

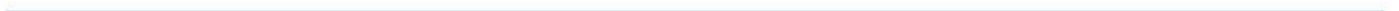


Eastwood Terrace Apartments, Nacogdoches, TX

Multifamily Section 8 Project-Based Rental Assistance

**Office of Audit, Region 6
Fort Worth, TX**

**Audit Report Number: 2018-FW-1005
August 2, 2018**





To: Mary Walsh, Southwest Region Director, Multifamily Housing, 6AHMLA

//signed//

From: Kilah S. White, Regional Inspector General for Audit, 6AGA

Subject: Eastwood Terrace Apartments, Nacogdoches, TX, Multifamily Section 8, Subsidized Questionable Tenants, Overhoused Tenants and Uninspected Units

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of the Eastwood Terrace Apartments in Nacogdoches, TX.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG website. Accordingly, this report will be posted at <http://www.hudoig.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at 817-978-9309.



Audit Report Number: 2018-FW-1005

Date: August 2, 2018

Eastwood Terrace Apartments, Nacogdoches, TX, Multifamily Section 8, Subsidized Questionable Tenants, Overhoused Tenants and Uninspected Units

Highlights

What We Audited and Why

We audited the Eastwood Terrace Apartments multifamily Section 8 Project-Based Rental Assistance (PBRA) program. We selected Eastwood Terrace in accordance with the Office of Inspector General's (OIG) goal to review HUD's multifamily housing programs. Our objective was to determine whether the owner administered its Section 8 PBRA program in accordance with U.S. Department of Housing and Urban Development (HUD) regulations and guidance; specifically, whether the owner ensured that tenants were eligible for the program and that housing assistance subsidies were correct.

What We Found

The owner did not administer its Section 8 PBRA program in accordance with HUD regulations and guidance. It did not ensure that tenants were eligible for the program and that housing assistance subsidies were correct. Specifically, the owner (1) billed HUD for at least 81 tenants without the required documentation for recertifications and did not ensure that it could support the eligibility of its tenants, as certified on its reimbursement requests to HUD, (2) housed tenants in units larger than their family size should have allowed, and (3) failed to ensure that required annual inspections were conducted. These conditions occurred because the owner failed to implement appropriate controls and lacked proper oversight of its staff, which allowed onsite managers to mismanage its program and admit tenants with questionable qualifications into uninspected units. As a result, HUD paid the owner more than \$1.8 million for unsupported tenants and units that it could not assure HUD were decent, safe, or sanitary.

What We Recommend

We recommend that the Southwest Region Director of Multifamily Housing require the Eastwood Terrace owner to (1) support or repay HUD more than \$1.8 million for tenants whose eligibility the owner could not support, (2) properly house tenants in the correct unit size, (3) perform annual inspections as required, and (4) ensure that its recently implemented quality control program is working as designed and in accordance with HUD requirements.

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Background and Objective

The Section 8 Project Based Rental Assistance (PBRA) program was authorized by Congress in 1974 to provide rental subsidies for eligible tenant families residing in specific multifamily rental properties. Under the program, the U.S. Department of Housing and Urban Development (HUD) enters into long-term housing assistance payments contracts with project owners to provide housing units to eligible tenants. HUD also contracts with project-based contract administrators to monitor and enforce owner compliance with the terms of the contracts and HUD regulations and requirements.

Eastwood Terrace Apartments is a 192-unit complex at 2817 E J Campbell Blvd. in Nacogdoches, TX. It is a combination of two formerly separate apartment complexes (Eastwood Terrace and Oakhill Plaza). The property is not insured by the Federal Housing Administration, but it is 100 percent HUD subsidized. The owner of the property is Eastwood Terrace and Oakhill Plaza, LLC, a Texas limited liability company,¹ and its management agent is Arnold Grounds.² Eastwood Terrace received approximately \$5.1 million in multifamily project-based Section 8 subsidies between June 2014 and September 2017.

HUD subsidized rents for the 192 units through a yearly housing assistance payments contract with the owner. The contract summarized the terms and conditions for subsidy payments. Based on the tenant's income, the owner determined how much rent each tenant was responsible for and submitted monthly claims to HUD for the difference between the tenant's portion of the rent and the total approved rent for an adequate housing unit.

Southwest Housing Compliance Corporation (SHCC) was HUD's performance-based contract administrator for Eastwood Terrace's Section 8 PBRA program. Due to national litigation between HUD and other parties, HUD amended its contracts with administrators throughout the country to delete certain monitoring tasks, effective October 1, 2011. HUD reinstated the monitoring tasks in May 2016.

SHCC performed an onsite management and occupancy review at Eastwood Terrace on February 15 and 16, 2017, and issued a report, dated March 17, 2017, assigning Eastwood Terrace an unsatisfactory score. As a result, the management agent performed a 100 percent file review for the period January 2014 through March 2017 and completed mass inspections of all 192 units. Eastwood Terrace provided SHCC required corrective action responses and supporting documentation to address the findings and observations in the review. On April 2, 2018, SHCC closed the 2017 review summary report.

¹ Eastwood Terrace and Oakhill Plaza, LLC, is owned 100 percent by ZG Investment Properties, Ltd.

² Arnold Grounds Apartment Management and Affordable Housing Specialist became Eastwood Terrace's management agent effective January 2018. J. Allen Management was Eastwood Terrace's management agent from May 2014 through August 2015. The owner served as the management agent from September 2015 through December 2017.

The owner hired Arnold Grounds, effective January 2018, as its management agent to oversee day-to-day operations at Eastwood Terrace. Previously, the owner was the management agent and relied on onsite managers to oversee the day-to-day operations at Eastwood Terrace.

