

February 28, 2008

TO: State Directors

ATTENTION: Multi-Family Housing Program Directors

FROM: Russell T. Davis *(Signed by Russell T. Davis)*
Administrator
Housing and Community Facilities Programs

SUBJECT: Fiscal Year 2006 Management Control Reviews
Multi-Family Loan Servicing for Section 515 Rural Rental Housing and
Section 514/516 Off-Farm Labor Housing

The purpose of this memorandum is to address the concerns raised as a result of the Fiscal Year (FY) 2006 Management Control Reviews (MCRs) conducted for the Section 515 Rural Rental Housing Program and the Section 514/516 Farm Labor Housing Loan and Grant Program. As a result of the MCRs, several internal program weaknesses were identified and need to be addressed. We have combined the Loan Servicing guidance for both programs into one letter because both are serviced similarly.

- A. The National Office noted during its docket review for both Section 515 and Section 514-516 programs that the Servicing files lacked Servicing Letters and follow-up actions by Servicing Officials where site inspections disclosed deficiencies and borrowers did not respond to the Servicing Office with explanations or the status of curing deficiencies. As per the Agency's regulations, it is the responsibility of the borrower to provide documentation of resolution and justification of delays for any deficiencies found within the timeframes issued by the Servicing office. Additional guidance and instructions can be found in HB-2-3560, Chapter 9.

Although it is the responsibility of the borrower/management company to correct and report all deficiencies, the Agency must monitor the borrower/management company performance to:

1. Ensure the property is managed in accordance with the goals and objectives of Multi-Family Housing;
2. Preserve the value of the property;
3. Ensure the property that the property is maintained in accordance with the Agency and requirements for providing housing that is decent, safe, sanitary and affordable;
and
4. Verify compliance with occupancy requirements.

EXPIRATION DATE:
January 31, 2009

FILING INSTRUCTIONS
Housing Programs

- B. For both Rural Rental Housing and Off-Farm Labor Housing - Proposed Budgets and Year End Budget Actuals were not timely received and, when received, lacked borrower justifications for budget variances. As guidance, HB-2-3560, Chapter 4, Section 4.22 1, provides a description of the budget and highlights important elements to aid Loan Servicers in their review of the budget. HB-2-3560, Exhibit 4-3 lists items to be covered in a Budget Narrative. Servicing Officials should be utilizing the budget analysis feature now available in the Multi-Family Housing Information System (MFIS). The analysis quickly and accurately detects variances, and prompts the Servicing Official to request additional information and a Budget Narrative from the borrower.
- C. Both the Rural Rental Housing and Off-Farm Labor Housing Programs showed significant weaknesses on borrower determination of tenant contributions. Tenant income verifications were either from inappropriate sources, were not from third parties, were miscalculated, and/or lacked the required information to verify income and assets. Borrowers of all Rural Rental Housing and Off-Farm Labor Housing properties must verify and document in the tenant's file all income, assets, expenses, deductions, family characteristics, and any other factors that affect family eligibility or level of assistance. These weaknesses included tenants with zero income. It is Agency policy not to accept a tenant certification for an applicant or tenant with zero income **unless all income is specifically exempted**. See HB-2-3560, Chapter 6, Section 2.
- Findings from prior Improper Payments Information Act (IPIA) audits on the Rental Assistance Program revealed similar weaknesses in these two housing programs. Those audits showed that borrowers and management agents did not have proper income verification document or file documentation was inadequate to make a proper subsidy determination. Corrective actions were initiated in cases found, but both the MCR and IPIA audits identified this as a issue for immediate corrective action. Management agents must improve their internal controls for documenting and following-up on tenant income verification procedures.
- D. Farm Labor Housing - Rural Development Servicing Officials are not following the existing regulations regarding review of the Management Plan and other management documents. Farm Labor Housing borrowers/management companies are required to submit Management Plans, Management Agreements, Management Certifications and Identity of Interest documents - similar to Section 515 borrowers - which establish guidelines and procedures to ensure that the property complies with the Agency's requirements. Rural Development Servicing Officials are to review all documentation submitted with the management plan to ensure the plans meet Agency requirements and properties operate in compliance with regulations. See HB-2-3560, Chapter 3, Section 3.1 - 3.5, and Attachment 3-A.
- E. Farm Labor Housing - Rural Development Servicing Officials are not verifying documentation when an Identity of Interest is involved in the purchase of goods and services. Borrowers are required to provide Form RD 3560-31, "Identity of Interest Disclosure," as required by 7 CFR part 3560, Section 3560.102 (g)(3), once an Identity of Interest has been disclosed:

