CHAPTER SIX: PROGRAM MONITORING

SECTION 1: INTRODUCTION

6.1 GENERAL

This chapter provides basic guidance on monitoring management agent activities to ensure that program requirements and procedures are followed. It specifically focuses on how to apply HUD's monitoring strategy in reviewing management agent performance. Where specific instructions for carrying out individual monitoring activities are provided in other HUD Handbooks, these documents are referenced.

6.2 OVERVIEW OF MONITORING ACTIVITIES

a. Types of Monitoring Activities. There are three basic types of monitoring activities.

(1) Physical Inspections. To assure that properties provide decent, safe, and sanitary housing, HUD regularly inspects the physical condition of all HUD-insured and HUD-assisted projects. Section 2 of this chapter discusses the use of physical inspections to monitor property conditions.

(2) Management Reviews. HUD also conducts on-site visits to review the management of HUD-insured and HUD-assisted properties. Key management areas, such as occupancy practices and on-site record-keeping, are examined to ensure that program requirements and procedures are properly followed. Section 3 of this chapter describes the use of management reviews in more detail.

(3) Financial Reviews. The financial management of HUD projects is also regularly monitored. HUD staff review financial statements and other documents to ensure that project funds are handled properly. Financial reviews are discussed in Section 4 of this chapter.

In addition to these regular monitoring activities, HUD will check that owners/agents comply with all elements of rental assistance contracts (e.g., HAP Contract) or Regulatory Agreements governing the property that are not included as part of the above reviews. These activities are outlined in Section 5 of this chapter.

b. Applicability. The responsibility for carrying out individual monitoring activities varies by activity and the type of project. The responsibility for performing each type of review is discussed in the sections below as part of the description of each activity.

6.3 MONITORING GOALS

Broadly speaking, HUD's monitoring goal is to ensure the success of its statutory mission to provide decent, safe, and sanitary housing. Management agents and owners, as HUD's partners in this effort, each have responsibilities in fulfilling this mission.

More narrowly, HUD seeks to protect the Department's interest as the insurer of project mortgages and as the regulator of millions of dollars in physical assets. HUD has a Congressional mandate to oversee the provision of physically and fiscally sound housing, and to protect the integrity of the resources that underwrite its production.

Last, HUD has a statutory obligation to monitor compliance with housing program requirements as set out in rental assistance contracts and Regulatory Agreements. Fulfillment of this goal requires HUD to directly oversee owners' and management agents' activities through periodic management, project, and documentation reviews. Within this review process, HUD seeks to work objectively and in a professional manner to identify strengths and weaknesses in project management, to communicate findings openly with the owner and management agent, and to find mutually acceptable solutions to management problems.

Monitoring and enforcing program compliance is a responsibility that HUD takes very seriously. HUD also recognizes that this responsibility is a component of its overall partnership with owners and management agents in providing affordable housing. In carrying out its monitoring activities, HUD will simply seek to assure that owners and agents are fulfilling their responsibilities and at the same time will respect the contribution of its partners.

6.4 HUD'S MONITORING STRATEGY

To guide its monitoring activities, HUD uses a strategy known as accountability monitoring. Under this strategy, HUD focuses the majority of it's monitoring efforts on program participants who pose the greatest risk to HUD's mission.

6.5 IMPLEMENTING ACCOUNTABILITY MONITORING

a. Monitoring Based on Risk. Decisions regarding monitoring reviews and resources are made using a risk management process which determines both the participants and areas to be reviewed based on the risk posed to HUD's objectives. Under this approach, the frequency and intensiveness of monitoring reviews increases as the risk posed by a project or participant increase.

b. Monitoring Schedule. Schedules for monitoring activities will be based on an assessment of the risks posed by projects within a jurisdiction. A risk rating system has been developed to guide the scheduling of monitoring activities. The rating system to be used to schedule physical inspections (see paragraph 6.12) is also used in scheduling other monitoring reviews.

(1) In developing their monitoring schedules, Loan/Asset Management staff should schedule projects that fall near the top of these ratings earliest in the schedule and consider the potential need for follow-up reviews.

(2) Projects that pose lower risks should be scheduled after higher risk properties.

c. Interrelationship of Monitoring Reviews. Although each type of review is discussed separately, Loan/Asset Management staff should conduct each review with an eye toward overall performance. For example:

- many contract monitoring requirements directly overlap with the financial review and management review requirements; and
- management reviews contain most of the steps required to complete a financial review.

Loan/Asset Management staff not only need to complete an individual monitoring activity, but also recognize the implications of a finding in a particular area for other functional areas, as well as for the project overall. The following guidelines apply in all cases:

(1) Risk Assessment. After identifying the goal of their review procedures, Loan/Asset Management staff should use their knowledge of project conditions to identify and focus their attention on higher-risk items. It is more efficient to concentrate on areas where problems have been identified, even at the risk of neglecting lower-risk areas, than to spend equal time on all issues and not adequately cover the highest-risk issues.

(2) Trend Analysis. Individual findings should be viewed in the context of the project as a whole. Loan/Asset Management staff should try to look "behind" an individual finding to see if its cause lies elsewhere or is having a larger effect. For example, if cash management controls are weak, the problem may lie in the management agent's training policies.

Or, if a project is in poor physical condition, a reviewer should consider whether its Replacement Reserve Account is managed properly.

(3) Portfolio Analysis. Loan/Asset Management staff should evaluate a management agent's performance by looking at all projects that the agent manages, not simply at the project currently under review. A pattern of findings at other projects might suggest that a control weakness exists in the project currently under review.

d. Adapting to Changing Conditions. Monitoring schedules should be flexible to allow for periodic revisions based on changes in monitoring objectives and available resources. For example, the discovery of a series of unanticipated compliance problems during the course of monitoring reviews may require Loan/Asset Management staff to revise the monitoring schedule to account for the presence of a previously unknown problem.

6.6 WHEN TO PERFORM NON-SCHEDULED REVIEWS

While individual monitoring techniques can follow different schedules, there are situations where one or more reviews is immediately appropriate. Loan/Asset Management staff should recognize that they can and should use any of the monitoring activities discussed in paragraph 6.2 when the need arises. The following paragraph outlines situations in which each monitoring technique is appropriate. HUD Handbook 4350.1 provides more detailed guidelines for using each of these techniques.

a. Physical Inspections. Physical inspections should be performed as soon as possible once the Loan/Asset Management staff determine that a project is troubled or potentially troubled (see Exhibit 6-1). Such projects are characterized by:

(1) Physical deterioration or specific substandard conditions identified by a legitimate, representative resident organization;

(2) Evidence of drug use, drug sales, or other criminal activities;

(3) Financial stress; and/or

(4) A high level of significant resident complaints.

The Loan/Asset Management staff should also inspect the project if it determines that the mortgagee inspection is inadequate or if the project requests additional HUD financial assistance.

b. Management Reviews. When physical inspections are required for any of the reasons listed in paragraph (a), a management review should also be performed. Loan/Asset Management staff may also perform a management review when a physical inspection is not necessary, but there is evidence of:

(1) Poor accounting, budgeting, and/or cost controls;

(2) Failure to submit required periodic reports, including vouchers, in a complete and timely manner;

(3) Low rent collection or high accounts receivables;

(4) Complaints about or evidence of poor procedures for resident screening and selection;

(5) High vacancy rates or turnover;

(6) Specific and verifiable evidence of project mismanagement or harassment of residents or resident associations reported by petition from a legitimate resident association;

(7) Other staffing/supervisory failures; and/or

(8) A high level of significant resident complaints.

c. Financial Reviews. Financial reviews should be performed when the project management does not submit fiscal reports in a timely manner. For example, a financial review is appropriate when there are frequent requests for Section 8 special claims or Reserve for Replacement withdrawals. The Loan/Asset Management staff should also conduct a financial review if rent collections are below expected levels and accounts receivables are excessively high.

d. Resident File Reviews. Resident file reviews are conducted as part of an on-site review to verify that the project manager is complying with HUD resident screening, selection, and other occupancy policies. If remote monitoring suggests occupancy problems at any project that the agent manages, Loan/Asset Management staff should review a sample of files to assess the extent of the problem and determine appropriate corrective actions.

6.7 MONITORING LOBBYING ACTIVITIES

a. Pursuant to Section 319 of Public Law 101-121, all mortgagees, mortgagors, and their agents participating in any multifamily, assisted housing, or coinsurance program under Title II of the National Housing Act are required to submit certifications and disclosures regarding their lobbying activities.

(1) The certification states that the recipient of federally-appropriated funds does not, has not, and will not use those funds for lobbying purposes.

(2) The disclosure form (Standard Form-LLL) reports any payments made or agreement to make any payment from funds other than federally-appropriated funds for the purpose of influencing or attempting to influence any Executive of Legislative personnel in connection with the award of HUD contracts, grants, cooperative agreements, loans, or other form of assistance.

b. Applicability. The certification and disclosure requirements are triggered when contracts or grants exceeding $100,000 and loans or commitments exceeding $150,000 are made. However, any attempt to influence federal agency actions through the use of federally-appropriated funds to this end is prohibited and such actions which come to the attention of HUD staff must be reported to the Office of Ethics.

c. Submission Requirements

(1) The Area Office is required to provide each applicant for an insured/coinsured mortgage commitment or for other federal assistance (e.g., contract, grant, loan, etc.) with the standard certification and disclosure language, and a Standard Form-LLL to report lobbying activities.

