u>5743</u>	<u>Mar. 9, 2006</u>	<u>2338</u>	<u>None</u>	<u>\$0.00</u>	<u>\$2,107.89</u>	<u>\$2,107.89</u>
Totals				\$8,097	\$16,173	\$24,270

Appendix E

SCHEDULE OF UNSUPPORTED COSTS INCURRED BY CHARTWELL AND AFFORDABLE HOUSING

Amount	Check number	Date of check	Invoice number	Date of invoice	Buisness or payee	Comments
\$1,134	001582	Aug. 21, 2006	Unknown	July 6, 2007	Supplies	Invoice lacked sufficient detail
\$1,000	001567	July 26, 2006	Unknown	June 13, 2007	Supplies	Invoice lacked sufficient detail
\$3,500	001606	Sept. 25, 2006	Unknown	Unknown	Paving	Missing invoice
\$9,000	001576	Aug. 17, 2006	Unknown	Unknown	Paving	Missing invoice
\$1,150	001636	Nov. 3, 2006	6056-1A	Aug. 11, 2006	Construction	Invoice lacked sufficient detail
\$10,000	001563	July 24, 2006	6046-1	June 15, 2006	Construction	Invoice lacked sufficient detail
\$3,000	01004M	Aug. 29, 2006	6046-1A	Aug. 1, 2006	Construction	Invoice lacked sufficient detail
\$3,694	001593	Sept. 7, 2006	6046-1A	Aug. 1, 2006	Construction	Invoice lacked sufficient detail
\$2,000	001643	Nov. 8, 2006	Unknown	Unknown	Lawn care	Missing invoice and lack of contract
\$5,250	001648	Nov. 28, 2006	Unknown	Unknown	Lawn care	Missing invoice and lack of contract
\$2,083	001659	Dec. 18, 2006	Unknown	Unknown	Lawn care	Missing invoice and lack of contract
\$2,000	001662	Dec. 22, 2006	13315	Nov. 24, 2006	Lawn care	Invoice lacked detail and no contract
\$3,250	001679	Jan. 19, 2007	13315	Nov. 24, 2006	Lawn care	Invoice lacked detail and no contract
\$6,000	1006	Feb. 14, 2007	Unknown	Unknown	Lawn care	Missing invoice and lack of contract
\$4,500	001723	Mar. 9, 2007	13484	Feb. 1, 2007	Lawn care	Invoice lacked detail and no contract
\$1,500	001723	Mar. 9, 2007	13575	Mar. 1, 2007	Lawn care	Invoice lacked detail and no contract
\$3,750	001744	Apr. 6, 2007	13575	Mar. 1, 2007	Lawn care	Invoice lacked detail and no contract
\$2,000	001764	Apr. 24, 2007	13753	Apr. 4, 2007	Lawn care	Invoice lacked detail and no contract
\$1,000	001769	Apr. 30, 2007	13753	Apr. 4, 2007	Lawn care	Invoice lacked detail and no contract
\$2,250	1783	May 21, 2007	13753	Apr. 4, 2007	Lawn care	Missing invoice and lack of contract
\$750	1783	May 21, 2007	13891	May 16, 2007	Lawn care	Missing invoice and lack of contract
\$3,000	1797	June 29, 2007	13891	May 16, 2007	Lawn care	Invoice lacked detail and no contract
\$1,500	1814	July 27, 2007	13891	May 16, 2007	Lawn care	Invoice lacked detail and no contract
\$500	1814	July 27, 2007	14141	May 25, 2007	Lawn care	Invoice lacked detail and no contract
\$3,000	1826	Aug. 14, 2007	14141	May 25, 2007	Lawn care	Missing invoice and lack of contract
\$1,135	1838	Sept. 14, 2007	14141	May 25, 2007	Lawn care	Missing invoice and lack of contract
\$620	1905	Dec. 12, 2007	112	Unknown	Cleaning	Invoice lacked sufficient detail
\$620	1888	Nov. 12, 2007	100	Nov. 12, 2007	Cleaning	Invoice lacked sufficient detail
\$620	1849	Oct. 4, 2007	902	Oct. 1, 2007	Cleaning	Invoice lacked sufficient detail
\$620	1841	Sept. 20, 2007	901	Sept. 1, 2007	Cleaning	Invoice lacked sufficient detail
\$620	1828	Aug. 22, 2007	801	Aug. 1, 2007	Cleaning	Invoice lacked sufficient detail
\$620	1800	July 9, 2007	701	July 5, 2007	Cleaning	Invoice lacked sufficient detail
\$620	1792	June 13, 2007	601	June 2, 2007	Cleaning	Invoice lacked sufficient detail
\$620	1782	May 21, 2007	8	May 2, 2007	Cleaning	Invoice lacked sufficient detail
\$620	001743	Apr. 6, 2007	1038	Apr. 1, 2007	Cleaning	Invoice lacked sufficient detail
\$620	001722	Mar. 9, 2007	1026	Mar. 1, 2007	Cleaning	Invoice lacked sufficient detail
\$620	001704	Feb. 19, 2007	1016	Feb. 1, 2007	Cleaning	Invoice lacked sufficient detail
\$620	001678	Jan. 19, 2007	1008	Jan. 9, 2007	Cleaning	Invoice lacked sufficient detail
\$11,423	5853	Aug. 21, 2007	82107	Aug. 21, 2007	Chartwell	Missing invoice
\$1,400	1001	Apr. 19, 2006	Unknown	Unknown	Chartwell	Missing invoice
\$2,000	001520A	May 22, 2006	10570	May 1, 2006	Chartwell	Missing invoice
\$4,805	001531	June 2, 2006	10607	May 1, 2006	Chartwell	Missing invoice
\$680	001632	Oct. 23, 2006	10896	Sept. 14, 2006	Chartwell	Missing invoice
Total						

