Asset Management, Yes—Micromanagement, No

PHADA’s solutions for getting HUD’s asset management guidance on the right track
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Public housing is currently undergoing a sea change in how it is funded and how it operates. Property-based accounting and management are the biggest change in the public housing program since the Brooke Amendment 35 years ago and will require a massive investment in effort, time and money. These changes must not compromise public housing authorities’ ability to provide decent, safe housing to their low-income residents.

The Quality Housing and Work Responsibility Act of 1998 (QHWRA) called on HUD to replace the older performance funding system with a new operating fund formula. In 2003, the Congressionally mandated Harvard Cost Study reported that public housing was underfunded compared to private and nonprofit owners managing comparable property serving the country’s low-income population. It also recommended that public housing adopt the asset-based system that the private sector uses to account for and manage its property.

In 2004, a negotiated rulemaking committee wrote a rule implementing the cost study’s recommendations. Unfortunately, HUD has not lived up to its responsibilities under this rule. It intends to implement the new management requirements in 2007, but its 2007 budget only requests enough funding for 78 percent of the subsidy amount that—according to the rule—is needed to sustain well-run public housing. With such a low proration, even some agencies who stand to gain under the new system will end up losing funding.

Housing authorities are expected to convert to the new asset-based system starting this year, but the details of that conversion are still up in the air, especially since much of the Department’s proposed guidance does not implement the rule clearly allows management functions to be performed centrally when they are cost-effective. HUD is also trying to dictate housing authorities’ organizational structure by restricting how they can spend their own money, despite language to the contrary in the rule and in existing law. This micromanagement will affect all housing authorities—“winners” and “losers” alike.

PHADA is concerned that the way HUD is implementing and funding this new rule will hurt even those agencies that should be gaining funding.
The PHADA membership supports the new public housing operating fund formula with its effective date of January 1, 2007. Our goal is to ensure that HUD’s guidance is fair and workable for all housing authorities. Unfortunately, there are some significant flaws in HUD’s implementation of the rule. PHADA is offering these constructive solutions as a way HUD can implement the rule without delaying the new funding formula.

Constructive solutions for implementing the new operating fund rule

PHADA supports the new operating fund formula with its effective date of January 1, 2007. Our goal is to ensure that HUD’s guidance is fair and workable for all housing authorities. PHADA is offering these solutions as a way HUD can implement the rule without delaying the new funding formula.

Inadequate funding

Problems:

• HUD is only providing 78 percent of the funding it says public housing needs (see page 5).
• Public housing’s inflation factor does not include health care costs (see page 9).
• HUD’s formula assumes housing authorities can collect rent on authorized vacant units (see pages 10–11).

Solutions:

• Fully fund the new rule to achieve parity with HUD’s other assisted housing programs.
• Adopt the inflation factor from the negotiated rule, based on Bureau of Labor Statistics data.
• Adopt the system from the negotiated rule for calculating income on vacant units.

Property and asset management fees

Problems:

• HUD is proposing unreasonable property management fees, with guidance that would micromanage the way housing authorities use their funding (see page 12).
• The asset management and bookkeeping fees in HUD’s proposed guidance are “one size fits all” and are based on inadequate data (see page 14).

Solutions:

• Make sure the fee structures for HUD’s multifamily programs, which are the basis for the new rule, are consistent and accurate, and adjust them where necessary to apply to public housing properties.
• Consider basing management fees on operating costs, or on standards available for comparable property.
• Account for asset management responsibilities and costs using comparable market standards, such as private owners and project-based Section 8 contract administrators, instead of adopting a fixed nationwide asset management fee.
• Account for geographic and other cost differences in bookkeeping costs and analyze bookkeeping responsibilities and existing data more thoroughly, instead of adopting a fixed nationwide bookkeeping fee.
Maximum flexibility

Problems:
- The new rule calls for housing authorities to have the “maximum flexibility” possible, but HUD’s proposed guidance does not provide the flexibility housing authorities need in order to implement the business plans they have developed for their unique portfolios.
- The rule calls for “reasonable” asset management practices, but HUD is interpreting “reasonable” to mean “the same practices required in HUD multifamily programs,” instead of allowing for the differences between public housing and other assisted housing programs (see page 6).
- By requiring that centralized front-line costs be paid for out of management fees, HUD is in effect micromanaging PHAs’ organizational structures (see pages 16–17).
- HUD says that any property with 80 or more units, not in proximity with another property, should be a separate project (see page 15).

Solutions:
- Implement changes to regulations and support changes to statutory requirements that require public housing to do more than other HUD assisted housing programs. Until these changes are achieved, HUD should provide housing authorities as much flexibility as possible to juggle competing priorities.
- Follow the language in the rule and in the multifamily program handbook, and allow housing authorities to expense centralized front-line functions at the project, on a rational basis.
- Apply the language on fungibility from the final rule to the central office cost center.
- Offer agencies genuine flexibility in determining property groupings, based on local management and financial considerations.

No unauthorized Section 8 or Capital Fund changes

Problems:
- Contrary to federal law and the rule itself, HUD is attempting to apply operating fund rules to Section 8 and the Capital Fund programs (see pages 18–20).

Solutions:
- Housing authorities should continue to be paid a fee-for-service for each Section 8 unit leased.
- Maintain the current capital fund regulations that allow housing authorities to use some of their Capital Fund resources for operations and administration.

Achievable stop-loss opportunity

Problems:
- HUD has not released guidance for agencies seeking to meet the stop-loss criteria by October 1, 2006. For many housing authorities, this late release of guidance effectively nullifies the opportunity to stop their losses (see page 21).
- HUD will not tell stop-loss agencies if they have successfully complied with the stop-loss criteria until halfway through the funding year, after they have had to deal with the consequences of withheld funding for six months.