Our objective was to determine whether the owner administered Eastwood Terrace's Section 8 PBRA program in accordance with HUD regulations and guidance; specifically, whether the owner ensured that tenants were eligible for the program and that housing assistance subsidies were correct. This is the third audit in a series³ of Office of Inspector General (OIG) Region 6 reviews of multifamily Section 8 PBRA programs.

³ We also conducted the following audits: (1) The Beverly Place Apartments, Groves, TX, Subsidized Nonexistent Tenants, Unqualified Tenants, and Tenants With Questionable Qualifications, audit report 2017-FW-1009, issued June 29, 2017, and (2) Villa Main Apartments, Port Arthur, TX, Subsidized Nonexistent Tenants, Unsupported Tenants, and Uninspected Units, audit report 2018-FW-1002, issued January 31, 2018.

Results of Audit

Finding: Eastwood Terrace Apartments Subsidized Questionable Tenants, Overhoused Tenants and Uninspected Units

Eastwood Terrace’s owner did not administer its Section 8 PBRA program in accordance with HUD regulations and guidance. It did not ensure that tenants were eligible for the program and that housing assistance subsidies were correct. Specifically, the owner (1) billed HUD for at least 81 tenants without the required documentation for recertifications and did not ensure that it could support the eligibility of its tenants, as certified on its reimbursement requests to HUD, (2) housed tenants in units larger than their family size should have allowed, and (3) failed to ensure that required annual inspections were conducted. These conditions occurred because the owner failed to implement appropriate controls and lacked proper oversight of its staff, which allowed onsite staff to mismanage its program and admit tenants with questionable qualifications into uninspected units. As a result, HUD paid the owner more than \$1.8 million for unsupported tenants and units that it could not assure HUD were decent, safe, or sanitary.

The Owner Billed HUD for Questionable Tenants

The owner billed HUD for at least 81 tenants whose eligibility it could not support as shown in Table 1. The owner could not locate four tenant files, which left it unable to support that the subsidies HUD paid benefited eligible tenant families. A review of the remaining 77 tenant files showed that all of the files contained deficiencies. The files (1) showed that Eastwood Terrace overhoused tenants; (2) lacked annual certification documents; (3) lacked Enterprise Income Verification (EIV) reports,⁴ third-party income verifications, or both; (4) included unsigned forms HUD-50059, which are used to submit eligibility information to HUD for housing assistance payments; and (5) had income discrepancies, as shown in Appendix C. The resulting unsupported payments for these deficiencies totaled more than \$1.9 million.⁵

Table 1: Subsidies paid for 81 questionable tenants and uninspected units

Issue	Unsupported subsidy payments (see appendix D)	Reimbursed to HUD via repayment agreements	Total
Lack of documentation for 81 tenants and uninspected units	\$1,906,228	\$40,884	\$1,865,344
Totals	\$1,906,228	\$40,884	\$1,865,344

⁴ The EIV system is a web-based computer system containing employment and income information on individuals participating in HUD’s rental assistance programs. Regulations at 24 CFR (Code of Federal Regulations) 5.233 and HUD Handbook 4350.3, REV-1, require its use as a third-party verification source.

⁵ Eastwood Terrace reimbursed HUD \$40,884 during our fieldwork for deficiencies it identified for nine tenant files in our sample. It also reimbursed HUD \$6,879 for two tenant files before our fieldwork started.

Missing Tenant Files

The owner could not locate 4 of the 81 files requested. Therefore, only 77 of the files were available for review. The owner repaid HUD \$15,675⁶ for the subsidies it received for the four missing files. The amounts related to these missing tenant files were not included in our recommendation in appendix A to support or reimburse HUD for identified deficiencies.

Overhoused Tenants

Of the 77 tenant files reviewed, 35 families (45 percent) were living in units larger than their household size should have allowed. In seeking the most efficient use of housing assistance, HUD requires owners of all federally subsidized properties to assign a family to a unit of appropriate size, taking into consideration all persons residing in the household.⁷ In one instance, a three-member household moved into a three-bedroom unit in February 2015. At the family's 2016 annual recertification, there were only two members left in the household; however, Eastwood Terrace allowed them to remain in the three-bedroom unit. At the 2017 annual recertification, Eastwood Terrace moved the two-member family into a four-bedroom unit, when they should have been in a two-bedroom unit according to HUD requirements and its own policy. This error resulted in Eastwood Terrace receiving a contract rent of \$1,085⁸ per month instead of \$744. Although Eastwood Terrace completed a 100 percent file review, it did not identify this error.

Missing Documents and Signatures

All 77 of the available files were missing one or more significant documents or required certifications, including annual certifications, income documents, and unsigned or questionable documents.

Annual certifications. Of the 77 available files, 21 (27 percent) were missing evidence of annual certifications. HUD requires providers to certify tenant eligibility at least yearly.⁹ Without a certification, there was no evidence that the provider considered possible changes in the tenant's income and family composition.

Income documents. All 77 available files were missing EIV reports, third-party income verifications, or both. HUD mandated the use of the EIV system¹⁰ for (1) verification of employment and income of tenants, (2) reducing administrative and subsidy errors, and (3) required third-party verification of income. Even when the staff had EIV reports, the records showed that they disregarded the information or did not follow up on inconsistent information.

⁶ This amount was included in the Eastwood Terrace reimbursements via repayment agreements.

⁷ HUD Handbook 4350.3, chapter 3

⁸ The \$1,085 monthly contract rent for the four-bedroom unit included a HUD subsidy of \$950 and \$135 for the tenant's portion of the rent.

⁹ HUD Handbook 4350.3, chapter 7

¹⁰ 24 CFR 5.233

Unsigned and questionable documents. Of the 77 available files, 43 (56 percent) were missing tenant or owner signatures or both on forms HUD-50059 and HUD-50059-A as required by HUD Handbook 4530.3, REV-1, chapter 7. Many of the forms had inconsistent tenant signatures, which indicated that someone other than the tenants (such as former Eastwood Terrace staff) may have signed the documents. In at least eight instances, tenant signatures¹¹ on documents such as Social Security cards, Texas driver's licenses and identification cards, and other HUD forms did not appear to match the multiple signatures on the tenant eligibility certifications.¹² Without relevant information and tenant signatures on required forms, the owner could not assure HUD that eligible tenants occupied the subsidized units.

