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Ms. Audrey Hinton
Project Director, Handbook 4350.1 Re-Write
U.S. Department of Housing and Urban Development
451 7th Street S.W.
Washington, DC 20410

Revising Handbook 4350.1, Multifamily Asset Management and Project Servicing
Phase I: Units and Topics

Thank you for the opportunity to submit these comments on behalf of the National Affordable Housing Management Association (NAHMA). NAHMA commends the Department for undertaking this rewrite and for engaging industry partners.

Overview: Units and Topics

Much has changed in the affordable housing industry since the last 4350.1 handbook revision in 1992. HUD has proposed units and topics for the Phase I which will reflect these changes. At this time, NAHMA requests no changes to the list of proposed units and topics.

Specific Information Which Should Be Covered Under the Units and Topics

HUD also invited comments on specific information about the topics that we would like the handbook to cover. Our recommendations are listed in the order laid out in the subject document.

*Unit II.D. Previous Participation***.** The most common frustration NAHMA members report about the previous participation certification process is the difficulty of getting flags removed by the field offices. In our members' experiences, some field staff are reluctant to remove flags even after the problem which caused the flag has been cured, or even when a flag was placed in error. We understand that HUD intends to rewrite its 2530 regulations at a later date. However, this handbook revision presents an opportunity to provide clear instructions about when and how field offices should remove flags.

Unit III.C. Multifamily Emergency and Disaster Guidance (Chapter 38 of 4350.1). The Multifamily Emergency and Disaster Guidance focuses primarily on Presidentially Declared Disasters (PDDs) and displaced residents that are FEMA certified. While there are a few references to applicability when a HUB Director determines an emergency exists, Section 4 - Program and Disaster Relief Options During a PDD, the main source of information regarding relocated residents, tenant files, wait list preferences, Section 8 Pass Through, etc., is limited to PDD situations. However, it is more common that an owner / agent will experience a smaller, local natural disaster or event (fire, flood, etc.). These types of scenarios often require resident relocation, even if it's only a portion of the project population, for multiple months.

Due to a lack of guidance on how to handle these types of situations, some NAHMA members have worked with their local PBCA to develop procedures and forms that were subsequently approved for use by the local HUD office and HUB Director. These procedures were based on the spirit and intent of the guidance outlined in Section 4 of Chapter 38, but customized to fit a local disaster scenario.

To ensure consistency and compliance, we recommend that Chapter 38 be expanded to give guidance regarding relief and options for non-PDDs and to give the local HUD Program Centers and/or HUB the authority to approve remedial action. This expansion should cover topics such as:

- Establishing a resident's right of return to their damaged unit if they were not the cause of the disaster.
- Authorizing a property to execute a 30-day renewable lease to temporarily house residents that are displaced. The lease would terminate the earlier of the tenant moving out, or the resident's permanent housing becoming available. This will ensure a resident that is temporarily housed at another property is not deemed permanently housed. A sample lease addendum with these provisions would be ideal.
- Requiring owner notices to residents communicating when their unit will be repaired, and resident responses to the owner notices. These provisions should allow for truncated timeframes from those required in PDDs when the displacement will be short-term (6 months or less). For example, allowing a 30-day notice that the unit is ready for re-occupancy.
- Allowing displaced residents to temporarily reside with a friend or neighbor and exceed the occupancy standards for the unit.
- Providing for suspension of voucher payments on non-habitable units and proper documentation of the resident file.
- Allowing the HUB Director to issue letters of priority for a waiting list preference for the displaced residents at HUD subsidized or insured properties near the disaster location.

Unit IX.B. Reserve for Replacements. NAHMA strongly urges HUD to update Chapter 4 Reserve Fund for Replacements at the earliest opportunity. HUD should utilize the knowledge, judgment and competence of property owners and their managing agents to develop coherent, consistent and reasonable R4R policies. Such policies must also account for the financial challenges properties are facing. Likewise, they must account for the fact that except for rent increases, which are capped at OCAF, O/As have limited means of increasing a property's cash flow.

Maintaining sufficient reserves for replacements (R4Rs) is an essential component of property management. The primary objective of reserve-for-replacement policies must be to ensure the long-term physical and financial viability of the asset, which is reason enough to place high priority on the Chapter 4 update. Our sense of urgency is even greater because of the inconsistent and conflicting reserve for replacement policies established in the current Chapter 4 and Notice H-2011 30.

In HUD Notice H 2011-30 "Use of Reserve for Replacement Accounts in Restructured Mark-to-Market (M2M) Properties," HUD described the rationale for its policy that owners of M2M restructured properties are required to use the Reserve for Replacements account as the primary source for capitalized expenses. Following a thorough review of this notice, NAHMA members voiced substantial concerns about vague terminology, conflicts with other HUD policies and the impact of the policy described on the M2M properties. When HUD released Notice 2011-30 on October 19, 2011, industry members were told Chapter 4 would be revised to incorporate the R4R policies for Mark-to-Market properties described in the Notice. The update has still not been released.

