



Cypress Meadows Assisted Living, Antioch, CA

Section 232 Loan Program

**Office of Audit, Region 9
Los Angeles, CA**

**Audit Report Number: 2017-LA-1004
June 13, 2017**





To: Dane Narode, Associate General Counsel for Program Enforcement, CACC
Craig T. Clemmensen, Director, Departmental Enforcement Center, CACB
Timothy Gruenes, Director, Asset Management and Lender Relations, HI
//SIGNED//

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

Subject: Cypress Meadows Assisted Living, Antioch, 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 Cypress Meadows Assisted Living.

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 213-534-2471.



Audit Report Number: 2017-LA-1004

Date: June 13, 2017

Cypress Meadows Assisted Living, Antioch, CA, Was Not Administered in Accordance With Its Regulatory Agreement and HUD Requirements

Highlights

What We Audited and Why

We audited Cypress Meadows Assisted Living based on a U.S. Department of Housing and Urban Development (HUD), Departmental Enforcement Center, referral. The referral asserted that the owner took distributions from Cypress Meadows for expenses other than the operation and maintenance of the project. Our objective was to determine whether Cypress Meadows was managed in accordance with its regulatory and operating agreements and HUD requirements.

What We Found

Cypress Meadows was not administered in accordance with its regulatory and operating agreements and HUD requirements. It disbursed a total of \$478,690 for ineligible expenses, was unable to support \$65,232 in expenses, and recorded project debt liabilities of an additional \$412,723 for ineligible expenses. Also, Cypress Meadows did not collect \$620,937 in rent from residents and did not deposit \$163,462 in lease agreement charges into its bank account. In addition, Cypress Meadows did not make payments on its mortgage and was \$2.8 million delinquent on its Federal Housing Administration-insured loan. This condition occurred because the owner and operator disregarded the project's regulatory and operating lease agreements and HUD requirements and did not have controls over the operation of the project.

What We Recommend

We recommend that HUD's Associate General Counsel for Program Enforcement pursue civil and administrative remedies against the owner and operator of Cypress Meadows. We also recommend that the Director of the Departmental Enforcement Center pursue appropriate civil money penalties and administrative actions against the owner and operator. We further recommend that the Director of Asset Management and Lender Relations require Cypress Meadows to (1) repay \$543,922 for ineligible and unsupported expenses, (2) remove \$412,723 in improper accrued debt, (3) pay \$620,937 in uncollected rent, (4) pay \$162,462 in lease agreement charges not deposited, (5) replace Skyline Crest Enterprises as the operator, and (6) develop written policies and procedures including financial policies for cash disbursements and cash receipts.

Table of Contents

Background and Objective.....	3
Results of Audit	4
Finding 1: Cypress Meadows Was Not Administered in Accordance With Its Regulatory Agreement, Operating Lease Agreement, and HUD Requirements	4
Scope and Methodology.....	11
Internal Controls.....	13
Appendixes.....	15
A. Schedule of Questioned Costs and Funds To Be Put to Better Use.....	15
B. Auditee Comments and OIG’s Evaluation.....	17
C. Criteria.....	34
D. Questioned Rents and Fees	38

Background and Objective

On December 1, 2004, the U.S. Department of Housing and Urban Development (HUD) entered into an agreement with Cypress Meadows Antioch, LLC (owner), to insure the mortgage on Cypress Meadows Assisted Living located in Antioch, CA. The mortgage at the time of insurance was more than \$14 million and was insured under Section 232 according to section 223(f) of the National Housing Act. Section 232 of the National Housing Act authorizes the Federal Housing Administration to insure mortgages made by private lenders to finance nursing homes and other eligible facilities. The Office of Residential Care Facilities, under HUD's Office of Healthcare Programs, manages the Section 232 program. Federal regulations at 24 CFR (Code of Federal Regulations) 200.105(a) state that as long as the Federal Housing Commissioner is the insurer or holder of the mortgage, the Commissioner will regulate the borrower by means of a regulatory agreement, providing terms, conditions, and standards established by the Commissioner or by other prescribed means.

Cypress Meadows Assisted Living is a 110-unit facility located in Antioch, CA. Cypress Meadows provides elderly care services, such as meals, housekeeping services, transportation services, and social activities. On December 15, 2004, the owner entered into an agreement with an identity-of-interest operator, Skyline Crest Enterprises, to manage the project in exchange for a management fee of 8 percent of gross collections. The same individual owns both Cypress Meadows and Skyline Crest and has control over all project operations. Cypress Meadows has struggled to pay its mortgage and as of January 31, 2017, is more than \$2.8 million delinquent on the mortgage. Due to recurring net losses, negative cash flows from operations, and a failure to generate sufficient revenues, Cypress Meadows' financial auditors expressed doubt regarding its ability to continue as a going concern. As of January 31, 2017, the outstanding balance of the loan totaled more than \$12 million. While Skyline Crest was contracted to manage the operations of the project, the owner has the overall responsibility to ensure compliance with the operating agreement and HUD requirements.

Our objective was to determine whether Cypress Meadows was managed in accordance with its regulatory and operating agreements and HUD requirements.

Results of Audit

Finding: Cypress Meadows Was Not Administered in Accordance With Its Regulatory Agreement, Operating Lease Agreement, and HUD Requirements

Cypress Meadows did not follow its regulatory agreement, operating lease agreement, or HUD program requirements. Specifically, it disbursed funds on ineligible expenses, charged its accounts payable for ineligible expenses and was unable to support expenses were for the operation and maintenance of the project. Also, Cypress Meadows did not collect rents from all residents and did not deposit rents and fees collected into its bank account. This condition occurred because Cypress Meadows and its identity-of-interest operator disregarded the regulatory agreements, operating lease agreement, and HUD regulations and did not develop controls over the operation of the project. As a result, the owner used \$543,922 in project funds for ineligible and unsupported costs and charged \$412,723 in accounts payable for ineligible salary and accounting fees. Also, the owner did not collect \$620,937 in rent and did not deposit \$162,462 in lease agreement charges. These ineligible disbursements and uncollected rents reduced funds available to pay the project's mortgage and increased the risk of mortgage default.

Cypress Meadows Disbursed Project Funds for Expenditures That Were Ineligible and Could Not Support Some Expenditures

Cypress Meadows did not disburse funds in accordance with its regulatory and operating agreements and HUD requirements. HUD repeatedly instructed the owner to use funds for necessary and reasonable operating expenses only. However, the owner disregarded HUD guidance and made ineligible payments of \$478,690 in project funds.

Ineligible expenses	Amount
Administrator salary	\$263,289
Accounting fees	110,710
Personal health insurance	99,160
Bank fees	4,179
Hair salon	1,352
Total	478,690

Cypress Meadows Made Ineligible Payments for Its Administrator's Salary

From January 2014 through December 2016, Cypress Meadows paid \$263,289 in salary to its administrator and recorded an additional \$283,307¹ in project debt for unpaid salary. During this period, Cypress Meadows also paid a management fee to the operator, Skyline Crest.² The owner of Cypress Meadows is also the owner and only employee of Skyline Crest. HUD required that services acquired in connection with the project be reasonable and necessary for the operation and maintenance of the project (appendix C).³ The administrator was unable to identify any duties that were not already part of his responsibility as project operator. There was no evidence that the salary paid to the administrator and the debt incurred by the property were for reasonable and necessary services beyond those paid for by the project management fee. This practice also violated the operating lease agreement, which limited project compensation expenses to those that were reasonably necessary and below the level of administrator.⁴

Cypress Meadows Made Ineligible Payments for Accounting Fees

Cypress Meadows and its operator violated the operating lease agreement when project funds were used to pay for offsite accounting services. The agreement stated that the operator was financially responsible for all offsite accounting expenses.⁵ HUD stated that payment of accounting services from operations remained an ongoing issue. However, despite HUD's concerns, Cypress Meadows paid a total of \$110,710 and incurred an additional \$129,416 in project debt⁶ for offsite accounting services.

Cypress Meadows Made Ineligible Payments for Health Insurance

Cypress Meadows paid \$99,160 for the owner's family health insurance. As discussed above, the owner's compensation, which would include health insurance, should have been paid from nonproject funds. Further, the project did not offer health insurance to any other employees. As a result, the health insurance expense was ineligible.

Cypress Meadows Made Ineligible Payments for Unreasonable Bank Fees

Cypress Meadows paid a total of \$4,179 in bank fees. Due to the ineligible uses of project funds noted above, the project was unable to maintain a positive bank account balance. In 1 month during our audit period, the project incurred 25 insufficient funds and returned item fees totaling \$850. These excessive fees were not reasonable and necessary for the operation and maintenance of the project.

¹ Project debt is considered to be funds to be put to better use and is not included as an ineligible cost in the table. (See appendix A.)

² Operating Lease Agreement, V(B)(10), states that the management fee includes the maintenance of licensing requirements by the operator.

³ 24 CFR 232.1007, Operating Expenses

⁴ Operating Lease Agreement, V(B)(5)(e)

⁵ Operating Lease Agreement, V(B)(5)(e)

⁶ Project debt is considered to be funds to be put to better use and is not included as an ineligible cost in the table. (See appendix A.)

Cypress Meadows Made Ineligible Payments for an Identity-of-Interest Business

Cypress Meadows paid a total of \$1,352 in expenses for an onsite hair salon owned by the wife of Cypress Meadows' owner. These expenses were not necessary for the operation and maintenance of Cypress Meadows and, therefore, should not have been paid for by the project. Cypress Meadows' auditor noted in a finding that no rent was charged for the use of facilities at the property. The owner provided a lease showing that the salon leased the space from Cypress Meadows for \$1 per year. The regulatory agreement stated that the terms of commercial leases must be approved by HUD.⁷ In July of 2011, the owner requested a waiver from HUD. HUD asked for additional documentation to evaluate the request, but there was no evidence that the additional support was provided and the waiver was not granted. HUD stated that it had not approved the current lease for \$1. As a result, Cypress Meadows violated its regulatory agreement when it did not collect rent from the hair salon in an amount approved by HUD.