(2) When applicable, sponsors, mortgagors, and mortgagees must submit certifications and disclosure forms in conjunction with the following documents:

(a) Mortgage insurance application at any stage – HUD-92013, 92013-Hosp, 92013-NHICF, or HUD-93201, as appropriate;

(b) Cost Certification forms HUD-92330 or FHA-2205A;

(c) Request for Final Endorsement of Credit Instrument – FHA-2023;

(d) Applications for Flexible Subsidy assistance;

(e) Requests for Loan Management Set-Aside assistance; and

(f) Applications for drug grants and other forms of competitive awards.

d. HUD Processing

(1) The Loan/Asset Management staff will review each certification and disclosure for completeness prior to issuing any commitment or award of insurance or financial assistance

(2) The Area Office will send the original of any disclosure form (Standard Form-LLL) immediately to the Office of Ethics in Headquarters and will retain a copy in the application, project, or program file.

SECTION 2: PHYSICAL INSPECTIONS

6.8 HUD'S PHYSICAL INSPECTION PROGRAM

Well-maintained projects are central to HUD's mission of providing decent, safe, and sanitary housing. HUD will not accept deteriorated conditions in housing under its jurisdiction.

a. Purposes. A comprehensive inspection program:

(1) Verifies the quality of housing provided to residents and enables Loan/Asset Management staff to identify and correct problems in project conditions and maintenance.

(2) Serves as a control for the quality of mortgagees' inspections of projects.

(3) Helps to safeguard the integrity of the FHA Insurance Fund for HUD-insured and HUD-held projects.

b. Annual Inspections. The Loan/Asset Management staff is responsible for ensuring that all multifamily projects under HUD's jurisdiction are inspected yearly by HUD, a designated Contract Administrator, a HUD-selected contractor, or by the mortgagee. Loan/Asset Management staff should follow the procedures set forth in Chapter 6 of HUD Handbook 4350.1 for performing inspections of insured and non-insured projects where HUD is the Contract Administrator.

c. Additional Funding or Funding Changes. Before approving additional HUD funding or changes to HUD funding arrangements, a physical inspection must be conducted if the most recent inspection is more than 12 months old. Examples of additional funding or funding changes include:

(1) receiving additional LMSA units;

(2) awarding Flexible Subsidy funding;

(3) awarding Service Coordinator funding; or

(4) conversion of a Rent Supplement contract to a Section 8 contract.

NOTE: Section 8 budget authority amendments are not considered additional HUD funding.

6.9 MORTGAGEE AND CONTRACT ADMINISTRATOR INSPECTIONS

a. Mortgagee Inspections. The Loan/Asset Management staff must ensure that mortgagees comply with the procedures outlined in the Mortgagee Monitoring Handbook (HUD Handbook 4350.4), which sets forth the requirements for mortgagees to complete physical inspections.

(1) Loan/Asset Management staff must establish a tracking and quality control system for mortgagee physical inspections.

(2) Loan/Asset Management staff must inspect a portion of the portfolio sufficient to evaluate the reliability of mortgagee physical inspections and to follow up where a mortgagee inspection or other indicator identifies a project as troubled or potentially troubled.

b. Contract Administrator Inspections. For projects with an entity other than HUD serving as the contract administrator, Loan/Asset Management staff must ensure that the administrator is performing physical inspections. Loan/Asset Management staff must also ensure that the physical integrity of the property is being maintained as required in the applicable rental assistance contract and under HUD Handbook 4350.5, Subsidy Contract Administration.

(1) Loan/Asset Management staff must establish procedures for ensuring that contract administrators are conducting physical inspections as required.

(2) Loan/Asset Management staff must inspect a portion of the portfolio sufficient to evaluate the reliability of contract administrator physical inspections and to follow up where such inspections or other indicators identify a project as troubled or potentially troubled.

For more detailed instruction, see HUD Handbook 4350.5.

6.10 USE OF CONTRACTORS

Area Offices must not use contractors to conduct Physical Inspections for projects with HUD-insured and HUD-held mortgages which are troubled projects. Area Offices may use contractors to inspect only the remaining portion of the insured and HUD-held portfolio which HUD staff did not inspect during the year.

a. Contracting and Payment. Contractors will be paid with fee money from the FHA Insurance Fund.

b. Resource Utilization Strategy. Area Offices should include in their resource utilization strategy the staff required to oversee and review contract physical inspections.

6.11 INSPECTION STANDARDS

a. Housing Quality Standards. At a minimum, all assisted units must comply with Section 8 Housing Quality Standards (HQS) and/or local housing codes, whichever are more stringent. However, inspectors should expect management agents to maintain the projects at physical conditions above these minimum maintenance standards.

b. Serious vs. Non-serious Deficiencies. The Loan/Asset Management staff must develop criteria for classifying physical deficiencies as serious or non-serious. Criteria may include:

(1) Whether the repair need was judged as "immediate";

(2) Whether the deficiency poses a health and/or safety threat to residents and/or project staff;

(3) The cost to repair the deficiency; and

(4) Any other criteria the Area Office reasonably deems appropriate.

Serious deficiencies will serve as the basis for the Area Office Manager's determination of technical default. See paragraph 6.19.

6.12 PRIORITIES FOR SCHEDULING PHYSICAL INSPECTIONS

a. The Loan/Asset Management staff should use the priorities described in Figure 6-1 to schedule physical inspections. Exhibit 6-1 at the end of this chapter provides additional guidance on indicators of "troubled" or "potentially troubled" status.

b. Within each priority area, identify and rank projects in the worst condition. These projects should be targeted for physical inspection first, followed by the remaining projects within that category. Sources of information include: mortgagee inspections, management review reports, previous physical inspection reports, and resident complaints.

FIGURE 6-1
PRIORITIES FOR HUD INSPECTIONS

1. Insured assisted troubled
2. HUD-held assisted troubled
3. Non-insured assisted troubled
4. Insured unassisted troubled
5. HUD-held unassisted troubled
6. Insured assisted potentially troubled
7. HUD-held assisted potentially troubled
8. Non-insured assisted potentially troubled
9. Insured unassisted potentially troubled
10. HUD-held unassisted potentially troubled
11. Insured assisted
12. HUD-held assisted
13. Non-insured assisted
14. Insured unassisted
15. HUD-held unassisted

6.13 CONDUCTING THE INSPECTION

a. Scope of Inspection. Each physical inspection must include:

(1) A physical review of the inside and outside of projects' housing units, buildings, grounds, commercial space, and common areas for condition and maintenance.

(2) A visual check of all common areas (equipment rooms, laundries, storage rooms, etc.).

(3) A review of at least 10 percent of the occupied units and all vacant units. The Director of Multifamily Housing may authorize or require a lesser or greater number of units to be inspected, based on the number of units in the project, to establish a reasonable sample size.

b. Identifying Deficiencies. For any identified deficiency, HUD should work with owners/agents to estimate the cost of repairs in order to provide as much useful information as possible to the owner and/or management agent.

(1) Loan/Asset Management staff should conduct inspections of troubled projects with the assistance of either the loan servicer, a construction analyst, or an engineer who is capable of determining the cost of the required repairs.

(2) If this expertise is not readily available to the Multifamily Housing staff, the Director of Multifamily Housing and the Director of Housing shall coordinate to provide either in-house resources or a third-party contractor to produce the needed cost estimate.

c. Conducting Close-out Meeting

(1) The owner and manager must be notified of findings upon the conclusion of the inspection so they can begin to address the problems.

(2) Inspectors should stress that areas of concern identified are not necessarily all-inclusive and that the final report could include additional findings of deficiency based on the analysis of the overall inspection.

6.14 DOCUMENTATION OF THE PHYSICAL INSPECTION AND FINDINGS

a. Format. The prescribed format for the documentation is the Form HUD-9822, "Physical Inspection Report," included in Appendix 5.

b. Contents. The written report of the physical inspection should document:

(1) Detailed deficiency explanations, including locations of the deficiencies and classification as "serious" or "non-serious";

(2) Cost estimates for needed repairs;

(3) Recommended or required actions and time frames; and

(4) Overall conclusions on the physical condition of the project.

c. Use of Photographs. Where practicable, inspectors should include photographs with the Form HUD-9822 documentation to describe both good and bad conditions. Any photographs used in the report should be cross-referenced to their location in the report.

d. Report Conclusion. Each report must be signed, dated, and must specify the recommended corrective actions specified by the inspector. The report to the owner may summarize the deficiencies, but Loan/Asset Management staff must retain detailed descriptions of deficiencies and locations in the project files for follow-up review.

e. Time for Completion

(1) If HUD performs the inspection, HUD staff will prepare the report once the field work is complete.

