



# Dolores Frances Affordable Housing Project, Los Angeles, CA

Section 221(d)(4) Program



**To:** Thomas Azumbrado, Acting Director, Los Angeles Office of Multifamily Housing Programs, 9AHMLAP

Craig Clemmensen, Director, Departmental Enforcement Center, CACB

//SIGNED//

**From:** Tanya E. Schulze, Regional Inspector General for Audit, 9DGA

**Subject:** The Dolores Frances Affordable Housing Project, Los Angeles, CA, Was Not Administered in Accordance With Its Regulatory Agreement and HUD Requirements

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 Dolores Frances Affordable Housing project.

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 Web site. 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 213-534-2471.



**Audit Report Number: 2016-LA-1008**

**Date: August 26, 2016**

**The Dolores Frances Affordable Housing Project, Los Angeles, CA, Was Not Administered in Accordance With Its Regulatory Agreement and HUD Requirements**

## Highlights

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### What We Audited and Why

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We audited the Dolores Frances Affordable Housing project, based on a citizen complaint and a suggestion from the U.S. Department of Housing and Urban Development's (HUD) Departmental Enforcement Center. The complaint alleged nonpayment of HUD utility allowances and security deposits, mismanagement of the maintenance department, related parties hired in supervisory positions, and conflict-of-interest vendor contracts by the related party of Dolores Frances (Pico Union Housing Corporation). Our audit objective was to determine whether Dolores Frances was administered in accordance with HUD rules and requirements.

### What We Found

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The allegations stated in the complaint were generally unsubstantiated and had no merit. However, Dolores Frances was not administered in accordance with HUD requirements. The project made ineligible payments of \$531,186 for expenses that were not reasonable and necessary for the operation of the project. In addition, Dolores Frances inappropriately secured more than \$10.9 million in unsupported loans that encumbered the properties of the project without HUD approval. These actions increased the project's risk of mortgage default.

### What We Recommend

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We recommend that the Acting Director of HUD's Los Angeles Office of Multifamily Housing Programs require the owners of Dolores Frances to (1) stop disbursing project funds for ineligible social services fees and reimburse the project \$300,000, (2) reimburse the project for \$74,784 in consulting fees and \$18,178 in fees charged by the management agent that were ineligible, (3) reimburse the project for \$114,068 in ineligible legal fees, (4) provide documentation to support HUD approval for the loan between Dolores Frances and Pico Union for more than \$6.3 million and how the funds were used or remove the loan and associated encumbrance from the project, (5) provide documentation to support that the loan between Dolores Frances and Alliant for more than \$4.5 million was approved by HUD or remove loan and any associated encumbrance from the project, and (6) implement controls to ensure that management and ownership follow the project's policies and procedures, the regulatory agreement, and HUD program requirements. We also recommend that the Director of the Departmental Enforcement Center pursue civil and administrative remedies, as appropriate, against the owners of Dolores Frances.

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# Background and Objectives

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Dolores Frances Affordable Housing, L.P., a California limited partnership, HUD project no. 122-35638, was formed to rehabilitate and operate 366 units of affordable housing and 5 commercial units in Los Angeles, CA, that were originally ready for occupancy at various dates from 1974 to 1992. The project's 366 affordable housing units were divided into 11 different subproperties, with the units also scattered at different site locations within a small community neighborhood in the central Los Angeles area known as the Pico Union district. One of the project's subproperties, Villa, contained the most units (115).

The general partner is Dolores Frances Affordable Housing, Inc., a California nonprofit corporation; the investor limited partner is Alliant Tax Credit Fund 31-A, Ltd., a Florida limited partnership; and the administrative limited partner is Alliant Tax Credit 31, Inc.

On February 1, 2004, Dolores Frances Affordable Housing, L.P., secured a mortgage note for nearly \$19.9 million, insured by the U.S. Department of Housing and Urban Development (HUD) under section 221(d)(4) of the Housing Act. Section 221(d)(4) insures mortgage loans to facilitate the new construction or substantial rehabilitation of multifamily rental or cooperative housing for moderate-income families, the elderly, and the handicapped and will also insure lenders against loss on mortgage defaults. Dolores Frances also receives funding through HUD's project-based Section 8 housing choice voucher program for 271 housing units. The program provides rental assistance for low-income households in privately owned and managed rental units.

The Pico Union Housing Corporation is a related party of the Dolores Frances Affordable Housing project. The principals for Pico Union are also the same principals for the Dolores Frances Affordable Housing, L.P. and for the project's general partner, Dolores Frances Affordable Housing, Inc. Pico Union had managed and operated the project as a management agent in 2014 but was replaced by the Genessy Management & Development LLC in 2015.

The objective of our audit was to determine whether the Dolores Frances Affordable Housing project was administered in accordance with HUD rules and requirements.

# Results of Audit

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## **Finding 1: The Dolores Frances Affordable Housing Project Was Not Administered in Accordance With Its Regulatory Agreement and HUD Requirements**

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The Dolores Frances Affordable Housing project did not follow its regulatory agreement or HUD program requirements. Specifically, it made ineligible payments to its general partner, management consultant, and management agent. It also incurred ineligible legal expenses and excessive bookkeeping fees. In addition, Dolores Frances inappropriately secured loans on the project without HUD approval. This condition occurred because the project lacked adequate controls to prevent the owner and agent of Dolores Frances from disregarding project policies and procedures, the regulatory agreement, and HUD handbook requirements. As a result, the owners of the project made ineligible payments of \$531,186 in project funds and placed additional encumbrances on the project totaling more than \$10.9 million, increasing the project's risk of mortgage default.

### **Dolores Frances Disbursed Project Funds for Expenditures That Were Ineligible**

Dolores Frances did not disburse project funds in accordance with HUD rules and requirements. Overall, the owners of the project made ineligible payments of \$531,186 in project funds.