1. The borrower, management agent, and supplier of goods and services must provide documentation proving that use of identity-of-interest firms is in the best interest of the housing project;
 2. Any supplier of goods and services must certify in writing to the Agency that the individual or organization has a viable, on-going trade or business qualified and licensed, if appropriate, to do the work for which a contract is being proposed;
 3. The borrower, management agent, and supplier of goods and services must agree, in writing, that all records related to the housing project will be made available to the Agency, Office of the Inspector General, Government Accountability Office, or a representative of the Agency, upon request; and
 4. The Agency will deny the use of an identity-of-interest firm when the Agency determines such use is not in the best interest of the Federal Government or the tenants.
- F. Farm Labor Housing - Rural Development Servicing officials are not observing the existing regulations pertaining to prioritizing budget reviews in accordance with Agency regulations. Servicing Officials should review HB-2-3560, Chapter 4, Section 4.21 and Exhibit 4-1 which outlines the timelines for submission and review of budgets.
- G. HB-2-3560 and HB-3-3560 provide guidance for Servicing Officials in the administration, management and monitoring of Rural Rental Housing and Off-Farm Labor Multi-Family Housing loans. A substantial part of the guidance is devoted to maintaining MFIS. It was noted in the both MCRs that the database was not being maintained or updated promptly. Servicing Officials were not properly or timely entering such specific items as budgets, inspections, and follow-up on budget or inspection deficiencies. A three-part MFIS training PowerPoint is available on the Rural Development Intranet at this address: <http://teamrd.usda.gov/rd/rhs/index.htm>, click on Training Materials, Multi-Family Housing. Servicing Officials are strongly encouraged to view this PowerPoint and ensure that loan specialists charged with monitoring properties and enforcing Agency regulations also view the PowerPoint.

MFIS is the Agency's main source of data on the Multi-Family Housing portfolio. Accurate and timely information is critical to appropriate monitoring and enforcement of Agency regulations to ensure continued availability of decent, safe and sanitary affordable housing for rural residents. This data is used to develop National Office Performance and Accountability Reports, Program Assessment Reports, and to determine achievement of goals in the Rural Development Strategic Plan.

To assist you in educating borrowers and management agents in some of the Agency's requirements related to budget preparation, budget submissions and tenant income verification requirements, the Agency has prepared the attached Guide Letter, which will be mailed directly to borrowers by the Centralized Servicing Center.

Should you have any questions regarding this Unnumbered Letter, please contact the Multi-Family Housing Portfolio Management Division at (202) 720-1603.

Attachment: Borrower Guide Letter

TO: Borrowers and Management Agents of
Section 515 Rural Rental Housing and
Section 514/516 Off-Farm Labor Housing

SUBJECT: National Office Internal Review Findings

The National Office conducted an internal review of the Section 515 Rural Rental Housing Program and Section 514/516 Off-Farm Labor Housing Loan Grant Program. The purpose of the review was to determine if regulatory requirements and administrative procedures for loan servicing are properly implemented and administered. As a result of the review, the National Office discovered several weaknesses and deficiencies.

1) Budgets and year-end actuals are being received in a timely manner; however justifications for variances in budget expense sub-totals are consistently not being submitted by borrowers. HB-2-3560, Chapter 4, Section 4.22 1, provides a description of the budget and highlights important elements to aid Loan Servicers in their review of the budget. The following items are to be covered in the budget narrative which can be found in HB-2-3560, Exhibit 4-3.