Unfortunately, Notice 2011-30 abandons many of the sound, time-tested management practices detailed in Chapter 4 of the *4350.1 Multifamily Asset Management and Project Servicing Handbook,* such as maintaining a minimum R4R balance. In fact, the notice does not propose any specific number for minimum reserves, nor is it specific about its target "sufficient ending balance" for R4R at year 20. The policies outlined in Notice 2011-30, which emphasize Mortgage Restructuring Note (MRN) repayment in the short-term, could have the unintended consequence of cash-starving properties by depleting reserves in the long-term. The notice over-relies on estimates made years ago in the underwriting process, without sufficiently considering that circumstances change over time. Likewise, the notice offers no solutions as to how owners and agents (O/As) should replenish their R4R accounts when rents are capped at OCAF. It also fails to define the term “major replacements or repairs.” This point is especially important because O/As have strongly disagreed with OAHP’s surplus cash analysis reviewers about whether an item should have been paid with reserve or operating funds if the reviewer’s determination conflicted with Chapter 4. (The surplus cash analysis is Unit VI.J.) As an alternative to the current practice in which OAHP’s reviewers make after-the-fact decisions as to which expenses should have been paid from reserves, HUD should simply defer to Chapter 4 of the 4350.1 and make any necessary updates to the appropriate uses of R4R, such as bed bug eradication.

Appendix A, attached to this letter, outlines key conflicts between HUD R4R policies in Notice H 2011-30 and Chapter 4 of the 4350.1. This information was previously shared with Multifamily Housing officials as part of NAHMA’s “Affordable Housing HUD Regulatory Policy Priorities 2012.” We submit this information in hopes that it will be helpful in reconciling HUD’s R4R policies for M2M and non-M2M properties.

Unit VII.F. Management and Operating Reviews. A great number of assisted properties in 42 states / U.S. territories have not had MORs since August 2011. Considering this time lapse, it no longer seems imperative to conduct annual MORs on every assisted property. NAHMA strongly urges HUD to reduce the frequency of MORs to a risk-based assessment timeframe similar to REAC inspections—that is, every three years for the highest performing properties, every two years for high performers, and annually for all others. This approach would allow HUD to satisfy its regulatory oversight obligations, to use limited resources more efficiently and to incentivize excellent property management.

Conclusion

Thank you again for seeking NAHMA’s input on this important handbook revision. Please do not hesitate to contact me if you would like additional information on any of the subjects covered in these comments.

Sincerely,

Kris Cook, CAE
Executive Director

APPENDIX A

In HUD Notice H 2011-30 "Use of Reserve for Replacement Accounts in Restructured Mark-to-Market (M2M) Properties," HUD described the rationale for its policy that owners of M2M restructured properties are required to use the Reserve for Replacements account as the primary source for capitalized expenses. Following a thorough review of this notice, NAHMA members voiced substantial concerns about vague terminology, conflicts with other HUD policies and the impact of the policy described on the M2M properties.

NAHMA strongly urges HUD to reexamine the policies outlined in Notice H 2011-30 with the goal of *achieving long-term sustainability* of the properties in mind. The primary objective of reserve-for-replacement policies must be to ensure the long-term physical and financial viability of the asset. The goals of repayment on Mortgage Restructuring Notes ("MRNs") and viability of the restructured properties are not mutually exclusive. In fact, NAHMA believes HUD is most likely to achieve repayment of the MRNs if the properties *are viable over the long-term*. Prudent management is necessary to achieve both goals. Unfortunately, Notice 2011-30 abandons many of the sound, time-tested management practices detailed in Chapter 4 of the *4350.1 Multifamily Asset Management and Project Servicing Handbook,* such as maintaining a minimum R4R balance. In fact, the notice does not propose any specific number for minimum reserves, nor is it specific about its target "sufficient ending balance" for R4R at year 20.

The policies outlined in Notice 2011-30, which emphasize MRN repayment in the short-term, could have the unintended consequence of cash-starving properties by depleting reserves in the long-term. The notice over-relies on estimates made years ago in the underwriting process, without sufficiently considering that circumstances change over time. For example, HUD is aware of the financial difficulties early M2M "Demonstration" properties experience because of their restrictive underwriting. More recently, properties are facing expensive draws on their R4R accounts due to bed bug infestations that were never anticipated in the underwriting. Likewise, the notice offers no solutions as to how owners and agents (O/As) should replenish their R4R accounts when rents are capped at OCAF. It also fails to define the term "major replacements or repairs." This point is especially important because O/As have strongly disagreed with OAHP's surplus cash analysis reviewers about whether an item should have been paid with reserve or operating funds if the reviewer's determination conflicted with Chapter 4.

From the perspective of O/As, HUD is implementing policies in Notice 2011-30 that have far-reaching consequences for the financial health of the M2M portfolio before those policies have been thoroughly explained.

