



# NAHMA analysis<sup>TM</sup>

## **Ensuring NAHMA Members Receive the Latest News and Analysis of Breaking Issues in Affordable Housing**

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### **Treatment of Properties which Score Below 60 on REAC Inspections**

#### **Effective Date of the Policy**

November 1, 2002.

#### **Background**

Under pressure from the Office of Management and Budget (OMB) and the General Accounting Office (GAO), and pursuant to the President's Management Agenda, HUD is implementing a new policy to deal with properties which score above 30 but below 60 on their REAC inspection. OMB believes that government should not be "forcing subsidized households to live in substandard housing as a condition for keeping their subsidy." The crux of this policy is referral to the Departmental Enforcement Center (DEC) of properties with REAC scores ranging from 31 through 59. Properties which score 30 or below will continue to be automatically referred to DEC. HUD is no longer interested in approving long-term repair plans on properties that are receiving market rents. HUD is operating under the assumption that properties should be operating at 100 on REAC scores at all times.

NAHMA members were alerted that changes in treatment of sub-60 properties were imminent in an October 11 e-mail entitled "Forthcoming Policy Changes at HUD." In addition, members attending the NAHMA Fall Meeting on October 29 participated in an intense panel discussion with Ken Hannon, Director of Business Relationships and Special Programs, HUD Office of Asset Management.

HUD considers this a change in "protocol," not a change in policy. HUD has not published a notice in the Federal Register to announce these changes. The information NAHMA has received is derived from an October 8 industry stakeholders meeting at HUD, phone calls and e-mails to HUD staff, the panel discussion with Hannon at the October 29<sup>th</sup> NAHMA Fall Meeting, and items sent to HUD field offices, which include a copy of the letter HUD will be sending to owners who receive sub 60 scores, and a copy of the new protocol.

HUD has repeatedly stated this new policy will apply to only 1200 properties, or approximately 3 percent of the multifamily portfolio. Upon review of the new protocol, this claim is doubtful.

Considering that all scores of 31 through 59 will be referred to DEC as “physical elective referrals,” HUD’s claim is likely to be underestimated.

### Summary

Based on the information received to date, it is NAHMA’s understanding that if a property receives a sub-60 REAC score, the following chain of events will occur:

1. Properties with scores of 30 and below will continue to be automatically referred to DEC
2. Scores from 31 through 59 will result in referrals to DEC within 5 business days, unless the HUB Director withholds them “for good cause.” (See Issues of Concern)
3. HUD will send owners written notification of the DEC referral
4. Following the referral, DEC staff assumes the responsibility of dealing with the owner
5. DEC will analyze documents concerning the property’s physical *and financial* condition to determine whether the money is available for repairs
6. DEC will contact the owner to schedule a meeting. Based on timelines established in the protocol for referrals and paperwork transfers, this call could come 20 days after the REAC inspection was released.
  - a. If the owner won’t meet with DEC, a Notice of Violation (NOV) will be issued
  - b. If the owner still won’t meet, DEC will make recommendations to the HUB director for appropriate action, and include a proposed Notice of Default
    - i. The HUB director will decide how to proceed
7. DEC’s meeting with owners may occur roughly 25 days to one month after the inspection’s release.
  - a. Owners will be served with a NOV
  - b. Discussions of options
    - i. Make repairs within 60 days from the date of the meeting, certify completion, submit to a new REAC inspection
    - ii. Transfer the property
    - iii. Out-year OMHAR restructuring
    - iv. Prepayment
    - v. Refinancing
  - c. Owners will be advised that a sub-60 score on the reinspection will result in enforcement action and possible foreclosure and termination of their subsidy
8. Owner’s options