Items to Be Covered in a Budget Narrative

- A brief description of the project and its status. The description should address key indicators of project status. For example, it should highlight any issues concerning vacancies, unexpected maintenance, or other items that affect the budget.
- A statement of project compliance. This statement should indicate the borrower's progress in addressing any outstanding compliance problems.
- A description of the project's financial status, highlighting the project's overall financial status, important changes during the last year, and factors contributing to financial difficulties.
- An explanation of any changes in project expenses or cash sources that exceed the tolerance threshold. (In reviewing the proposed budget, Loan Servicers must apply a tolerance threshold of 10 percent.)
- An explanation of projected capital expenditures and reserve withdrawals for the upcoming year and capital needs for the next three years beyond the budget year.
- If applicable, a statement that the proposed budget includes a rent increase and reasons for the increase.
- Any additional documentation necessary for the Agency to establish that applicable Agency requirements have been met.

2) Both the Rural Rental Housing Program and Off-Farm Labor Housing Loan Grant Program had significant weaknesses found when reviewing the determination of tenant contribution. Tenant income verifications were from inappropriate sources, not from third parties, or were not obtained at all. There were numerous cases of zero income tenants with unsupported file documentation. Please see guidance in 7 CFR part 3560, Subpart D, section 3560.152 (e). The following guidance is from HB-2-3560, Chapter 6, Section 7, 6.28 B:

“Tenants and borrowers must execute an Agency-approved tenant certification form establishing the tenant's eligibility prior to occupancy. In addition, tenant households must be recertified and must execute a tenant certification form at least annually or whenever a change in household income of \$100 or more per month occurs. borrowers must recertify for changes of \$50 per month, if the tenant requests that such a change be made.

(A) Tenant requirements

- (i) Tenants must provide borrowers with the necessary income and other household information required by the Agency to determine eligibility.
- (ii) Tenants must authorize borrowers to verify information provided to establish their eligibility or determination of tenant contribution.
- (iii) Tenants must report all changes in household status that may affect their eligibility to borrowers.
- (iv) Tenants who fail to comply with tenant certification and recertification requirements will be considered ineligible for occupancy and will be subject to unauthorized assistance claims, if applicable, as specified in 7 CFR part 3560, subpart O.

(B) Borrower requirements

- (i) Borrowers must verify household income and other information necessary to establish tenant eligibility for the requested rental unit type, in a format approved by the Agency, prior to a tenant's initial occupancy and prior to annual or other recertifications.
- (ii) Borrowers must review all reported changes in household status and assess the impact of these changes on the tenant's eligibility or tenant contribution.
- (iii) Borrowers must submit initial or updated tenant certification forms to the Agency within 10 days of the effective date of an initial certification or any changes in a tenant's status. The effective date of an initial or updated tenant certification form will always be a first day of the month.
- (iv) Since tenant certifications are used to document interest credit and rental assistance eligibility and are a basic responsibility of the borrower under the loan documents, borrowers who fail to submit annual or updated tenant certification forms within the time period specified in paragraph 6.27 B of this section will be charged overage, as specified in §3560.203(c). Unauthorized assistance, if any, will be handled in accordance with 7 CFR part 3560, subpart O.
- (v) Borrowers must submit tenant certification forms to the Agency using a format approved by the Agency.
- (vi) Borrowers must retain executed tenant certification forms and any supporting documentation in the tenant file for at least 3 years or until the next Agency monitoring visit or compliance review, whichever is longer. “

It is also Rural Development policy **not** to accept a tenant certification for an applicant or tenant with zero income unless all income is specifically exempted. If the tenant or applicant experiences regular lay-off as part of his or her employment, then the tenant will be certified based on their annual income. Furthermore, borrowers of all Rural Rental Housing properties must verify and document in the tenant's file all income, assets, expenses, deductions, family characteristics, and any other factors that affect family eligibility or level of assistance.