Income Discrepancies

Of the 77 available files, 58 (74 percent) contained income discrepancies because they did not include all income required to be reported. Annually, HUD required the owner to calculate each tenant's rent subsidy and the tenant's share of the rent based on the tenant's income.¹³ However, the forms HUD-50059 in the files did not include all required income sources. Specifically, they did not include employment income shown on EIV reports in the tenant files. Instead, the forms showed either \$0 income or much lower income from nonwage sources, such as child support and gifts. Further, other household members failed to report income. For example, three adult members of a household all signed statements certifying that they had \$0 income. However, EIV reports showed that at least one family member had employment income. There was no evidence in the file that Eastwood Terrace addressed the discrepancy. Further, as shown in Table 2, many of the annual recertifications included multiple forms HUD-50059 for the same year with inconsistent income information and missing signatures.

¹¹ Although we have evidence to support our conclusion, for privacy reasons, we did not include examples of the inconsistent signatures in this report.

¹² Forms HUD-50059 and 50059A

¹³ See footnote 10.

Table 2: Multiple forms HUD-50059 annual recertifications for the same year

Sample	Number of annual recertifications				Deficiencies
	2017	2016	2015	2014	
2		2			Incomes differed and signature missing on some forms
3		3			Incomes differed and signature missing on some forms
4	2	3		2	Incomes differed and signature missing on some forms
5	2	2	2	2	Incomes differed
6	2				Incomes differed
8	2	2		2	Incomes differed and signature missing on some forms
11		2	3		Incomes differed and signature missing on some forms
12	2	2	2		Incomes differed
16		3			Incomes differed and signature missing on some forms
17		2	2		Incomes differed and signature missing on some forms
20			2	2	Incomes differed and signature missing on some forms
21	3	4			Incomes differed and signature missing on some forms
25	2	2	2		Incomes differed and signature missing on some forms
26	2	2			Incomes differed and signature missing on some forms
29	2	3	2		Incomes differed
30		2			Signature missing on form
35		2	2		Incomes differed and signature missing on some forms
41		2			Incomes differed and signature missing on some forms
47	2	2			Incomes differed and signature missing on some forms
48	2	2			Incomes differed and signature missing on some forms
50	2	2			Incomes differed and signature missing on some forms

The Owner Billed HUD for Uninspected Units

Of the 77 files reviewed, 75¹⁴ (97 percent) had missing inspection reports, or the inspection reports were not completed for the entire review period. HUD required the owner to complete annual inspections to ensure that the units for which it provided subsidies were decent, safe, sanitary, and occupied or available for occupancy.¹⁵ After the file reviews were completed, the owner provided auditors with additional annual inspections from its 2017 100 percent inspections and a spreadsheet that summarized inspections conducted by the former management agent.¹⁶ We were able to accept only the 2017 inspections, which were largely duplicates of reviewed inspections already in the files,¹⁷ and applied them if they were within a reasonable

¹⁴ If the file did not contain an inspection report for each year of the audit period (2014 through 2017), we counted the file as a missing inspection report error. See appendix C.

¹⁵ 24 CFR 5.705 and form HUD-52670 part V – owner's certification

¹⁶ The former management agent was J. Allen Management.

¹⁷ Many of the 2017 inspection reports in the files were either illegible, incomplete, or both.

timeframe of the recertification date. Although the owner explained that he believed the inspection information provided in the spreadsheets was from 2015 and 2016 inspections, it was not sufficient to support the housing assistance payment subsidies or to assure HUD and taxpayers that the units were decent, safe, or sanitary. The spreadsheets did not include required information, such as when the inspections were conducted and by whom, and required signatures. In addition, the spreadsheet creation dates were from 2018, indicating that the spreadsheets were not completed contemporaneously.

The Owner Lacked Oversight and Did Not Have Controls to Detect or Prevent Deficiencies

The owner did not have appropriate oversight or controls to detect or prevent deficiencies in the tenant files. In addition, it did not verify the information that the onsite managers provided when it certified the accuracy of its monthly requests to HUD for subsidy payments. Instead, the owner (1) hired the prior owner's employees; (2) relied on the onsite staff, which engaged in questionable practices and mismanaged its program; and (3) allowed questionable mass document processing. The owner blamed former employees for subsidy issues and other inconsistencies. However, the owner was ultimately responsible for submissions to HUD for unsupported housing payments.

The Owner Hired the Prior Owner's Employees

Despite being aware of the property's troubled history, after acquiring Eastwood Terrace in 2014, the owner hired the same onsite property employees who had worked for the prior owner. The owner believed that if he maintained the previous owner's experienced employees, it would maintain continuity between owner changes.

The Owner Relied on Staff, Which Had Questionable Practices and Mismanaged Its Program

For day-to-day operations, the owner relied on its former onsite staff, which engaged in questionable practices and mismanaged its program. The files reviewed contained multiple issues, which the onsite staff should not have allowed. These issues included overhoused tenants, income discrepancies, missing required documents, and a lack of required inspections and signatures. In some instances, it appeared that the onsite staff had conflicts of interest or actively engaged in questionable behavior. For example, a former employee, who regularly certified applications, forms HUD-50059, and other required documents maintained in the tenant files, was also a HUD-subsidized tenant at Eastwood Terrace for part of the time when she was an employee. In at least one instance, the former employee certified that she was a gift donor for a different tenant. The former employee also signed a document containing a tenant's signature. During the 100 percent file review, the tenant verified with Eastwood Terrace that the signature on the document represented as hers was not her signature. Further, the tenant verified that although she completed an application in 2016, she did not move into Eastwood Terrace, which could be an indication of a ghost tenant.¹⁸ The onsite staff processed a form HUD-50059 for this tenant and collected \$5,062 in related subsidies on behalf of the owner. Upon discovering the issue, the owner reimbursed HUD for the overpayment. When potential conflicts of interest and questionable practices existed, Eastwood Terrace was at risk for fraudulent activity.