Solutions:
- Provide agencies an opportunity to stop their losses at five percent on October 1, 2006, and comply with reasonable achievable asset management criteria.
- Have complete evaluations October 1, 2007, once the guidance is finished.
The new operating fund rule was designed from the start as a way to make sure housing authorities have just the right amount of funding to manage their properties well. The rule includes a unique property expense level (PEL) for each housing project in the nation, which is based on what private owners spend managing similar properties. It also includes a formula to add funding for utilities and other such expenses. The total “formula expenses” in the new rule represent “the costs of services and materials needed by a well-run PHA to sustain the project” (Section 990.160(a)).

HUD’s 2007 budget request, however, only asks for about 78 percent of the amount needed to fund these formula expenses. This means the Department is asking housing authorities to implement a rule which entails enormous changes to their operations, while at the same time—according to the language in its own rule—not providing the funding “needed by a well-run PHA to sustain the project.”

The Department cannot realistically expect housing authorities to implement project-based accounting—which will mean setting up new accounting systems, reorganizing staff, writing new job descriptions, training for new assignments, negotiating with unions, outfitting new physical spaces at site locations, and countless other details—when it is providing the lowest percentage of needed funding in the history of the public housing program.

This underfunding is especially indefensible because according to HUD’s own definition, there are no longer any cost efficiencies to wring out of the new property expense levels. The new PELs are already based on the amount private owners spend. By not fully funding public housing, HUD is simply not providing resources that are necessary to manage the properties.

Meanwhile, HUD’s 2007 budget fully funds multifamily properties in the project-based Section 8 program. This inequity means that people who rely on the private sector for housing assistance will have the quality housing they need, while people who rely on the government for the same kind of housing assistance will not.

HUD should not discriminate against some low-income people just because they live in housing authority property. If the private sector model is HUD’s benchmark for operating property efficiently, HUD must provide public housing the same amount of funding it is giving private owners.

Total public housing funding has declined by $1.4 billion since 2001

HUD’s 2007 budget request is only 78% of what HUD says housing authorities need to manage well-run housing.
What is “multifamily” housing?

As part of the initiative to shift public housing agencies to asset management, HUD is requiring that housing authorities adopt financial and operational practices like those used in the Department’s multifamily housing programs. This is an extension of an earlier effort to tie public housing operating costs to multifamily programs. The Harvard Graduate School of Design (GSD) compared the costs of those programs to public housing in its cost study. Under the new operating fund rule, local HAs will now receive funds based on the costs of similarly situated multifamily housing in their area.

There are more than a dozen housing programs under the purview of HUD’s multifamily office. Some of the major ones include the Section 221(d)(3) and (4) rental and cooperative housing programs and the Single Room Occupancy program. The Section 202 and 811 programs, which provide supportive housing for the elderly and persons with disabilities, are also in this category. A complete list of the programs can be found on HUD’s website.

According to the Harvard GSD’s final report, there are roughly 1.5 million multifamily units in the HUD portfolio. Approximately 1 million of these units are “assisted” properties. The remainder of the properties are “unassisted,” but receive some type of government aid through HUD’s Federal Housing Administration (FHA). Typically, this comes in the form of mortgage insurance or capital advances. Insured mortgages may be used to finance the construction or rehabilitation of detached, semi-detached, row, walkup, or elevator-type rental or cooperative housing.

Public housing is rarely fully funded

Unlike multifamily housing providers, public housing authorities have historically been underfunded. Since public housing rents are tied to tenants’ income and limited by the federal Brooke Amendment, housing authorities have to deal with budget shortfalls as best they can.

Public housing is already doing the job more cost efficiently than multifamily

HUD is trying to use PBA/PBM to force housing authorities to cut their overhead. However, the Harvard Public Housing Operating Fund Cost Study found that, when benchmarked against similarly situated FHA housing, 75 percent of housing authorities are performing their mission at a lower cost than their counterparts in the multifamily arena—a percentage that would be even higher if the study had taken into account public housing’s prorated funding. Public housing agencies are accomplishing this feat even though they have to deal with more statutory and regulatory burdens than FHA providers.

Private housing providers have the option of increasing rent. Public housing authorities do not.

Even as utility costs are skyrocketing by up to 50 percent. In stark contrast to public housing, private housing providers are not short-funded by the federal government. Any new PBA/PBM rules must take this budget reality into account, and be flexible enough to allow
Public housing agencies are more heavily regulated than their multifamily counterparts, and don’t operate in the same way.

The Harvard cost study found more than two dozen regulatory and operating differences between public housing and multifamily (see below).

Any new project-based accounting and management rules must take this budget reality into account, and be flexible enough to allow housing authorities to deal with budget shortfalls as best they can.

HUD can’t wave a magic wand and make these differences disappear.

HUD believes public housing needs to become more of a real estate program similar to privately-managed multifamily housing. Many in the industry agree. The reality is, however, that as long as 535 members of Congress, HUD, the Office of Management and Budget, and other stakeholders are involved in shaping public housing’s policy objectives, there will always be social service, economic development, welfare, and other related elements entwined in public housing management and operations. The federal government cannot on the one hand require these kinds of services, but then pretend they do not exist, or that they do not add significant cost.