Ineligible expenditures	Fiscal year	Ineligible amount
Social services	2014-2015	\$300,000
Consulting services	2014	74,784
Legal services	2015	114,068
Overseeing and supervising services	2015	18,178
Bookkeeping	2015	24,156 <sup>1</sup>
<b>Total</b>		<b>531,186</b>

### Dolores Frances Made Ineligible Payments for Social Services

Dolores Frances paid \$300,000 to its general partner (Dolores Frances, Inc.) for social services expenditures, through flat monthly payments of \$12,500 in 2014 and 2015. Dolores Frances, Inc., then paid the social service fee to the related party of the project, Pico Union Housing

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<sup>1</sup> The management agent repaid the project after we discussed the issue with project management.

Corporation. These fees were categorized as community-based activities for Dolores Frances tenants for activities and programs like painting and art programs, after-school programs, and holiday event activities. However, these social service costs were not reasonable and necessary expenses incurred for the operation of the project as defined by HUD Handbook 4381.5, paragraph 6.38(a), and the regulatory agreement, paragraphs 6(b) and 6(e)(i) (appendix C). Therefore, the expenditure for social service fees within our audit scope (January 1, 2014, to December 31, 2015) amounting to \$300,000 were ineligible.

#### Duplicative Fees Were Paid to a Consultant

Dolores Frances entered into an agreement for consulting services in 2014. Compensation was paid at a rate of \$16.67 per unit per month, and total payments in 2014 amounted to \$74,784. However, these services were similar to the duties of the project's management agent at that time, including preparing and reviewing the annual budget, reviewing revenue and expense statements, and attaining a certified public accountant for the annual yearend audit of the financial statements. Dolores Frances had acquired Pico Union Housing Corporation as its management agent in 2014 and paid it \$288,625 for management fee services. The consulting services were duties already covered by the management agent's fee, as defined in HUD Handbook 4381.5, paragraphs 6.39(a) to (c), (appendix C), and should not have been charged again to the housing project. As a result, the consulting fees were ineligible.

#### Disbursements for Legal Expenses Were Ineligible

Dolores Frances paid a total of \$114,068 to Lurie, Schmalz & Hogan for legal expenses in 2015. The supporting documentation described the fees as payment for legal services tied to a lawsuit over ownership title of a parking lot located at a subproperty of Dolores Frances (Bellevue property). The use of project funds to pay for these legal fees was inappropriate since they were not reasonable and necessary expenses for the actual operation of the project according to HUD Handbook 4381.5, section 6.38, and the regulatory agreement, paragraph 6(b) (appendix C). The legal fees were ownership costs and not project costs; therefore, the \$114,068 paid to the law firm was ineligible.

#### Payments Made to the Management Agent for Overseeing and Supervising Were Ineligible

Dolores Frances paid its management agent, Genessy Management & Devevelopment LLC, "overseeing and supervising" fees totaling \$18,178 from February 2015 to November 2015 for the replacement of a resident manager at one of the project's subproperties (Villa).

According to HUD requirements, project funds may be used to pay the allowable portion of the costs of the salary for a supervisory employee of the agent designated to replace a project employee on temporary leave for a period of up to 90 days after the first 40 consecutive hours. The amount paid out of project funds for the replacement employee may not exceed the lesser of twice the amount of the absent employee's salary or the actual amount of the replacement employee's salary.

Project officials stated and provided documentation indicating that the project's occupancy specialist was handling the duties as a resident manager to cover the full-time position during this period. However, the replacement resident manager was already performing duties and

being paid by the project as a full-time occupancy specialist. No documentation was provided to demonstrate that the project used additional staff to fill the full-time resident manager position and earn the additional fee.

The project's records also showed that the resident manager who had reportedly been replaced was charged to the project as "janitorial." He performed some resident manager functions in addition to his janitorial duties. As a result, the project did not previously have a full-time resident manager position to replace. The janitorial employee also continued to work at the Villa property through August 2015 and resided in a rent-free unit during the majority of the period in which the management agent charged the additional fee.

The disbursements made to the project's management agent for added supervision fees were not in accordance with guidelines in HUD Handbook 4381.5, section 3.1 and paragraphs 6.39c(2)(a) and(b) (appendix C). Therefore the overseeing and supervisory fee of \$18,178 was ineligible.

#### Dolores Frances Paid Excessive Bookkeeping Fees

Dolores Frances' current management agent, Genessy Management & Development LLC, was paid bookkeeping fees at a rate above the allowable rate approved by HUD. The rate charged by Genessy did not follow HUD Handbook 4381.5, paragraph 6.38a, and HUD's management fee letter (effective August 1, 2011) (appendix C). The management fee letter set the allowable monthly bookkeeping fee for centralized services chargeable to each project at \$9.50 per unit. However, Genessy charged fees at \$15 per unit, an increase of \$5.50 (\$15 - \$9.50) per unit in bookkeeping fees, from August 2015 to December 2015 (5 months). Further, Dolores Frances made a retroactive lump sum payment to Genessy for the excessive bookkeeping fee for January 2015 to July 2015 (7 months). The total ineligible bookkeeping fees for the year, January to December 2015, amounted to \$24,156 [(\$5.50 x 366/unit) x 12 months]. To exceed the allowable threshold cost of \$9.50, a justification with supporting documentation must be submitted to HUD for approval. However, there was no documentation showing that HUD approved the increase in bookkeeping fees to Genessy. Therefore, the costs of \$24,156 for these bookkeeping fees were ineligible.

After we discussed this matter with the management agent, it recognized the error and repaid the ineligible amount.

#### **Dolores Frances Lacked Supporting Documentation for Internal Loans**

Dolores Frances could not provide adequate support for two internal loans that were not approved by HUD. The project inappropriately secured these loans, encumbering the ownership interest or properties of the project, without maintaining evidence of HUD approval, resulting in unsupported encumbrances totaling more than \$10.9 million.