¹⁸ Ghost tenants refers to subsidized units, which Section 8 PBRA tenants did **not** occupy but the owner billed HUD for those tenants on its certified reimbursement requests, resulting in ineligible monthly housing subsidies from HUD.

In addition, paperwork was often misfiled,¹⁹ and onsite staff was inconsistent in how it recorded tenant names, which led to confusion. Tenant files contained a mixture of documents with variations on names, which made it difficult to determine which documents applied to the correct tenant file or whether individuals with different names were the same tenant. In one case, onsite staff processed documents for a tenant using different names. In reviewing payment history data, it appeared that Eastwood Terrace received subsidies for multiple tenants for the same unit. The only way to identify the potential duplicate issue was through cumbersome individual file reviews, paying close attention to the possibility of unrelated name errors. A typical owner would not have the resources to regularly engage in that level of review. These examples show the importance of providing proper oversight of staff and implementing effective controls to prevent and detect questionable practices.

The Owner Allowed Mass Document Processing

Onsite staff processed and approved mass tenant actions on the same date, which did not appear feasible. For example, onsite staff processed 19 move-ins on October 30, 2015; 15²⁰ move-ins on June 30, 2016; and 12 move-outs on June 23, 2016. Moving this many tenants in or out of units on the same day, when the process was time consuming and required detailed information collection procedures, appeared questionable. We reviewed 9²¹ of the 15 move-ins processed on June 30, 2016, and found inconsistencies and errors. In one case, records in the file showed that a tenant moved in on June 30, 2016, when the tenant did not apply for admission to the program until March 30, 2017.

The Owner Blamed Former Employees for Issues

The owner acknowledged that there were subsidy issues in 2015 and that he saw “things that were not right,” which led to the management and occupancy review. The owner stated that the low score Eastwood Terrace received was a result, in part, of suspected instances of employee dishonesty and collusion related to tenant eligibility, including underhousing²² and overhousing. He also said he met with the contract administrator, who pointed out signatures in files that were not correct. The owner said he believed that the employees took advantage of him. However, on the requests for subsidy payment, the owner certified that each tenant’s eligibility and assistance payment was computed in accordance with HUD regulations and the facts and data submitted were true and correct; the required inspections had been completed; and the units for which assistance was billed were decent, safe, and sanitary. The certifications were incorrect, and the owner received unsupported payments totaling more than \$1.8 million.

The Owner Had Made Improvements

In response to administrative and physical condition issues identified by HUD and its project-based contract administrator, the owner took steps to improve its program operations by hiring a new management agent and implementing changes to its oversight procedures. The owner admitted that being the owner of a HUD-subsidized multifamily property and being the property

¹⁹ The misfiled documents often belonged to other tenants.

²⁰ Four of these files were missing.

²¹ These 9 files were included in our review of 77 sample files. See Scope and Methodology section.

²² In our review of 77 tenant files, we did not identify any instances of underhousing.

manager was new to him. Therefore, the owner said he decided to find a team of consultants to assist him and hired an audit team to address the deep-rooted problems. As Eastwood Terrace conducted its 100 percent file review, the owner repaid HUD for errors that it identified.

The Owner Entered Into Repayment Agreements

The owner entered into three repayment agreements to reimburse HUD for tenant files it could not support. The owner received a reduced monthly housing assistance payment subsidy to satisfy the repayment agreements. As of June 2018, the owner had repaid HUD the amounts in two of the three repayment agreements as shown in Table 3. We deducted the amounts the owner repaid to HUD for each of our 81 sample files totaling \$40,884. We did not deduct any amounts for the third repayment agreement because payments had not been made by the end of our fieldwork.

Table 3: Owner repayment agreements

Repayment number	Agreement setup month	Voucher reimbursement month	Repayment agreement amount	Paid
1	August 2017	August 2017 – January 2018	\$56,750	Yes
2	October 2017	February 2018 – June 2018	41,747	Yes
3	March 2018	July 2018 – December 2018	182,919	No
Total repayment agreement amount			281,416	

Conclusion

The owner violated its housing assistance payments contract with HUD for its Section 8 PBRA program by submitting incorrect certifications to bill HUD for questionable tenants and by charging HUD for units that it failed to ensure were decent, safe, and sanitary. This condition occurred because the owner relied on its onsite managers, who mismanaged the program. Further, the owner and former management agent lacked oversight of their staff and failed to implement appropriate controls to ensure that they could support the eligibility of their tenants and that more than \$1.9 million in HUD housing assistance payments was accurate, as certified on their reimbursement requests. In understanding the issues it faced, the owner undertook steps to manage its program in a more efficient and effective manner. It hired a new management agent, conducted a 100 percent file review and mass inspections, and entered into repayment agreements with HUD for tenant files it could not support.²³ However, the owner collected housing assistance payments of more than \$1.8 million, which it could not support.

Recommendations

We recommend that the Southwest Region Director of Multifamily Housing require the Eastwood Terrace Apartments owner to

- 1A. Support that the subsidies for 77 tenants and units with income discrepancies, missing EIV reports, missing income verifications, missing annual certifications and missing signatures are supported and accurate or repay HUD \$1,865,344 for those subsidies. Repayment must be from non-project funds.

²³ Of its repayments through June 2018, \$40,884 related to 9 of 81 tenant files in our sample.