Regulatory and operating differences between public and multifamily housing:

- Public Housing Assessment System (PHAS)
- the annual plan
- lease and grievance
- deconcentration
- rents
- Section 3
- Procurement
- wage rates
- annual unit inspections
- community service
- pets
- the cooperation agreement
- tenant participation requirements
- waiting lists
- mixing the young with disabled populations
- 14-day notice of non-payment of rent
- employee compensation
- organization and work rules
- resident programs
- information technology
- security
- population housed
- legal
- local mandates
- responsiveness
- public entity costs

—Harvard Cost Study, project director Gregory Byrne (now directing HUD’s asset management initiative)
Agencies expecting gains may be unpleasantly surprised

According to the Harvard cost study, 76 percent of housing authorities were supposed to gain funding or keep the same funding level. Since then, however, HUD has made unilateral changes to the inflation factor and the way it calculates formula income, and it has failed to request the full amount of funding that the study called for. These changes mean agencies may gain far less than the cost study predicted. This analysis considers a fairly typical agency, expecting a 10 percent eligibility increase. An increase in eligibility generally translates into twice that amount, or a 20 percent increase, in subsidy, since subsidy only reflects about half of an agency’s eligibility (the other half being dwelling rent). But instead of receiving the expected 20 percent increase in subsidy, this fairly typical agency will receive less than 2 percent.

This example compares operating subsidy using the old Performance Funding System (PFS) and the new rule, not including add-ons. The figures below are for a 1,000-unit agency with an occupancy rate of 94 percent (with two percent of its vacant units in an approved modernization program), an average rent of $200 per unit per month in 2004 (frozen under the new rule) and $212 in 2007, and a 20 percent inflation increase over the past seven years. Congress historically appropriates less money than public housing authorities are eligible for. In 2007, if Congress appropriates HUD’s requested $3.55 billion for operating subsidies, under PFS housing authorities would receive 85 percent of the amount they are eligible for, while under the new rule they would receive only 78 percent (assuming a $4.17 billion total under PFS and $4.53 billion using the new rule, according to PHADA’s interpretation of HUD’s budget justifications).

This fairly typical example agency, expecting a 20 percent jump in funding, will actually only see an increase of 1.9 percent. In addition, it will receive just one-half of this amount in 2007. Housing authorities may want to use this template with their actual data to determine their 2007 subsidy.

The final subsidy figure may change with the add-ons. While some add-ons increase funding, such as the $4 asset management fee, the $2 IT fee and PILOT, others, such as the loss of FICA and unit reconfiguration, will reduce funding.

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<tr>
<th></th>
<th>Subsidy under PFS</th>
<th>Subsidy under new rule</th>
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</thead>
<tbody>
<tr>
<td>1. 2000 eligibility</td>
<td>$300 PUM</td>
<td>$330 PUM</td>
</tr>
<tr>
<td>2. Deduct audit cost</td>
<td>($2 PUM)</td>
<td></td>
</tr>
<tr>
<td>3. Inflated to 2007</td>
<td>$370.50*</td>
<td>$393.60</td>
</tr>
<tr>
<td>4. Total eligibility</td>
<td>$4,446,000**</td>
<td>$4,675,968**</td>
</tr>
<tr>
<td>5. Rental income</td>
<td>$2,416,800***</td>
<td>$2,376,000***</td>
</tr>
<tr>
<td>6. Operating subsidy eligibility</td>
<td>$2,029,200</td>
<td>$2,299,968</td>
</tr>
<tr>
<td>7. Subsidy after proration</td>
<td>$1,724,820</td>
<td>$1,793,975</td>
</tr>
<tr>
<td>8. After new rule’s two percent subsidy holdback for appeals</td>
<td>$1,758,096</td>
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* Also includes seven years of the .005 age delta increase, not included in new rule
** PFS uses 100 percent of units, while new rule uses eligible unit months (11,880 in this case representing 94 percent occupancy, 2 percent approved mod and 3 percent allowable vacancies)
*** PFS assumes rental income from 95 percent of the units, while the new rule assumes rental income from 99 percent of the units.
Public housing’s inflation factor does not cover essential costs

In this case, HUD contradicts itself and opts not to apply multifamily rules

The inflation rate used for public housing has long been deficient because it did not include one of the most inflationary costs—employer-provided health care. The Bureau of Labor Statistics provides a national index for these increases, which is included in the inflation factor HUD uses in the multifamily program. Therefore, the negotiated rulemaking committee—including HUD’s Assistant Secretary for Public and Indian Housing—adopted this same index to be used in calculating public housing’s inflation factor.

When it issued the final rule, though, HUD arbitrarily changed the inflation formula, pulling out the index measuring health care. This will once again leave public housing with an inflation factor that doesn’t include one of life’s necessities—one whose cost growth has far exceeded the national inflation average.

This change alone has reduced public housing’s funding eligibility by approximately $300 million a year, and this amount will increase with each coming year.

Public housing’s inflation factor

HUD originally agreed to an inflation factor that included benefits. The negotiated rule included the following language: “The factor shall reflect a weight of four tenths (.4) to increases in wages, salaries and benefits for such period as shown in the Bureau of Labor Statistics Employment Cost Index (ECI) for State and Local Governments occupational group” (emphasis added) (Section 990.155(d)).

When the final rule came out, benefits had disappeared from the inflation factor: “The local inflation factor shall be the HUD-determined weighted average percentage increase in local government wages and salaries for the area in which the PHA is located and non-wage expenses” (emphasis added) (Section 990.165(d)).

This HUD-determined inflation factor, without increases in benefit costs, will not provide adequate funding to manage public housing.

Multifamily’s inflation factor

Multifamily projects covered by the Low-Income Housing Preservation Act and the Mark-to-Market program use an annual inflation factor called the OCAF (operating cost adjustment factor).

The OCAF consists of nine components, one of which is precisely the index that HUD removed from the final rule—the Bureau of Labor Statistics Employment Cost Index (ECI), Employment Benefits at the National Level. This means the multifamily inflation index provides for increases in benefit costs, while HUD unilaterally eliminated benefit costs from public housing’s inflation rate. HUD is not treating public housing expenses equivalently to those in the multifamily program.