To further assist you in evaluating eligibility and necessary file documentation, we have attached two checklist documents: ***Eligibility, Income and Deduction*** and ***Required Tenant File Documentation***. Both documents will provide additional guidance when determining tenant income/ assets and documents to be included in the tenant file. For further guidance and examples see HB-2-3560, Chapter 6.

3) The National Office also noted in the review that some Off-Farm Labor Housing tenants did not have a substantial portion of their income derived from farm labor employment, as described in regulation 7 CFR part 3560, Section 3560.576 (b)(2)(i)(A). Actual dollars earned from farm labor by domestic farm laborers other than migrant farm workers must equal at least 65 percent of the annual income limits indicated for the Standard Federal regions as published by the Agency for their particular region of the country. For migrant farm workers living in seasonal housing, the actual dollars earned from farm labor by a domestic farm laborer must equal at least 50 percent of annual income limits indicated for the Standard Federal regions, published by the Agency.

4) Some Off-Farm Labor Housing borrowers and/or management companies did not obtain prior approval from Rural Development before renting to non-farm laborers (ineligible tenants). As the basis for Agency approval or disapproval of the borrower's determination of diminished need, the borrower must submit a current analysis of need and demand to the Agency, identical to the market analysis that is required of loan applicants in the loan origination process. The borrower's determination and the State Director's recommendation should be forwarded to the National Office for concurrence in accordance with 7 CFR part 3560, Section 3560.576 (e).

5) Farm Labor Housing borrowers are submitting management certifications without the appropriate Identity of Interest Disclosures forms. The Management Certification should be submitted to the Agency each time the borrower proposes a new management agent and a management agreement is executed. The borrower and the management agent must jointly submit the certification to the Agency. The Management Certification also requires that the borrower and the management agent disclose any and all Identity of Interest relationships that involve property funding by executing Form RD 3560-31.

The weaknesses and deficiencies described above apply to borrowers in both the Rural Rental Housing Program and Off-Farm Labor Housing Program. Your cooperation in providing Rural Development Servicing Officials with any required documentation in a timely manner will be appreciated. Rural Development staff is available to answer your questions or assist you in preparation of documentation.

Should you have any questions regarding any of these findings, please contact your local Rural Development Servicing Office.

Sincerely,

Rural Development Servicing Official

Attachments: Checklists

ELIGIBILITY, INCOME, AND DEDUCTION CHECKLIST

Head of household and/or the co-head should complete.

LIST ALL HOUSEHOLD MEMBERS:

<u>Name (Last, First, M.I.)</u>	<u>Relationship</u>	<u>Date of Birth</u>	<u>Sex</u>	<u>Social Security #</u>
_____	_____	_/_/_	_	_____
_____	_____	_/_/_	_	_____
_____	_____	_/_/_	_	_____
_____	_____	_/_/_	_	_____
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ELIGIBILITY:	YES	NO
1. I have a household member who is absent from the home due to:		
Employment		
Military service		
Placement in foster care		
Temporarily in nursing home or hospital		
Permanently confined to nursing home		
Away at school		
Other		
2. I have a live-in attendant		
3. Expected changes in household:		
Baby due on _____		
Adopting a child(ren) on _____		
Obtaining custody of a child(ren) on _____		
Obtaining joint custody of a child(ren) on _____		
Receiving a foster child(ren) on _____		

INCOME, ASSET, AND DEDUCTIONS

A. Income:	YES	NO
1. Are you or any other members of the household currently receiving income from any of the following sources?		
Wages/salaries		
Wages earned through a government program such as Senior Aides, Older American Community Service Employment Program, AmeriCorps If yes, which program: _____		
Tips, bonuses, or commissions		
Overtime pay		
Income from operation of a business		
Social Security		
Disability / SSI		
Death Benefits		
Pension / retirement funds		
Annuities or non-revocable trust		
Unemployment		
Military pay		
Workman's Compensation		
Public assistance / TANF		
Alimony		
Child Support		
Income from rent or sale of property		
Periodic payment from lottery winnings		
Regular recurring contributions from persons or agencies outside of household		
Insurance policies		
Severance pay		
Other		
2. Are there any adult members of the household (18 years of age or older) receiving income not listed above?		
If yes, specify the source of the income _____		