- 1B. Ensure tenants are housed in the correct unit size.
- 1C. Ensure annual inspections are performed in a timely manner and in accordance with HUD requirements.
- 1D. Ensure that its new property management agent is providing oversight to its onsite staff and that its recently implemented quality control program is working as designed and in accordance with HUD requirements.
- 1E. Maintain tenant files in a manner that ensures they contain the correct records and all required documentation.

Scope and Methodology

We performed our fieldwork at Eastwood Terrace’s office located in Nacogdoches, TX, and the OIG Office of Audit in Houston, TX, from November 2017 through June 2018. Our audit period was June 2014 through September 2017.

To accomplish our objective, we

- Reviewed relevant HUD regulations and requirements.
- Reviewed Eastwood Terrace’s policies and procedures.
- Reviewed the contract administrator’s management and occupancy review period for Eastwood Terrace, dated March 17, 2017.
- Reviewed Eastwood Terrace’s latest Real Estate Assessment Center inspection report.
- Reviewed Tenant Rental Assistance Certification System move-in and move-out reports and unit payment history reports.
- Reviewed the project’s audited financial statements.
- Interviewed employees at Eastwood Terrace.
- Interviewed the owner, project-based contract administrator and management agent staff.
- Corresponded with HUD staff.
- Removed HUD reimbursed amounts for unsupported tenant files from repayment agreements.

Of the 401 subsidized tenants during our review period receiving more than \$5.1 million in housing assistance payments, we selected a nonstatistical sample of 15 tenants totaling \$482,375 in housing assistance payments during the survey phase for tenants who (1) had housing assistance payment amounts of more than \$10,000, (2) received payments under more than one name (duplicates),²⁴ (3) and had low income. Based on the results, we expanded our review in the audit phase to include an additional 66 tenants²⁵ for the audit phase totaling more than \$1.4 million in housing assistance payments. We selected tenants who had (1) housing assistance payment amounts of more than \$10,000 and (2) income of \$5,000 or less. For these 81 (15 + 66) tenants totaling more than \$1.9 million in housing assistance payments, we reviewed their files to determine whether documentation supported the tenant’s eligibility for subsidized housing.

²⁴ We could not precisely identify the number of duplicate tenants because there were several tenants with multiple variations of their names and some with different names for the same tenant in the unit payment history data, which we used to identify our universe and select our sample.

²⁵ Four of the files were missing. Records showed these four tenants moved into Eastwood Terrace on June 30, 2016.

To achieve our audit objective, we relied on computer-processed data regarding the unit payment history for each tenant. We assessed the reliability of the computer-processed data and determined that the data were generally reliable. The test results refer only to the tenants tested and cannot be projected to the population of tenants.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Internal Controls

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- effectiveness and efficiency of operations,
- reliability of financial reporting, and
- compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Policies and procedures that Eastwood Terrace's owner implemented to ensure that its Section 8 PBRA program was administered in accordance with HUD's rules and regulations.
- Policies and procedures that Eastwood Terrace's owner implemented to provide adequate oversight of former onsite managers at Eastwood Terrace.
- Policies and procedures that Eastwood Terrace's owner implemented to ensure that its monthly HUD billings were accurate.
- Policies and procedures that Eastwood Terrace's owner implemented to ensure that its units were decent, safe, and sanitary.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- The owner and former management agent lacked oversight and did not have sufficient controls in place to ensure that they implemented the Section 8 PBRA program in accordance with HUD's rules and regulations, including that their monthly billings to HUD were accurate (finding).

Appendixes

Appendix A

Schedule of Questioned Costs

Recommendation number	Unsupported 1/
1A	\$1,865,344
Totals	1,865,344

- 1/ 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 the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.

Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

Eastwood Terrace and Oakhill Plaza, LLC

MEMORANDUM

TO: Kilah S. White, Regional Inspector General for Audit, U.S. Department of Housing and Urban Development, Office of Inspector General – Office of Audit (Region 6) (*via Email and Overnight Mail*)

CC: Danita Wade, Assistant Regional Inspector General for Audit (*via Email*)
Darlene Haniak, Auditor in Charge (*via Email*)
Mary Walsh, Southwest Region Director, Multifamily Housing (*via Email*)

FROM: Eastwood Terrace and Oakhill Plaza, LLC

DATE: July 13, 2018

RE: Eastwood Terrace Apartments, Nacogdoches, TX – Response to Draft Audit Report

This memorandum is in response to the Audit Report discussion draft (the "Draft Report") concerning Eastwood Terrace Apartments ("Eastwood Terrace" or the "Property") issued by the U. S. Department of Housing and Urban Development ("HUD") Office of Inspector General – Office of Audit Region 6 (the "OIG") on June 29, 2018, and which was the subject of an exit conference held on July 10, 2018 (the "Exit Conference"). This written response is due by July 13, 2018, and therefore is submitted timely.

Introduction

Eastwood Terrace is a 192-unit apartment complex located in Nacogdoches, TX. The Property is owned by Eastwood Terrace and Oakhill Plaza, LLC (the "Owner"), and its current management agent is Arnold-Grounds Apartment Management & Affordable Housing Specialists, LLC ("Arnold-Grounds" or the "Current Agent"). There is no identity of-interest between the Owner and the Current Agent. The Property is subject to HUD oversight given that all of its units receive Section 8 subsidy. The Property is not financed with a HUD-insured or HUD-held loan.

Discussion

The Owner sincerely appreciates the professionalism and courteousness with which the OIG conducted its audit of Eastwood Terrace and looks forward to working with HUD's Multifamily Southwest Region to resolve this matter. However, the Owner respectfully

Auditee Comments

Comment 1

submits that the Draft Report does not fully reflect and thereby sufficiently account for certain over-arching facts and circumstances, favorable to the Owner and the Property, that shed important light on the OIG audit itself and the conclusions reached in the Draft Report. As such, the Owner respectfully presents the responses below so that the next steps with HUD will be informed by those facts and circumstances.