Cypress Meadows Did Not Maintain Adequate Support for Some Expenses

Cypress Meadows and its operator did not maintain adequate support for all disbursements made and were not able to support a total of \$65,232 in operating expenses. The regulatory agreement and HUD requirements stated that all expenses must be reasonable and necessary for the operation and maintenance of the project. HUD regulations further require that the owner maintain appropriate records to establish that the use of funds was made for a reasonable operating expense or necessary repair. Also, the operating lease agreement stated that the operator must maintain a system of records consistent with industry standards. During our review, we identified the following questionable disbursements, which were missing adequate supporting documentation:

- \$22,644 in miscellaneous expenses,⁸
- \$11,433 in non-project-related telephone expenses,
- \$10,236 in restaurant expenses,
- \$7,325 in payments made to the owner's family members,
- \$7,275 in non-project-related gas expenses, and
- \$6,319 in nonproject mortgage payments.

The owner was unable to provide receipts, invoices, and additional documentation to support that these expenses were necessary for the operation and maintenance of the project. In one example, Cypress Meadows' owner made disbursements to his family. The owner stated that these disbursements to his family members were for project-related expenses, such as items for a model room and training provided to the kitchen staff. However, the owner was unable to provide supporting documentation for these disbursements. As a result of the lack of documentation, all \$65,232 spent on these items was unsupported.

⁷ Owner Regulatory Agreement for Multifamily Housing Projects, 4(a)

⁸ Miscellaneous expenses include purchases in Reno, NV, at Peppermill Casino, Costco, El Dorado Casino, and Atlantis Casino and payments to the Nevada Commission, Afterhim Media, Moneygram, and car rental agencies.

Cypress Meadows Did Not Collect Rent, Make Deposits Into Its Bank Account, and Make Payments on the Mortgage

Cypress Meadows and its operator did not collect a total of \$620,937 in rent from 21 residents. It also collected \$162,462 in rents and fees and did not deposit the funds into its bank account. Because of the uncollected revenues and revenues not deposited, Cypress Meadows did not have sufficient funds to make its mortgage payments. As of January 2017, Cypress Meadows was more than \$2.8 million delinquent on its mortgage payments.

Cypress Meadows Did Not Collect Rent From Three Family Members

Cypress Meadows' owner violated requirements⁹ and did not charge or collect rent for three family members residing in two project units. The owner's mother and father moved into a two-bedroom unit in July 2009, and his mother-in-law moved into a one-bedroom unit in July 2014. HUD told the owner that his parents could not live at Cypress Meadows without paying rent. However, the owner refused to charge his parents rent and did not include them on the rent rolls. This action reduced the bed capacity of the facility without HUD's permission,¹⁰ and the owner failed to collect \$512,400¹¹ in rent from these identity-of-interest residents.

Cypress Meadows Did Not Collect Rent From 18 Residents

In a sample of 101 resident files, Cypress Meadows violated requirements and did not collect rent for 18 residents totaling \$108,537 (appendix D). In one case, Cypress Meadows did not collect rent from a resident who moved to the project in April of 2016. The resident continued to reside at the project, and Cypress Meadows had not collected a total of \$30,683 from this resident. In addition to not collecting rent, Cypress Meadows violated requirements and did not record the uncollected rent in its accounting records.¹²

Cypress Meadows Did Not Deposit All Lease Agreement Charges Into Its Bank Account

Cypress Meadows did not deposit a total of \$162,462 in lease agreement rent and fees into its bank account. Cypress Meadows' resident lease agreement contained a provision requiring new residents to pay a nonrefundable community fee of \$2,000. The project's regulatory agreement required all rents and other receipts of the project to be deposited in the name of the project and stated that the owner would be in violation of the regulatory agreement if it did not immediately deposit such funds into the project's bank account.¹³ However, the community fee charged in the lease for 70 of 101 leases totaling \$138,834¹⁴ was not deposited into the project's operating account (appendix D).

⁹ Operating Lease Agreement, V(B)(15)

¹⁰ Operator Regulatory Agreement for Nursing Homes, paragraph 12

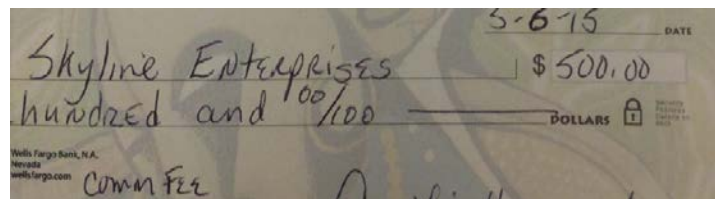
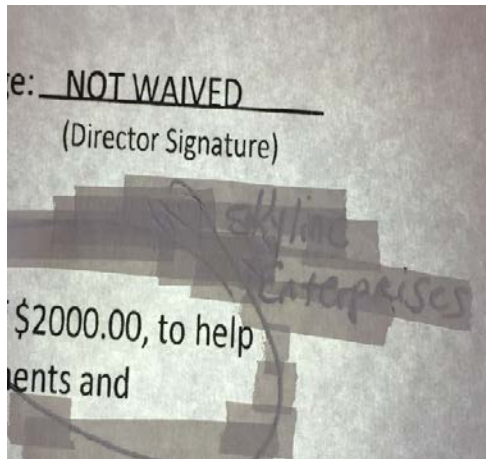
¹¹ We calculated the amount of uncollected rent using the fee schedule for one-bedroom and two-bedroom units provided during the audit.

¹² Owner Regulatory Agreement for Multifamily Housing Projects, paragraphs 9(c) and (d); Operating Lease Agreement, V(B)(15)

¹³ Owner Regulatory Agreement for Multifamily Housing Projects, paragraph 9

¹⁴ This amount includes 68 occasions in which the entire \$2,000 fee was not deposited and two instances where only a portion (\$1,500 and \$1,334) of the fee was not deposited.

During our review, we found documentation showing that the residents were instructed to write the first month's rent check to Cypress Meadows and a separate community fee check to Skyline Crest. (See photos below)



The documents pictured above were obtained during our review of resident files. The handwritten words Skyline Enterprises (photo on the left) and Cypress Meadows (top right) were whiteed out but can be read with a light source as shown in the photos.

Resident lease with handwritten instructions to pay Skyline Crest (left and top right) and resident check written to Skyline Crest for a portion of the community fee (bottom right)

One project employee stated that she was instructed by the owner to have residents write separate checks for rent and the community fee. This statement is consistent with the documentation found during the audit, including the documents pictured above. Cypress Meadows' accounting records showed that the project collected the community fee for only 10 of the 101 resident files reviewed. However, the employee stated that the fee was rarely waived and residents generally paid the fee. We asked the owner for Skyline Crest bank statements or accounting information to determine whether these funds were collected and deposited into Skyline Crest's bank account instead of Cypress Meadows' account. The owner was unwilling to provide this information. Cypress Meadows employees were also unable to provide an explanation for the Skyline Crest payment instructions and checks pictured above. The owner was required by the regulatory agreement to collect all project revenue and deposit all project funds into the project. The owner did not deposit \$138,834 in community fees from 70 residents into the project. As a result, the project did not have \$138,834 in revenue for project operations.

For 10 of the 101 files reviewed, the lease showed that the owner collected \$23,628 in rent and fees (appendix D). However, the project's accounting records and bank statements did not show a corresponding accounting entry or bank deposit. One lease contained a note stating that Cypress Meadows received a check for the community fee and first month's prorated rent. The check was for \$4,454, and the note showed that it was given to the project's business

manager. However, this check was not recorded in the general ledger, and we could not find a corresponding deposit in the bank statements.

Conclusion

The condition described above occurred because the owner of both Cypress Meadows and Skyline Crest disregarded the regulatory agreements, operating lease agreement, and HUD requirements. The owner signed the agreements; however, he stated that he did not read the agreements or HUD regulations. HUD instructed the owner that funds were to be used for necessary and reasonable expenses only. However, the owner continued to use funds for ineligible expenses. Also, he disregarded HUD guidance when he allowed his parents to live at the property without paying rent. In addition, HUD requested an improvement plan and a written marketing plan from the owner. However, the owner did not submit the plan and did not develop a written marketing plan as requested.

This condition also occurred because the owner and operator did not develop controls over the operation of the project. Specifically, Cypress Meadows employees stated that there were no written policies and procedures for cash receipts and cash disbursements.

As a result, the owner used \$543,922 in project funds for ineligible and unsupported costs and charged \$412,723 in accounts payable for ineligible salary and accounting fees. Also, the owner did not collect \$620,937 in rent and did not deposit \$162,462 in lease agreement rent and fees. These ineligible disbursements and uncollected rents reduced funds available to pay the project's mortgage and increased the risk of mortgage default.

Recommendations

We recommend that HUD's Associate General Counsel for Program Enforcement

- 1A. Determine legal sufficiency and if legally sufficient, pursue civil and administrative remedies against Cypress Meadows, LLC; Skyline Crest Enterprises, LLC; the project's owner; or all three for inappropriately disbursing funds in violation of the project's regulatory agreement, operating lease agreement, and HUD requirements.

We recommend that the Director of the Departmental Enforcement Center

- 1B. Pursue appropriate civil money penalties and administrative actions, up to and including debarment, against Cypress Meadows LLC; Skyline Crest Enterprises LLC; the project's owner; or all three for violating the project's regulatory agreement, operating lease agreement, and HUD requirements.