(2) If a contractor performs the inspection, the contractor must deliver the report to the Area Office within the time frame specified in its contract with HUD.

6.15 AREA OFFICE COUNSEL REVIEW

When inspection results reveal serious deficiencies, Loan/Asset Management staff should submit the inspection documentation to Area Office Counsel to determine whether the deficiency represents a "waste" of assets or whether there has been a failure to maintain the property in good repair. Area Office Counsel should provide the program office with guidance regarding which documentation should be retained.

See Handbook 4350.1, Chapter 6 for further instruction the on Area Office Counsel review.

6.16 NOTIFICATION OF THE OWNER/MANAGEMENT AGENT

a. The Loan/Asset Management staff should send a completed physical inspection report to the owner upon completion of the report by HUD staff or contractors. Loan/Asset Management staff must also send a copy of the report to the management agent and/or other contacts identified by the owner.

b. The Area Office is not required to send any photographs with the report unless such pictures are specifically referenced in the report.

6.17 CORRECTIVE ACTION PLANS

Once HUD has notified the owner and management agent of the report's findings, the owner/agent is expected to prepare a corrective action plan to address any deficiencies. The Area Office shall not approve the corrective action plan unless it provides for the final resolution of all deficiencies.

a. Time Frames for Owner Response

(1) When serious deficiencies are identified in the inspection report, owners must:

(a) Meet with Loan/Asset Management staff within ten (10) working days from the date of issuance of the report to discuss the deficiencies identified during the inspection, unless an alternate schedule is agreed upon by HUD staff and the owner.

(b) At this meeting, provide a written report on all actions taken since the report was issued to correct the deficiencies noted.

(c) Provide a commitment within 20 working days of the meeting outlining how and when the remaining deficiencies will be corrected and provide a written plan for addressing these deficiencies within a time frame agreed upon by the Area Office. The owner may use the Management Improvement and Operating (MIO) Plan format, and must include a budget identifying the source of funds used to implement corrective actions. See HUD Handbook 4355.1 REV-1, Flexible Subsidy, for a description of the MIO Plan.

(2) For deficiencies identified as non-serious, owners are not required to meet with the Loan/Asset Management staff. However, they must submit a plan to resolve those deficiencies within 30 calendar days of the date of the receipt of the report. Owners will be subject to all monitoring and enforcement actions outlined in this Handbook, and in accordance with HUD Handbook 4350.1, Chapter 6.

b. Required Contents

(1) Corrective action plans for insured projects, including those submitted for non-serious deficiencies, must be appropriately formulated and organized so that they can be monitored in the Area Offices.

(2) The action plan must be well-considered and specific. It must include timetables for deficiency resolution and must identify sources of funds necessary to bring the project to an acceptable condition.

(a) If the project's cash flow is not sufficient, the owner should provide a MIO plan covering how he/she proposes to correct the problem or what savings he/she suggests.

(b) The owner must make all reasonable efforts to secure additional funding needed to implement corrective actions.

(3) Where an owner requests increased HUD funding to pay for all or part of the required repairs, the owner must present a certification and supportive documentation that he/she has made efforts to secure funding from non-HUD funding sources.

c. Area Office Counsel Review. When serious deficiencies exist, Area Office Counsel must review the corrective action plan prior to Loan/Asset Management staff approval. Area Office Counsel will advise program staff on any legal issues raised within the plans.

d. Corrective Action Plans for HUD-Held Projects will be included in and made part of a workout plan.

6.18 MONITORING CORRECTIVE ACTION

a. Use of Monitoring Systems. If a monitoring system is not in place, Loan/Asset Management staff in each Area Office will develop a system to monitor planned and completed corrections. The Early Warning System, when implemented, may aid in the tracking of corrective plans.

b. Follow-Up Inspections

(1) Where serious deficiencies were identified during the physical inspection, Loan/Asset Management staff shall schedule a follow-up inspection within **30 days or less** of the meeting to assure satisfactory completion of all corrections the owner indicates are completed.

(2) Follow-up inspections on completed tasks may be performed by permanent staff, or by contract inspectors if the project is HUD-insured or HUD-held.

(3) All follow-up inspections must be documented either through a memorandum to the file or on a Form HUD-9822. Documents must be clearly marked to show that the inspection is a follow-up.

b. Addressing Noncompliance. Loan/Asset Management staff shall notify the owner in the case of noncompliance with the plan.

(1) The owner must take remedial action **immediately** upon receipt of notification and must provide an explanation of any noncompliance. In addition, the owner must develop and provide to the Area Office proposed revisions to the corrective action plan.

(2) The Loan/Asset Management staff will analyze any suggested modifications to determine their feasibility and their effect on the continued viability of the plan.

(3) If the Loan/Asset Management staff determine that the owner and/or management agent is not making a good-faith effort to bring the project into acceptable condition, or if the plan, as revised, is no longer feasible, then they may impose sanctions as described in Chapter 7 of this Handbook and, if applicable, in accordance with Chapter 8, HUD Handbook 4350.1.

6.19 TECHNICAL DEFAULTS

If the owner does not remedy noncompliance with the corrective action plan and the physical condition of the property has fallen to an unsatisfactory level, Loan/Asset Management staff must determine whether to declare default under the clauses of the Regulatory Agreement or under the waste provision of the mortgage.

a. Recommendation of Default. If the Director of Multifamily Housing determines that a declaration of default is appropriate, the Director of Housing has the authority to approve or disapprove the recommendation.

b. Notification. If the Director of Housing accepts the Director of Multifamily Housing's recommendation, the Loan/Asset Management staff must notify the owner of the intended action by certified mail with return receipt requested, and must send a copy of the notification to the management agent.

(1) The notification must be reviewed by Area Office Counsel and signed by the Director of Housing before being sent to the owner. Area Office Counsel must review and concur on all notices of intent and all subsequent correspondence to the owner.

(2) The Loan/Asset Management staff must inform owners in the notification that they will be given thirty calendar days to show sufficient cause why the default should not be declared, or otherwise to provide a new or revised corrective action plan, or to carry out the previously approved plan.

c. Extension of Notice. The Director of Housing may extend the time frame for declaration of default for specific cause on a case-by-case basis. The Director must document such cause for the record.

d. Declaration of Default. If the owner does not satisfactorily show cause or comply with the Director of Housing's requests regarding corrective actions within thirty days or the approved time frame, the Area Office Counsel shall proceed with a written request to the mortgagee to accelerate the principal balance of the mortgage.

(1) For declarations of default under the waste provision of the mortgage, the request shall require that, under the authority provided the Secretary contained in 24 CFR 207.257, the mortgagee declare a Covenant Default and accelerate the principal balance of the mortgage.

(2) For projects with HUD-held mortgages, the Director of Housing Management must request the Office of Mortgage Insurance Accounting and Servicing (MIAS) to accelerate the principal balance of the mortgage and to declare the balance immediately due and payable.

(3) If the housing condition is below acceptable levels, but the documentation or the problem does not support a declaration of default based on the Regulatory Agreement or the waste provision of the mortgage, HUD should determine the advisability of initiating immediate litigation against the owner. Civil penalties should also be implemented where appropriate to ensure compliance with the corrective action plan.

e. Foreclosure and Mortgagee-in-Possession (MIP) Status.

(1) After the mortgagee has prepared the election to assign the mortgage, or MIAS has completed the necessary steps for HUD-held mortgages, the Area Office Counsel, upon instruction from the Director of Housing, should take action to obtain either voluntary or involuntary mortgagee-in-possession status.

(2) The Area Office must request or begin foreclosure concurrently with the commencement of MIP status. This is imperative and must occur in all cases.

(3) When the Department is awarded MIP status, the Director of Housing Management should authorize the management agent to begin making the needed repairs to restore the project to acceptable living standards as quickly as possible. The repairs should be paid for out of project funds and the Insurance Fund.

Refer to Handbook 4315.1, Multifamily Property Disposition -- Management, for further instruction on foreclosure and MIP responsibilities.

6.20 NON-ROUTINE INSPECTIONS

a. Inspections for Funding Changes. In addition to regularly-scheduled inspections, Loan/Asset Management staff must ensure that a physical inspection has been carried out prior to approving actions that entail funding changes, such as additional subsidy approvals and workouts. Loan/Asset Management staff may waive this requirement if:

(1) A physical inspection performed in compliance with this Handbook has been completed within the past year; or

(2) Loan/Asset Management staff determine that project operations will be imperiled if approval of the requested assistance is withheld.

b. Ad-hoc Reviews. If time permits, HUD staff on official travel should drive by any HUD-assisted and insured projects located nearby their travel route or destination. Area Office staff should observe the physical condition of the project with a quick walk-through or drive-by inspection and assess whether the project requires further inspection.

SECTION 3: MANAGEMENT REVIEWS

6.21 PURPOSE OF MANAGEMENT REVIEWS

a. Compliance. Management reviews are another integral step for ensuring compliance with HUD program requirements. Management reviews allow HUD to determine whether owners and management agents are providing the services which HUD requires under its Regulatory Agreements, Housing Assistance Payments Contracts, mortgages, and general and industry standards.

b. Communication. Effective management of HUD-insured and HUD-assisted multifamily properties requires adequate communication between owners, managers, and residents. Management reviews serve as HUD's primary means of assessing the communication between owners, management agents, and residents and resident organizations. Chapter Four of this Handbook provides more detailed guidance on communication between owners, management agents, and residents.