Overarching Facts and Circumstances for Inclusion in the Final Audit Report

While the Draft Report notes that the Owner undertook its own 100% file audit for the period January 2014 through March 2017, the Draft Report does not sufficiently convey that: (1) the Owner's 100% file audit overlapped with the OIG audit, (2) the OIG ceased collecting information before the Owner's 100% file audit could be completed, (3) therefore, that much of the subsidy payment the OIG determined was unsupported was supported by Owner's 100% file audit, and (4) what the Owner has thus far determined was unsupported has been repaid through voucher adjustments not reflected in the Draft Report and repayment agreements reflected but not credited in the Draft Report.

Specifically, Eastwood Terrace received its MOR Summary Report on March 17, 2017 from Southwest Housing Compliance Corporation ("SHCC"). The MOR required that a 100% file audit be completed, as well as 100% unit inspections. With regard to the 100% file audit in particular, the Owner engaged several third parties to assist in conducting the file audits. The third parties included industry recognized experts in voucher processing and file auditing services. The 100% file audit began in March 2017. The Owner hired Arnold-Grounds in January 2018 as the new management agent for the Property. Arnold-Grounds participated in and was instrumental in completing the 100% file audit.

The MOR required that the Owner audit 100% of the tenant files for both current and former tenants for the period of September 1, 2015 to March 17, 2017. (Once the OIG audit commenced, the Owner's 100% file audit was expanded to include 2014 to be compatible with the period being covered by the OIG audit.) Pursuant to the MOR, the Owner's 100% file audit included a review of the accuracy and verification of tenant adjusted income, household composition, signed move-in lease and move-in 50059, and the accuracy of household members and signatures. Additionally, Move-In and Move-Out files were required to be audited to verify the accuracy of the move-in and move-out dates. As required by the MOR, all units were inspected as well.

During the Owner's 100% file audit, SHCC suggested that the Owner create new forms packets to ensure that all tenants complete the most recent HUD forms and that all tenants were properly certified. The Owner conducted tenant meetings and brought in several other management agent companies with Section 8 HUD experience to assist with the tenant meetings and the file audit process. The 100% file audit was completed in March 2018 and SHCC closed out the MOR on April 2, 2018.

Comment 2

As a result of the Owner's 100% file audit, the Owner has already taken steps for HUD to be paid back for a considerable amount of acknowledged unsupported subsidy. Some of these steps occurred prior to the OIG audit in the form of repayment agreements; some

Ref to OIG
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Auditee Comments

Comment 3

have occurred since the OIG audit began but prior to issuance of the Draft Report through monthly voucher adjustments. These amounts largely relate to the \$1,865,344 that the Draft Report states is at issue, and the Owner anticipates that when credited as the matter is resolved with HUD's Multifamily Southwest Region, the \$1,865,344 figure will be significantly reduced.

The Draft Report also states that the OIG performed its fieldwork for the OIG audit from December 2017 through June 2018. However, information collection by the OIG ceased in late January 2018, meaning that the conclusions reached by the OIG could not and do not reflect a range of information obtained during the Owner's 100% file audit that the Owner believes addresses much of the OIG's concerns which will now need to be addressed by and resolved with HUD's Multifamily Southwest Region. This includes having located documents the OIG believed were missing.

Comment 4

In addition, while the Draft Report credits the Owner with being "proactive" and having "made improvements" based on the Owner's 100% file audit and other factors, the Draft Report does not include a very important fact and circumstance. Specifically, the Owner first became aware of certain employee misconduct and fraudulent actions that are significant contributing factors to the matter now at hand during the Management Occupancy Review exit interview conducted on the late afternoon of February 16, 2017. The Owner proactively contacted the OIG that same evening and scheduled a meeting for the following day to initiate discussions and pledge its full cooperation and assistance with next steps. As the Owner trusts the OIG will agree, the Owner has since fully cooperated with the OIG, including but not limited to assisting the OIG with next steps that may be taken with regard to the employees and their misconduct and fraudulent actions.

Responses to Draft Report Sub-Findings and Supporting Conclusions

The Draft Report includes the finding that "Eastwood Terrace Apartments Subsidized Questionable Tenants, Overhoused Tenants, and Uninspected Units". Within that finding are 4 sub-findings: (1) "The Owner Billed HUD for Questionable Tenants", (2) "The Owner Billed HUD for Uninspected Units", (3) "The Owner Lacked Oversight and Did Not Have Controls to Detect or Prevent Deficiencies", and (4) The Owner Was Proactive and Had Made Improvements. Except for the second sub-finding regarding billing for uninspected units, each of the other 3 sub-findings includes several supporting conclusions, much of which directly relates to the overarching facts and circumstances set forth above. The following Owner responses to the sub-findings and supporting conclusions therefore and where applicable refer back to that discussion above.

The Owner Billed HUD for Questionable Tenants

Comment 2

This sub-finding includes supporting conclusions regarding "Missing Tenant Files", "Overhoused Tenants", "Missing Documents and Signatures", and "Income Discrepancies". As discussed above, for the 77 tenant files for which the OIG has determined that a total of \$1,865,344 in unsupported subsidy payments is at issue, the Owner is confident that much of what was concluded in this regard has: (1) already been

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Auditee Comments

Comment 5

resolved by monthly voucher adjustments that have already been made by the Owner that are not reflected in the Draft Report or by repayment agreements referenced in the Draft Report but that have not been fully credited, or (2) will be resolved once the Owner has the opportunity to share the results of its 100% file audit with HUD. The Owner looks forward to working with HUD's Multifamily Southwest Region.