We recommend that the Director of Asset Management and Lender Relations require Cypress Meadows to

- 1C. Repay the project from non-project funds \$263,289 for ineligible salary expenses.
- 1D. Remove \$283,307 in ineligible accrued salary fees payable from its financial statements and records and ensure that these expenses are not accrued or paid for with project funds.
- 1E. Repay the project from non-project funds \$110,710 for ineligible offsite accounting expenses.
- 1F. Remove \$129,416 in ineligible accrued offsite accounting fees payable from its financial statements and records and ensure that these expenses are not accrued or paid for with project funds.
- 1G. Repay the project from non-project funds \$99,160 for ineligible personal health insurance expenses of the owner.
- 1H. Repay the project from non-project funds \$4,179 for excessive bank fees.
- 1I. Repay the project from non-project funds \$1,352 for expenses related to the identity-of-interest hair salon.
- 1J. Obtain approval from HUD for a lease agreement with the hair salon.
- 1K. Provide documentation to support that \$65,232 in disbursements was used on reasonable and necessary operating expenses or repay the project from non-project funds.
- 1L. Pay the project \$620,937 in uncollected rent from non-project funds.
- 1M. Pay the project from non-project funds \$162,462 in lease agreement charges not deposited into Cypress Meadows' bank account.
- 1N. Remove Skyline Crest Enterprises, LLC, as the operator and replace it with a HUD-approved independent operator.
- 1O. Develop and implement written policies and procedures for the management of the project, including but not limited to financial policies for cash disbursements, cash receipts, and documentation requirements.

Scope and Methodology

Our objective was to determine whether Cypress Meadows was managed in accordance with its regulatory and operating agreements and HUD requirements. Our audit period was January 1, 2014, to December 31, 2015. However, our review of accounting debts, owner salary, owner health insurance, and cash receipts was extended to December 31, 2016 to meet our audit objective. We conducted our fieldwork at Cypress Meadows in Antioch, CA, between September 2016 and March 2017.

To accomplish our objective, we

- Held discussions with HUD program staff.
- Interviewed Cypress Meadows' employees, including the owner.
- Identified and reviewed relevant internal controls.
- Reviewed applicable HUD regulations as well as regulatory and operating agreements.
- Obtained the transaction by account report and bank statements to determine whether there were questionable purchases.
- Reviewed supporting documentation, such as receipts and invoices, for all questionable purchases.
- Compared actual occupancy to monthly statements sent to HUD to ensure that all revenue was collected.
- Determined monthly rent due by reviewing the general ledger and lease agreements to ensure that all project income was deposited into the project's bank account.

Cypress Meadows disbursed more than \$2.8 million in 2014 and \$3.2 million in 2015. We reviewed the entire universe of cash disbursements recorded in the general ledger and bank statements for each month in our audit period to identify potential unallowable disbursements. We reviewed the disbursements, along with supporting documentation, to determine whether they were reasonable and necessary for the operation and maintenance of the project.

We selected 3 months of cash receipts from the universe of 24 months in our audit period. The 3 months were selected because the amounts deposited into the bank were less or just more than the potential rent listed on the rent rolls. We reviewed the rent rolls and the general ledger to identify the total rent and fees due for each resident during the 3 months. There was a total of 228 potential payments with rent and fee income of \$880,059 (not including the community fee). We found that Cypress Meadows did not collect a total of \$46,135 in rent from 11 residents. Also, during our review, we found evidence that residents paid the \$2,000 community fee to Skyline Crest, not Cypress Meadows. As a result of this review, we expanded our review to 100 percent of all new move-ins during our audit period to determine whether Cypress Meadows properly collected rent and community fees and deposited those funds into its bank account.

We reviewed 100 percent of all residents that moved into Cypress Meadows from January 1, 2014, through December 31, 2016. There was a total of 112 residents whose statement charges

began during this period. Of the 112 residents, we determined that 7 did not move into the project, and Cypress Meadows was unable to find the resident files for 4 others. As a result, we reviewed a total of 101 resident files to determine whether Cypress Meadows collected rent and fees and deposited those funds into the its bank account.

We did not rely on computer-generated data as audit evidence or to support our audit conclusions. We based our conclusions on the source documentation we reviewed during the audit. We also used source documentation obtained from HUD and the auditee for background information purposes.

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:

- Controls to ensure that Cypress Meadows disbursed funds only for reasonable and necessary expenses for the operation and maintenance of the project.
- Controls to ensure that Cypress Meadows collected all rent and fees and deposited the amounts collected into its bank account.

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:

- Cypress Meadows did not have controls to ensure that the project funds were used for necessary and reasonable operating and maintenance expenditures as required by its regulatory agreement and HUD requirements (finding).

- Cypress Meadows did not have controls over its cash receipts to ensure that all rents were collected and deposited into its bank account as required by its regulatory agreement, operating lease agreement and HUD requirements (finding).

Appendixes

Appendix A

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

Recommendation number	Ineligible 1/	Unsupported 2/	Funds to be put to better use 3/
1C	\$263,289		
1D			\$283,307
1E	110,710		
1F			129,416
1G	99,160		
1H	4,179		
1I	1,352		
1K		\$65,232	
1L	620,937		
1M	162,462		
Totals	1,262,089	65,232	412,723

- 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. Cypress Meadows used operating funds on disbursements that were not reasonable and necessary for the operation and maintenance of the project. Also, it failed to collect rent from all tenants and did not deposit lease agreement charges into its bank account. As a result, the lost revenue was not available to pay for the operation and maintenance of the project.
- 2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of 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. Cypress Meadows was unable to provide

documentation to support that all distributions were for necessary and reasonable operating expenses.

- 3/ 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. Cypress Meadows incurred project debt for ineligible expenses. Removing these debts will allow future project funds to be used on reasonable and necessary operating and maintenance expenses.

Appendix B

Auditee Comments and OIG's Evaluation

Auditee Comments

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May 18, 2017

VIA E-MAIL

Tanya E. Schulze
Regional Inspector General for Audit
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300 N. Los Angeles St., Suite 4070
Los Angeles, CA 90012
tschulze@hudoig.gov

Re: Response to HUD Office of Inspector General's Draft Audit of
Cypress Meadows Assisted Living

Dear Ms. Schulze:

This letter is in response to the HUD Office of Inspector General's ("OIG") request that Cypress Meadows Antioch, LLC (the "Owner"), comment on the OIG draft audit report that was sent to the Owner on April 27, 2017 (the "Draft Report"). The Draft Report relates to a project known as Cypress Meadows Assisted Living (the "Project"), that was financed by a mortgage loan (the "Loan") insured by HUD under Section 232/223(f) of the National Housing Act. Our office represents the Owner in connection with the Draft Report.

I. INTRODUCTION AND GENERAL COMMENTS

The conclusions and recommendations in the Draft Report are deeply flawed in several respects. They are all premised on the OIG improperly substituting its own post hoc judgments for the Owner and HUD personnel. The OIG's Draft Report fails to acknowledge HUD's significant role in the Loan, including the fact that it approved audits every year which disclosed many of the proposed findings (that OIG now criticizes) which audits complied with HUD requirements. The OIG Draft Report is replete with errors, including demands for repayment for periods for which the audit did not cover, and demands repayment for expenses even though the expenses were project related expenses. For these reasons, the Owner requests that the OIG review its report to correct those significant flaws or that it withdraw the Draft Report and close the audit altogether.

A. The OIG is improperly substituting its own judgment for that of HUD and the Owner

1

Comment 1

Comment 2

The OIG, with the benefit of hindsight, improperly substitutes its judgment for the judgments that the Owner and HUD professionals made during the period in question. This significant problem permeates the Draft Report as is demonstrated below.

Comment 2

B. HUD accepted the accuracy and appropriateness of the Audits, which the OIG now cites as evidence against the Owner

The OIG's analysis also fails to consider HUD's role in processing and approving the Audits and approving expenditures. While an OIG investigator, acting with the benefit of hindsight, might disagree with the conclusions and decisions of the Owner, that disagreement does not mean that those conclusions and decisions were inconsistent with the directions that were given by HUD to the Owner.

C. Just because OIG could not verify every expense does not mean that that expense was not a project related expense.

Comment 3

In many instances, the Owner has lost or misplaced certain receipts. The OIG confirmed in the exit interview that if even \$1 of a line item could not be proven to be project related with a receipt, that all of the amounts for this line item would be deemed to be disallowed and would be considered to be non-project related expenses. Even though the Owner confirmed the expenses were project related, the OIG claimed the expenses were non-project related, even though the OIG confirmed that some of the items were project related expenses. The OIG Draft Audit, as explained below, also incorrectly demands for repayment for periods for which the audit did not cover, and incorrectly demands repayment for expenses even though the expenses were project related expenses.

Comment 4

II. SPECIFIC RESPONSES TO PROPOSED OIG FINDINGS

A. HUD OIG Proposed Finding: Cypress Meadows Disbursed Project Funds for Expenditures that were Ineligible and Could Not Support Some Expenditures

There were 6 proposed findings under this heading. The Owner's response to each of these are as follows:

Comment 5

1. Cypress Meadows Made Ineligible Payments for its Owner's Salary

The OIG Draft Report refers to "salary paid to the Owner", but in the exit interview, the OIG confirmed that this statement is in error, and in fact the "salary" in question in the OIG Draft Report was NOT paid to Cypress Meadows Antioch, LLC (which is the Owner), and agreed that the "salary" paid was, in fact, (i) paid to the [REDACTED] and (ii) was paid for him acting in his capacity, and performing the duties, as the Administrator for the project.