6.22 TYPES OF MANAGEMENT REVIEWS

There are two types of management reviews.

a. Comprehensive Management Reviews. A comprehensive review covers all aspects of property operations and addresses all questions on the HUD-9834 "Management Review of Multifamily Projects." Exceptions to the comprehensive review format may be granted in writing by the Director of Housing Management on a case-by-case basis.

b. Limited Management Reviews. Limited management reviews examine only the key areas of project operations. These reviews use 17 of the questions on the HUD-9834, in addition to all questions addressing the suspected or known problem area(s).

Refer to HUD Handbook 4350.1, Chapter Six for a full discussion of comprehensive vs. limited reviews.

6.23 DETERMINING THE SCOPE OF REVIEW

a. Loan/Asset Management staff must conduct comprehensive reviews for all physically or fiscally troubled projects.

b. Loan/Asset Management staff may choose to perform limited reviews for some projects. The Director of Multifamily Housing will determine whether the scope may be limited or comprehensive. Chapter 6 of HUD Handbook 4350.1 outlines the appropriate circumstances in which to use limited reviews.

6.24 SCHEDULING MANAGEMENT REVIEWS

a. The Area Office should use the same priority standards shown in Figure 6-1 to schedule management reviews. Loan/Asset Management staff should ensure that assisted projects which are physically or fiscally troubled receive first priority.

b. In addition to the normal review plan, Loan/Asset Management staff must arrange to review projects at which there are serious management problems or significant resident complaints.

c. When possible, Loan/Asset Management staff should schedule management reviews to coincide with the project physical inspection to minimize the impact on project operations and to use HUD resources most efficiently.

6.25 STEPS FOR PERFORMING THE MANAGEMENT REVIEW

a. Preparation. Loan/Asset Management staff should review the records, listed below, for each project scheduled for review to determine whether the review is warranted and, if so, its extent. Staff should keep in mind, however, that these records alone may not fully indicate the project's needs and condition.

(1) The priority status assigned to the project.

(2) Any records of the agent's performance at other projects.

(3) Quality, scope, and results of previous HUD on-site reviews (management or physical) and mortgagee physical inspection reports.

(4) Results from FHEO reviews.

(5) Financial condition reports, including the Independent Public Accountant's report.

(6) Early Warning System, MIPS, and TRACS printouts.

(7) Results of Occupancy Specialist desk reviews of subsidized project resident certifications and vouchers.

(8) Resident comments and complaints.

(9) Local police reports, if available.

b. Documentation

(1) Format. The review will be documented on form HUD-9834, "Management Review of Multifamily Projects." See Appendix 4.

(2) Contents.

(a) The report will summarize all identified deficiencies, recommended or required corrective actions and time frames, and conclusions. Area Office records shall contain a detailed description of any deficiency.

(b) If the report refers to materials that are not physically attached to it (such as annual financial statements), it should clearly identify the location of those materials.

c. Close-out Meeting. The owner and/or manager should be notified of findings upon the conclusion of the review so they can begin to address the problems. The reviewers should stress at the meeting that the areas of concern identified are not necessarily all-inclusive and that the final report could include additional findings of deficiency based on the analysis of the overall review.

6.26 FAIR HOUSING AND EQUAL OPPORTUNITY CONSIDERATIONS

a. Referrals to FHEO. During management reviews, Loan/Asset Management staff examine resident records together with the agent's resident screening and selection procedures for compliance with the occupancy requirements established in HUD Handbook 4350.3. If concerns about an owner/agent's compliance with Fair Housing requirements arise during such reviews, Loan/Asset Management staff should notify FHEO of these concerns.

b. FHEO Reviews. FHEO staff conduct separate compliance reviews based upon Loan/Asset Management referrals or the results fo FHEO risk assessments concerning the following areas.

(1) Management and administration;

(2) Equal employment opportunity and training;

(3) Outreach and affirmative marketing;

(4) Occupancy reviews and resident data;

(5) Maintenance and facility management;

(6) The provision of services to persons with disabilities; and

(7) Procurement practices and the use of minority- and women-owned businesses.

For additional information, see FHEO Notice 92-1, Implementing FHEO Accountability Monitoring/Risk Assessment.

6.27 TIMEFRAME FOR COMPLETING REPORT

a. If HUD performs the management review, it will issue the report upon completion of the field work.

b. If a contractor performs the management review, the contractor must deliver the report to the Area Office within the time frame specified in its contract with HUD.

6.28 NOTIFICATION OF THE OWNER/MANAGEMENT AGENT

The Loan/Asset Management staff must notify the owner of the results of the review upon completion of the report by HUD staff or contractors. Loan/Asset Management staff must also send a copy of the report to the management agent and/or other contacts identified by the owner and to the mortgagee if the property has an insured mortgage. See HUD Handbook 4350.1 for specific procedures regarding owner notification.

6.29 CORRECTIVE ACTION PLANS

a. Format. Once HUD has notified the owner and management agent of the report's findings, the owner/agent is expected to prepare a corrective action plan to address deficiencies. Like the corrective action plan for a physical inspection, this plan may use the MIO plan format. (See HUD Handbook 4355.1, Flexible Subsidy Handbook.)

b. Time Frame for Response. Owners must provide the Area Office with a corrective action plan addressing the noted deficiencies within thirty 30 days of the date of notification.

c. Appeals. The owner may appeal the findings of the management review according to HUD Handbook 4350.1, Chapter 6. However, the owner may not delay submitting the response or correcting valid deficiencies that are not under appeal.

d. Monitoring Corrective Action.

(1) To monitor corrective action, Loan/Asset Management staff may, as appropriate:

(a) Conduct discussions with owners, agents, and residents;

(b) Review the deficient area by performing a limited management review using form HUD-9834; and

(c) Review desk reports and other documentation to verify that management deficiencies have been corrected.

(2) Each Area Office must develop its own procedures and timetables for monitoring management corrections given the severity of the deficiencies and available staff resources, but the following guidelines apply to all monitoring activities.

(a) Follow-up. HUD staff must ensure that owners are carrying out the required corrective actions. The Loan/Asset Management staff will monitor the project for as long as deficiencies are being corrected, and will determine whether the owner is acting in a timely and professional manner in carrying out the corrections.

(b) Discovery of Additional Deficiencies. If new deficiencies are revealed as a result of routine monitoring or as a result of a subsequent review of operations, Loan/Asset Management staff will repeat all steps necessary to assure owner compliance.

(c) Follow-up System. If a follow-up system is not in place, Loan/Asset Management staff shall establish a follow-up and reporting system which monitors the actions taken by the owner to cure existing deficiencies.

6.30 ADDRESSING NONCOMPLIANCE

a. The Loan/Asset Management staff shall notify the owner in the case of noncompliance with the corrective action plan. The owner must take remedial action **immediately** upon receipt of notification, and must provide an explanation of any noncompliance.

b. The owner also must develop and provide to the Area Office proposed revisions to the corrective action plan within ten (10) days of the notification. The Loan/Asset Management staff will analyze any modifications to determine their feasibility and their effect on the continued viability of the plan.

c. If noncompliance is caused by a management agent, Loan/Asset Management staff should follow the procedures described in Chapter 7 to enforce agent compliance.

6.31 TECHNICAL DEFAULTS

For properties with HUD-insured or HUD-held mortgages, if the Loan/Asset Management staff determine that:

a. A good-faith effort is not being made to correct deficiencies noted in the management review report;

b. A plan is not received; or

c. The plan, as revised, is no longer workable.

then the Area Office should pursue a declaration of default, under either the waste provision of the mortgage or under the Regulatory Agreement. See paragraph 6-19.

6.32 AGENTS MANAGING MORE THAN ONE PROPERTY

a. If the Loan Management or other Area Office staff are familiar with the management agent's performance because the agent manages more than one property under HUD's jurisdiction, the Loan/Asset Management staff may perform a Limited Management Review. They may also examine a sample of the more important management tasks (cost controls and budgeting, resident screening and selection, preventive maintenance, etc.).

b. If the Area Office has observed problems at one or more of the agent's projects, Loan/Asset Management staff should perform a Comprehensive Management Review at all current projects.

