APPENDIX C
Internal PHA Asset Management

This study is charged with the responsibility of estimating the cost to operate well-run public housing. Those estimated amounts are derived from the operating costs reported by owners of rental housing whose mortgages are insured by the FHA. This appendix looks at the issue of internal PHA asset management and its relationship to this cost study. Specifically, are there additional "asset management" costs that are not captured in the FHA benchmark and for which public housing should be funded?

DEFINING THE TASKS

The term asset management comes from real estate finance, where it means buying, selling, and managing assets to maximize value. In the affordable housing arena, different entities use the term to describe a wide range of purposes and there is no commonly-accepted definition. For example, the term asset management is frequently used to refer to the contract administration of project-based housing assistance contracts (where, say, a state housing finance agency transmits to a property its rental subsidies and conducts various reviews/inspections) or in compliance monitoring of tax-credit projects. In both cases, however, these described services are regulatory functions performed by the funding organization and are not necessarily the same asset management tasks (defined shortly) that an owner of public housing bears. Likewise, one frequently hears the term "asset management" to describe the tasks of lender oversight, but those roles are more limited to evaluating a borrower's continued ability to pay.

For the purposes here, GSD suggests that asset management be thought of as "owner responsibilities" that are separate and distinct from property management, although, as noted below, there is a fine line separating asset management from property management. Those "distinct" owner responsibilities would generally include the following:

- Approving the operating budget,
- Monitoring the performance of the management agent (the frequency of which will depend on the owner), and approving budget deviations,
- Selecting and replacing management agents,
- Deciding legal actions by or against the owner (other than normal resident lease enforcement),
- Interacting with lenders and regulatory bodies, and other third parties, regarding major issues that cannot be handled by the property management company (refinancing decisions, major compliance issues, interventions to relieve financial or physical stress, alleged or actual defaults under governing documents),
- Approving rents and leases of non-residential space,
- Approving operating policies,

- Reviewing and accepting the annual audit,
- Creating and revising property-specific strategic plans and capital budgets, including disposition or refinance, and
- Approving major contracts and capital expenditures that exceed the management agent's authorized levels.

Should PHAs also be funded for these distinct owner responsibilities? Conceptually, that should be the case; however, there are a number of caveats:

- First, many of the above-listed tasks do not directly apply to public housing or occur infrequently. Public housing properties, for example, are not sold, transferred, or refinanced with any regularity. Moreover, such transaction costs in conventional housing are more typically reimbursed with proceeds from sales/refinancing.

- Second, through the Capital Fund, PHAs are reimbursed for preparation of the annual and five-year capital plan and for the preparing, advertising, awarding, and monitoring construction projects.

- Third, as indicated below, it would appear that the cost of some of these tasks is already included in the FHA benchmark.

THE FUNDING AND ACCOUNTING OF ASSET MANAGEMENT COSTS IN THE FHA BENCHMARK

Unfortunately, because asset management (as defined here) is an evolving concept, there is no specific account to which these "owner responsibilities" are charged in the FHA chart of accounts. One cannot look into the FHA database and find a specific line item that shows how much owners spend on asset management. Where, then, might these costs be funded and absorbed?

One possibility is that asset management costs are funded through proceeds from development or refinancing. If that were the case, PHAs would be comparatively disadvantaged since they received no development fee when public housing was built. While this might be the case, for the more on-going asset management tasks, it is likely that costs would be funded from on-going or recurring sources.

Another possibility is that asset management costs are funded from a property's cash flow. In other words, although not separately accounted for, an owner may be covering the costs of asset management simply through annual cash flows. Hence, some portion of cash flow represents pure profit and some represents payment for the tasks of ownership.

The third possibility is that some of the tasks of asset management are actually funded through the operating budget and "buried" in operating expenses. Most likely, these costs are built into the management fee that a property is charged, meaning that the management company has assumed many of these "owner tasks" as part of the management contract. This appears especially to be the case of owner-managers and identity-of-interest managers. It is also the case that there is a fine line between asset management and property management, particularly when the owner and the management agent are one in the same.

While no hard evidence exists, it is reasonable to assume that the primary source of funding for these asset management tasks includes a combination of operating funds and cash flow.

RANGE OF COSTS

Regardless of how it is funded, or where it is expended, what does asset management cost? What does it require to play the role of an owner, separate and apart from property management? Again, there is no clear answer, but one can possibly set some parameters.

- Tax credit monitoring agencies typically charge $5,000 to $10,000 per property as an asset management fee, or around $1 to $17 PUM (higher for smaller properties and lower for larger properties). For this fee, the monitoring agencies will conduct an annual physical inspection of the property, review the financials typically on a quarterly basis, review the annual audit, and conduct one on-site management or file review annually. This fee also includes developing management plans for troubled properties.

- Depending on the area of the country, the type of property, and the services performed, management fees can typically run from around $20 PUM to $40 PUM. Most professionals would easily surmise that the task of ownership (beyond property management) should cost half or less than what is charged in management fee.

- The median profit (before depreciation) of properties in the FHA database for 2000 was $76 PUM. If profit, or cash flow, is a potential source of funding for asset management, and if owners want to maximize proceeds, it stands to reason that any asset management costs would be some small percentage of this profit.

With these three pieces of information, one might expect that the cost of asset management might be in the range of $5-$15 PUM.

COMMENTS/ RECOMMENDATION

There are important tasks of being an owner, above and beyond merely operating the real estate. It is not clear, however, what precisely those tasks cost and how much they are already reflected in FHA operating statements. And, some of these tasks either do not apply to public housing or are already currently funded through the Capital Fund.

In the history of public housing, with fairly permanent ownership and management by the PHA, and with little freedom to access outside funds and make redevelopment/reinvestment decisions, PHAs typically have not performed the asset management functions previously described. Mixed-financed properties often generate cash flow for the PHA for the ownership functions. Similarly, if public housing were to move to a development-based subsidy program, a PHA could pay for asset management functions through cash flow, as is the case with other assisted and conventional housing.[1] However, to the extent that public housing's separate system of operating and capital programs is maintained, and where public housing remains semi-permanent in its ownership, there appears less need to provide a separate source of funding for asset management.

For the above reasons, GSD does not recommend any additional funding above the FHA benchmark cost for asset management.

As a final note, some PHAs currently contract with private firms for property management services. Under those circumstances, should the PHAs receive additional compensation? Would the absence of an add-on for asset management deter agencies from adopting private management, if that course were preferred? GSD believes that the previous answers still hold here (ambiguity/lack of definition over tasks, the fact that many of these tasks are funded through the capital program, some of these costs are likely already in the benchmark, etc). Nonetheless, to the extent that the model includes a 10% differential for non-profit ownership, agencies should be able to afford the cost of contract monitoring provided they procure services with firms with for-profit cost structures.

[1] Cash flow is created as a result of the lender's requirement for debt-coverage (the cushion to assure funds to service the debt).