Comment 5

It is customary for an assisted living facility to hire and to pay for an Administrator. In fact, this facility is required to have a licensed Administrator under the RCFE laws of the State of California. The fee paid to the Administrator, as discussed below, is separate and apart from the fee that is paid to the Operator for operating the facility. Furthermore, in this matter, upon the closing of the HUD-insured loan back in 2004, HUD was aware of the fact that the fee paid to the Administrator would be separate from the fee paid to the Management Company. This fee was disclosed on all audits going

The names contained in the response redacted for privacy reasons.

forward from 2004.

Comment 5

During the period from 2014-2016, the OIG has alleged that the total sum of \$263,289 was paid to [REDACTED], and has alleged that the alleged payments of \$263,289 to [REDACTED], the Administrator, who holds the RCFE Administrator's license for this project, were improper. HUD acknowledged in the exit interview that these fees in question were the fees paid to the Administrator in his capacity as the administrator for the project. The Administrator also confirmed that the payments he received were made to him in his capacity as the RCFE Administrator. The HUD Audit for 2014 and 2015 acknowledged that a salary was paid to this Administrator, and that the agreed upon salary was reasonable and necessary, and there was no prior finding against the Owner on this issue. Prior to the issuance of this OIG Draft Report, HUD never raised any objection to the fact that the an Administrator's salary was being paid, as disclosed each year on the HUD audit that was submitted to HUD. Since California RCFE laws require that there be an Administrator for the operation of the project, the fees paid were both necessary and reasonable. Therefore, the Owner contends that the fees paid to the Administrator were in fact reasonable and necessary, and that this finding is incorrect. We also note that the amount paid in the OIG Draft Report is incorrect. According to the accountant for the Owner, the amount paid was actually \$241,333 for the 2014-2016 period in question.

Comment 6

Comment 5

The OIG Draft Report indicates also objected to the payment of the Administrator's Fee and alleges that the Administrator's Fee should have been paid by the Operator out of the management fee received by the Operator pursuant to the Operating Lease. However, the Operating Lease does not mention how the Administrators' fee is to be paid. In fact, there is no mention at all in the Operating Lease about the Administrators' fee. Furthermore, HUD never objected to [REDACTED] being the licensed administrator. On Page 5 of the Operating Lease, the Operating Lease provides in the first sentence that the manager is required to "maintain" the licenses for the project. It does not require that the Operator pay, out of its fee, the cost to pay the Administrator to perform the services required under the Administrator's License. The obligation of maintaining and making sure that a license exists is different than actually paying someone to perform services under that license. Here, the Operating Lease does not state that the administrator's fee was part of the management fee paid to the Operator. Accordingly, when the OIG Draft Report states that the administrator's fee should have been paid by the Operator from the project management fee that the Operator received, this allegation is based on the OIG's erroneous interpretation of what the Lease says when the Lease states that the Manager "maintains" all licenses and permits. Furthermore, it is not required under HUD rules that the operator's fee must be used to pay the administrator fee. Since HUD rules do not require that the Administrator's Fee be paid out of the Operator's Fee, and the Operating Lease also does not require that the Administrator's Fee be paid out of the Operator's Fee, then there is no basis for HUD to now claim that there is, as stated in the OIG Draft Report, "no evidence that the salary paid to the owner and the debt incurred for the property were for reasonable and necessary services beyond those paid for by the project management fee" (emphasis added).

Comment 5

The OIG cannot decide, on its own, to now re-write the Operating Lease Agreement, and require that the Administrator's Fee be paid out of the Operator's Fee. The project was required to have an Administrator, and the Administrator was required to perform services. There is no document or HUD rule that required that those services be paid out of the fee paid to the Operator under the Operator Lease. Therefore, the Owner contends that the fees paid to the Administrator were in fact reasonable and necessary, and were not required to be paid out of the Operator's Fee, and that this finding is incorrect.

2. **Cypress Meadows Made Ineligible Payments for accounting fees**

Comment 7

The OIG Draft Report does not claim that the \$110,710 of fees paid for the accounting services in 2014 and 2015 were not reasonable and necessary. Instead, their only objection is that these fees should have been paid by the Operator pursuant to the Operator Lease, and not by the Owner. In essence, they have no objection to the payment of these fees, and only object to the account from which these fees were paid. What the OIG Draft Report fails to take into account in connection with these payments is that there is a 100% identity of interest between the Operator and the Owner. Had these payments been made by the Operator instead of by the Owner, the payment would have been permissible. Since the Owner and Operator have a 100% identity of interest, the fact that the payment was made from the wrong account is an immaterial accounting error. The payment was reasonable, necessary and was paid to an independent third party entity, and was required to have been paid. Whether it was paid from the Owner or the Operator, would have resulted in the same net effect, as the Owner and Operator are both 100% owned by the same persons. Had the Operator instead paid this amount, then the sum of \$110,710 which the Owner used to pay these fees would not have been available to the Owner. The net effect to the Project is \$0. Since this had no monetary effect on the Project, and was just an accounting error that was pointed out, there is no need for the Owner to now pay \$110,710 back to the Operator so that amount can be deposited into the project operating account.

Comment 4

In fact, because of the lack of revenue, the full amount of the management fee that was to be paid to the Operator under the Lease was not paid and instead was reflected as an "accounts payable and accrued liabilities" on the balance sheet. So, even though there was an identity of interest between the Owner and Operator, the Owner and Operator agreed that the Operator would not be paid in order to create more cash so that other project related expenses could be paid.

Comment 8

The OIG Draft Report also states that an additional amount of \$129,416 was accrued during the audit period. The OIG Draft Report is incorrect. The \$129,416 includes \$78,805 of unpaid charges and finance fees from periods before 1/1/14. The correct amount is only \$50,611.

It should also be noted that the fees of \$110,710 that were paid over 36 months works out to \$3,815 per month. If the Operator or Owner would have hired an internal accountant, it would have paid \$3,075.27 per month, which works out to \$36,903 per year, which would be a low wage for that position. Accordingly, the fees incurred were clearly reasonable.

Comment 9

3. **Cypress Meadows Made Ineligible Payments for Health Insurance**

HUD, the Lender, and the auditor all knew the Owner was paying health insurance and never once did HUD or anyone else tell the Owner it was wrong or to stop doing it. These amounts were reported on all prior HUD audits. The HUD auditor never identified these payments as improper, and HUD, upon receipt and review of each audit containing these payments, never advised the Owner to stop doing it. The OIG cannot now step in and demand the fees paid in 2014-2016 for \$99,160 be repaid when HUD previously reviewed and approved these items when these items were reported and disclosed in the audits filed with HUD.

Comment 10

The OIG also states that the fees "should have been paid using the management fee." However, once again, there is no provision in the Operating Lease that requires that the management fee received by the Operator is to be used to pay this expense. Furthermore, HUD is once again saying, in essence,

they have no objection to the payment of these fees, and only object to the account from which these fees were paid. HUD alleges that the 100% Identity of Interest Operator, and not the Owner, should have paid these fees. Had the Operator instead paid this amount, then the sum of \$99,160 which the Owner used to pay these fees would not have been available to the Owner. The net effect to the Project is \$0. Since this had no monetary effect on the Project, and was just an accounting error that was pointed out, there is no need for the Owner to now pay \$99,160 back to the Operator so that amount can be deposited into the project operating account

4. Cypress Meadows Made Ineligible Payments for Unreasonable Bank Fees

The bank fees incurred in 2014-2015 in the amount of \$4,179 were charged by an independent third party bank. The OIG Draft Report does not object to the fact that the bank had the right to charge these fees, and does not claim that the fee charged by the bank was unreasonable. The bank charges are not controlled by the Owner. The Owner had no control over what his bank would charge.

During the period 2014-2015, the OIG acknowledged that the project was not at 100% occupancy, and at times was below 90%. The OIG agreed that the failure to have occupancy at or near 100% would have affected the account balance maintained by the Owner, since less revenue was being generated. If less revenue is being generated, this lack of revenue clearly contributed to the bank account not having, at times, a positive bank account balance. If an account does not have a positive balance, the bank is going to charge fees because of insufficient funds. And the fact that the bank would then charge a fee for overdraft is clearly an operational cost. If the account was overdrawn, the owner has no control over what the bank would charge. However, the OIG makes the assumption that these bank fees were solely caused by "ineligible uses of project funds". However, the fact that occupancy was below 90% resulted in the lack of revenue at times and insufficient funds available to pay checks presented. When this happened, it was reasonable for the bank to charge a fee for overdraft and insufficient funds so that the checks could be paid. The fact that there was a shortfall in the account at the time the check was presented was due to the fact that the project was not generating sufficient revenue due to low occupancy. The OIG has assumed, instead, that each time a bank fee was charged, this was caused each time by an alleged misuse of project funds, and totally fails to acknowledge that due to occupancy levels at times hovering around 85%, the project was not generating sufficient revenue and therefore the bank account, at times, did not have sufficient funds to cover the checks that had been written.

5. Cypress Meadows Made Ineligible Payments for an Identity of Interest Business

HUD has always been aware that [REDACTED] runs the salon as a resident amenity. HUD requested that the Owner to use a lease for \$1 and the Owner complied. The facility did pay the salon liability insurance of \$1,352, in part to protect the project from additional liability. HUD was aware of this arrangement, and never advised the owner it was incorrect.

A lease was subsequently submitted to HUD. The OIG says the lease was not approved, but it does not indicate why, and when requested in the exit interview, the OIG did not provide any evidence that the lease was not approved. There is no way to determine if the lease is objectionable because it is an identity of interest lease, or if the lease is objectionable because the lease payment being made is too low.