6.33 REVIEWS OF MANAGEMENT AGENTS' CENTRAL OFFICES

a. In some cases, agents with more than one property perform certain management functions from a centralized location. General management functions, as well as financial management and selected occupancy functions, are activities these agents often choose to centralize. Loan/Asset Management staff must perform management reviews of the agent's central office activities as well as regular on-site reviews of functions carried out at the projects. The purpose of the centralized review is to limit the time spent reviewing individual properties. For example, once a review is performed on the agent's central offices books, records, and internal controls, they will not need to be inspected at each individual property.

b. The HUD Super A Area Office covering the area in which the management agent's central office is located has responsibility for centralized reviews. They may solicit assistance from the Area Office which is located closest to the Central Office proposed for review. The Super A Area Office has the responsibility for assuring the review is conducted, resolving any outstanding findings, and forwarding a copy of the review to other Area Offices with properties managed by that agent.

c. Central office management reviews should be performed at least once every 18 months.

d. Whenever possible, a team of the appropriate HUD specialists, rather than a single staff person, should perform these reviews. An ideal team would consist of a Loan Specialist/Asset Manager, a Financial Analyst, and an Occupancy Specialist, if staffing permits. Additional members may be appropriate depending on the size of operation and types of functions handled by the agent's central office.

e. Central office management reviews follow a modified management review format. Loan/Asset Management staff performing this type of review should complete the following portions of the Management Review Form (Form HUD-9834):

(1) Part B - Financial Management (All items)

(2) Part C - Occupancy and Tenant Selection (Those items that correspond to activities handled at the agent's central office)

(3) Part E - Drug Free Housing Policy (Items 33, 34, 36, & 37)

(4) Part F - General Management (Items 38 - 42 and 44- 45)

In completing the review, Loan/Asset Management staff should assess whether the agent's procedures allow HUD to examine the performance of each project individually for all of the applicable items above.

SECTION 4: FINANCIAL COMPLIANCE

6.34 OVERVIEW

a. Purpose. Management agents are charged with protecting the financial viability of HUD-insured multifamily projects. The purpose of financial reviews is to verify that owners and management agents are in compliance with HUD Handbook 4370.2, Financial Operations and Accounting Procedures for Insured Multifamily Projects, and related HUD requirements and guidelines. This section provides an overview of the financial compliance review requirements for Loan/Asset Management staff.

Inadequate internal controls and procedures for financial operations and accounting can result in

- insufficient funds to pay for maintenance and emergency repairs;
- willful misappropriation of project funds; and/or
- claims and losses against the FHA Insurance Fund.

To prevent these occurrences, Loan/Asset Management staff are responsible for determining that owners and management agents observe HUD guidelines and maintain an effective set of reporting systems and internal controls.

b. Applicability. All HUD-insured and HUD-assisted properties are subject to some degree of financial review. HUD Handbook 4370.2 describes the review procedures that must be performed for different types of projects and who is responsible for conducting the review (i.e., HUD, the mortgagee, or Contract Administrators other than HUD).

6.35 RELATIONSHIP TO MANAGEMENT REVIEW

Part B of the HUD-9834, Management Review of Multifamily Projects, addresses financial management. Questions on Part B of the HUD-9834 relate directly to the following paragraphs. See Appendix 4.

6.36 REVIEWING ANNUAL FINANCIAL STATEMENTS

a. Purpose. Annual financial statements show the project's financial condition. Loan/Asset Management staff may review the statements, which are sent to the Area Office, to measure the current and near-term financial stability of the project by using financial ratios and other indicators. (Reports from existing MIPS applications may provide additional detail.) Loan/Asset Management staff should determine whether project assets and liabilities, rates of rent collection, accounts payable, etc., appear reasonable given the project's size and history. This information may suggest areas where increased oversight is needed.

b. Review requirements. Loan/Asset Management staff must verify that annual financial statements are prepared and submitted to the Area Office in compliance with the following procedures and with HUD Handbook 4370.2.

(1) Preparation

(a) Each annual financial report must be based on books and accounts for that project only.

(b) The annual financial report must cover the project's entire fiscal period under review.

(c) The annual financial report must be prepared on an accrual basis.

(d) The annual financial report must be audited by an Independent Public Accountant (IPA) who is a Certified Public Accountant or who has been licensed or registered on or prior to December 31, 1970.

(2) Submission. Chapter 3 of HUD Handbook 4370.2 REV-1 provides a detailed listing of the required annual reports. Audited financial statements must be submitted annually for each project. The Regulatory Agreement requires submission within 60 days following the end of each fiscal year.

6.37 ASSIGNING MANAGEMENT COSTS

a. HUD allows owners to charge certain management costs to the project's operating account. However, other management costs may be paid only out of the management fee. The assignment of these costs is discussed in paragraphs 6.38 and 6.39. Asset management costs for the project must be paid out of distributions to the owner. The assignment of asset management costs is described in paragraph 6.41.

b. In reviewing a project's financial statements, Loan/Asset Management staff should follow the procedures in paragraphs 6.38 through 6.41 and in

Handbook 4370.2 to ensure that management costs have been properly assigned.

c. Rather than maintaining separate payroll and separate fringe benefits plans for each property, some agents consolidate payroll and fringe benefit plans in order to reduce costs for the properties. In such a system, all personnel for several properties are listed under a single Federal Employer I.D. Number. The salary and fringe benefits costs are prorated to the various properties in the following ways.

(1) Salaries and fringe benefits of personnel performing front-line duties are prorated among the properties served in proportion to actual use.

(2) The agent may not impose surcharges or administrative fees in addition to actual costs.

(3) The properties served may make reimbursement payments to the consolidated employer upon issuance of payroll checks.

(4) Discounts, rebates, dividends, commissions, or other recoveries of fringe benefits costs must be prorated among the properties served in proportion to actual use during the period to which the recovery applies.

6.38 MANAGEMENT COSTS CHARGED TO THE PROJECT'S OPERATING ACCOUNT

a. Front-line Costs and Day-to-Day Activities

(1) Reasonable expenses incurred for front-line management activities may be charged to the project operating account. HUD Handbook 4370.2, Financial Operations and Accounting Procedures for Insured Multifamily Projects, provides a complete listing of allowable expenses. Front-line activities include:

- taking applications;
- screening, certifying, and recertifying residents;
- maintaining the project; and
- accounting for project income and expenses.

Figure 6-2 provides examples of front-line management costs.

Figure 6-2

Examples of Costs Paid from Management Fee and Project Account

Costs Paid from Fee	Costs Paid from Project Account
The selection and establishment of an accounting system and internal management control procedures. Visits to spot check performance of on-site staff (e.g., reviews of occupancy files, office procedures, etc.).	Reimbursement of all costs related to maintaining a centralized or project-based accounting functions of the project, including resident certifications, worksheets, and monthly subsidy billings, as well as monthly accounting reports required by the owner or HUD. Includes prorated costs on a per-unit basis for centralized accounting systems, including hardware, software and technical support. Agent can be reimbursed for the prorated cost to the project of personnel providing property-specific accounting and computer services. The cost to the project for such services provided by the agent may not exceed the cost of procuring comparable services from an independent vendor. Each year, the agent must determine that these costs are at or below the market and maintain such evidence on-site.
Fidelity bond coverage for the agent's supervisory staff	Fidelity bond coverage for front-line employees and principal management staff.
Bookkeeping expenses attributable to agent's company Overhead expenses (e.g., supplies and equipment, transportation and phone calls to projects, regularly scheduled long distance calls from project to agent, office space, data processing, etc).	Costs of front-line project operations -- e.g., managers and their apartments, legal and auditing expenses, bookkeeping and associated expenses, occupancy clerks, project management delinquency notices, evictions, project checks, envelopes, postage, air express delivery charges, copying, unscheduled long distance calls to agent, costs of IRS Section 401-K, 125, and 403-B, and related retirement and health plans for on-site staff so long as they are comparable with industry standards and in compliance with the guidelines set forth in paragraph 6.38(e), and the salary of a supervisory employee of the agent designated to replace a project employee for hours worked at the project above and beyond the first 40 consecutive hours of the assignment.
Directing the investment of project funds.	Reasonable brokerage fees and interest costs incurred in investing project funds
Agent's travel expenses to visit project and meet with owners. Training and travel expenses for agent's supervisory staff.	Travel expenses incurred by front-line staff's responsibilities (e.g., making bank deposits, meeting with contractors, attending training, etc.).
Agent office phone lines not dedicated to TRACs or the project, and automation equipment not required by HUD.	Dedicated line and modem for transmitting TRACs data (such lines can be shared with FAX machines). Automation required by HUD (e.g., equipment for the implementation of TRACs). Reasonable costs for on-site equipment, software, and technical support necessary for performing other front-line activities of the project, including FAX machines, automated credit terminals, and other telephones and electronic transmission devices at the site.
Recruiting costs for agent's staff, including roving staff members.	Recruiting costs for on-site staff.

(2) If front-line management functions for several properties are performed by 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. Allowable total associated costs include:

(i) Salaries and fringe benefits of personnel performing front-line duties; and

(ii) Actual office expenses, fees, and contract costs directly attributable to the performance of front-line duties.

(b) The agent may not impose surcharges or administrative fees in addition to actual costs.

(c) The cost of performing front-line management functions off-site may not exceed the total cost of performing these functions at the property.

(3) The salaries of the agent's supervisory personnel may not be charged to project accounts, with the exception of supervisory staff providing oversight for centralized accounting and computer services for the project.

b. Agent Staff Performing Front-Line Functions

A management agent employing generalist staff members specifically designated to assume front-line responsibilities on an as-needed basis may bill the project's operating account for time spent on front-line activities for the property if each of the following conditions are met.