### A Loan From Pico Union Housing Corporation Was Unsupported

Dolores Frances acquired a loan from the Pico Union Housing Corporation for more than \$6.3 million, issued on February 25, 2004, 24 days after the original HUD-insured mortgage note was issued. Dolores Frances provided a promissory note as the only supporting documentation for the loan. The note indicated that the loan from Pico Union to Dolores Frances was used to finance a portion of the cost of acquisition and rehabilitation of the project (legally described in exhibit A to the promissory note secured by subordinate deed of trust) and the maintenance of affordable housing in the project under the agreement. However, exhibit A was missing from the note, and there were no related documents to indicate or support how the funds were used. Further, there was no documentation provided to show that this loan was HUD approved. Our review determined that a portion of the note (\$667,549) was paid within 1 year of its issuance, bringing the principal balance to more than \$5.7 million (\$6,422,172 - \$667,549). Accumulated interest was calculated to be \$585,881. Since there was no documentation to properly support the use of the loan and that it was properly approved by HUD under the regulatory agreement (appendix C), we determined the loan balance amount of more than \$6.3 million (\$5,754,623 + \$585,881) to be unsupported.

### A Loan With Alliant Tax Credit Fund 31-A, LTD, Was Unsupported

Dolores Frances acquired a loan from the Alliant Tax Credit Fund, LTD, for \$897,565 in June 2006. The loan was secured by the ownership interest (or properties) of Dolores Frances. The loan was to be repaid by December 1, 2006, with interest at prime plus 10.25 percent annually, compounded semiannually. However, Dolores Frances did not repay the loan by the due date. By December 31, 2015, the annual rate of interest had increased to 18 percent. The lack of payment resulted in an accumulation of interest and no reduction of the original principal. No support was provided to show that the loan was properly approved by HUD in accordance with the regulatory agreement (appendix C). As a result, the loan balance amount of more than \$4.5 million (which included accumulated interest and principal) was unsupported.

### **Conclusion**

The Dolores Frances Affordable Housing project made ineligible payments to its general partner, management consultant, and management agent. It also incurred ineligible legal expenses and had excessive bookkeeping fees. In addition, Dolores Frances inappropriately secured unsupported loans, which encumbered the properties of the project, without HUD approval. This condition occurred because the project lacked adequate controls to prevent the owner and agent of Dolores Frances from disregarding project policies and procedures, the regulatory agreement, and HUD handbook requirements. As a result, the owners of Dolores Frances made ineligible payments of \$531,186 in in project funds. Additionally, the owners of the project secured two internal loans for more than \$10.9 million, which encumbered the properties of Dolores Frances, without evidence of HUD approval. These actions by the project's ownership and management increased the risk of mortgage default and jeopardized the project's ability to provide continued affordable housing for low-income persons.

## **Recommendations**

We recommend that the Acting Director of HUD's Los Angeles Office of Multifamily Housing Programs require the owners of Dolores Frances to

- 1A. Stop the practice of disbursing the monthly social service fee to the general partner and reimburse the project for \$300,000 in ineligible social service fees from non-Project funds.
- 1B. Reimburse the project \$92,962 from non-Project funds for ineligible consulting fees (\$74,784) and supervising fees (\$18,178).
- 1C. Reimburse the project from non-Project funds for \$114,068 in ineligible legal fees.
- 1D. Provide adequate documentation to support HUD approval for the \$6,340,504 loan between Dolores Frances and Pico Union and how the funds were used or remove the loan and any associated encumbrance from the project.
- 1E. Provide adequate documentation to support that the \$4,586,471 loan between Dolores Frances and Alliant Tax Credit Fund, LTD, was approved by HUD or remove the loan and any associated encumbrance from the project.
- 1F. Implement additional written controls to ensure that management and ownership follow the project's policies and procedures, the regulatory agreement, and HUD program requirements.

We also recommend that the Director of the Departmental Enforcement Center

- 1G. Pursue civil and administrative remedies, as appropriate, against the owners of Dolores Frances for making ineligible payments using project funds and securing loans that encumbered the properties of Dolores Frances without HUD approval.

# Scope and Methodology

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We performed our onsite audit work at Dolores Frances' main office on 1038 Venice Boulevard, Los Angeles, CA, from November 30, 2015, to June 9, 2016. Our review generally covered the period January 1, 2014, to December 31, 2015, and was expanded as necessary.

To accomplish our objective, we performed the following:

- Reviewed HUD regulations and reference materials related to multifamily requirements;
- Reviewed regulations and requirements stated in the regulatory agreement and housing assistance payments contracts;
- Interviewed appropriate Dolores Frances management and staff personnel;
- Reviewed relevant management, procurement, and accounting procedures and records;
- Reviewed vendor disbursement documentation for project expenditures;
- Reviewed the monitoring reports issued by HUD;
- Reviewed loans secured by the project; and
- Reviewed the tenant rent rolls, utility allowances, and security deposits;
- Reviewed organizational charts;
- Reviewed audited financial statement for fiscal years 2014 and 2015; and
- Reviewed family relationships between staff and the director of Pico Union Housing Corporation (ownership entity) based on the complaint.

## Sampling Information

- We selected a nonstatistical sample of vendor invoices for testing. We reviewed Dolores Frances' check registers within our audit scope (January 1, 2014, through December 31, 2015) and determined the total amount of vendor expenditures annually to determine the universe for sample testing. The total universe of disbursements paid to vendors within our audit scope was more than \$9 million for 2014 and 2015 (\$4,175,058 + \$4,875,939 respectively). The total disbursements paid to vendors we chose to test in 2014 amounted to \$290,485. For 2015, the total disbursements paid to vendors we chose to test amounted to \$292,790. We primarily focused on high-dollar payment amounts or payments to management and ownership. The results of the sample testing was limited to the expenditures reviewed and cannot be projected to the universe.