For these reasons, NAHMA recommends:

- **Rather than continue the current practice in which OAHP's reviewers make after-the-fact decisions as to which expenses should have been paid from reserves, HUD should simply defer to Chapter 4 of the 4350.1 (making any necessary updates, such as bed bug eradication);**

- **HUD should utilize the knowledge, judgment and competence of property owners and their managing agents to develop coherent, consistent and reasonable R4R policies;**
    - **Such policies must also account for the financial challenges properties are facing; and**
    - **They must account for the fact that except for rent increases, which are capped at OCAF, O/As have limited means of increasing a property's cash flow.**

NAHMA's Specific comments on Notice H 2011-30, "Use of Reserve for Replacement Accounts in Restructured Mark-to-Market (M2M) Properties"

Terminology in Notice H 2011-30

a. HUD must define "major replacements or repairs." (See page 2, last sentence of the 2nd paragraph under the heading "Requirements Governing Use of Reserve for Replacements in M2M Properties.) HUD should refer to Chapter 4 of the 4350.1 REV-1 Handbook, which thoroughly discusses what is to come from Replacement Reserves and what is to come from operating accounts on pages 4-5, 4-6, and 4-7.

b. HUD should reveal the exact dollar amount of the "sufficient ending balance" for Reserve for Replacements that HUD projects for year 20 in order to establish the minimum balance to be sustained. (See page 5, 5th bullet under the "Summary" heading.)

Notice H 2011-30 Conflicts with Other HUD Policies—Especially Chapter 4 of *HUD Handbook 4350.1 Multifamily Asset Management and Project Servicing*

a. Period covered by R4R: The notice states that a M2M property is to be maintained in good order for 20 years, but Chapter 4 states that a property is to be maintained in good order for its economic life, which was estimated at 55 years.

b. Purpose of R4R: The first paragraph of the notice states R4R in M2M properties are to be the "primary source for capitalized expenses" because of M2M requirements [for paying the MRN note from surplus cash]. Chapter 4 Section 4-1 of the 4350.1 handbook states, "it was not the original purpose of this Reserve Fund to provide for a complete, dollar for dollar, capability of replacing all the building structural components and equipments as these wear out but rather to provide a readily available source of capital that will help defray these costs in the latter years of amortization of the mortgage note."

c. Level of Reserves:

   i. The notice is unclear about what would be considered an adequate level of reserves, but Chapter 4 gives a number. HUD provides no formula--or even a ballpark estimate--for a recommended minimum R4R balance in the notice. This complicates management of the property, especially since NAHMA has received a number of reports describing how OAHP's SCA reviewers have pushed reserves below the $1000 per unit recommended in Chapter 4. In contrast, Chapter 4 also clearly delineates how to determine if the balance in a reserve fund is adequate.

   ii. Flexibility on Adjusting the Reserve Levels. Chapter 4 provides a moving target, but OAHP is rigid. In Chapter 4, HUD states, "Owners should rely on their own personal knowledge of the physical condition of the project, evaluations made by their managing agents, and physical inspection reports furnished by their mortgagee and by HUD" in making determinations as to the adequacy of reserve funds on an ongoing basis. The Notice takes a more rigid approach by over-relying on initial reserve estimates with built-in "inflationary factors."

Potential Impact on Properties from Notice H 2011-30

a. NAHMA members are seriously concerned that OAHP is placing too much emphasis on finding surplus cash at the expense of the long-term physical and financial viability of the properties.

b. NAHMA believes the physical and financial viability of restructured M2M properties at the end of year 20 are two of the most important criteria for judging the program's success.

   i. Maintaining a minimum R4R balance is the logical way to ensure the long-term viability of the property. However, the notice does not propose any specific number, nor is it specific about its target for the "sufficient ending balance" for R4R at year 20.

   ii. The notice offers no concrete guidance on how to replenish depleted reserves.

      1. On page 4-8, HUD states that "If non-traditional items, such as routine carpet replacement, are to become eligible Reserve Fund items, the minimum to be held in the fund would certainly need to be increased." BUT

         - HUD only allows OCAF increases on restructured M2M properties, not budget-based increases. How are properties that are not generating positive cash flow supposed to increase deposits to R4R?

         - The problem is especially difficult for early "demo" M2M deals because the underwriting understated repairs & maintenance, which in turn, understated the reserve levels.

c. SCAs in practice—reports of conflicting HUD policies & financial strain on properties:

   i. NAHMA has received a number of reports describing how OAHP's SCA reviewers have pushed reserves below the $1000 per unit recommended in Chapter 4.

   ii. One member reported OAHP's reviewers adjusted surplus cash on the financial statement to reduce expenses they deemed eligible for funding from reserves, even though there was not R4R funding available to cover the expenses. HUD Multifamily had previously approved a suspension of R4R deposits, and because the balance was low, HUD was not approving release of R4R funds for all eligible expenses.

   iii. Likewise, a member said, "We have also encountered problems with OAHP in terms of the timing of the release of expenses – OAHP is adjusting the surplus cash computation to add back all expenses during the fiscal year that are eligible for reserve for replacement funding, even though the request has not yet been submitted. Chapter 4 of 4350.1 indicates that the requests for releases should be submitted at least sixty days before the close of the project's fiscal year (section 4-17 C). Based on this timing, there will be at least 2 months of expenses for which releases would not be submitted."