(1) Salaries of an agent's supervisory personnel may not be charged to the project's operating account (See exceptions to this rule in paragraph 6.39).

(2) The agent develops a job description for each generalist position outlining the front-line and non-front-line responsibilities of the position. The non-front-line responsibilities in the generalist description may not include supervisory functions.

(3) The agent develops a reasonable hourly rate, which will be used to bill individual projects for time spent on front-line functions. A reasonable hourly rate includes the hourly salary for the position and an allocation

for overhead expenses, and should not exceed the amount that would be paid to an on-site staff member with similar experience.

(4) An agent's generalist staff must document hours spent and duties performed on front-line activities for each project and those spent on the central office functions. Weekly timesheets are an acceptable method of documenting hours spent on front-line tasks.

c. Training Costs for Front-Line Staff

(1) Project funds may be used to obtain project related training for front-line management staff.

(2) Loan/Asset Management staff may use the following guidelines to assess whether amounts proposed for training are reasonable.

(a) At a minimum, the budget amount should be sufficient to allow one staff person from each functional area to attend a minimum of one project related training session per year.

(b) As a rule of thumb for most projects, a reasonable training budget would not exceed the greater of $5,000 or one half of one percent (0.005) of gross rents.

(c) Loan/Asset Management staff have the authority to approve training budgets that exceed the guidelines in paragraph (b) above if the owner/agent can clearly document the conditions that necessitate more extensive training for project staff.

d. Training Costs for Board Members of Resident-Owned/Co-op Housing

(1) Project funds may be used to provide project related training for the Board of Directors of a housing cooperative.

(2) Project funds approved by the Board may be used to pay for each board member to attend one project related training session or conference per year.

(3) The guidelines presented in paragraph 6.38c(2)(b) and 6.38c(2)(c) should be used in evaluating whether the amounts proposed for training are reasonable.

e. Retirement Accounts for Front-Line Staff

(1) Funding of retirement accounts for front-line staff can be paid out of a project's operating account. Retirement accounts for an agent's central office staff may be paid only out of the management fee.

(2) HUD will allow employer contributions to retirement accounts for front-line staff to be paid out of project funds if the following requirements are satisfied.

(a) The retirement account plan complies with all applicable federal, state, and local laws and regulations governing such programs.

(b) Only permanent, front-line employees who work full-time at the project (i.e., more than 20 hours per week) may participate. Temporary or part-time on-site employees are not eligible. Also, rotating employees working at more than one project are not eligible unless they qualify as a full-time employee at one project.

Note: The definition of full-time employment must be consistent with applicable federal and state law definitions of full-time employment, however in no event can it be less than 20 hours per week.

(c) The projected cost of employer contributions to be paid out of project funds may not exceed ten percent of the base pay of eligible employees.

(d) The employee is to be vested ownership of no less than 20% of the employer's contribution each year until fully vested. Employees must be fully vested after five full years of employment.

(e) Employees must remain 100 percent vested for all personal contributions to their account.

(f) The actual cost of administering the retirement account plan will be prorated to the projects.

(g) No commingling of employee accounts may occur.

(h) The plan must be managed by a qualified outside entity with an established history of handling such programs.

(i) Agents will make modifications to the plan as necessary to comply with changes in the laws and regulations governing such programs.

To further the plan's goals, the agent may make modifications to the program without notice to HUD as long as the program continues to satisfy the provisions of paragraphs (a) through (i) above.

(3) Agents must certify to HUD that the retirement account plan meets the requirements set forth in this paragraph before any funds are charged to a project's operating account. In addition, agents must include the additional cost in their Budgeted Rent Increase request.

To further the plan's goals, the agent may make modifications to the program without notice to HUD as long as the program continues to satisfy the provisions of paragraphs (a) through (i) above.

(3) Agents must certify to HUD that the retirement account plan meets the requirements set forth in this paragraph before any funds are charged to a project's operating account. In addition, agents must include the additional cost in their Budgeted Rent Increase request.

6.39 MANAGEMENT COSTS PAID FROM THE MANAGEMENT FEE

a. Expenses for services that are not front-line activities must be paid out of management fee funds, except for centralized accounting and computer services. Figure 6-2 above presents examples of costs that may only be paid out of the management fee.

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

(1) Designing procedures/systems to keep the project running smoothly and in conformity with HUD requirements.

(2) Preparing budgets required by the owner or HUD, exclusive of rent increase requests and MIO Plans.

(3) Recruiting, hiring, and supervising project personnel.

(4) Training for project personnel that exceeds the line item budget for training expenses.

(5) Monitoring project operations by visiting the project or analyzing project performance reports.

(6) Analyzing and solving project problems.

(7) Keeping the owner abreast of project operations.

(8) Overseeing investment of project funds.

(9) Ensuring that project positions are covered during vacations, sickness, and vacancies.

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

(1) The cost of supervisory personnel providing oversight of centralized accounting and computer services for a project may be paid out of project funds.

(a) A prorated share of the salaries for such supervisors may be charged to the project's account.

(b) The total charges to a project for centralized accounting and computer services (including supervisory staff costs) provided by the agent may not exceed the cost of procuring comparable services from an independent contractor.

(2) The costs of the salary for a supervisory employee of the agent designated to replace a project employee on temporary leave may be paid out of project funds after the first 40 hours of the assignment.

(a) The amount paid out of project funds to cover the weekly salary of the replacement employee may not exceed the lesser of:

(i) Twice the amount of the absent employee's weekly salary; or

(ii) The actual amount of the replacement employee's weekly salary.

(b) Project funds may be used to pay the allowable portion of the replacement employee's salary for a period of up to 90 days after the first 40 consecutive hours.

6.40 OFFSETTING AGENT'S COSTS FOR PURSUING RESIDENT FRAUD

As part of HUD's efforts to reduce the incidence of resident fraud in HUD-assisted projects, HUD will allow owners/agents to keep a portion of the resident repayments they collect from residents who have improperly reported their income at the time of certification or recertification to help defray the cost of pursuing these cases. Owners/agents should take the following steps when they become aware that a resident may have provided inaccurate information about household income during the certification or recertification process.

a. Follow the procedures in Chapter 5 of HUD Handbook 4350.3 for investigating and correcting inaccurate information provided during certification or recertification of resident income.

b. If a resident supplies inaccurate income information and, as a result, is charged less than the amount required by HUD's rent formulas, the resident must reimburse the owner for the difference between the rent the resident should have paid and the rent he/she was actually charged. Chapter 5 of HUD Handbook 4350.3 describes HUD's requirements for resident repayment.

c. When residents submit inaccurate income information and are found to have received overpayments of assistance, owners/agents are required to reimburse HUD for any resident repayments received. To help offset the expense of obtaining resident repayments, owners/agents may retain up to a maximum of 20 percent of the amount of resident repayments they actually collect from residents who have provided inaccurate information about their income to cover their actual costs. Owners/agents must reimburse HUD for the remaining portion of resident repayments they collect in accordance with the procedures in Chapter 5 of the 4350.3.

6.41 ASSET MANAGEMENT SERVICES

a. Asset management functions are those activities associated with managing and protecting the assets of the ownership entity and overseeing the management agent's performance. Asset management activities include:

   (1) Disbursing surplus cash.

   (2) Periodic owner visits to the project to review the agent's performance.

   (3) Obtaining or providing tax advice to the ownership entity or its principals and preparing the ownership's tax return.

b. Asset management costs must not be billed to a project's operating account. These costs may only be paid from funds available for distribution to owners in accordance with the terms of the Regulatory Agreement and HUD Handbook 4370.2.

   NOTE: On limited distribution projects, any asset management fees paid from project funds must be included in the distributions-paid entry on Line 2C of Form HUD-93486, Computation of Surplus Cash, Distributions and Residual Receipts.

c. Reasonable expenses for preparing the ownership entity's tax return, and Schedule K-1 if the entity is a partnership, may be charged to a project's operating account.

6.42 FIDELITY BOND COST ALLOCATION

a. The cost of the management agent's fidelity bonds must be allocated as follows:

(1) The agent must pay fidelity bond costs for the agent's supervisory staff.

(2) The agent may charge the project operating account for bond costs for front-line employees and the agent's principals. If a bond covers the front-line employees of several projects, the bond costs applicable to those projects must be allocated in direct proportion to the gross rent potentials in effect for those projects at the time the bond is purchased. Bond costs for the agent's principals should also be prorated among all properties if the agent manages more than one property.

b. When conducting financial reviews, Loan/Asset Management staff should ensure that fidelity bond costs have been properly allocated.

6.43 WORKER'S COMPENSATION DIVIDENDS

a. Dividends received from Worker's Compensation insurance premiums must be distributed in the following manner.

(1) If Worker's Compensation insurance for project staff is paid for out of project funds, all dividends are returned to the project.

(2) If Worker's Compensation premiums are paid by the agent out of the management fee, the dividends are paid to the agent.

b. In reviewing a project's financial statement, Loan/Asset Management staff should identify the source of funds used to pay Worker's Compensation premiums and verify that all dividends are returned to the project when the premiums are paid out of project funds.