B. Assets:	YES	NO
1. Do you or any other members of the household have any of		
The following:		
Checking accounts		
Savings accounts		
Certificates of deposit		
Money market funds		
IRA/Keogh account		
Stocks		
Bonds		
Treasury bills		
Trust funds		
If yes, is the trust irrevocable?		
Real estate		
Whole life or universal life insurance policy		
Cash held in safety deposit boxes or home		
Assets held in another state or foreign country		
Other		
2. Have you or any other members of the household received any		
lump sum payments, such as:		
Inheritance		
Lottery winnings		
Insurance settlements		
Other		
3. Have you or any other household members disposed of any asset(s)		
for less than fair market value in the past two (2) years?		
4. Do you or any other household members have any assets that are		
held jointly with another person?		

C. Deductions:	YES	NO
1. Are there any fulltime students 18 years of age or older in the household?		
2. Is any household member elderly (age 62 or older) or a person with disabilities?		
3. Do you have medical expenses that are not paid for by an outside source such as insurance (applicable to elderly/disabled)?		
4. Do you have disability expenses that are not paid for by an outside source?		
If yes, is this service necessary to enable a household member (including the member with a disability) to be employed?		
5. Do you have attendant care expenses?		
If yes, is this service necessary to enable a household member (including the member with a disability) to be employed?		
6. Do you currently pay for childcare services for any children under the age of 13 residing in your household?		
If yes, is this service necessary in order for you to be employed or to attend school?		
If yes, are any of these expenses reimbursed by an outside source?		

Required Tenant File Documentation

Tenant file records are critical pieces of source documentation, perhaps *the* critical source documentation, used as evidence to support determinations and conclusions in all areas of occupancy monitoring. The tenant file records must be complete and contain all information and forms relevant to occupancy at the project, including:

I. Application/Household Information

- A. Application
- B. Verification/certification of social security numbers, if available
- C. Citizenship declaration/immigration status (all household members) FARM
LABOR ONLY
- D. Eligibility verification documents (e.g., person with disabilities, elderly, live-in aide, assistive animal, etc.)
- E. Acknowledgement of the head of household's receipt of lead based paint disclosure brochure, if applicable

II. Lease

- A. Lease
- B. Lease amendments/addendums/agreements
- C. Project rules and regulations
- D. Pet rules and pet deposit receipt, if applicable
- E. Security deposit receipt, if applicable
- F. Move-in inspection report
- G. Annual inspection reports
- H. Lead-based paint addendum, if applicable

III. Certification/Recertification

- A. Initial and annual recertifications
- B. Recertification notices (initial and, if applicable, first, second, and third)
- C. Verifications for income, assets, and deductions
- D. Disposal of assets verification (head of household, spouse, co-head)
- E. Payment plans, if applicable
- F. Correspondence either issued to, or received from, tenant(s)

IV. Other Files That Need to Be Maintained

A. Move-out files

The current tenant file will become the move-out file. In addition to the above items, the move-out files must contain:

- 1. Copy of the intent to vacate notice received from the tenant
- 2. Move-out inspection report
- 3. Copy of the security deposit disposition notice provided to the tenant
- 4. Documents supporting retaining all or a portion of the security deposit

B. Application/Reject Files

- 1. Application
- 2. Documentation to support the reason(s) for rejecting, such as screening information from previous landlords, personal references, credit reports, criminal activity, and refusal to sign consent form
- 3. Copy of the written notice of rejection sent to the applicant
- 4. Any information or letters regarding appeals by applicants