Comment 11

Comment 12

6. **Cypress Meadows Did Not Maintain Adequate Support for Some Expenses**

There were six items identified in the OIG Draft Report, totaling \$65,232, in which the OIG now claims are to be paid back to the operating account because the owner did not maintain adequate support for "some" of the expenses. The OIG alleges that since "some" of the expenses do not have adequate support, the entire \$65,232 must be disallowed. These six items are discussed below.

Comment 15

a. With respect to the miscellaneous expenses totaling \$22,671, the Owner was previously made aware of these issues, and has paid all of these expenses back to the Project, as required by HUD. There is no need to again pay these expense back to the project operating account since these expenses have already been paid back.

Comment 16

b. With respect to the \$11,433 for phone expenses: These were normal and customary phone expenses that all related to the Project and were Project phone expenses. The Owner does not have every single receipt for these phone expenses, as some appear to be missing, but contends that these are all project related phone expenses. Just because some of the receipts are missing does not mean that the ENTIRE amount must be disallowed. The only basis on which OIG makes this claim is that the owner could not provide every receipt or invoice. However, the OIG has no evidence that these expenses were not project related expenses. So, what the OIG has done is they have made an assumption that these are ALL non-project related expenses, and has demanded that the full amount be repaid.

Comment 13

c. With respect to the \$10,236 for restaurant expenses: These were all project related expenses and normal marketing expenses, including gifts for referring sources. The Owner does not have every single receipt for these expenses, as some appear to be missing, but contends that these are all project related expenses. Just because some of the receipts are missing does not mean that the ENTIRE amount must be disallowed. Once again, the only basis on which OIG makes this claim is that the owner could not provide every receipt or invoice. Then, when an invoice was in fact presented to the OIG, the OIG still will not allow the receipt because the Owner failed to have an additional narrative as to what occurred during this meal, and who attended, and was project related business involved. However, the OIG has no evidence that these expenses were not project related expenses. So, what the OIG has done is they have made an assumption that these are ALL non-project related expenses. In other words, the Owner is "guilty" unless it can prove it is innocent, and therefore the OIG wants the entire amount repaid.

Comment 14

d. With respect to the \$7,325 for identity of Interest/Family member payments: While it is true that \$7,326 of expenses were paid to family members of [REDACTED], these were for his children who worked in the dining room and for his daughter, who is a Chef, who trained staff and meal planned on occasion. Here, the amounts were reflected in the books as payroll. So, even though there is a record and a receipt/invoice does exist, the OIG still will not allow the expense because the Owner failed to have additional narrative as to what each person did for the work performed. However, not every person is required to have a written contract, and the fact that there is no written contract or a written narrative showing what services were performed by each such person does not mean that the expense should be disallowed. The OIG has no evidence that these expenses were not project related expenses. So, what the OIG has done is they have made an assumption that these are ALL non-project related expenses. In other words, the Owner is "guilty" unless it can prove it is innocent.

Comment 17

e. With respect to the \$7,266 for gas: these expense as explained by the Owner to the OIG were for gas used solely by the Facility Bus and Van, which were only used for Project related trips. The Owner does not have every single receipt for these expenses, as some appear to be missing, but contends that these are all project related expenses. Just because some of the receipts are

Comment 15

missing does not mean that the ENTIRE amount must be disallowed. Once again, the only basis on which OIG makes this claim is that the owner could not provide every receipt or invoice. Then, when an invoice was presented, the OIG still will not allow the receipt because the Owner failed to have additional narrative as to how the Facility Van and Bus were used for the trip that required gas. However, the OIG has no evidence that these expenses were not project related expenses. So, what the OIG has done is they have made an assumption that these are ALL non-project related expenses. In other words, the Owner is again "guilty" unless it can prove it is innocent.

- f. With respect to the \$6319 of mortgage payments—This was a clerical error, and once discovered, all funds were paid back in full to the Project. There is no need to again pay these expenses back to the project operating account since these expenses have already been paid back.

B. HUD OIG Proposed Finding: Cypress Meadows Did Not Collect Rent, Make Deposits Into its Bank Account, and Make Payments on the Mortgage

There were 4 proposed findings under this heading. The Owner's response to each of these are as follows:

1. **Cypress Meadows Did Not Collect Rent from Three Family Members**

The OIG alleges that the Owner did not collect rents in the amount of \$512,400 from his parents and mother-in-law in rent. HUD was informed of this arrangement, and never objected to it. Also, please note that [REDACTED] parents have now passed away and are no longer residents at the facility. Only his mother-in-law lives there now, and she began her residency in 2014.

Comment 18

The OIG Draft Report was solely for the period for 2014-2016. However, the \$512,400 amount was not for the period that was audited. The OIG, even though they did not audit the years 2009-2013, and did not audit 2017, the OIG is now demanding repayment for periods for which they did not audit and for which they did not review any records. Since the audit was for the period from 2014-2016, the only amount in question should be the years for which the OIG audit was performed. Based on the documents produced by the OIG, the amounts of alleged uncollected rent for 2014-2016 for [REDACTED] and [REDACTED] for this period would be \$4,750 from January 2014-January, 2016, which is a total of \$118,750, and not \$354,900, as alleged by the OIG. Based on the documents produced by the OIG, the amounts of alleged uncollected rent for 2014-2016 for [REDACTED] mother-in-law [REDACTED] for this period would be \$3,750 from July 2014-December, 2016, which is a total of \$67,500, and not \$120,000, as alleged by the OIG.

Since the OIG audit only covers 2014-2016, the OIG cannot demand repayment for items for periods for which no audit was performed, and no books and records were audited. Therefore, the OIG can only allege that the amount due is the sum of \$118,750 for [REDACTED], \$67,500 for [REDACTED] mother-in-law [REDACTED], and \$37,500 for [REDACTED] (after [REDACTED] passed away), for a total of \$223,750, and not \$512,400.

Comment 19

With respect to the \$223,750 for the 2014-2016 period for which the OIG audit was performed, it should be noted that the Owner had previously disclosed to HUD that both his parents and that his mother-in-law were living at the facility. The OIG report stated that HUD told the Owner that the parents needed to pay rent, but the OIG was unable to provide any evidence of when, how, and from

whom this was stated to the Owner, and has no written or corresponding evidence to this effect. During the exit interview, the Owner asked the OIG auditor and HUD to provide a copy of any evidence that HUD told the Owner that the parents needed to pay rent. No such document was produced by either OIG or HUD.

Comment 20

It should be further noted that during this period, the facility was occupancy below 90%, so there were existing vacant units. The units occupied by [REDACTED] and by [REDACTED] mother-in-law [REDACTED] would have otherwise gone vacant. They did not displace any other tenants, nor did they occupy the units and deny other tenants from occupying a unit in the facility. The units would have remained vacant and would not have generated any revenue, so the fact that the units did not generate revenue when they were occupied by [REDACTED] and by [REDACTED] mother-in-law [REDACTED] had no monetary affect, as the units would not have generated revenue even if they were not occupied by [REDACTED] and by [REDACTED] mother-in-law [REDACTED].

2. Cypress Meadows Did Not Collect Rent from 18 Residents

Comment 21

The Draft Report alleges that the Owner did not collect rent in the amount of 108,537 from a total of 18 tenants. In 2016, the State of California requested that the Owner, due to a fire in an adjacent facility, would agree to take in the displaced residents from this other facility. The Owner agreed, and had an oral agreement with the owner from the other facility that this other owner would reimburse Cypress Meadows's costs and expenses once the insurance was settled. To date, no reimbursement have been made.

Comment 22

On this item, there also appears to be considerable confusion relative to move in dates and when monies were collected. It was explained to auditor by [REDACTED] who monitors when residents actually move in, that although a resident may have paid fees or deposits on a certain date, they don't necessarily move in on that same date and start paying rent. They may still need hospitalization or rehabilitation in a skilled nursing facility or have other medical issues that cause them not to move in until months afterwards. This delay in a move results in the appearance that a resident has signed their lease, paid fees and has actually moved in, which the auditor interpreted as the resident having been in the facility as of the contract date. However, as explained to the Auditor, this in fact was not the case, as that resident has not yet moved in and has not yet paid rent. The auditor made the assumption that the resident was in the facility and was paying rent, when in fact the resident was not paying rent and, as was often times the case, had not even have been discharged from the Hospital.

3. Cypress Meadows Did Not Deposit All Funds Collected Into Its Bank Account

Comment 23

There are two components to this finding. The first is that \$138,834 in community fees were allegedly not collected. Here, the OIG is making an assumption about the receipt of community fees. HUD says the fee was not collected, but then claims this uncollected fee was deposited into another account. However, this appears to be based on one employee's statement, and since HUD reviewed 73 files and did not find any payment of a community fee, HUD has made an assumption that the 73 of these fees were paid and deposited into an incorrect account. This finding, as stated in the OIG report, says that it "appears" that \$138,834 in community fees were allegedly not collected. However, this "appearance" is based on an assumption only, and the OIG cannot demand repayment based on and assumption. The only evidence the OIG has is shown on the OIG report, on page 8, where OIG shows

only two checks. These are the only checks that supports the allegations regarding the community fees, and these checks only relate to the \$2,000 community fee for one unit.

Comment 24

Another basis for this claim by the OIG appears to be the fact that the lease used at the project that the OIG Auditor reviewed has a boiler plate reference to the term "Not Waived" printed on the line relative to community fees. When the fee wasn't charged, that verbiage was always supposed to be crossed out by the employee dealing with that particular case, but unfortunately there were also instances where that term "Not Waived" was not crossed out even though the community fee was not charged. However, the OIG has assumed that the fee was collected each time. In fact, only a very small number of residents were actually charged that fee, and all of those fees charged were shown to be deposited in the project operating account. The OIG then assumes that since there is no record of the payment of the community fee by the other 73 residents, and since the term "Not Waived" (which was boiler plate language in lease) was inadvertently not crossed out when the lease was signed, the OIG assumes that this fee was in fact paid, even though there is no record of such payment for these 73 residents. In fact, in the exit interview, the OIG Auditor admitted that there was no other evidence, and therefore since he could not figure out why the box "Not Waived" was not crossed out, he then assumed that payment was made, even though there is no evidence that any payment was made.