6.44 PROJECTS NOT SUBJECT TO MANAGEMENT FEE REVIEWS

Owners of projects not subject to HUD review of management fees may not inflate management fees to receive project funds monthly rather than through semi-annual or annual distributions of surplus cash. During all financial reviews of such projects, Loan/Asset Management staff should examine management fee payments to make sure they have not been inflated.

6.45 CASH MANAGEMENT

a. Purpose. Loan/Asset Management staff must verify that the management agent secures cash receipts and disbursement checks to prevent unauthorized use of funds.

b. Review Requirements. Loan/Asset Management staff must review the management agent's cash management controls in accordance with Part B of the HUD-9834, Item 12 – Cash Controls, as part of the management review.

See Chapter 2, Handbook 4370.2 REV-1, for details on Cash Management Controls. Generally:

(1) All receipts must be promptly deposited to a federally insured bank account held in the name of the project. Security deposits should be held separate and apart from other project funds in a segregated account.

(2) The management agent must obtain a fidelity bond in an amount at least equal to potential collections for two months. Blanket coverage must extend to all employees handling cash.

(3) Receipts and disbursements should be controlled through procedures for reconcilement of cash movements to banking and accounting statements and vouchers.

(4) Cash instruments (e.g. blank checks) must be kept secure in a locked drawer or safe with limited access.

6.46 DISTRIBUTION OF SURPLUS CASH

a. Purpose.

(1) Uses of surplus cash are governed by the Regulatory Agreement. Loan/Asset Management staff must verify that owners do not distribute surplus cash before satisfying all obligations to mortgage repayment, payment of reasonable project expenses, and replacement reserve accounts.

(2) Distributions may not be made when the project is in default or under a forbearance agreement, and distributions to owners may not be made on nonprofit projects.

b. Review Requirements. Loan/Asset Management staff must review the Income Statement and Cash Flow Statement to verify that distributions have been made in compliance with the Regulatory Agreement and with the requirements of Chapter 2, Handbook 4370.2 REV-1. These guidelines include the timing as well as the amount of the distribution.

6.47 MAINTAINING PROJECT FUNDS IN INSURED ACCOUNTS

a. Purpose. Given the size of most project accounts, it is vital that they be held in a federally-insured bank. An unreimburseable loss to any of these accounts would unnecessarily burden the FHA Insurance Fund.

b. Review Requirements

(1) Loan/Asset Management staff must ensure that each project maintains at least these bank accounts in a federally-insured bank (descriptions of each account are included in Chapter 2 of Handbook 4370.2 REV-1):

(a) Regular Operating Account;

(b) Replacement Reserve Account;

(c) Tenant Security Deposit Account (if the project takes security deposits); and

(d) Residual Receipts Account.

(2) Loan/Asset Management staff must review the project's bank account statements and verify that the bank is federally-insured and that each account is established and in use.

(3) Loan/Asset Management staff must verify that the project has opened additional security deposit accounts in different banks, if necessary, to ensure that the balance of each security deposit account does not exceed the insurance limit of $100,000 per FDIC regulations. See Handbook 4370.2 for further guidance.

6.48 MONITORING EXCESS INCOME FROM SECTION 236 PROJECTS

a. Purpose. Rents collected in excess of basic rental charges from residents in a Section 236 project must be remitted monthly to HUD. Excess rents is the amount by which the rent collected on a dwelling unit exceeds the approved basic rent for that unit.

b. Review Requirements

(1) Annual Review. The IPA should confirm the transfer of excess rents for Section 236 projects with the Excess Rental Income Office in Pittsburgh. Loan/Asset Management staff should review the results of this confirmation.

(2) Mid-year Review. If Loan/Asset Management staff determine it necessary to review excess rent transfers mid-year, they should request copies of the project's forms HUD-93104, Monthly Report of Excess Income and Accrued Unpaid Excess Income and HUD-93104A, Schedule for Calculating Excess Income and Report of Excess Income Delinquencies from the management agent, and compare the recorded amounts to the project's Monthly Accounting Reports.

(3) Paragraph 7-28 of HUD Handbook 4350.1 provides detailed guidance on the specific actions loan management staff need to take to properly monitor excess income from Section 236 projects.

6.49 MONITORING EQUITY SKIMMING

a. In reviewing a project's financial statements, Loan/Asset Management staff must make sure that owners are not receiving unauthorized distributions from the project. To ensure that no unauthorized distributions have been made, also referred to as equity skimming, Loan/Asset Management staff should compare the amount of distributions paid during the period covered by the annual statements to the amount of surplus cash available, keeping in mind the distribution limitations imposed on limited dividend owners. Proper distributions meet the following conditions:

(1) No distributions are permitted for projects with a nonprofit ownership entity.

(2) Limited dividend owners may pay both the annual distribution earned (i.e., the 6 or 10 percent permitted by the Regulatory Agreement) plus distributions unpaid from previous years, but only up to the amount of surplus cash available.

(3) Distributions may not be paid in excess of the surplus cash available as of the end of the prior fiscal year. Distributions may be paid semi-annually for certain projects with HUD approval.

(4) Distributions may not be paid when:

(i) A project is in default under the mortgage;

(ii) The owner has agreed to waive payment of distributions;

(iii) The project is in a non-surplus cash position; or

(iv) The project is not in "good repair and condition" (a requirement of the Regulatory Agreement) based on a mortgagee physical inspection, or a HUD management review or physical inspection.

b. Loan/Asset Management staff should refer to HUD Handbook 4370.1, and Chapter 8 of Handbook 4350.1 for more detailed guidance on monitoring for equity skimming.

6.50 CONTRACTING GUIDELINES

a. When an owner/agent is contracting for goods or services involving project income, an agent is expected to solicit written cost estimates from at least three contractors or suppliers for any contract, ongoing supply or service which is expected to exceed $10,000 per year, or the threshold established by the HUD Area Office with jurisdiction over the project.

b. For any contract, ongoing supply or service estimated to cost less than $5,000 per year, the agent should solicit verbal or written cost estimates in order to assure that the project is obtaining services, supplies and purchases at the lowest possible cost. The agent should make a record of any verbal estimate obtained.

c. Documentation of all bids should be retained as a part of the project records for three years following the completion of the work.

d. For further information on contracting guidelines and requirements, see Chapter 5 of this Handbook.

SECTION 5: PROVISIONS OF CONTRACTS AND REGULATORY AGREEMENTS

6.51 OVERVIEW

a. Purpose. When HUD is the Contract Administrator, the Loan/Asset Management staff must verify that the project owner and management agent are complying with their legal agreements between the owner and HUD, and that the project owner is providing decent, safe, and sanitary housing to assisted residents in compliance with HUD guidelines.

When HUD is not the Contract Administrator, the Loan/Asset Management staff should review the work of the Contract Administrator (PHA, State Agency, etc.) to be sure that the owner and management agent remain in compliance, and that the contract administrator itself is taking all necessary steps to prevent the opportunity for fraud, waste, and mismanagement in the operation of the project.

b. Applicability. The following project types are covered under this section.

(1) Section 8 Loan Management Set-Aside
(2) Section 8 Property Disposition Set-Aside
(3) Section 8 New Construction and Substantial Rehabilitation
(4) Section 515/8 Administration for Rural Housing and Economic Development Services
(5) Section 8 State Agencies
(6) Section 236 Interest Reduction Payments for Rental Projects
(7) Section 221(d)(3) Below Market Interest Rate (BMIR)
(8) Rent Supplement
(9) Rental Assistance Payment (RAP)
(10) Section 202 Projects for the Elderly or Handicapped
(11) Section 202 Nonelderly Handicapped Families and Individuals
(12) Project Rental Assistance Contract (PRAC)
(13) Project Assistance Contract (PAC)
(14) Flexible Subsidy Program for Troubled Projects

6.52 REVIEWS AND CORRECTIVE ACTION

The monitoring tasks described in this Section are similar to those covered in Section 2. In the event that the Loan/Asset Management staff identify waste, fraud or noncompliance while monitoring rental assistance contracts and Regulatory Agreements, they should require and monitor corrective action as described in Section 2 and/or pursue sanctions as discussed in Chapter 7 of this Handbook and, if applicable, Chapter 8 of Handbook 4350.1.

6.53 MONITORING RENTAL ASSISTANCE CONTRACTS

Owners and managers of subsidized projects agree to comply with the procedures and practices stated in the rental assistance contract, including (but not limited to) the maintenance of housing units to meet Section 8 Housing Quality Standards. The contract administrator -- HUD, the PHA, or the State Agency -- is responsible for ensuring that the owner/agent complies with the clauses of the rental assistance contract.