The Owner Billed HUD for Uninspected Units

Because the OIG conclusion in this regard is largely based on, respectfully, what the Owner believes is misinterpretations and/or misapplication of HUD programmatic requirements and guidance, the Owner looks forward to revisiting this issue with HUD's Multifamily Southwest Region which is responsible for such matters.

The Owner Lacked Oversight and Did Not Have Controls to Detect or Prevent Deficiencies

Comment 6

This sub-finding includes supporting conclusions that "The Owner Hired the Prior Owner's Employees," "The Owner Relied on Staff, Which Had Questionable Practices and Mismanaged Its Program", "The Owner Allowed Mass Document Processing", and "The Owner Blamed Former Employees for Issues". The Owner respectfully suggests that the following summary regarding the history of its ownership and the management of the Property clarifies certain information and statements set forth in the Draft Report and thereby addresses this sub-finding and supporting conclusions.

When the Owner acquired the Property in May 2014 it engaged J Allen Management, an experienced third-party property management company with several thousand HUD units under management, to take over management of the Property. The Property's on-site office and maintenance staff were retained and employed by J Allen Management. When the Owner's newly-formed affiliated management company took over management of the Property in October 2015, that management company retained and employed those same staff. The Current Agent began managing the Property in January 2018, and has since replaced the entire on-site office and maintenance staff.

The Owner Was Proactive and Had Made Improvements

Comment 7

This sub-finding includes the supporting conclusion that "The Owner Entered Into Repayment Agreements".

The Owner sincerely appreciates the OIG's recognition that it was proactive and has made improvements, including improvements to the Property's physical condition, management, and oversight procedures. In that regard but not detailed in the Draft Report, the Owner notes the following due to their significance: (1) in an effort to create an additional set of checks and balances and prevent future issues, the Owner has hired a third-party independent company to process its vouchers, (2) the entire on-site office and maintenance staff have been replaced and have undergone extensive training, (3) the Owner has implemented quarterly unit inspections, and (4) since acquiring the Property and to date,

Auditee Comments

the Owner has expended over \$2.5 Million for physical improvements and repairs to the Property.

In addition, the Owner reiterates here that: (1) most of the repayment agreements referenced in the Draft Report were executed prior to the OIG audit, (2) as a result of the Owner's 100% file audit, the Owner has already paid back HUD through monthly voucher adjustments for a considerable portion of the \$1,865,344 of unsupported subsidy alleged in the Draft Report, (3) once the repayment agreements referenced in the Draft Report are properly credited, the \$1,865,344 will be further reduced, and (4) the Owner anticipates that it will be able to satisfy HUD's concerns as to the remaining subsidy alleged to be unsupported. The Owner looks forward to working with HUD's Multifamily Southwest Region to resolve this matter.

Conclusion

The Owner thanks the OIG for its handling of this matter and looks forward to working with HUD's Multifamily Southwest Region to reach a final resolution.

OIG Evaluation of Auditee Comments

Comment 1 The owner explained that its most recent management occupancy review (MOR) required a 100 percent file review and 100 percent unit inspections. The owner stated that its file review overlapped OIG's audit and the OIG results were based on information collected before the owner completed its review. The owner provided details on its required file reviews and unit inspections, who conducted them, and when they were conducted.

We agree that the owner undertook the required 100 percent file reviews and unit inspections because it received an unsatisfactory score in its MOR, as discussed in the background and objective section of the report. We revised a portion of the finding for clarification. The OIG report was based on information the owner provided throughout the audit process, including review of information collected after the owner's 100 percent file audit. The owner will need to work with HUD to resolve the finding and recommendations during the audit resolution process.

Comment 2 The owner asserted that it had already taken steps for HUD to be paid for a considerable amount of the acknowledged unsupported subsidy and that its voucher adjustments were not reflected in the OIG report. It also stated that repayment agreements were reflected, but not credited in the report. The owner believes that the questioned costs will be significantly reduced when it resolves the issue with HUD.

We maintain our position as described in the finding. We considered voucher adjustments that were included in the contract administrator's unit payment history reports. Further, we reported \$281,416 in repayment agreements that the owner entered into with HUD and credited repayment agreement amounts in Appendix D of the report in determining unsupported questioned costs of \$1.8 million for the audit period. The owner will need to work with HUD to resolve the finding and recommendations during the audit resolution process. Additional repayments after the audit period should be discussed with HUD at that time.

Comment 3 The owner asserted that although the draft report stated that OIG performed fieldwork from December 2017 through June 2018, information collected by the OIG ceased in late January 2018.

We revised the report to reflect the entrance conference date as the fieldwork start date. However, we maintain that fieldwork, which included work at both the Eastwood Terrace and OIG offices, was conducted through June 2018. Our audit work did not cease in January 2018. For example, the owner provided a USB drive with additional file documents in April 2018 that we evaluated before drafting the report.

Comment 4 The owner asserted that OIG's report did not include how the owner became aware of employee misconduct and fraudulent actions during the MOR, and how it responded by notifying OIG and pledging cooperation and assistance.

The report appropriately reflects the owner's corrective actions and responsiveness related to its MOR. We maintain our position as stated in the finding.

Comment 5 The owner believes the OIG misinterpreted and misapplied HUD program requirements and guidance.

We maintain our position as described in the finding. The owner will need to work with HUD to resolve the finding and recommendations during the audit resolution process.

Comment 6 The owner provided a summary of the history and management of the property to clarify information and statements in the OIG's finding and conclusion.

The background and objective section of the report described Eastwood Terrace's history and management structure. We did not revise the report.

Comment 7 The owner outlined its efforts to improve the property's physical condition, management, and oversight procedures, which it said were not detailed in the report.

OIG recognized that the owner had made improvements in the finding section of the report. The owner will need to work with HUD during the audit resolution process to ensure the improvements meet program requirements.