We determined that data contained in source documentation provided by Dolores Frances agreed with data contained in the project's bank accounts and supporting documentation. We, therefore, assessed the data to be sufficiently reliable for our use during the audit.

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(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

# Internal Controls

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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:

- Effectiveness and efficiency of program operations – Implementation of policies and procedures to ensure that program funds are used for eligible purposes.
- Reliability of financial information – Implementation of policies and procedures to reasonably ensure that relevant and reliable information is obtained to adequately support program expenditures.
- Compliance with applicable laws and regulations – Implementation of policies and procedures to ensure that monitoring, onsite inspections, and expenditures comply with applicable HUD rules and requirements.

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 Deficiencies**

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

- The Dolores Frances Affordable Housing project did not have sufficient controls to ensure that project expenditures were used for eligible purposes and in accordance with HUD requirements (finding).

- The Dolores Frances Affordable Housing project did not have adequate controls to ensure that loans secured by the project were properly approved by HUD and in accordance with HUD requirements (finding).

# Appendixes

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## Appendix A

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**Schedule of Questioned Costs and Funds To Be Put to Better Use**

Recommendation number	Ineligible 1/	Funds to be put to better use 2/
1A	\$300,000	
1B	92,962	
1C	114,068	
1D		\$ 6,340,504
1E		4,586,471
<b>Totals</b>	<b>507,030<sup>2</sup></b>	<b>10,926,975</b>

- 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/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. In this instance, implementation of recommendations 1D and 1E will result in the support or removal of improper loan encumbrances on the HUD-insured mortgage, reducing the risk of default.

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<sup>2</sup> Since the ineligible bookkeeping fee overcharge of \$24,156 was already repaid, the amount was not included as a recommendation for repayment. The total ineligible amount on the Schedule of Questioned Costs of \$507,030 plus the \$24,156 in bookkeeping costs results in the total ineligible finding amount of \$531,186.

# Appendix B

## Auditee Comments and OIG's Evaluation

### Ref to OIG Evaluation      Auditee Comments

**Dolores-Frances Affordable Housing Inc.**  
1038 W. Venice Blvd., Los Angeles, CA 90015  
Tel: (213) 747-2790; Fax (213) 867-0341

Augusts 1, 2016

Ms. Tanya E. Schulze, Regional Inspector General for Audit  
Office of Audit (Region 9)  
U.S. Dept. of Housing and Urban Development  
300 N. Los Angeles Street, Suite 4070  
Los Angeles, CA 90012

Sent via e-mail to:  
[TSchulze@hudoig.gov](mailto:TSchulze@hudoig.gov)

Subject:            Audit Report Number 2016-LA-100X  
                         Dolores-Frances Apartments  
                         FHA Project No.: 122-35638  
                         Section 221(d)4 of the Act

Dear Ms. Schulze:

As a preliminary matter, we would like to genuinely thank you and the HUD OIG staff for visiting our offices and providing us the draft audit report for the above-referenced project, as well as discussing the findings and recommended corrective actions with our staff during the exit interview.

Incorrect Background Information Re Ownership: Please be advised that Pico Union Housing Corporation (PUHC) is not a related party of Dolores Frances Affordable Housing, Inc. (DFAHI). The Board Members for PUHC are different from the Board Members of DFAHI, the non-profit corporation that is the general partner of Dolores Frances Affordable Housing, L.P., the project owner. We visited HUD's Active Partners Participation System (APPS) website, and found reference to the HUD-2530 for the PUHC Board Members. Oddly, DFAHI's HUD- 2530 was not completely filled-in. Back in 2004, when this project secured a HUD-insured loan, the electronic submission of the HUD-2530 form was not a common practice. Toward this end, enclosed please find the latest HUD-2530 for DFAHI. We are currently in the process of filing the HUD-2530 for DFAHI to, hopefully, dispel the existing confusion between the two distinct non-profit corporations. In both organizations, one Board Member has passed away and has been replaced. We are, as noted herein, in the process of obtaining the corrected HUD-2530 approval from HUD.

The following are the responses to each of the findings noted in your draft audit dated July 7, 2016:

Finding: The Dolores Frances Affordable Housing Project Was Not Administered in Accordance with its Regulatory Agreement and HUD Requirements. The Dolores Frances Affordable Housing project (hereinafter the Project) did not follow its regulatory agreement or HUD program requirements by paying consulting services, legal fees, overseeing service fees, and bookkeeping fees. Your findings and our responses are as follows:

Dolores Frances Made Ineligible Payments for Social Services. The project paid \$300,000 to its general partner DFAHI, for social services expenditures, through flat monthly payments of \$12,500 in 2014 and 2015. DFAHI then paid those fees to PUHC. These fees were categorized as community-based activities for

Comment 1

## Auditee Comments and OIG's Evaluation

### Ref to OIG Evaluation

### Auditee Comments

Comment 2

Dolores Frances Response  
Page 2

the Project's activities and programs, such as like painting and art programs, after-school programs, and holiday events.

Response: Positive Surplus Cash Positive/Equitable Estoppel:

The community service activities provided at the Project was a *requirement* of the Tax Exempt Bond and Tax Credit Application. Without these much-needed services, the Project would most likely not have qualified for credits. To memorialize the commitment to provide these services to the Project's tenants, a Service Agreement was signed. The Service Agreement was part of the closing package provided to HUD, who then in turn insured the mortgage. Since at least 2004, HUD has been well aware of this commitment. Per the Project's Regulatory Agreement, the Project performs an annual Surplus Cash Computation, which is submitted to HUD electronically through HUD's Real Estate Assessment Center (REAC), Financial Analysis Sub-System (FASS) as part of the annual audit. At all relevant times, meaning fiscal year ended 2008 through 2014, the Project's Computation of Surplus Cash was in a *positive* surplus cash position. Therefore, at worst, the monthly Service Agreement fees were taken prematurely, as opposed to at the end of the computation period. In any event, and moving forward the Service Agreement fees will be taken after each annual Computation of Surplus Cash, instead of monthly. In terms of prospective administrative penalties and/or civil money penalties, HUD would be equitably estopped from now, more than eight (8) years later, seeking to penalize the Project for a practice that has been disclosed to HUD, both initially and annually.