This paragraph summarizes the responsibilities of the owner/manager and the contract administrator, and highlights some of the monitoring tools that the contract administrator may use to fulfill its responsibilities. A complete discussion of contract monitoring is contained in HUD Handbook 4350.5, Subsidy Contract Administration and Field Monitoring. Owners/managers and contract administrators are reminded that the exact wording of HAPs can vary depending on the project type and whether or not the project is HUD-insured; this discussion is only a general overview of the administrative responsibilities.

a. Under the HAP, the owner/agent is responsible for:

(1) Marketing units and selecting families in accordance with HUD guidelines and applicable fair housing regulations;

(2) Maintaining and operating the project in a decent, safe, and sanitary manner and in conformance with Housing Quality Standards and industry practices;

(3) Verifying resident income and household composition on at least a yearly basis to ensure compliance with occupancy guidelines;

(4) Collecting resident rents;

(5) Establishing and maintaining project financial accounts and records; and

(6) Obtaining the necessary insurance contracts, including flood insurance for projects located in special flood hazard areas.

b. The contract administrator will verify that the owner/agent is fulfilling these responsibilities in a timely and professional manner, and will also initiate any procedures to bring about necessary corrective actions. Specifically, the contract administrator will:

(1) Assess the project's operating policies and procedures through on-site visits, interviews with the owner, management agent, and project staff;

(2) Review operations for evidence of waste, mismanagement, or fraud, and take appropriate steps as outlined in this handbook and in Handbook 4350.5 and 4350.1 to initiate corrective action;

(3) Review the project's operating budget, Reserve for Replacement withdrawal requests, and owner distributions for propriety;

(4) Ensure that rent increase requests are submitted in a timely and reasonable manner;

(5) Review rent collection procedures, including the tracking of delinquencies;

(6) Determine whether the vacancy rate is comparable to other projects in the area, and assess causes for high turnover if any;

(7) Verify that owners/agents are screening and selecting residents in compliance with HUD guidelines;

(8) Verify that the owner/agent is managing mandatory meals and pet owner policies in accordance with HUD Handbook 4350.1;

(9) Review Section 8 utilization, including monthly vouchers, special claim vouchers, rent rolls, and other project records, to ensure that funds are being used properly and that unused funds are returned to HUD;

(10) Verify that utility allowance adjustments are calculated properly; and

(11) Review project property tax and flood insurance matters as appropriate.

Additionally, the contract administrator must ensure that the owner/manager is operating in compliance with the regulatory requirements as listed in HUD Handbook 4350.5, Chapter 1.

6.54 MONITORING FLEXIBLE SUBSIDY CONTRACTS

Area Office instructions for evaluating and monitoring projects that request or operate under Flexible Subsidy contracts are discussed in Handbook 4355.1 REV-1, Flexible Subsidy, particularly in Chapter 6. Flexible Subsidy contracts include both the Operating Assistance Program (OAP) and the Capital Improvement Loan Program (CILP). The following paragraphs provide an overview of the Loan/Asset Management staff's responsibilities for monitoring Flexible Subsidy contracts.

a. HUD will review the project requesting a Flexible Subsidy prior to approving an application to verify that the project is free of significant or repetitive resident complaints and physical problems, or that the owner/agent will rectify the cause of the complaints and problems through the assistance. These reviews may include any of the monitoring techniques discussed in Section 1.

b. The Loan/Asset Management staff must determine that the Flexible Subsidy will:

(1) Restore or maintain the project's physical soundness;

(2) Restore or maintain the project's fiscal soundness;

(3) Provide the least costly financing alternative that also retains the low- and moderate-income character of the project for the remaining term of the project mortgage;

(4) Be applied within the conditions of an approved Management Improvement and Operating (MIO) Plan or Work Write-Up; and

(5) Be provided under competent project management, and that project management meets satisfactory levels of experience and ability as determined by the management review and other monitoring processes.

c. HUD will not provide assistance until the owner/agent:

(1) Submits a plan to correct and remedy any deficiencies documented by the Department, and

(2) Certifies and documents that he/she has taken steps to secure funding from all possible sources.

d. After a Flexible Subsidy contract has been awarded, the Area Office will receive from the owner on a monthly basis:

(1) A Monthly Accounting Report for the previous month (Forms HUD-93479, 93480, and 93481);

(2) Form HUD-9835, Part II, Section A of the MIO Plan, covering progress and payments for action items; and

(3) Any Requisition for Advance of Flexible Subsidy Funds, Form HUD-9823a, processed during the previous month.

The Loan/Asset Management staff will verify that the forms are complete and that all requests for funds are reasonable.

e. On a quarterly basis, the Loan/Asset Management staff will conduct an in-depth review of each Flexible Subsidy contract. These reviews will include:

(1) Remote monitoring of submitted progress reports, budgets, cost estimates, schedules, and invoices; and

(2) On-site visits to verify that work undertaken is being completed in a satisfactory manner in compliance with subparagraph b., above.

6.55 MONITORING REGULATORY AGREEMENTS

HUD requires different forms of Regulatory Agreements for different project and owner types. In many cases, the Agreement specifies owner/management agent responsibilities which the Loan/Asset Management staff already monitors pursuant to other paragraphs in this chapter. The guidance below covers general issues related to monitoring Regulatory Agreements. More detailed guidance can be found in Chapter 2 of HUD Handbook 4350.1.

a. Financial issues. The Loan/Asset Management staff will verify that reports and other documents are submitted on required schedules, confirm that these items are complete, and investigate questionable transactions. These reports and documents include:

(1) The Annual Financial Statement and Budget.

(2) Monthly Accounting Reports.

(3) Evidence that the owner/management agent is utilizing the Receipts Fund Account and, for nonprofits, the Residual Receipts Fund Account in the required manner.

(4) Statements of Replacement Reserve Account use (deposits and withdrawals), to verify that all transactions are authorized.

(5) Vouchers, invoices, and other evidence that distribution and expense payments are proper and authorized.

b. Occupancy and Resident Selection Issues. The management agent will submit monthly reports on occupancy levels. In addition, the management agent must provide, at the Loan/Asset Management staff's request, information on its resident screening and selection processes. The Loan/Asset Management staff should review this information to determine that the management agent:

(1) Observes federal preferences for resident selection; and

(2) Admits income-eligible residents to achieve an overall population that is at least 90 percent lower income.

In addition, the Loan/Asset Management staff should verify that the management agent conducts income recertification annually or more often if necessary. If such reviews reveal that the agent may be in violation of civil rights statutes, or is possibly discriminating against families with children or applicants of any age, Loan/Asset Management staff should advise FHEO staff.

c. On-site Review Issues. The management agent must maintain the property in suitable physical condition and must maintain all records, books, accounts, documents, etc. in suitable condition for on-site review.

Exhibit 6-1

INDICATORS FOR TROUBLED/POTENTIALLY TROUBLED PROJECTS

A multifamily project may be considered troubled when it requires assistance in order to meet its obligations and/or to provide the quality of housing and services to which its owner committed in the rental assistance contracts and/or Regulatory Agreement. Potentially troubled projects are those where critical information regarding the operation of the project is not available or where the project may soon require assistance if action is not taken to address existing or emerging difficulties. Indicators such a situation include:

1. High or increasing vacancy rate.
2. A major system that requires replacement, major repair, or repair beyond existing or potential project resources.
3. Persistent physical problems of a serious nature (such as health and safety problems, security problems, deferred maintenance, or lack of janitorial services or routine maintenance).
4. Improper or unauthorized distributions, as defined in HUD Handbook 4370.2, Financial Operations and Accounting Procedures for Insured Multifamily Projects, or unauthorized diversion of project assets.
5. The Management Review or other financial analysis determined that annual or monthly operating expenses exceed income potential and will more than likely continue.
6. Project expenses are abnormally high or low compared to previous years or comparable projects.
7. Project rents are abnormally low or in excess of authorized limits.
8. The owner/sponsor has threatened or has declared bankruptcy.
9. There has been more than one request from the owner(s) to use Reserve for Replacement Account money for the mortgage payment, fuel, utilities, insurance, security, or for routine expenses for which the account was never intended.
10. The Management Review reveals management policies or procedures that jeopardize the project, as indicated by a below satisfactory rating in one or more categories.

11. There are persistent, validated resident complaints of a serious nature, including but not limited to: harassment, leasing irregularities, improper certification, discrimination, or fraud by the project management or owner.

12. The owner/agent has not met the contractual, statutory and/or managerial obligations and has not developed programs to address them.

13. Annual financial statements disclose significant irregularities, such as: qualified auditor's opinions; negative cash throw-offs; line items that are inconsistent with each other, with the prior years, or with similar projects; under-funded General Operating Reserves (GOR), Replacement for Reserves, or escrow accounts; or increasing accounts payable, receivables, or bad debts.

14. Failure to provide required or requested data with respect to fiscal items for significant matters involving the management/operation of the project.

15. Physical inspection indicates serious emergency health and safety hazards for which there is no acceptable plan of correction.

16. Section 8 units do not meet HQS and project funds are not available to immediately correct the deficiencies.

17. Serious drug problems prevail in the complex or in the neighborhood.

18. In the case of a non-profit, the Board does not meet the criteria used when it was originally constituted.

19. The owner has threatened to abandon or has abandoned the complex.

20. Commercial space is unrentable, or is being rented at less than market rents, causing a cash drain on the project, or commercial space detracts from project liveability.

21. The mortgage is in default.