Amount	Check number	Date of check	Invoice number	Date of invoice	Buisness or payee	Comments
\$105,695						

Appendix F

CRITERIA

Provisions under the regulatory agreement:

- Paragraph 6(a) provides that owners shall not convey, transfer, or encumber any of the mortgaged property, or permit the conveyance, transfer, or encumbrance of such property.
- Paragraph 6(b) provides that owners shall not, without prior written approval of HUD, assign, transfer, dispose of, or encumber any personal property of the project, including rents, or pay out any funds except from surplus cash, except for reasonable operating expenses and necessary repairs.
- Section 6(i) states that owners shall not, without the prior written approval of the HUD, incur any liability, direct or contingent, other than for current operating expenses, exclusive of the indebtedness secured by the mortgage and necessarily incident to the execution and delivery thereof.
- Paragraph 7 states that the owners shall maintain the mortgaged premises, accommodations, and grounds in good repair and condition.
- Section 9(a) states that the owners shall provide for the management of the project in a manner satisfactory to the HUD.
- Paragraph 9(b) provides that payment for services, supplies, or materials shall not exceed the amount ordinarily paid for such services or materials in the area where the services are rendered or the supplies or materials are furnished.
- Paragraph 9(c) requires that books and records be maintained in reasonable condition for proper audit.
- Paragraph 9(e) provides that within 60 days following the end of each fiscal year, HUD shall be furnished with a complete annual financial report, based upon an examination of the books and records of the borrower, prepared in accordance with the requirements of HUD, certified by an officer or responsible owner, and when required by HUD, prepared and certified by a certified public accountant or other person acceptable to HUD.

The project owner's/management agent's certification provides that the project owner and management agent certify under

- Part 1 to comply with HUD requirements and contract obligations and agree that no payments have been made to the project owner in return for awarding the management contract to the agent and that such payments will not be made in the future.
- Part 3(d) to refrain from purchasing goods or services from entities that have identify of interest unless the costs are as low as or lower than arms-length, open-market purchases.
- Part 4(a) to ensure that all expenses of the project are reasonable and necessary.
- Part 4(b) to exert reasonable effort to maximize project income and take advantage of discounts, rebates, and similar money-saving techniques.
- Part 4(c) to obtain contracts, materials, supplies, and services on terms most advantageous to the project.
- Part 4(d) to credit the project with all sales tax granted through the government.
- Part 4(e) to obtain the necessary verbal or written cost estimates and document the reasons for accepting other than the lowest bid, and part 4(f) requires that copies of such documentation be maintained and made available during normal business hours.
- Part 6(b) that the management agent agrees to establish and maintain project accounts, books, and records in accordance with HUD's administrative requirements and generally accepted accounting principles.