Duplicative Fees Were Paid to a Consultant

The Project entered into an agreement for consulting services in 2014. Compensation was paid at a rate of \$16.67 per unit per month, and total payments in 2014 amounted to \$74,784. However, these services were similar to the duties of the project's management agent at that time, including preparing and reviewing the annual budget, reviewing revenue and expense statements, and attaining a certified public accountant for the annual yearend audit of the financial statements. The Project had acquired PUHC as its management agent in 2014 and paid it \$288,625 for management fee services. The consulting services were duties already covered by the management agent's fee, as defined in HUD Handbook 4381.5, paragraphs 6.39(a) to (c), (appendix C), and should not have been charged again to the housing project. As a result, the consulting fees were ineligible.

Response: Fee Were Not Duplicative:

The Project totals 366 units, which is comprised of 11 separate buildings. As HUD has been well aware, one of the buildings placed-in-service a few years later due to unforeseen construction issues. These consulting fees were not routine tenant-related costs, but rather interacting with the Project's investors, and ensuring that the credits were appropriately applied to each building, throughout the 10-year credit period, in light of the one late placed-in-service building. Consequently, we submit the fees were not duplicative of routine property-management fees. In any event, the Project was in a positive Surplus Cash position at fiscal year ended 2014.

To be clear, the Courts have interpreted the phrase "reasonable operating expenses" from the Regulatory Agreement as "...those [expenses] paid or incurred in connection with the actual operation of the project...[and] management fees may under some circumstances be considered operating expenses because they are expenses incidental to and incurred in connection with the day-to-day operation of the project. (*Multifamily Mortg. Trust 1996-1 v. Ara Associates-Shangri-La* (200) 242 Ga. App. 465, quoting *In re Garden Manor Assoc.* (1987) 70 B.R. 477, 481).

Comment 3

## Auditee Comments and OIG's Evaluation

### Ref to OIG Evaluation

### Auditee Comments

### Comment 4

Dolores Frances Response  
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Consequently, with the above case law in mind, we submit the fees were not duplicative, they were reasonably related to the operation of the Project and not ineligible project expenses.

Disbursements for Legal Expenses Were Ineligible: Dolores Frances paid a total of \$114,068 to Lurie, Schmalz & Hogan for legal expenses in 2015. The supporting documentation described the fees as payment for legal services tied to a lawsuit over ownership title of a parking lot located at a sub-property of Dolores Frances (Bellevue property). The use of project funds to pay for these legal fees was inappropriate since they were not reasonable and necessary expenses for the actual operation of the project according to HUD Handbook 4381.5, section 6.38, and the regulatory agreement, paragraph 6(b) (appendix C). The legal fees were ownership costs and not project costs; therefore, the \$114,068 paid to the law firm was ineligible.

Response: Legal Fees In Defense of Lawsuit Permitted by Regulatory Agreement:

Legal Fees are permitted to be paid from Project account, where the legal fees benefit the Project. The reviewing Court noted that: "We think there is a more natural reading of the term 'reasonable' in this context. In our view, 'reasonable' is a broad and inherently amorphous term, not susceptible to precise definition. It is therefore telling that the Regulatory Agreement uses the term 'reasonable,' rather than narrower or more precise language, to limit the set of permissible operating expenses. To us, this suggests a 'hands off' approach, an intent to allow project owners to engage in a wide range of normal project operations without fear of violating the Regulatory Agreement. Therefore, while operating expenses that are extraordinary in amount or character may be 'unreasonable,' we conclude that operating expenses that are typically or predictably incurred in the course of operating a project and are within normal limits as to amount are 'reasonable' for the purposes of the HUD Regulatory Agreement." *Arizona Oddfellow-Rebekah Hous. v. United States HUD* (1997) 125 F.3d 771, 776.

The legal expenses incurred herein were necessary to defend a law suit against DFAHI. Both entities, the PUHC and DFAHI were named as defendants in the complaint. Each entity paid their respective share of the legal defense. The lawsuit pertained to defending a title action on the adjacent parking lot area. This parking lot area was part of the legal description of the HUD-insured loan. The lawsuit has since settled and both the PUHC and DFAHI were successful and were able to retain the ownership of the lot. Moreover, the DFAHI obtained a recorded easement on the lot. In sum, and according to the case law, and the fact noted herein, legal fees are a reasonable operating expense and therefore not ineligible. See *United States v. Thompson* (1967) 272 F.Supp. 774; *United States v. Frank* (1978) 587 F.2d 924, 927; *United States v. Berk & Berk* (1991) 767 F.Supp. 593, 598; *In re RLA of Madison, Inc.* (1994) 177 B.R. 78, 80; *In the Matter of Tampa Bay Briarwood Assocs. Ltd.* (1990) 118 B.R. 126, 128; *In re Garden Manor Assocs.* (1987) 70 B.R. 477, 482; and *In the Matter of EES Lambert Assocs.* (1986) 63 B.R. 174, 175.

Consequently, with the above cases in mind, we submit the legal fees were reasonably related to the operation of the Project and eligible project expenses.

Payments Made to the Management Agent for Overseeing and Supervising Were Ineligible: Dolores Frances paid its management agent, Genessy Management & Development LLC, "overseeing and supervising" fees totaling \$45,632 from February 2015 to November 2015 for the replacement of a resident manager at one of the project's sub-properties (Villa). According to HUD requirements, project funds may be used to pay the allowable portion of the costs of the salary for a supervisory employee of the agent designated to replace a project employee on temporary leave for a period

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of up to 90 days after the first 40 consecutive hours. The amount paid out of project funds for the replacement employee may not exceed the lesser of twice the amount of the absent employee's salary or the actual amount of the replacement employee's salary.