The Department should revert to the negotiated rule and treat public housing fairly.
To calculate how much funding housing authorities need, HUD first figures out how much they collect in rent. Under the new rule, HUD has changed the way it calculates this rental income. Housing authorities’ “formula income” now includes rent that they never collected—rent on routine vacant units and units that are being modernized. This unjustified change in the rule may deprive housing authorities of $100–$200 million in funding eligibility each year.

How HUD changed the negotiated rule

The rule HUD agreed to during negotiated rule-making described the calculation of formula income as follows: “For the purpose of the Operating Fund formula this revenue is equal to the amount of rent charged to tenants minus any applicable utility allowance calculated as a per unit month (PUM) and frozen at 2004 levels” (Section 990.180(a)).

This means housing authorities’ rental income is the amount they charge tenants. It doesn’t indicate that HUD should make any changes to the existing system of estimating total resident rent.

In the new rule, HUD unilaterally changed this negotiated description to read as follows: “To calculate formula income in whole dollars, the PUM amount will be multiplied by EUMs (eligible unit months) as described in subpart B of this part” (Section 990.195(b)).

According to this more complicated formula, HUD will now figure rental income by taking the per unit month amount of rent charged to tenants and multiplying that by the number of “eligible units.” This includes not only occupied units, where tenants are actually paying rent, but also units that no one is living in—apartments that the housing authority has permission from HUD to renovate, plus the normal three percent of units that are being cleaned and repaired between tenants.

This method is clearly unfair. It will ascribe income to housing authorities that they will not collect.

This formula will likely discourage some housing authorities from undertaking comprehensive modernization projects and improving their housing stock.

Does HUD expect housing authorities to collect rent on these units? HUD’s changes to the rule will mean big funding cuts, especially for well-run housing authorities. This will likely discourage some housing authorities from undertaking comprehensive modernization projects and improving their housing stock.
never receive. As a result, housing authorities will not receive the amount of funding recommended by the Harvard cost study, and their residents will not be treated equally to those in the multifamily program. Well-run agencies—who often have more approved vacancies for modernization projects—will be hit the hardest.

Even more alarmingly, this new calculation will likely discourage housing authorities from undertaking comprehensive modernization projects and improving their housing stock, because creating any temporary vacancies will mean losing rental income.

**Why treat public housing vacancies differently from multifamily vacancies?**

When HUD is determining whether multifamily properties will be viable, it has to calculate whether they will collect sufficient rent to cover their expenses. To make this determination, the Department applies a “Standard Occupancy Adjustment Factor” of 95 percent (The Management Agent Handbook, 4381.5 Rev-2, page 3-14). In other words, when HUD is evaluating these properties’ revenue, it assumes that they will have no income from 5 percent of their units. This means public housing properties are not being funded in a manner equivalent to multifamily properties.

HUD should abandon this unfair funding formula and revert to the formula it agreed to during negotiated rulemaking.
Property management fees

HUD is adopting a cookie-cutter approach that pays agencies the same property management fee regardless of differences between properties

Under the new rule, housing authorities will track two kinds of expenses: front-line costs (such as maintenance) and central management costs (such as the executive director’s office). These central office costs will be paid for out of a property management fee, which the central office can charge to each of the properties it manages. According to the rule, this property management fee has to be “reasonable,” so that housing authorities are not spending too much on overhead.

HUD has proposed basing this fee on the amount properties in the multifamily program pay for management. Public housing and multifamily housing, though, are different programs (see pages 6–7), and any guidance based on the multifamily program should allow for those differences. Not only has HUD not accounted for these differences, it does not provide some of the flexibility permitted in multifamily.

Multifamily guidelines for developing property management fees

1. Generally brand new properties can have a fee up to 120 percent of the mean in their area.
2. The fee can be appealed to HUD, if the property’s characteristics differ from the benchmark properties.
3. It is a percentage of revenue, so each year as revenue increases, the fee increases.
4. There is no cap on the fee over time.
5. Once the fee is negotiated, various add-ons are eligible, including for assisted properties, nonprofit, small size, scattered site, and adverse conditions.

HUD’s proposal for public housing

1. One HUD option is to base the fee on the 75th or 80th percentile of a truncated version of the FHA database made up of properties very dissimilar to public housing—nonprofit properties, including those funded under Section 202 and Section 811, and for-profit unlimited dividend properties. These properties are generally newer, serve more elderly and disabled persons in efficiencies and one-bedroom units, serve higher-income clients, are not in impacted areas, cost much less, and have much smaller capital needs. HUD has arbitrarily excluded the properties in the FHA database with the highest management fees.
2. No add-ons would be available under this first proposal.
3. The second proposal is to use the field office schedules, which are out of date, unavailable, inaccurate, inconsistent, and not transparent.

Under HUD’s one-size-fits-all proposal, these two properties from the Raleigh, North Carolina Housing Authority would have the same property management fee—regardless of which one actually costs more to manage.
4. Under both of the above proposals, there will be only one property management fee for every property in a field office, regardless of whether it is a large family development in a high-poverty census tract or a suburban development for elderly residents.

5. An appeal based on property characteristics may not be permitted.

6. No adjustment will be made for the more than two dozen regulatory and operating environment differences separating public housing from other assisted housing. PHADA has suggested that HUD consider several other options, including the management fee safe harbor for public housing units in mixed finance properties and multifamily’s fee percentage of its operating cost.

HUD’s proposal does not meet the rule’s standard of being “reasonable.” The Department must use a more accurate benchmark, provide the flexibility available in multifamily housing to allow for differences between properties, offer genuine add-ons, and adjust for public housing’s unique environment.