Comment 25

In the exit interview, the OIG Auditor said [REDACTED] was the employee that allegedly stated that she was instructed to have residents write a separate check for the community fees. [REDACTED] is new employee of only 5 months duration, and she will testify that the OIG coerced, confused, intimidated her to provide this statement, which statement is incorrect. In fact, at no time did the Owner ever advise her to do anything inappropriate. Her supervisor, [REDACTED], specifically informed the OIG Auditor that the Owner never advised her or anyone else in to do anything untoward. [REDACTED] advised the OIG Auditor that [REDACTED] was a new employee and was still learning policies and procedure. [REDACTED] said she would accompany [REDACTED] to her interview with the OIG auditor, but that was not allowed to happen and instead the OIG auditor demanded that [REDACTED] be interviewed with no other persons from the owner or the project in attendance.

Comment 26

It should be further noted that [REDACTED], the OIG Auditor who performed the audit, informed [REDACTED] on multiple occasions that he was new to auditing assisted living projects, and had no prior experience in auditing assisted living projects, and had previously only audited multifamily housing projects (i.e., apartment projects).

Comment 27

The second component to this finding is that \$23,628 in rent was allegedly collected and not deposited into the project operating account.

On this item as well, there appears to be considerable confusion relative to move in dates and when monies were collected. Once again, it was explained to the OIG auditor by [REDACTED], who monitors when residents actually move in, that although a resident may have paid fees or deposits on a certain date, they don't necessarily move in on those same dates and start paying rent. They may still need hospitalization or rehabilitation in a skilled nursing facility or other medical issues that cause them not to move in until months afterwards. This delay in a move results in the appearance that a resident has signed their lease, paid fees and has actually moved in, which the auditor interpreted as the resident having been in the facility as of the contract date, but in fact was not the case, as that resident has not yet moved in and has not yet paid rent. The auditor then assumes that the resident was in the facility, when in fact they had still, for example, not even have been discharged from the Hospital.

Also, on the list of these ten residents provided by the OIG, some of the residents on this list

were again reviewed by the Owner and its Operator and staff, and in fact, the amounts that the OIG auditor points out as not showing up on the books, do in fact show up and are clearly posted in the Cypress project operating account.

Once again, this is more evidence of an auditor who lacks experience in auditing an assisted living facility, and clearly not accepting the explanations of staff, except in the one instance when [REDACTED] misspoke about the community fees.

Comment 28

4. Cypress Meadows Did Not Make Payments on its Mortgage

The OIG Audit also alleges that the Owner didn't make timely payments. This is "technically" correct. However, the Owner and Operator did work diligently to try to correct the default. For example, in 2015 the actual fee that was supposed to be paid to the Operator under the Lease was \$309,198. However, due to project cash constraints, only \$153,800 was paid and therefore \$155,398 was voluntarily left in the project by the Owner. In 2016, the Operator was only paid \$15,000, and the remaining amount was voluntarily left in the project operating account by the Owner. The Owner and Operator did this solely to help the cash flow of the project. In addition, the Owner would voluntarily contribute money to the project operating account to help the project be in a better financial position. The net of these contributions in 2014-2015 totals 154,403. These figures for 2014 and 2015 were on the financial statements and were in the audited financial statements provided to HUD, yet the OIG audit fails to mention this effort by the Owner to correct the default, and also fails to mention the voluntary act of not taking a fee by the Operator, which each resulted in infusing the project operating account with additional cash.

Comment 29

It should be noted that the primary reason the loan went into default is due to the low occupancy. The owner has diligently attempted to increase the occupancy at the facility. Also, the Owner has been working with HUD and the lender for years to try and do a 223a7 refinance to cure the default and to lower the interest rate. The Owner recently came to a point where the Lender was ready to move forward with the 223a7 refinance, but HUD would not allow the submission to go forward. Perhaps most important, the Owner has been diligently trying to sell the project so as to use the sale proceeds to cure the default and pay the loan in full. At this time, a purchase agreement has been signed with an independent third party Buyer, and the Seller hopes to have the Project sold in the next 45 days, and at that time the existing loan will be paid off and all payments will have been made and brought current. This is the best possible result for HUD, and would not have come about without the efforts of the Owner and the Operator.

Comment 30

C. HUD OIG Proposed Finding: Certain Accrued Expenses are to be Removed

The audit states that \$412,723 of accrued expenses should be removed. This consists of \$283,307 of accrued owners salary and \$129,416 of accrued accounting fees. This is erroneous. The accrued "salary" dates back to periods prior to January 1, 2014, and no audit was performed for the period prior to January 1, 2014. This amount represents the Administrator's salary that was earned but not paid, as the Administrator never cashed the checks. The annual audit disclosed this. HUD never challenged this issue. In essence, this is the equivalent of the owner earning the wages and then re-depositing them into the project to help the cash flow and keep the project alive. The OIG Draft Report paints this as unauthorized expenses. Instead, this should be viewed as the owner contributing cash into the project to assist the cash flow of the project.

With respect to the accounting fees, the OIG Draft Report states \$129,416 was accrued during the audit period and should be disallowed. As stated above, \$78,805 was from a prior period outside the scope of the audit. These fees were also approved in the annual audit and were never questioned by HUD.

III. CONCLUSION

HUD reviewed all the information provided in the audits for the Project from 2005-2015, and concluded that the information complied with all program requirements, and never objected to the audits. Those judgments, exercised at the time the audits were prepared and submitted, demonstrate that Cypress Meadows Antioch, LLC, complied with its obligations. HUD should be estopped from requiring repayments for items for which HUD never objected to, and for which the Owner relied upon going forward when it made these payments, as HUD had never previously objected to the payments as disclosed in the audits. Furthermore, as outlined in this response, the OIG Draft Report is replete with errors, including demands for repayment for periods for which the audit did not cover, and demands repayment for expenses even though the expenses were project related expenses. Thus, the OIG findings should be substantially revised or withdrawn.

Comment 31

This Owner is not an experienced HUD owner of healthcare facilities. The Owner was not aware of certain HUD rules and regulations, as this is the only HUD project it owns, and is in fact the only assisted living facility it owns, and the Owner tried to follow the HUD rules and the directions it received from HUD. Furthermore, the OIG Draft Report, as outlined herein, is replete with errors and is so flawed that, until the issues raised in this response are addressed and discussed with the Owner, this OIG Draft Report should not be published. The flaws in the OIG Draft Report as discussed herein, if published in its present form, will cause the Owner and its members great harm in the public eye and irreparable damage to their reputation.

Comment 32

To summarize, while the Owner disagrees with the OIG Draft Report, the Owner is presently in the process of selling the project to an independent third party, which sale will allow the loan and all past due amounts to be paid in full at closing, and will eliminate HUD's mortgage insurance risk. This also eliminates any remaining issues with the audit, as the project will have been sold and the loan paid off. If this sale does not occur, the Owner will immediately seek other alternatives to pay the loan off in full, including refinancing the loan. Should such a refinance involve a HUD 223a(7) loan, the Owner will consider, if required by HUD, removing the current operator and replacing the Operator with a new HUD-approved independent Operator.

Comment 29

Very truly yours,

LEVY, LEVY & LEVY

By:


Mark P. Levy, Esq.

OIG Evaluation of Auditee Comments

- Comment 1 The audit was conducted in accordance with Generally Accepted Government Auditing Standards. The report is accurate based on the audit work conducted. The owner claimed that some statements made in the audit report were incorrect but did not provide any additional supporting documentation to substantiate its claims in its response. We also note that during the audit fieldwork we discussed the issues with Cypress Meadows and also provided finding outlines, which preceded the draft report. There were opportunities for Cypress Meadows to express disagreement and provide any additional supporting documentation. Cypress Meadows can provide additional supporting documentation to HUD during the audit resolution process.
- Comment 2 It is the owner's responsibility to operate the project in accordance with any pertinent requirements and agreements. While HUD may receive and review financial statements audited by an independent auditor, HUD does not "approve" the financial statements, nor any of the reported transactions. The financial statements are a representation made by the owner. Furthermore, while HUD may have reviewed the financial statements, it did not have supporting documentation such as general ledger entries, invoices and receipts. HUD did identify concerns with the use of project funds, which prompted it to refer the matter to the OIG for a more detailed review. We conducted a more thorough review of the project operations to determine whether Cypress Meadows was managed in accordance with HUD requirements and found that it was not. The owner and identity-of-interest operator entered into agreements with HUD that placed certain restrictions on operations. The owner disregarded these requirements.
- Comment 3 Cypress Meadows did not provide documentation to support that some costs were necessary and reasonable operating expenses. The regulatory agreement and HUD regulations require the owner to support project costs. The owner must provide supporting documentation for all expenses and cannot simply verbally confirm that the items were project related expenses. If the expenses are not supported, and we cannot separate non-project expenses from project expenses, we are compelled to question the entire amount. These questioned costs can later be reduced or eliminated if Cypress Meadows can demonstrate documentary evidence that the items are project costs. Cypress Meadows can provide additional supporting documentation to HUD during the audit resolution process.
- Comment 4 OIG audits are not restricted to a particular audit period. The audit notification letter specifically stated that the audit period would be expanded as necessary. We expanded the audit period for some items to meet the objective of the audit.
- Comment 5 We revised the audit report to state that the salary was for the administrator. The administrator solely owns and solely operates Skyline Crest, the operator. It has no employees except for the administrator. Skyline Crest, not the administrator,

holds the facility license and collects the 8 percent management fee. The operating lease agreement between Cypress Meadows and Skyline Crest permits use of project funds for employee compensation below the level of administrator. It does not permit use of project funds for administrator compensation. Further, the compensation paid to the administrator was not reasonable or necessary. Skyline Crest received management fees of \$449,440 during the period of 2014-2015. The administrator was compensated through these management fees as the administrator is the sole beneficiary of the management fee collected by Skyline Crest.

