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May 3, 2004

Mr. Stillman D. Knight
Deputy Assistant Secretary for Multifamily Housing
U.S. Department of Housing and Urban Development
451 Seventh Street S.W.
Washington, DC 20410

Dear Stillman,

In follow-up to our meeting on Tuesday with Dr. Weicher, and the HUD-Industry meeting the preceding week, I had promised to send you a more detailed memo on the 401K administrative problems being encountered by managers of HUD-regulated properties, due to inconsistent and excessive requirements outlined in the HUD Management Handbook 4381.5.

The attached memo is provided by an attorney, Marcia Wagner, based in the Boston area, who specializes in ERISA requirements, and who represents a major NAHMA (Board) member. As I had mentioned, this large member company has suspended all employer contributions to its employees' 401K retirement plans due to the problems outlined in Marcia's memo.

Two of the key problems detailed in the memo are that 1) HUD's requirements are in conflict with ERISA and IRS requirements, and 2) HUD's requirements are inconsistent between sections of the 4381.5 handbook.

As you know, the ability of a company to provide a competitive benefits package, including retirement benefits, to its employees is critical in its efforts to attract and retain experienced, competent employees.

I would be happy to provide any other information that might be useful in your review of this issue, and Marcia has graciously volunteered to travel to DC to meet with you, your staff or other representatives at HUD if that would be helpful.

I look forward to talking with you further regarding this important issue.

Thanks again and best regards,

Kris Cook, CAE
Executive Director

THE WAGNER LAW GROUP
A PROFESSIONAL CORPORATION

M E M O R A N D U M

TO: **Kris Cook, Executive Director**
National Affordable Housing Management Association

FROM: **The Wagner Law Group, A Professional Corporation**

DATE: **April 27, 2004**

RE: **HUD Retirement Plan Requirements**

The sponsor of a tax-qualified retirement plan may charge the contributions and related administration costs for eligible "frontline employees" who work at a HUD site to the site's operating account if certain requirements are satisfied pursuant to Section 4381.5, par. 6.38e of the U.S. Department of Housing and Urban Development ("HUD") Management Agent Handbook (the "Handbook"); a copy of the relevant portion of the Handbook is appended to this memorandum. The Handbook, however, creates severe impediments to employers who desire to maintain tax-qualified plans and in some cases conflicts with the requirements imposed on tax-qualified plans by the Internal Revenue Code of 1986, as amended (the "Code") and the Employee Retirement Income Security Act of 1974, as amended ("ERISA").

<u>The Management Agent Handbook</u>

The Handbook in Section 4381.5, par. 6.38e(2) sets forth certain requirements that must be satisfied for employers to charge plan contributions and related administrative expenses for eligible frontline staff to HUD-governed site accounts.

To meet HUD's requirements, the tax-qualified plan must comply with the following:

- (i) The plan must comply with all applicable federal, state, and local laws and regulations governing such programs;[1]
- (ii) The plan must cover only employees who perform frontline tasks, including certification paperwork, bookkeeping, or maintenance;
- (iii) The staff must be permanent/full-time employees who work more than 30 hours per week;
- (iv) Employer contributions generally must vest within 5 years;
- (v) Employer contributions must be capped at no more than 10% of the base pay of eligible employees;
- (vi) A separate account must be maintained for each participant;
- (vii) An outside administrator must be appointed; and
- (viii) A letter must be sent to HUD outlining the plan's compliance with these rules.

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[1] Tax-qualified plans are subject to myriad and strict requirements under the Code and ERISA.

If these requirements are satisfied, then:

(i) Employer contributions may be paid out of project funds and factored into the site's operating budget; and
(ii) The actual cost of administering the retirement plan may be factored into the site's operating budget.

The Issues

Employers are more likely to sponsor tax-qualified plans for frontline employees and provide expanded benefits if it is easier for their contributions and related administrative costs to be allocated to the operating accounts of HUD sites. In that regard, we respectfully propose that consideration be given to revising the Handbook as follows:

1. Reduce the 30-hour per week rule for plan eligibility to a 20-hour per week rule so that the Handbook requirements are consistent with the Code and ERISA;

2. Eliminate the separate plan requirement for defined contribution plans; and

3. Permit employees who perform front-line management functions off-site and employees who rotate among different HUD sites to aggregate hours in order to attain the requisite 20-hours.

Discussion

1. Reduce the 30-hour per week rule for plan eligibility to a 20-hour per week rule so that the HUD requirements are consistent with the Code and ERISA. (Section 4381.5, par. 6.38e(2)(b)).

Under the Code and ERISA, a plan may not require more than 1,000 hours of service during a plan year for an employee to become (or remain) a participant and receive retirement benefits. The Handbook's requirements are more stringent by requiring employees to work more than 30 hours per week which, over the course of a plan year, would exceed 1,000 hours in direct violation and contravention of the Code's and ERISA's maximum service requirement.