HUD’s property management fee proposal does not make any adjustment for the more than two dozen regulatory and operating environment differences separating public housing from other assisted housing. This will harm all housing authorities, including those expecting gains.

Reasonable fees-for-service: “We’ll know it when we see it”?

Stop-loss agencies fear their evaluation will be too subjective

The new rule says that if front-line functions are performed centrally, they should be accounted for through a “fee-for-service,” which must be “reasonable.”

HUD’s guidance

HUD’s only guidance to date has said that these fees-for-service must be based on three source documents reflecting market price. This is not enough information, especially for those agencies who are trying to stop their funding losses by converting to asset management, because demonstrating reasonable fees-for-service is one of the criteria HUD is expecting them to meet by October 1, 2006.

In response to industry concerns about the lack of a more objective standard, HUD has said that the evaluators will know a reasonable fee-for-service when they see one.

Housing authorities clearly need more information on what they have to do to comply with the requirement for a reasonable fee-for-service. Otherwise, a subjective evaluation could lend itself to being manipulated.
HUD recognizes that housing authorities are more than just property managers—they have ownership responsibilities as well. To pay for these responsibilities, HUD has proposed providing housing authorities with an asset management fee. In addition, since in multifamily accounting is performed centrally, but paid for by the projects, HUD has also said it will provide public housing a separate bookkeeping fee.

Unfortunately, the Department is imposing a one-size-fits-all solution: a $10/unit monthly fee for asset management and a $7.50/unit monthly bookkeeping fee for every housing authority in the country, regardless of their location or their individual characteristics.

**Why a $10 asset management fee?**
- HUD has provided no explanation or methodology describing how it arrived at its asset management fee proposal.
- The Harvard cost study reported that in 2000, the average profit for multifamily properties that the owner could use for asset management was $71 per unit per month.
- Contract administrators overseeing project-based Section 8 properties receive considerably more than $10 PUM for similar work.
- Many housing authorities are actively engaged in refinancing, revitalizing, repositioning or redeveloping their properties. These authorities may require additional funding for their activities.
- Ownership costs will clearly vary by geographic location, authority size and condition of the property.
- The asset management fee only becomes available if a project has two months’ cash reserve on hand. This means a property might not qualify for the asset management fee, even if it had a positive cash flow.
- Maintaining this reserve is especially difficult when the operating fund is prorated down to 78 percent and utility costs are skyrocketing.

**Why a $7.50 bookkeeping fee?**
- In many cases, multifamily properties charging a bookkeeping fee either have no guidelines from HUD or are allowed to negotiate their bookkeeping fees with their field offices.
- As a result, bookkeeping fee data HUD uses as its basis is neither consistent nor accurate.
- Housing authorities have accounting responsibilities that multifamily properties do not have—preparing agency-wide budgets, financial statements and balance sheets, as well as central office cost center statements—so a straight comparison with multifamily may not be valid.
- Accounting for cost-effective centralized functions adds an additional complication to an agency’s financial management.
- Fees will not be uniform for every housing authority in the country. Creating a national benchmark for the bookkeeping fee when the practice varies so considerably by field office in the multifamily program may leave some regions inadequately funded.
- HUD has not shared its dataset with the industry to analyze and verify the amounts it has presented.

The asset management fee only becomes available if a project has two months’ cash reserve on hand. Maintaining this reserve is difficult when the operating fund is prorated down to 78 percent.

Section 8 properties receive considerably more than $10 PUM for similar work.
- Many housing authorities are actively engaged in refinancing, revitalizing, repositioning or redeveloping their properties. These authorities may require additional funding for their activities.
Public housing was not developed with the idea of property-based management in mind. Much of the nation’s public housing stock consists of smaller properties—many are even scattered-site single-family homes. Before housing authorities can implement “project”-based management, they have to combine these smaller properties into groupings that make managerial and financial sense.

The new rule simply says that these property groupings must be reasonable, and that HUD has the right to disapprove of them.

**What is a “reasonable” property grouping?**

The rule says that “PHAs that own and operate fewer than 250 dwelling rental units may treat their entire portfolio as a single project” (990.260(b)).

It also says that “PHAs may group up to 250 scattered site dwelling units into a single project” (990.265).

There are more than 2,000 public housing agencies that manage fewer than 250 units. HUD is letting all these small housing authorities group their entire portfolio into a single project. It is also permitting housing authorities to group up to 250 scattered-site homes into one project. Clearly, by the standards of this rule, grouping 250 units into one project is “reasonable.”

The Harvard cost study also showed that units with more than 150 units were less expensive to manage than smaller properties, which means these larger groupings would save taxpayer dollars.

If it is reasonable to group 250 units into one project, why should it be unreasonable to group 251 units into one project? Adding one unit surely does not make such a difference that rules that applied to over 2,000 agencies could not be applied to an agency with 251 units as well. The number 250 is not a bright line, and HUD should be flexible enough to consider exceptions.

**HUD’s one-size-fits-all guidance**

Although it has qualified it by saying there is no optimal number, HUD has published guidance that says that projects with 80 or more units should be considered to be stand-alone, unless they are proximate to each other. The Department has not explained why it chose the number 80, and it has not provided a financial analysis to demonstrate the viability of an 80-unit property, elderly or family, as an independent entity.

HUD has also suggested that housing authorities should not combine elderly and family developments, even when they are neighbors. There is no management skill so unique to prevent elderly and family units to be managed together if they are part of the same site.

The rule seems clear: grouping up to 250 units is “reasonable.” HUD should be extremely flexible in allowing agencies to group properties up to that number. In addition, HUD should also give due consideration to agencies’ decisions to group more than 250 units together.