- Comment 6 We disagree that salary paid to the owner was \$241,333 and not \$263,289. Cypress Meadows did not provide supporting documentation to substantiate the \$241,333 amount. Our audit disclosed payments of \$263,289. Cypress Meadows can provide additional supporting documentation to HUD during the audit resolution process.
- Comment 7 We disagree with Cypress Meadows that regardless of who paid the offsite accounting fees the net effect to the project is zero. The accounting expenses in question are for offsite accounting services. The operating lease agreement required the operator (Skyline Crest) to pay for offsite accounting expenses out of its funds and that these expenses shall not be treated as property expenses. Therefore, these expenses cannot be paid from project funds. These expenses must be paid from non-project funds. This would result in the project having more funds available to pay for reasonable and necessary operating expenses such as the mortgage. The fact that a management fee was accrued rather than paid is not relevant. The off-site accounting fees are ineligible costs.
- Comment 8 The owner had employees performing onsite accounting functions and these costs were not questioned in the audit. The operating lease required non-project funds to be used for offsite accounting expenses. The questioned costs are for offsite accounting expenses.
- Comment 9 We disagree that HUD knew the owner was paying for his and his family's personal health insurance. The audited financial statements do not provide detailed transactional data for each line item. The financial audit reports for fiscal years 2014 and 2015 recorded a project expense for "Health insurance and other employee benefits." This line item did not state that project funds were used for the owner's personal health insurance. We updated the report to indicate that the health insurance "should have been paid using non-project funds."
- Comment 10 We disagree with Cypress Meadows that regardless of who paid the health insurance the net effect to the project is zero. The personal health insurance costs were not reasonable and necessary expenses for the operation and maintenance of the project. Therefore, these expenses cannot be paid from project funds. These expenses must be paid from non-project funds. This would result in more funds available to pay for reasonable and necessary operating expenses such as the mortgage.

- Comment 11 We recognize that a low occupancy resulted in less revenue. However, writing checks when sufficient funds were not available was avoidable and therefore not a reasonable expense of the project. Additionally, the owner's disregard of the regulatory agreement resulted in the owner not collecting all revenue due to the project, which exacerbated the problem with less revenue to cover project expenses.
- Comment 12 HUD was aware of the salon and that it was run by the owner's wife. However, as stated in the report, HUD never approved the lease. HUD documented a conversation with the owner in its Integrated Real Estate Management System (iREMS) in 2011 in which the owner requested a waiver from HUD but failed to produce documentation requested by HUD. As a result, HUD did not approve a waiver. During the audit, HUD confirmed that the lease for \$1 was never approved. Salon expenses, such as the insurance policy, were not project expenses. As a result, these expenses must be paid from non-project funds. The owner can work with HUD during the audit resolution process on an appropriate arrangement between the project and the salon.
- Comment 13 The restaurant expenses were questioned because Cypress Meadows did not provide any documentation to support that these expenses were necessary for the operation of the project. It provided receipts for some restaurant purchases, however, receipts alone do not establish that the expenses were necessary for the operation of the project. The regulatory agreement and HUD regulations require the owner to support project costs. The owner can work with HUD during the audit resolution process on addressing the questioned costs.
- Comment 14 We disagree that the \$7,325 was recorded as payroll expenses. We only questioned payments made to the owner's wife and daughter. These payments were identified in Cypress Meadows general ledger as bill payments or reimbursements and not as payroll expenses. For the expenses in question, Cypress Meadows was unable to provide any supporting documentation including receipts or invoices to support the expenses were necessary for the operation of the project. The regulatory agreement and HUD regulations require the owner to support project costs. The owner can work with HUD during the audit resolution process on addressing the questioned costs.
- Comment 15 The owner did not provide supporting documentation to show that the costs were repaid to the project. Cypress Meadows can provide additional supporting documentation to HUD during the audit resolution process.
- Comment 16 We disagree that these were normal and customary telecommunications expenses related to the project. Among the receipts provided by the owner, there were bills addressed to the owner's home address in the name of the owner's wife and to the salon. The bills addressed to the home were for cable and internet services. The project also paid for nonproject phone lines. We provided the owner with a list of 16 phone lines found on the invoices. The owner did not provide sufficient explanation or justification for most of the numbers. Discussions with project

employees indicated that they did not have phones issued by Cypress Meadows. As a result, we were unable to separate project expenses from non-project expenses in these invoices. Cypress Meadows can provide additional supporting documentation to HUD during the audit resolution process.

- Comment 17 We agree that some of the unsupported expenses may have been project related. However, we disagree that these were all project gas expenses used solely by facility vehicles for project related trips. Among the invoices provided by the owner, there were charges for family members' gasoline expenses. The invoices also included gasoline purchased outside of the Antioch area, including Southern California. Also, Cypress Meadows did not develop controls to track gas expenses for its vehicles. As a result, we were unable to separate project expenses from non-project expenses in these invoices. As clarified during the exit conference, if the expenses are not supported, and we cannot separate non-project expenses from project expenses, we are compelled to question the entire amount. The amount can be reduced or eliminated if the owner can provide evidence that the items are eligible project expenses. The owner can provide any supporting documentation to HUD during the audit resolution process to address the questioned costs.
- Comment 18 OIG audits are not restricted to a particular audit period. The audit notification letter specifically stated that the audit period would be expanded as necessary. We expanded the time period for this particular item. The owner told us that he never charged his parents rent. We used the resident files to determine the move in dates for the family members. The owner can provide documentation demonstrating that he collected rent from his family members to HUD during the audit resolution process or pay the project \$512,400 from non-project funds.
- Comment 19 We disagree that HUD never objected to this arrangement. When HUD became aware that the owner's parents lived at the property, HUD requested documentation from the owner to show that rent was paid to the property.
- Comment 20 The owner is required by the regulatory agreement to collect rent. The fact that the project was not fully occupied is not relevant. We disagree that the occupancy of the three family members had no monetary effect. The project not only lost rental revenue from the rent-free units, it incurred additional costs such as care and meals for the three family members.
- Comment 21 We acknowledge that Cypress Meadows received residents displaced due to a fire at another facility. Of the 18 residents, 16 moved into the facility before the fire. Therefore, these 16 residents were not displaced due to a fire at another facility. The other two residents were residents displaced due to the fire. However, we did not question the uncollected rent until these two individuals signed a lease with Cypress Meadows.

- Comment 22 We used the move-in dates provided by the senior resident care coordinator. We provided the owner with a detailed rent calculation, including move-in dates, for all 18 residents with the draft audit report. The owner did not provide any supporting documentation to show that the move-in dates or calculations were incorrect. Cypress Meadows can provide additional supporting documentation during the audit resolution process.
- Comment 23 The owner is required to collect all project revenue. The resident leases questioned included community fee charges. The owner is required by the regulatory agreement and lease to collect the fee and the resident is required by the lease to pay the fee. There was some evidence that Cypress Meadows instructed residents to write checks to Skyline Crest and that checks were made out to Skyline Crest for the community fee. However, we were unable to verify whether the funds were collected or deposited as the owner would not provide Skyline Crest bank statements or accounting information. We revised the report to state that the owner did not deposit community fees charged in the lease into the project account.
- Comment 24 We disagree that the lease terms regarding the community fees were boiler-plate. The leases reviewed included typewritten “n/a,” “waived,” or “not-waived” terms.
- Comment 25 We conducted interviews in a professional manner throughout the audit and the auditors never demanded that the marketing director be interviewed alone. The day the interview in question was scheduled the senior health care coordinator left work early and could not join the marketing director in the interview. The audit team only requested that the interview take place as scheduled. The marketing director did not object to doing the interview without the senior health care coordinator present. Also, we disagree that the marketing director was too inexperienced to answer questions specific to her day to day responsibilities. At the time of the interview in question, the marketing director had worked for Cypress Meadows for ten months and she stated that she was responsible for bringing approximately 50 new residents to the project.
- Comment 26 The staff assigned to perform the audit collectively possessed adequate professional competence needed to address the audit objective and performed the work in accordance with Generally Accepted Government Auditing Standards.
- Comment 27 We used the move-in dates provided by the senior resident care coordinator. The documentation reviewed showed that funds were collected from the residents. However, these funds were not shown on the Cypress Meadows bank statements or accounting records. We provided the owner with a detailed rent calculation for the 10 residents, including move-in dates, with the draft audit report. The owner did not provide any supporting documentation to show that the move-in dates or calculations were incorrect. Cypress Meadows can provide additional supporting documentation during the audit resolution process.