Provisions of the management agreement between Orchard Court Housing Corporation and Chartwell

- Section I, part 2, stipulate that the project owner is to ensure that the property is operated in a fashion consistent with good professional management practices. The project owner has a responsibility to provide decent, safe, and sanitary housing; provide housing to meet the needs of the population; and to accept financial responsibility for the project.
- Section I, part 3, states that the management company has the responsibility for the general supervision and the execution of the duties and services as outlined in the management plan.
- Section IV, part A, Responsive Maintenance, dictates that routine maintenance requests are to be made to the property manager via weekly visits or toll-free telephone calls to the main office. The request is entered on a work order that includes the date and time the request was made and is assigned to a site technician. Generally, work is performed within a 48-hour period unless emergency conditions require prompt attention.

Provisions of HUD Handbook 4350.3, Occupancy Requirements for Subsidized Multifamily Projects:

- Chapter 3, section G(2), Assigning Units Larger Than Required, states that a single person must not be permitted to occupy a unit with two or more bedrooms, except for the following persons: (1) a person with a disability who needs a larger unit as a reasonable accommodation, (2) a displaced person when no appropriate-size unit is available, (3) an elderly person who has a verifiable need for a larger unit, and (4) a remaining family member of a resident family when no appropriate-size unit is available.
- Chapter 5, section 3, paragraph 5-12(A), states the following as key requirements for income verification: (1) Owners must verify all income, assets, expenses, deductions, family characteristics, and circumstances that affect family eligibility or level of assistance; (2) Applicants and adult family members must sign consent forms to authorize the owner to collect information to verify eligibility, income, assets, expenses, and deductions. Applicants and tenants who do not sign required consent forms will not receive assistance; (3) Family members six years of age and older must provide the owner with a complete and accurate Social security number. For any members of the family who do not have a Social Security number, the applicant or family member must certify that the individual has never received a Social Security number.

The management plan is part of the management agreement between the project owner and Chartwell. Section IV of the plan dictates that a high level of occupancy will be maintained by constant marketing efforts to target groups of potential residents and word-of-mouth referrals. Brochures and flyers and presentations at community functions are used to encourage applicants as needed. Inquiries are answered by a 24-hour answering services as well as regular staff available at posted hours to show units.

HUD Handbook 4370.2, Financial Operations and Accounting Procedures for Insured Multifamily Projects, paragraph 2-6E, stipulates that all disbursements from the regular operating account must be supported by approved invoices/bills or other supporting documentation. The request for project funds should only be used to make mortgage payments, make required deposits to the reserve for replacements, pay reasonable expenses necessary for the operation and maintenance of the project, pay distributions of surplus cash permitted, and repay owner advances authorized by HUD.

HUD Handbook 4381.5, The Management Agent Handbook, paragraph 6.50(a), provides that the management agent is expected to solicit written cost estimates from at least three contractors or suppliers for any contract, ongoing supply, or services which are expected to exceed \$10,000 per year. Paragraph 6.50(b) provides that for any contract, ongoing supply, or service estimated to cost less than \$5,000 per year, the agent should solicit verbal or written cost estimates to ensure that the project is obtaining services, supplies, and purchases at the lowest possible cost. The agent should make a record of any verbal estimates obtained. In addition, paragraph 6.50(c) prescribes that documentation of all bids should be retained as a part of the project records for three years following the completion of the work.

24 CFR (*Code of Federal Regulations*) 236.60(g)(2) states that a narrative description of the amount and the uses made of excess income during the prior fiscal year of the project is required. The report must contain the following wording: “I certify that (1) the amount of excess income retained and used was for the purposes approved by HUD, (2) all eligibility requirements for retaining excess income were satisfied for the entire reporting period, and (3) all the facts and data on which this report is based are true and accurate.” The monthly report of excess income (HUD 93104) shows total gross rental income collections in excess of approved basic rent per unit for all units in the project. Owners/management agents are required to keep copies of the completed forms as part of the books and records of the project for at least seven years from the dates the forms are prepared.