These choices should basically be left to the housing authority and the local HUD field office, which know local conditions, and should not serve as a pretext for HUD headquarters to intervene and micromanage local governance from Washington.
Housing authorities must now assign their expenses either to the central office, where they are paid by the management fee, or to the individual properties, where they become a front-line expense. The new rule clearly says housing authorities can perform front-line functions centrally if they choose—for example, having a central maintenance department for all its properties, and distributing that cost among the properties as a front-line expense.

HUD has now proposed regulations that directly contradict the new rule and the multifamily housing handbook as well as the Department’s own lead architect of property based management, Gregory Byrne’s statements during the negotiated rulemaking process. These new regulations appear to be a kind of backdoor micromanagement. If HUD requires housing authorities to pay for these centralized front-line expenses out of its limited management fee funds, the housing authority will not be able to afford them and will have to physically move staff out to the property—even if it’s more cost-effective to perform the work centrally. Organizational decisions should remain at the local level, not be micromanaged from Washington.

**The language in the new rule**
The rule is very clear that housing authorities can perform front-line functions either centrally or at the site. In fact, it requires them to charge these functions out to the properties if they are performed in the central office.

Section 990.275—“Property management services may be arranged or provided centrally…”

Section 990.280(5)(d)—“In the case where a PHA chooses to centralize functions that directly support a project, it must charge each project using a fee-for-service approach.”

The rule is not ambiguous: housing authorities are authorized to perform services centrally. When those services directly support a project, they should be charged to the projects. The rule even specifies a mechanism—the fee-for-service approach—for charging centralized functions back to the properties.

**Conflict of Interest/Bribery/Kickbacks**

- Typically involves the procurement process— but can affect all areas of a PHA’s operations
- *Best way to avoid problems is to:*
  - Adopt and implement appropriate procurement and contract management policies and procedures including written code of standards for potential conflicts
  - Provide for segregation of duties in all high risk areas
  - Discourage fragmented contracting/procurements by various departments... encourage a Centralized Procurement Department

**Housing authorities are receiving conflicting information from HUD on procurement**

At PHADA’s January conference, the HUD Inspector General’s office strongly suggested that housing authorities should have a central procurement department. Under HUD’s draft guidance and inadequate management fees, however, it will be financially challenging for housing authorities to operate this important internal control mechanism. This could create future problems for housing authorities during audits and IG reviews.
central vs. front-line expenses
and its own statements during negotiated rulemaking

Multifamily guidance
Much of HUD’s new guidance for public housing is based on the multifamily handbook (Management Agent Handbook, 4381.5, Revision 2). Even it specifically permits property managers to expense centralized functions as front-line costs.

Section 6.38(a)(2)—“If front-line management functions for several properties are performed by the staff of the agent operating out of a single office, the following conditions apply. (a) The agent must prorate the total associated costs among the projects served in proportion to the actual use of services.”

HUD’s contradictory guidance
Despite these clear statements in the rule, in the multifamily handbook, and during the negotiated rulemaking, HUD’s proposed guidance specifically prohibits charging some key expenses to the front line, even when they directly support individual properties:
1. Centralized purchasing must be paid out of the management fee.
2. Centralized inspections must be paid out of the management fee.
3. Supervisors providing front-line functions, such as a maintenance supervisor or a work order supervisor, must be paid out of the management fee.

HUD must stop ignoring its own rule and the multifamily handbook, and allow centralized functions directly supporting the projects to be expensed at the front line.

HUD’s statements during negotiated rulemaking:
“Essentially my view… is, is the property running well and you actually have true costs. Over and done with. I don’t ask questions about whether the manager is sitting in the central office or sitting in the property.”

“There’s no language in here that says property management means you have to have this function done at the property or not… People do it a little differently. So not for HUD to get into that game.”

“[If] there are costs that you’re doing that are centrally provided that aren’t normally part of the management fee, then I want to make sure that those are the actual costs and those are reasonable. And I think that is the overall approach.”

“I agree there ought to be flexibility in how you charge out the direct property management services you may choose to do centrally.”

—Gregory Byrne, Harvard Cost Study director and chief architect of HUD’s asset management guidance; negotiated rulemaking session transcript, May 12, 2004

HUD’s proposed guidance:
Properties can’t pay the central office to do their purchasing or inspections, or pay for supervisors in the central office that provide front-line functions. Centralized purchasing and inspections must be paid out of the management fee, and supervisors providing front-line functions, such as a maintenance supervisor or a work order supervisor, must be paid out of the management fee. Essentially, housing authorities can’t charge purchasing and inspections to the property if the purchasing manager and the inspection manager are sitting in the central office.
The Harvard cost study determined the overall amount of money required to sustain a well-run property. In its implementation of asset management, however, HUD is trying to control how housing authorities can use the funds which they are provided. It wants to restrict the amount of money that can be spent on central office costs, but in so doing HUD is breaking the law and violating the intent of its own rule.

**Public housing authorities will lose the flexibility to use capital funds permitted by the 1998 Quality Housing and Work Responsibility Act (QHWRA).**

QHWRA says that housing authorities with 250 or more units can use up to 20 percent of the Capital Fund for everyday operations (“activities that are eligible under subsection (e) for assistance with amounts from the Operating Fund”—section 9(g)).

This language was confirmed in the negotiated rulemaking session when Assistant Secretary Michael Liu stated, “Fungibility between operating and capital funds will remain the same as provided by current statute” (transcript, April 15, 2004).

Now, however, HUD is saying that no more than 10 percent of the capital fund can be used to fund the central cost center—even though that is clearly an eligible expense under subsection (e)—and that management improvements, for such necessary activities as computer upgrades, may not be used to assist the central cost center.