Reducing the hours requirement in the Handbook from 30 hours per week to 20 hours per week would conform the Handbook requirement to the maximum permitted under the Code and ERISA. Alternatively, the Handbook could cross-reference the Code's and ERISA's maximum hours requirement or not provide a specific hours requirement but rely on the hours requirement contained in the employer's underlying tax-qualified plan. Any such change would be of great assistance to employers who currently must somehow satisfy different federal agencies (the IRS regarding the Code, the Department of Labor regarding ERISA and HUD regarding the Handbook) which impose differing and conflicting requirements concerning the maintenance of tax-qualified plans.

2. Eliminate the separate plan requirement for defined contribution plans. (Section 4381.5, par. 6.38e(2)(b), and (g)).

The Handbook requires that a plan cover only eligible front-line employees and further stipulates that no co-mingling of employee accounts may occur. It appears the separate plan requirement exists to ensure that there is no co-mingling of participants' account balances. However, under the Code, defined contribution plans are "individual account plans,"[2] which means that contributions, earnings, and other participant activities (loans, withdrawals, etc.) are maintained on an individual basis within a separate account for each participant. Such accounts are not "co-mingled" and therefore should satisfy that Handbook requirement. Thus, there is no ideological precept for HUD to require a separate plan covering only "HUD-eligible" employees.

Moreover, the practical effect of this Handbook requirement is that plan sponsors must "spin off" or otherwise create a separate "mirror" or "clone" plan that provides benefits only to the group of eligible frontline employees, while excluding employees who do not qualify under HUD's rules and who thus must be provided benefits under a separate plan. These separately maintained plans result in logistical problems (such as, where an employee's eligibility changes and he, along with his account balance, must be transferred between plans) and needless duplication (such as, the need for at least two plan documents, two summary plan descriptions, two Form 5500 Annual Return/Report for Employee Benefit Plans filings, and two IRS favorable determination letter applications, among other redundancies).

A more easily administrable solution is to eliminate the separate plan requirement and for HUD to instead require that existing plans be modified to create sub-accounts for each project site within the same plan. The applicable contributions and costs could be allocated based on the individual location of each frontline employee as required by the Handbook. Such an arrangement would be more cost-effective than creating separate plans because employees who do not qualify under HUD's rules will remain in the "main" portion of the plan, and employees who lose or gain HUD-eligible status would be subject to an intra-plan transfer (requiring only a recordkeeping change) and not an inter-plan transfer (requiring an actual transfer of assets). Furthermore, there will be no plan documentation redundancies, duplications and inefficiencies.

3. Permit employees who perform front-line management functions off-site and employees who rotate among different HUD sites to aggregate hours in order to attain the requisite 20-hours. (Section 4381.5, par. 6.38e(2)).

The Handbook specifies that employer contributions to a tax-qualified plan may be paid out of a project's operating funds only if the plan covers eligible permanent, front-line employees and excludes off-site employees, temporary or part-time on-site employees, and employees who rotate among more than one project unless they qualify as a full-time employee at one project. However, another provision in the Handbook, Section 4381.5, par. 6.38a(2), which pertains to allocating

[2] By contrast, defined benefit pension plans do not maintain individual accounts.

management costs to a HUD site's operating account, permits pro-rating the costs for staff operating out of a single office among several properties.[3]

Nonetheless, Paragraph 6.38e(2) of the Handbook imposes additional restrictions beyond those contained in Paragraph 6.38a(2) with respect to reimbursed retirement plan contributions and expenses. Thus, even though frontline employees may meet the cost allocation requirements, they must work more than 30 hours per week at a specific location to qualify for participation in a HUD-eligible plan; if they split their time at more than one project, rotate amongst sites or work off-site out of a more centrally located office but on behalf of one or more sites, they are not eligible unless they can qualify as full-time (more than 30 hours per week) at one project. Therefore, some employees who qualify for purposes of allocating site expenses may not be eligible for coverage under a HUD-eligible plan even though they provide services on a full-time basis to HUD sites. Consideration should be given to eliminating this arbitrary distinction so that if an employee qualifies for purposes of allocation of site expenses, he qualifies for purposes of allocation of retirement plan expenses, as well.

Two Additional Considerations

1. Vesting. The Handbook requires that employees' account balances under tax-qualified plans be vested within five (5) years (Section 4381.5, par. 6.38e(2)(d)). The Code and ERISA impose vesting requirements on tax-qualified plans, with a maximum allowable period of seven years with incremental vesting over the course of that period. Therefore, the vesting requirement is another instance where the Handbook is more stringent that the Code and ERISA, without any apparent need.

2. HUD Certification. The Handbook requires that the plan sponsor certify to HUD that the plan complies with the listed requirements before funds are charged to the sites' operating account (Section 4381.5, par. 6.38e(3)). However, administratively it would seem to be more advantageous to both HUD and employers if the certification could be included as an attachment with each budget-based rent increase disclosing the plan and its anticipated cost.

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[3] Section 4381.5, par. 6.38a(2) reads as follows:

"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."

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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 30 hours per week) may participate. Off-site employees and 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.

(c) The projected cost of employer contributions to be paid out of project funds may not exceed five[4] percent of the base pay of eligible employees.

(d) A reasonable portion of the employer contribution will vest relatively early in an employee's tenure with the company. Generally, employees should be 100 percent vested within five years.

(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.

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[4] The five percent limit has since been raised to ten percent.

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.

Winn/memos/Cook re HUD 042204
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