Appendix C

Unsupported Tenant File Results

Tenant	Over-housed	Income discrepancies	Missing EIV reports	Missing income verification	Missing annual certifications	Missing tenant files	Missing inspection reports	Missing signatures on 50059
1		X	X				X	
2	X	X	X				X	
3			X		X		X	
4	X		X				X	
5		X	X				X	
6			X		X		X	
7			X	X			X	
8	X	X	X	X			X	X
9	X	X	X	X			X	X
10		X	X	X	X		X	
11		X	X	X			X	X
12	X		X	X			X	X
13	X		X	X	X		X	X
14	X	X	X				X	
15			X	X			X	X
16	X		X				X	X
17		X	X				X	X
18	X		X	X			X	X
19		X	X				X	X
20		X	X	X	X		X	X
21	X	X	X				X	X
22	X		X				X	
23	X	X	X	X			X	
24	X	X	X	X			X	X
25		X	X				X	X
26			X	X			X	X
27			X	X			X	X
28		X	X	X			X	
29		X	X	X			X	
30		X	X	X			X	

Tenant	Over-housed	Income discrepancies	Missing EIV reports	Missing income verification	Missing annual certifications	Missing tenant files	Missing inspection reports	Missing signatures on 50059
31	X	X	X	X	X		X	X
32		X	X	X			X	
33		X	X	X			X	X
34	X	X	X	X			X	X
35	X	X	X	X			X	X
36	X	X	X	X			X	X
37			X	X			X	
38			X	X	X		X	
39	X	X	X	X			X	X
40	X	X	X	X	X		X	X
41		X	X	X			X	
42	X	X	X	X			X	X
43		X	X	X			X	X
44		X	X	X			X	
45		X	X	X	X		X	X
46		X	X		X		X	X
47		X	X	X			X	X
48	X	X	X	X			X	X
49		X	X	X			X	X
50	X	X	X	X			X	X
51	X	X	X	X			X	X
52			X					
53		X	X	X			X	
54						X		
55		X	X		X		X	
56						X		
57		X	X		X		X	
58		X	X	X			X	
59	X	X	X	X	X		X	X
60	X	X	X	X	X		X	
61						X		
62		X	X	X				
63		X	X		X		X	
64						X		

Tenant	Over-housed	Income discrepancies	Missing EIV reports	Missing income verification	Missing annual certifications	Missing tenant files	Missing inspection reports	Missing signatures on 50059
65	X	X	X	X			X	X
66	X		X		X		X	X
67	X	X	X	X			X	X
68		X	X	X	X		X	
69		X		X			X	
70		X		X	X		X	X
71		X		X			X	X
72		X	X		X		X	
73	X	X	X	X			X	X
74	X	X	X	X			X	
75	X	X		X			X	
76	X	X	X	X			X	X
77	X			X	X		X	X
78			X	X			X	
79	X	X	X	X			X	X
80	X	X	X	X	X		X	X
81			X	X			X	
Totals	35	58	72	57	21	4	75	43

Appendix D

Unsupported Tenant Subsidy Payments and Repayments to HUD

Sample	Unsupported housing assistance payments	Housing assistance payments reimbursed to HUD via repayment agreements	Remaining unsupported housing assistance payments
1	\$22,310		\$22,310
2	33,833		33,833
3	36,484		36,484
4	27,748		27,748
5	24,871		24,871
6	39,903		39,903
7	23,086		23,086
8	27,440		27,440
9	17,560		17,560
10	24,991		24,991
11	23,386		23,386
12	22,512		22,512
13	35,197		35,197
14	34,314		34,314
15	25,511		25,511
16	37,860		37,860
17	22,824		22,824
18	16,091		16,091
19	22,664		22,664
20	27,707		27,707
21	21,650		21,650
22	33,105		33,105
23	24,349		24,349
24	22,321		22,321
25	33,719		33,719
26	29,626		29,626
27	34,605		34,605
28	24,084		24,084
29	36,234		36,234
30	14,997		14,997
31	11,649		11,649
32	26,171		26,171
33	9,003		9,003

Sample	Unsupported Housing assistance payments	Housing assistance payments reimbursed to HUD via repayment agreements	Remaining unsupported housing assistance payments
34	35,497		35,497
35	19,642		19,642
36	18,707		18,707
37	36,433		36,433
38	24,463		24,463
39	36,448		36,448
40	30,270		30,270
41	14,476		14,476
42	34,732		34,732
43	21,700		21,700
44	16,117		16,117
45	12,856		12,856
46	17,056	\$12,730	4,326
47	18,222	4,692	13,530
48	31,998		31,998
49	34,632		34,632
50	27,270		27,270
51	21,833		21,833
52	14,205		14,205
53	16,981		16,981
54	5,269	5,269	-
55	9,480	1,427	8,053
56	-	1,817 ²⁶	-
57	4,185		4,185
58	10,740		10,740
59	2,766		2,766
60	9,608	6,552	3,056
61	3,183	3,183	-
62	9,572		9,572
63	4,010	1,527	2,483
64	5,406	5,406	-
65	8,291		8,291

²⁶ Eastwood Terrace reimbursed HUD for this sample item before we began our fieldwork. We did not question any costs for this sample item; thus, we did not include this amount in the housing assistance payment reimbursement total.

Sample	Unsupported Housing assistance payments	Housing assistance payments reimbursed to HUD via repayment agreements	Remaining unsupported housing assistance payments
66	-	5,062 ²⁷	-
67	42,522		42,522
68	41,365		41,365
69	39,949		39,949
70	37,552		37,552
71	39,181		39,181
72	38,560		38,560
73	38,232		38,232
74	37,618		37,618
75	36,994		36,994
76	36,994		36,994
77	20,568		20,568
78	22,120		22,120
70	28,888		28,888
80	11,492	98	11,394
81	10,340		10,340
Totals	1,906,228	40,884	1,865,344

²⁷ Ibid.