PHADA’s legal counsel states that these restrictions violate QHWRA. Based on Assistant Secretary Liu’s statement on fungibility during negotiated rulemaking, they also contradict the intent of the operating fund rule.

**Public housing authorities may not use excess cash generated by their properties to fund the central cost center.**

The new rule says housing authorities should be able to use excess cash flow for any eligible expense—anything a housing authority can normally spend money on: “If the project has excess cash flow available after meeting all reasonable operating needs of the property the PHA may use this excess cash flow for the following purposes:... (iii) Other eligible purposes” (990.280(b)(5)). Under QHWRA, the central cost center is clearly considered an eligible expense.

Furthermore, HUD agreed with this position during negotiated rulemaking, when Assistant Secretary Michael Liu said that “excess cash flow is fully fungible” (transcript, April 15, 2004).

In its new guidance, HUD is essentially saying after the fact that only certain HA activities are “eligible purposes.” These proposed restrictions would violate both the rule and HUD’s own statements during negotiated rulemaking.

**HUD will restrict the amount of funding that can be transferred from one project to another.**

The rule says that funds can be transferred from one project to another when there is “excess cash.” This provision was included in the rule because the cost study had an error rate of ±42 percent for any one property, and housing authorities need a way to adjust for such large errors in their properties’ funding levels. HUD has now proposed, though, that a project can only be considered to have excess cash if it has two months reserve. HUD has never before mandated a reserve level prior to allowing a PHA to spend its money. The rule does not authorize this restriction, nor are multifamily properties required to maintain a two-month reserve.
QHWRA explicitly allows housing authorities the flexibility to use 20 percent of the Capital Fund for everyday operations. HUD’s proposal to take away this flexibility would violate the letter and spirit of the existing law.

**PUBLIC LAW 105–276—OCT. 21, 1998**

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“(g) LIMITATIONS ON USE OF FUNDS.—
“(1) FLEXIBILITY FOR CAPITAL FUND AMOUNTS.—Of any amounts appropriated for fiscal year 2000 or any fiscal year thereafter that are allocated for fiscal year 2000 or any fiscal year thereafter from the Capital Fund for any public housing agency, the agency may use not more than 20 percent for activities that are eligible under subsection (e) for assistance with amounts from the Operating Fund, but only if the public housing agency plan for the agency provides for such use.
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Section 8
Under the latest HUD proposal, housing authorities will have to divide their Section 8 expenses into “front-line” and “central” costs. HUD will set a limit on how much of the Section 8 administrative payments can be spent on “central” costs and how much can be spent on “front-line” expenses. These “front-line” expenses, paid for through a fee-for-service, would include direct program costs such as the waiting list, income certification, and inspections, while “central” costs would be supervisory.

However, Section 8, unlike public housing, does not manage properties—so there are no front-line (or project-level) expenses. Any plan for dividing Section 8 expenses into “central” and “front-line” would make no sense from an asset management perspective.

By creating this artificial division between expenses, the Department is trying to restrict the amount of money that housing authorities can pay for “central” costs. In effect, HUD wants to substitute its judgment on how to administer the Section 8 program for that of the local housing authority.

It is also important to note that the operating fund rule specifically excludes Section 8:

“This part is not applicable to…the Housing Choice Voucher Program…or the section 8 Housing Assistance Payments Programs.” (Section 990.105(b))

HUD’s position also appears to conflict with OMB Circular A-87, which describes using the fee-for-service approach as voluntary.

Finally, HUD has presented no methodology on how it plans to divide expenses between “front-line” and “central.” Judging from HUD’s work on property management, asset management, and bookkeeping fees, it may be an arbitrary decision.

The Capital Fund
Under existing regulations, housing authorities can use 10 percent of their Capital Fund for administrative expenses and additional portions for management improvements, such as computer upgrades, and operations. HUD is now planning to require housing authorities to divide the funds used for administrative expenses into fixed amounts for central, front-line, and bookkeeping costs, substituting HUD’s decisions for those of the local board. It will also disallow administrative expenses on capital funds spent on operations or management improvements. This will reduce the amount housing authorities can spend on administrative expenses and central costs.

Having to charge a fee for service for direct management of the capital program will substantially increase accounting requirements, add payroll complications if staff are doing different kinds of work at different times, and create new paperwork.

As with the Section 8 proposal above, HUD has offered no evidence that this change will help housing authorities administer the Capital Fund more efficiently—nor even any claim that they are currently administering it poorly.

Asset management has nothing to do with Section 8—a program that manages no assets. HUD should not artificially apply asset management principles to the Section 8 program, and it should not tell housing authorities how to spend their administrative fees on programs they are already managing very successfully.
Stop-loss agencies are running out of time

HUD has not yet developed reasonable stop-loss criteria

HUD is now using a complex statistical formula from the Harvard cost study to decide how much funding each property needs. The formula isn’t perfect—even the study authors admitted that it has an error rate of plus or minus 42 percent. This means that HUD will now be underfunding some properties by as much as 42 percent. The new rule provides a safety mechanism for these underfunded agencies: if they adopt HUD’s asset management criteria by October 1, 2006, they can limit their losses to 5 percent of the 2004 difference between the old and new funding systems. Being able to comply with the stop-loss criteria is absolutely vital for these agencies, who otherwise won’t have enough funding to meet their residents’ basic needs. Unfortunately, the criteria HUD has proposed are so unreasonable that agencies won’t have a fair chance of meeting them in time.

Even worse, agencies that somehow manage to comply with all of HUD’s requirements will still lose funding for the first half of 2007. HUD is planning to distribute 2007 funding under the assumption that no one meets the requirements. Agencies will only be retroactively reimbursed halfway into the 2007 calendar year if HUD decides they qualify.