Project officials stated and provided documentation indicating that the project's occupancy specialist was handling the duties as a resident manager to cover the full-time position during this period. However, the replacement resident manager was already performing duties and being paid by the project as a full-time occupancy specialist. No documentation was provided to demonstrate that the project used additional staff to fill the full-time resident manager position and earn the additional fee.

The project's records also showed that the resident manager who had reportedly been replaced was charged to the project as "janitorial." He performed some resident manager functions in addition to his janitorial duties. As a result, the project did not previously have a full-time resident manager position to replace. The janitorial employee also continued to work at the Villa property through August 2015 and resided in a rent-free unit during the majority of the period in which the management agent charged the additional fee.

The disbursements made to the project's management agent for added supervision fees were not in accordance with guidelines in HUD Handbook 4381.5, section 3.1 and paragraphs 6.39a(2)(a) and(b) (appendix C). Therefore the overseeing and supervisory fee of \$45,632 was ineligible.

Response: Recalculated Amount Re Resident Manager/Occupancy Specialist

DFAHI has reviewed this item and discussed it with the management agent. To be clear, the staff of the management agent continued to perform services as Occupancy Specialist, (project funds may be used to pay the allowable portion of the Occupancy Specialist); payroll charges have been recalculated and allocations made between the Project funds that may be used to pay the allowable portion Occupancy Specialist Position and the Resident Manager Position. The excess amount collected will be reimbursed by the managing agent is \$18,177.86. Toward that end, enclosed please find an analysis schedule. We submit the OIG should reconsider this charge and accept the enclosed analysis and the reimbursement to the Project account of the revised amount.

Finding 1: Dolores Frances Paid Excessive Bookkeeping Fees. Dolores Frances' current management agent, Genessy Management & Development LLC, was paid bookkeeping fees at a rate above the allowable rate approved by HUD. The rate charged by Genessy did not follow HUD Handbook 4381.5, paragraph 6.38a, and HUD's management fee letter (effective August 1, 2011) (appendix C). The management fee letter set the allowable monthly bookkeeping fee for centralized services chargeable to each project at \$9.50 per unit. However, Genessy charged fees at \$15 per unit, an increase of \$5.50 (\$15 - \$9.50) per unit in bookkeeping fees, from August 2015 to December 2015 (5 months). Further, Dolores Frances made a retroactive lump sum payment to Genessy for the excessive bookkeeping fee for January 2015 to July 2015 (7 months). The total ineligible bookkeeping fees for the year, January to December 2015, amounted to \$24,156 [(\$5.50 x 366/unit) x 12 months]. To exceed the allowable threshold cost of \$9.50, a justification with supporting documentation must be submitted to HUD for approval. However, there was no documentation showing that HUD approved the increase in bookkeeping fees to Genessy. Therefore,

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the costs of \$24,156 for these bookkeeping fees were ineligible.

Response: Project Agrees With HUD OIG:

After the OIG discussed this matter with the management agent, the Project recognized the error and repaid the Project account \$24,156.

Finding: Dolores Frances Lacked Supporting Documentation for Internal Loans: Dolores Frances could not provide adequate support for two internal loans that were not approved by HUD. The project inappropriately secured these loans, encumbering the ownership interest or properties of the project, without maintaining evidence of HUD approval, resulting in unsupported encumbrances totaling more than \$10.9 million.

A Loan from Pico Union Housing Corporation Was Unsupported: Dolores Frances acquired a loan from the Pico Union Housing Corporation for more than \$6.3 million, issued on February 25, 2004, 24 days after the original HUD-insured mortgage note was issued. Dolores Frances provided a promissory note as the only supporting documentation for the loan. The note indicated that the loan from Pico Union to Dolores Frances was used to finance a portion of the cost of acquisition and rehabilitation of the project (legally described in exhibit A to the promissory note secured by subordinate deed of trust) and the maintenance of affordable housing in the project under the agreement. However, exhibit A was missing from the note, and there were no related documents to indicate or support how the funds were used.

Further, there was no documentation provided to show that this loan was HUD approved. Our review determined that a portion of the note (\$667,549) was paid within 1 year of its issuance, bringing the principal balance to more than \$5.7 million (\$6,422,172 - \$667,549). Accumulated interest was calculated to be \$585,881. Since there was no documentation to properly support the use of the loan and that it was properly approved by HUD under the regulatory agreement (appendix C), we determined the loan balance amount of more than \$6.3 million (\$5,754,623 + \$585,881) to be unsupported.

Response: HUD Approved the Seller Carry-Back Loan:

Attached herewith, please find the Insurance for Commitment Advances approved and signed November 17, 2003, by the then HUD Housing Director Mr. [REDACTED] from Los Angeles Multifamily Hub Office, as well as the Creditor Examiner Ms. [REDACTED] from HUD Headquarters, Washington DC, Form 92264-A Supplement to Project Analysis (I) Determination of Maximum Insurable Mortgage, (III) Sources to meet cash requirement has listed the mortgage amount of \$6,413,758.

To be clear, the \$667,549 cited by the HUD OIG was not paid, but is due. Consequently, the principal loan from PUHC remains outstanding at \$6,422,172, with unpaid accrued interest by year end 2015 at \$903,136. Consequently, we submit the Seller Carry-Back loan was approved by HUD.

A Loan With Alliant Tax Credit Fund 31-A, LTD, Was Unsupported: Dolores Frances acquired a loan from the Alliant Tax Credit Fund, LTD, for \$897,565 in June 2006. The loan was secured by the ownership interest (or properties) of Dolores Frances. The loan was to be repaid by December 1, 2006, with interest at prime plus 10.25% percent annually, compounded semiannually. However,

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\* Names redacted for privacy reasons

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Dolores Frances did not repay the loan by the due date. By December 31, 2015, the annual rate of interest had increased to 18 percent. The lack of payment resulted in an accumulation of interest and no reduction of the original principal. No support was provided to show that the loan was properly approved by HUD in accordance with the regulatory agreement (appendix C). As a result, the loan balance amount of more than \$4.5 million (which included accumulated interest and principal) was unsupported.

