● M&G Realty admitted using $54,000 security money from the state that was to have been kept in escrow as down payments on the homes.

● Although both HEA and M&G claim to operate at "arms length," HEA's $25,000-a-year housing coordinator, Vincent Naro, is the father-in-law of Gehm, one of the partners in the real estate firm. Naro also owned one of the homes purchased for use in the program. At least three other relatives of those involved with HEA or M&G were hired and paid by HEA on a part-time basis.

● House and office ledgers of the HEA operation were so incomplete auditors found them useless.

● None of the 25 clients in the program at the time of the June audit met the Medicaid eligibility criteria for the level of care each was getting.

● State auditors found inadequate daily treatment plans for most of the retarded residents in the program.

"The state, either through ignorance or criminality, has spent a large amount of money resulting in windfall profits for some people without ever really monitoring it," said Flanagan, a member of the Assembly Ways and Means Committee.

The first year of the program was funded with state start-up funds of $200,000 and state operating funds of $486,000. In addition, clients in the program are eligible for federal funds through Social Security and Medicaid. Federal payments for the 48 clients in the program, would amount to $408,000 in a year's time.

To a large degree, the home purchases were pyramided by M&G, which used the first month's rent from one house plus a 3-month security deposit paid by the state for placement in an escrow account to finance the purchase of the next home.

Flanagan began to investigate the HEA program because of complaints by residents of Cook Street in Huntington Station, where one of the homes is located.Residents said that they had not been informed the home was being set up and that the home's residents were walking the streets without proper supervision.

Flanagan reports that, at one public meeting called to discuss Cook Street, Bouklas was asked how much rent was being paid for the home and Bouklas claimed he didn't know, even though he had signed all the leases. "When I asked them later why they didn't supply the rental figure," Flanagan said Bouklas answered, "'They would have killed me.'"

The rents were calculated by the state's Facilities Development Corporation (FDC), which evaluates rental and purchase prices for other state agencies.

George Haggerty, director of the FDC'S real property division, said the rents were not intended to reflect rents being charged by private homeowners in the area, but were based on an "economic" approach. Under that approach, the state rental figures include mortgage principal and interest, taxes, insurance, depreciation, cost of structural repairs, and a 14 per cent return on M&G investment. Haggerty said banks and other investors consider doing business with the state a "high risk" and do not get involved.

According to the audit, the FDC calculated the rents based on information provided by HEA. The audit reportedthat a "a down payment of 25 per cent was made and a 5-year mortgage on the remaining 75 per cent of the purchase price was acquired at an annual rate of 12 per cent."

Haggerty, however, said that the audit information was not correct and that the rents and terms were only hypothetical because the houses at the time of the audit had not yet been purchased. Haggerty said that the FDC is now in the process of recalculating the rents based on actual mortgage terms. Tentative figures issued by OMRDD indicate that the current $216,348 yearly rents on the homes will be decreased to $182,844 a year. Past overpayments to M&G will be deducted from future rental payments, according to Cora Hoffman, OMRDD's director of community relations.

The houses are leased to HEA by M&G for five years with an option to renew for a second five years. The leases can be cancelled with 30 days notice.

Gehm and Maracina agreed that the rents their firm is charging do not reflect rents usually charged for houses in the area.

"If you look at the $1,800 rent, it looks like we're getting rich," Gehm said. "It's a high risk business . . . My motive was not monetary gain; my motive was to get the program started."

He said that he and Maracina bought the homes with the understanding that the state, through its rents, would pay them off in five to eight years.

Gehm told Newsday that he and Maracina used the $54,000 security deposit to buy homes because their lease with HEA stated that the money represented the last three months' rent rather than a security deposit and that they believed they could use it as they pleased. When the state threatened to terminate the contract with HEA and start criminal action to recover the money, Maracina and Gehm said they set up the account with borrowed money. They estimate that they initially invested about $60,000 of their own funds and now must also repay the $50,000 loan borrowed for the escrow account.

Maracina explained how they bought the houses: "When we closed on one home, we would take the first month rent and the last three months' rent and use it to buy the next house. We kept turning them over that way." Tentative figures supplied by the state show total purchase prices on the houses of $631,000, with M&G having about $168,000 invested at this point through the pyramiding process.

During one interview, Gehm said that there was an "arms- length" relationship between HEA and M&G, but, subsequently, he admitted that Naro, HEA's housing coordinator, was his father-in-law and that M&G bought a new house for the HEA program built by Naro in Ronkonkoma.

"The state had us up against the wall," Gehm said in explaining why theyhad bought the house of his father-in-law. "The people in Albany were under a mandate to place these kids or go to jail . . . The state kept pressing us for not meeting our contractual obligations and was threatening to cancel," Gehm said. Naro refused to talk to reporters.

Several other relatives, including Maracina's son, Richard, Naro's son, Sal, and a man named Arthur Bouklas, were hired to perform various jobs for HEA, including trucking, landscaping, and setting up furniture. According to HEA records, Richard Maracina got about $1,800 for mowing lawns and landscaping and for a trucking job. Sal Naro received $231 and someone named Arthur Bouklas, was paid $195.

When told of Gehm and Naro's relationships and other Newsday findings , OMRDD Commissioner James Introne said, "These things are highly irregular and need some special scrutiny."

The state budget process makes it difficult for the state to buy homes. Tom Coughlin, who was commissioner of OMRDD at the time the program was approved and now is commissioner of corrections, expressed frustration with the red tape.

"In 1975-76, I was given $12 million to open community residences," Coughlin told a reporter. "When I left last year, I gave $10 million back. The state procedures to spend money were not compatible with the timetable set by the [Willowbrook] decree," Coughlin said. Normally, homes for the retarded are purchased directly by the state or by non-profit agencies who then lease them back to the state. But Coughlin said many non-profit agencies are not willing to handle the severely retarded in their programs.