<table>
<thead>
<tr>
<th>Stop-loss requirement</th>
<th>Problem</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Property management fees must be reasonable</td>
<td>FHA properties used as basis are not comparable, as they are more frequently newer, one-bedroom properties or are often not even required to serve a low-income population. HUD’s own guidance on what costs can go into the management fee doesn’t comply with the rule (see page 5)</td>
</tr>
<tr>
<td>2. Fees-for-service must be reasonable</td>
<td>HUD has provided minimal guidance on this issue. It will be up to the individual evaluator at HUD to decide whether agencies’ fees-for-service are reasonable (see page 5).</td>
</tr>
<tr>
<td>3. Agencies must satisfy all criteria</td>
<td>Even one accounting mistake or one “unreasonable” fee-for-service could lose agencies their funding.</td>
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<tr>
<td>4. Agencies must meet all other HUD paperwork requirements.</td>
<td>Any simple problem, such as missing 50058 reporting requirements by one percentage point or having a RIM review finding could lose agencies their funding.</td>
</tr>
<tr>
<td>5. Agencies will be expected to review financial statements against their budget for Oct.–Dec. 2006</td>
<td>The 2006 fiscal year has already begun for some agencies, but HUD has provided no guidance on what their 2006 budgets should look like.</td>
</tr>
<tr>
<td>6. Funding will be withheld until midway through 2007 calendar year</td>
<td>HAAs will have to cut costs and reduce services, harming residents, even if they are complying with the new rules.</td>
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</tbody>
</table>

HUD should provide agencies an opportunity to stop their losses at five percent on October 1, 2006, and comply with reasonable achievable asset management criteria. It should conduct complete evaluations October 1, 2007, once the guidance is finished.
PHADA strongly encourages housing authorities to share the solutions on the facing page with their representatives and senators.
## Asset Management, Yes—Micromanagement, No

Constructive solutions from PHADA for implementing the new operating fund rule

The PHADA membership supports the new public housing operating fund formula with its effective date of January 1, 2007. Unfortunately, there are some significant flaws in HUD’s implementation of the rule. This will harm all housing authorities, including those expecting gains. PHADA is offering these constructive solutions as a way HUD can implement the rule without delaying the new funding formula.

### Inadequate funding

#### Problems:
- HUD is only providing 78 percent of the funding it says public housing needs.
- Public housing’s inflation factor does not include health care costs.
- HUD’s formula assumes housing authorities can collect rent on authorized vacant units.

#### Solutions:
- Fully fund the new rule to achieve parity with HUD’s other assisted housing programs.
- Adopt the inflation factor from the negotiated rule, based on Bureau of Labor Statistics data.
- Adopt the system from the negotiated rule for calculating income on vacant units.

### Property and asset management fees

#### Problems:
- HUD is proposing unreasonable property management fees, with guidance that would micromanage the way housing authorities use their funding.
- The asset management and bookkeeping fees in HUD’s proposed guidance are “one size fits all” and are based on inadequate data.

#### Solutions:
- Make sure the fee structures for HUD’s multifamily programs, which are the basis for the new rule, are consistent and accurate, and adjust them where necessary to apply to public housing properties.
- Consider basing management fees on operating costs, or on standards available for comparable property.
- Account for asset management responsibilities and costs using comparable market standards, such as private owners and project-based Section 8 contract administrators, instead of adopting a fixed nationwide asset management fee.
- Account for geographic and other cost differences in bookkeeping costs and analyze bookkeeping responsibilities and existing data more thoroughly, instead of adopting a fixed nationwide bookkeeping fee.
Maximum flexibility

Problems:

- The new rule calls for housing authorities to have the “maximum flexibility” possible, but HUD’s proposed guidance does not provide the flexibility housing authorities need in order to implement the business plans they have developed for their unique portfolios.
- The rule calls for “reasonable” asset management practices, but HUD is interpreting “reasonable” to mean “the same practices required in HUD multifamily programs,” instead of allowing for the differences between public housing and other assisted housing programs.
- By requiring that centralized front-line costs be paid for out of management fees, HUD is in effect micromanaging PHAs’ organizational structures.
- HUD says that any property with 80 or more units, not in proximity with another property, should be a separate project.

Solutions:

- Implement changes to regulations and support changes to statutory requirements that require public housing to do more than other HUD assisted housing programs. Until these changes are achieved, HUD should provide housing authorities as much flexibility as possible to juggle competing priorities.
- Follow the language in the rule and in the multifamily program handbook, and allow housing authorities to expense centralized front-line functions at the project, on a rational basis.
- Apply the language on fungibility from the final rule to the central office cost center.
- Offer agencies genuine flexibility in determining property groupings, based on local management and financial considerations.

No unauthorized Section 8 or Capital Fund changes

Problems:

- Contrary to federal law and the rule itself, HUD is attempting to apply operating fund rules to Section 8 and the Capital Fund programs.

Solutions:

- Housing authorities should continue to be paid a fee-for-service for each Section 8 unit leased.
- Maintain the current capital fund regulations that allow housing authorities to use some of their Capital Fund resources for operations and administration.

Achievable stop-loss opportunity

Problems:

- HUD has not released guidance for agencies seeking to meet the stop-loss criteria by October 1, 2006. For many housing authorities, this late release of guidance effectively nullifies the opportunity to stop their losses.
- HUD will not tell stop-loss agencies if they have successfully complied with the stop-loss criteria until halfway through the funding year, after they have had to deal with the consequences of withheld funding for six months.

Solutions:

- Provide agencies an opportunity to stop their losses at five percent on October 1, 2006, and comply with reasonable achievable asset management criteria.
- Have complete evaluations October 1, 2007, once the guidance is finished.