Response: HUD Approved Loan/Equitable Estoppel.

As noted above, one building, Bellevue, was placed-in-service much later. The loan to the Project was originated as result of a change order for the Bellevue Apartments. That building was retrofitted under the Earthquake Ordinance Division 88 of Los Angeles City Code in 1990. In 2004, however, during their due diligence inspection, the U.S. Department of Housing and Urban Development (HUD) informed the organization that the Earthquake job under Division 88 was not acceptable and the building needed to be reinforced under the Dorothy-Mae requirement. This was acknowledged and accepted by all Project partners, including HUD. In preparation for the reinforcement, an unexpected hurdle arose, the Bellevue project area was declared historical under the HPOZ Ordinance of the City of Los Angeles, and the earthquake reinforcement had to be performed from the inside of the building rather than from the outside. This requirement escalated the costs of reinforcement and created a budget shortage. With HUD's knowledge and support, the Project commenced negotiations with GMAC to increase the mortgage amount as the Project had sufficient equity. However, the Limited Partner insisted on providing the loan. Since the Project had not placed its last building in service, contributions due from the Limited Partners were still inaccessible. At that time, the Project felt confident this would be a temporary loan to address the requirements of HUD. Unfortunately, even though the last building was placed-in-service, the Limited Partner did not pay for then due contributions, and the loan was not paid as per the loan agreement terms, creating a sizable amount in interest due to the Limited Partner.

The Project understands HUD OIG's position and it is presently in discussions with the Limited Partner to bring resolution to this issue by following the recommendation of the HUD OIG to remove the loan from its balance sheet. To be clear, there is no deed of trust securing this loan against the Project. We ran a preliminary title report and the Limited Partner investor loan is not encumbering the property. We are attaching a copy of the preliminary title report.

Closing. Again, we genuinely thank the HUD OIG for its guidance, comments and recommendations and look forward to clearing these audit findings as soon as practicable.

Sincerely,

Dolores-Frances Affordable Housing Inc.



Gloriana Farias, its Executive Director

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Enclosures:

HUD 2530 for PUIIC  
HUD 2530 for DFAIII  
Resident Manager/Occupancy Specialist Analysis  
Bookkeeping Fees Reimbursement  
Insurance for Commitment Advances Approved by HUD  
Preliminary Title Report

Copies to:

Priya Jayachandran, Acting Deputy Assistant Secretary for Multifamily Housing,  
Tom Azumbrado, Director, Multifamily Housing, 9AHMLAP  
Craig Clemmensen, Director, Departmental Enforcement Center, CACB  
██████████, HUD-IOG Senior Auditor  
██████████, HUD-IOG Auditor  
Lydia Morales, Director, Los Angeles Departmental Enforcement Center, CVS9  
██████████, Supervisory Project Manager, 9DHML  
██████████, Senior Project Manager, 9DHML  
Ray Brewer, Los Angeles Field Office Director, 9DMA  
██████████, Senior Policy Advisor, S  
██████████, Principal Deputy General Counsel, C  
██████████, Senior Advisor, Office of General Counsel, C  
██████████, General Deputy Assistant Secretary for Congressional & Intergovernmental Relations,  
██████████, Deputy Assistant Secretary for Public Affairs, W  
██████████, Director, Audit Liaison Division, FMA  
██████████, Management Analyst, FMA  
Craig Clemmensen, Director, Departmental Enforcement Center, CACB

\* Names redacted for privacy reasons  
\* Enclosures and attachments available upon request

## OIG Evaluation of Auditee Comments<sup>3</sup>

- Comment 1: Dolores Frances Affordable Housing L.P. asserts that Pico Union Housing Corporation (PUHC) is not a related party of the Dolores Frances Affordable Housing, Inc. (DFAHI) since both entities have different board members. However, both entities comprise the same officers that administer both organizations. As a result, we consider the organizations to be related.
- Comment 2: We reviewed the service agreement identified in the auditee responses. The agreement is an internal agreement between the project, general partner, and limited partner. However, there is no information to verify that the service agreement was approved by HUD. We agree with the auditee that it performed surplus cash computations to identify positive surplus cash at year end as part of its annual audits. However, surplus cash distributions can only be taken on an annual or semi-annual basis in accordance with the Regulatory Agreement. There was no documentation submitted to indicate Dolores Frances informed HUD or obtained approval to prematurely draw surplus cash on a monthly basis to pay the fees in question. We acknowledge that the auditee plans to pay for these fees in the future only after computing and using positive surplus cash on an annual basis. However, until HUD is able to confirm this practice has been implemented through audit resolution the recommendation will remain. HUD will also evaluate the appropriateness of retroactive credit for early distributions or potential penalties for regulatory agreement violations as part of audit resolution.
- Comment 3: We disagree with the auditee's response that the consulting fees were not duplicative. The duties and responsibilities recorded in the consulting agreement are the same functions as those in the management agent agreement. These duties are the responsibility of the management agent, and the management agent was paid a fee to perform these services. We therefore continue to maintain the consulting fees to be ineligible.
- Comment 4: We acknowledge that legal fees can constitute reasonable operating expenses that benefit the project. The legal cases presented by Dolores Frances cite legal expenses for housing and employment discrimination suits and tenant related lawsuits for the collection of rent and eviction of tenants. However, the legal fees in question, paid from project funds, were used in a lawsuit to determine the legal or easement use of a parking lot. The legal fees were not used for tenant related lawsuits which would constitute the day to day operating expenses of a project, as stated by the auditee's legal examples. Furthermore, the project did not have title ownership of the parking lot when the adjacent building was initially acquired,

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<sup>3</sup> Attachments to the auditee's response mentioned in this section were not included in appendix B of the report but are available upon request.

thus the parking lot was not part of the HUD insured loan and was separate from the project. We therefore maintain the legal fees to be ineligible.