- Comment 28 The owner used project funds for ineligible and unsupported expenses. The owner also failed to collect all project revenue. The owner's mismanagement of the project reduced revenues and increased expenses. As a result, this increased the risk of the project defaulting on its FHA-insured mortgage.
- Comment 29 We disagree that the primary reason the loan went into default is due to the low occupancy. As noted in the audit report, the owner failed to collect all project revenues, and also used project funds for ineligible and unsupported expenses. This contributed to the unavailability of \$1.2 million to pay the mortgage. Also, as part of their monitoring and in an attempt to help the owner improve occupancy, HUD asked the owner to develop an action plan as well as a written marketing plan. However, the owner did not provide either document as requested. The refinance or sale of the project can be discussed with HUD during the audit resolution process.
- Comment 30 The administrator salary and accounting fees were ineligible expenses. OIG audits are not restricted to a particular audit period. As a result, accrual of these expenses also violated the regulatory agreement and HUD requirements. The project has recorded accounts payable liabilities totaling \$412,723 for these ineligible costs.
- Comment 31 The owner submitted audited financial statements to HUD at the end of each year. These were submissions of audited financial statements to HUD and not approvals of financial transactions. We disagree that HUD never objected to the audits. HUD referred Cypress Meadows to the OIG for an audit because of concerns with the administration of the project. The OIG audit included a detailed review of specific transactions and the related supporting documentation. We found significant misuses of funds that violated the regulatory and operating agreements and HUD requirements. The owner agreed to certain restrictions regarding the use of project funds when he signed the regulatory agreement in exchange for an FHA-insured mortgage for the property. As noted in the audit report, we made recommendations to HUD, not demands, for the owner to support the questioned expenses or repay the project. Because Cypress Meadows did not provide additional supporting documentation to support its statements in the response, we continue to question the costs identified in the report. The owner can work with HUD during the audit resolution process to address the recommendations.
- Comment 32 We disagree that the owner tried to follow HUD rules and the directions it received from HUD. The owner claimed that he did not read HUD regulations or relevant agreements that he signed; and, our audit found that on numerous occasions he ignored HUD's instructions. The owner agreed to certain restrictions when he signed a regulatory agreement with HUD for the \$14 million HUD-insured project mortgage. The owner disregarded these requirements and used project funds for ineligible and unsupported expenses throughout the audit period.

Appendix C

Criteria

12 USC 1715z-4a Double Damages Remedy for Unauthorized Use of Multifamily Housing Project Assets and Income

(a)(1) For purposes of this section, use of assets or income in violation of the regulatory agreement, or such other form of regulatory control as may be imposed by the Secretary, or any applicable regulation shall include any use for which the documentation in the books and accounts does not establish that the use was made for a reasonable operating expenses or necessary repair of the property and has not been maintained in accordance with the requirements of the Secretary and in reasonable condition for proper audit.”

24 CFR 232.1007, Operating Expenses

Goods and services purchased or acquired in connection with the project shall be reasonable and necessary for the operation or maintenance of the project, and the costs of such goods and services incurred by the borrower or operator shall not exceed amounts normally paid for such goods or services in the area where the services are rendered or the goods are furnished, except as otherwise permitted or approved by HUD.

24 CFR 232.1005, Treatment of Project Operating Accounts

All accounts deriving from the operation of the project, including operator accounts and including all funds received from any source or derived from the operation of the facility, are project assets subject to control under the insured mortgage loan’s transactional documents, including, without limitation, the operator’s regulatory agreement. Except as otherwise permitted or approved by HUD, funds generated by the operation of the healthcare facility shall be deposited into a federally insured bank account, provided that an account held in an institution acceptable to Ginnie Mae [Government National Mortgage Association] may have a balance that exceeds the amount to which such insurance is limited. Any of the owner’s project-related funds shall be deposited into a federally insured bank account in the name of the borrower provided that an account held in an institution acceptable to Ginnie Mae may have a balance that exceeds the amount to which such insurance is limited.

24 CFR 200.105, Mortgagor Supervision

(a) As long as the Commissioner is the insurer or holder of the mortgage, the Commissioner shall regulate the mortgagor [borrower] by means of a regulatory agreement providing terms, conditions and standards established by the Commissioner, or by such other means as the Commissioner may prescribe.

HUD Handbook 4232.1, Section II, Chapter 8.1

ORCF [Office of Residential Care Facilities] holds the Borrower ultimately accountable for all functions and actions necessary to sustain an insured healthcare project. That ultimate project

responsibility holds regardless of the Regulatory and/or Management Agreements the Operators and/or agents sign.

Owner Regulatory Agreement for Multifamily Housing Projects, Paragraph 1

Owners, except as limited by paragraph 17 hereof, assume and agree to make promptly all payments due under the note and mortgage.

Owner Regulatory Agreement for Multifamily Housing Projects, Paragraph 4

(a) Commercial facilities shall be rented for such use and upon such terms as approved by the Secretary. Subleasing of dwelling accommodations, except for subleases of single dwelling accommodations by the tenant thereof, shall be prohibited without prior written approval of Owners and the Secretary and any lease shall so provide. Upon discovery of any unapproved sublease, Owners shall immediately demand cancellation and notify the Secretary thereof.

Operator Regulatory Agreement for Nursing Homes, Paragraph 2

Lessee shall make payments under lease when due

Owner Regulatory Agreement for Multifamily Housing Projects, Paragraph 6

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.

(e) Make, or receive and retain, any distribution or assets or any income of any kind of the project... (2) No distribution shall be made... when there is any default under this Agreement or under the note or mortgage.

Owner Regulatory Agreement for Multifamily Housing Projects, Paragraph 9

(c) The mortgaged property... books, contracts, records, documents, and other papers relating thereto shall at all times be maintained in reasonable condition for proper audit and subject to examination and inspection...

(d) The books and accounts of the operations of the mortgaged property and of the project shall be kept in accordance with the requirements of the Secretary.

Owner Regulatory Agreement for Multifamily Housing Projects, Paragraph 9

(g) All rents and other receipts of the project shall be deposited in the name of the project... Any Owner receiving funds of the project... shall immediately deposit such funds in the project bank account and failing so to do in violation of this Agreement shall hold such funds in trust.

Operator Regulatory Agreement for Nursing Homes, Paragraph 12

The lessee shall not reduce or expand, allow to be reduced or expanded, or cause the expansion or reduction of the bed capacity of the project without the consent of the Commissioner. Any change in the bed capacity shall violate this Regulatory Agreement.

Operating Lease Agreement, V(B)(3)

Marketing...Manager shall prepare and/or review, approve and implement with Owner a marketing program...for the purpose of promoting the name and business of the Property.

Operating Lease Agreement, V(B)(5)(a)

Manager shall establish and maintain a system of records and books that is consistent with industry standards and all applicable laws and satisfactory to Owner.

Operating Lease Agreement, V(B)(5)(e)

Except as otherwise provided in this agreement or otherwise reasonably approved by owner, all off-site personnel, accounting, clerical, and other management overhead expenses (including but not limited to cost of off-site supplies and equipment, meals, lodging, transportation, supporting personnel, and telephone services) shall be borne by Manager out of its funds and shall not be treated as property expenses; provided however that the compensation payable to manager's on-site employees who are dedicated to the property, reasonably necessary, below the level of administrator, and within budget shall be property expenses.

Operating Lease Agreement, V(B)(10)

Licensing. Manager maintains all licenses, permits and clearances required for the Property or in connection with the management and operation of the Property, including, without limitation, an RCFE [residential care for the elderly] license 075600383 in the name of Manager...The RCFE license shall be and remain exclusive property of Owner.

Operating Lease Agreement, V(B)(13)(a)

Manager shall implement two (2) separate residency agreement forms at the property: (1) a rental agreement for residents who are deemed "low-income" pursuant to the federal tax credit program described in 26 United States Code Section 42 and all treasury regulations and rulings thereunder; and (2) a rental agreement for all other residents as required by the financing terms.

Operating Lease Agreement, V(B)(15)

Collection of Rents and Other Receipts – Manager shall promptly bill and use its reasonable best efforts to collect when due all rents, monthly fees, charges, and other amounts receivable in connection with the management and operation of the property. All such funds shall be deposited in the owner's project account.

Operating Lease Agreement, X(B)

Material breach of the agreement includes:

- Failure to obtains owner's approval of any item required in the agreement
- Any act or omission of manager that causes an event of default under the financing documents
- Manager's failure to maintain the property at greater than 85% occupancy

Appendix D

Questioned Rents and Fees

Resident identifier	Community fee not deposited	Rent not collected	Funds collected but not deposited
1	\$2,000		
6	2,000		
11	2,000		
16	2,000		
31		\$1,851	\$2,000
41	2,000		
52	2,000		
57	2,000		
62	2,000		
67			4,454
73	2,000		
78	2,000	3,017	
83	2,000	4,225	
88		30,383	300
108	2,000	10,192	
200	2,000	3725	
201	2,000	488	1,000
38	2,000	6,407	
112	2,000	4,590	
111	2,000		
105	2,000		
106	2,000		
92	2,000		
102	1,334		
99	2,000		
96	2,000		
91	2,000		
89	2,000		
86	2,000		
84	2,000	3,960	
85	2,000		
24	2,000		
80	2,000		
59	2,000	1,432	
69	2,000		
71	2,000		
66	2,000		
60	2,000		
63	2,000		

64	2,000	3,225	
61	2,000		
57	2,000		
53	2,000		
50	2,000		
54	2,000		
55	1,500		
56	2,000		
43	2,000		1,000
49	2,000		
48	2,000		
40	2,000		600
42			1,000
39	2,000		
37	2,000		2,600
44	2,000		
34	2,000		
33	2,000		
32	2,000		
22	2,000		
30	2,000		
19	2,000		
18	2,000		5,475
17	2,000		
15	2,000		
14	2,000		
23	2,000		
13	2,000		
9	2,000		
7	2,000		
5	2,000		
4	2,000		
3	2,000	241	
2	2,000		
109		5,000	
107		23,573	
77	2,000	500	
58		753	
35		4,975	
12			5,199
Count	70	18	10
Total amount	138,834	108,537	23,628