Comment 5: We reviewed Dolores Frances' analysis schedule allocating the allowable portion of the occupancy specialist's regular front line duties and supervisory salary. We accept the project's position that the additional project costs for supervisory replacement was ineligible. We adjusted the report to reflect the additional project costs of \$18,178 for supervisory replacement as ineligible.

Comment 6: We acknowledge Dolores Frances' bookkeeping fee error and recognize that the project paid back the ineligible amount. As a result, we did not include a recommendation for repayment.

Comment 7: Dolores Frances provided additional documents indicating that prior to the regulatory agreements, between HUD and Dolores Frances, HUD was initially aware of this loan. Specifically, Dolores Frances provided forms HUD- 92264 and HUD-92264-A indicating that an additional amount of \$17,557,715 was required over and above mortgage proceeds for completion of the project, which would include the loan from Pico Union, referred to as "Surplus cash note." However, the documentation still does not demonstrate the loan was properly approved by HUD. We therefore maintain our recommendation to support or remove the loan and any associated encumbrance from the project.

We could not verify Dolores Frances statement that the \$667,549 was not paid and still due. The project's financial statements indicated the amount was paid and identified a \$5.7 million net principal balance.

Comment 8: We recognize Dolores Frances' response to follow the audit recommendation to remove the loan with Alliant Tax Credit Fund and any associated encumbrance from the project's balance sheet. No additional information was provided to show that HUD approved the loan.

## Appendix C

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### Criteria

**HUD Handbook 4370.2(E), Financial Operations and Accounting:**

All disbursements from the Regular Operating Account (including checks, wire transfers and computer generated disbursements) 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, Section 3.1:**

Allowable Management Fees From Project Funds. Management agents operating HUD-insured and HUD-assisted properties are paid a management fee for their services. Management fees may be paid only to the person or entity approved by HUD to manage the project. Management agents must cover the costs of supervising and overseeing project operations out of the fee they receive.

**HUD Handbook 4381.5, Section 3.6, General:**

Bookkeeping Expenses Are Treated as a Project Cost. The cost of bookkeeping services for a project performed as part of a centralized bookkeeping system are treated as a project cost and should not be treated as a special fee. Such expenses are paid out of project funds based on actual costs attributable to the project. Further guidance on the treatment of such costs and the amount payable out of project funds is provided in Chapter Six, paragraph 6.37.

**HUD Handbook 4381.5, Paragraph 6.38(a), Costs Paid From Project Account:**

Costs of front-line project operations — e.g., managers and their apartments, legal and auditing expenses, bookkeeping and associated expenses, occupancy clerks, project management delinquency notices, evictions, project checks, envelopes, postage, air express delivery charges, copying, unscheduled long distance calls to agent, costs of IRS [Internal Revenue Service] Section 401-K, 125, and 403-B, and related retirement and health plans for on-site staff so long as they are comparable with Industry standards and in compliance with the guidelines set forth in paragraph 6.38(e), and the salary of a supervisory employee of the agent designated to replace a project employee for hours worked at the project above and beyond the first 40 consecutive hours of the assignment.

**HUD Handbook 4381.5, Section 6.39, Program Monitoring: Management Costs Paid From the Management Fee:**

a. Expenses for services that are not front-line activities must be paid out of management fee funds, except for centralized accounting and computer services.

b. Salaries, fringe benefits, office expenses, fees, and contract costs for the following activities must be paid out of management fee funds. These costs include:

- (1) Designing procedures/systems to keep the project running smoothly and in conformity with HUD requirements.
- ....(3) Recruiting, hiring, and supervising project personnel.
- ....(5) Monitoring project operations by visiting the project or analyzing project performance reports.
- (6) Analyzing and solving project problems.
- (7) Keeping the owner abreast of project operations.
- (8) Overseeing investment of project funds.
- (9) Ensuring that project positions are covered during vacations, sickness, and vacancies.

c. The salaries of agent supervisory personnel must be paid from the management fee unless one of the exceptions below is met.

- ... (2) The costs of the salary for a supervisory employee of the agent designated to replace a project employee on temporary leave may be paid out of project funds after the first 40 hours of the assignment.
  - (a) The amount paid out of project funds to cover the weekly salary of the replacement employee may not exceed the lesser of:
    - (i) Twice the amount of the absent employee's weekly salary; or
    - (ii) The actual amount of the replacement employee's weekly salary.
  - (b) Project funds may be used to pay the allowable portion of the replacement employee's salary for a period of up to 90 days after the first 40 consecutive hours.

**Regulatory Agreement, 6(a):**

Owners shall not without the prior written approval of the Secretary; Convey, transfer, or encumber any of the mortgaged property, or permit the conveyance, transfer, or encumbrance of such property.

**Regulatory Agreement, 6(b):**

Owners shall not without the prior written approval of the Secretary: (b) 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.

**Regulatory Agreement, 6(e)(i):**

Make, or receive and retain, any distribution of assets or any income of any kind of the project except surplus cash and except on the following conditions:

- (i) All distributions shall be made only as of and after the end of a semiannual or annual fiscal period, and only as permitted by the law of the applicable jurisdiction.

**Regulatory Agreement, 9(b):**

Payment for services, supplies, or materials shall not exceed the amount ordinarily paid for such services, supplies, or materials in the area while the services are rendered or the supplies or materials furnished.

**Management Fee Schedule and Letter, Effective August 1, 2011:**

The allowable bookkeeping fees for services performed as part of a centralized bookkeeping system are now set at \$9.50 per unit. The cost of these bookkeeping fees is treated as a project expense and should not be included on the Management Certification as a special fee. If the costs exceed the allowable threshold, we will require a narrative justification with supporting documents.