- a. Agree to make repairs, certify, and have a new REAC reinspection 60 days after the meeting with DEC
  - b. Ask DEC for more time to make repairs
    - i. DEC may reject the request
    - ii. Only requests that can be done in the short term and which the owner can fully fund will be considered
    - iii. If DEC agrees, the request is forwarded to Multifamily
      - 1. If Multifamily denies the request, the owner is still expected to make the repairs within 60 days from the date of the DEC meeting
  - c. Ask for HUD action to facilitate the repair
    - i. DEC must obtain Multifamily's approval to use reserves or residual receipts for repairs
  - d. Do not agree to make repairs
    - i. DEC "should advise" the owner of alternatives to foreclosure
    - ii. NOV issued
      - 1. If the owner is willing to work on alternatives, DEC will work with HUB director to determine if there are viable alternatives to foreclosure
      - 2. If the owner is unwilling to work on alternatives, DEC will close the referral and make recommendations to Multifamily which are likely to include foreclosure
9. The new REAC inspection will be performed as soon as possible 60 days after the owner's meeting with DEC

#### 10. Reinspection scores

- a. 60 or above
  - i. DEC closes the referral, notifies owner, and returns the property to Multifamily within 10 business days of receiving the new score
- b. 59 or below
  - i. DEC closes the referral, sends recommendations to the HUB director within 10 business days of receiving the new score
  - ii. Owner could face foreclosure, termination of the subsidy, debarment, Program Fraud Civil Remedies Act violations, civil money penalties
  - iii. HUB director will forward DEC's memo to the director of Multifamily Asset Management with his or her recommendation

#### 11. 2530 flags

- a. The protocol does not specifically mention when an owner's 2530 will be flagged.

- b. The letter notifying owners of the DEC referral reads, “This letter is the only notice that you will receive of the placing of a flag in the APPS for noncompliance.”
  - i. Conditions the letter warns will result in 2530 flags
    1. failing to correct physical deficiencies
    2. failing to correct EH&S violations
    3. failing to provide HUD with the required certification within the required timeframes
    4. falsely certifying repairs

### **Issues of Concern to NAHMA**

The issue of a 2530 flag resulting from the REAC score is troublesome because it affects the owner’s ability to do future business with HUD. As the 2530 process currently stands, many industry partners do not become aware of flags until the next time they try to deal with HUD. Under the new protocol, it is even more unclear when these flags would be placed, and when, or if, they could be removed. The letter claims to be the only notice of a flag, but it is not clear whether the flag is placed at the time of the initial DEC referral, or upon reinspection.

Moreover, there seems to be a lack of due process for owners. Despite substantial anecdotal evidence of REAC scores which vary wildly depending on the inspector, the protocol indicates that referrals will be made after that initial inspection. The only saving grace is if the HUB director withholds the referral for “good cause.” However, the examples of “good cause” listed in the protocol are limited to the owner’s exit from the HUD programs (voluntarily or through foreclosure) or if the owner is “in the process of refinancing the mortgage with HUD insurance within the next 90 days, and adequate funds will be escrowed, and repairs will be required as part of the transaction.” An owner who has not made plans to sell the property or leave the HUD arena should assume a REAC score less than 60 will send the property to the DEC.

Another concern is the lack of differentiation in the referral after the first inspection policy between the truly troubled properties and those which will be referred due to items that can easily be repaired. The referral upon first inspection seems to be more punitive than solution-oriented. In some instances, properties will be referred to DEC for deficiencies which could be easily remediated.

In addition to the misallocation that could result from the almost immediate referral, it should be noted that the reinspection is an entirely new complete inspection of the property. The new inspection will not be restricted to the deficiencies which prompted the referral.

### **Positive Aspects of This Policy**

HUD staff has publicly acknowledged that most of the multifamily portfolio is in good condition. In fact, 60 percent of the inventory scores 80 or higher on REAC inspections.

Per the advice of HUD staff, owners and managers can take certain actions to ensure they have a fair inspection. First, take precautions to avoid a bad inspection. Know when your inspection is scheduled. A link to the online REAC scheduler is available through NAHMA’s website, or you

can visit it directly at <https://hudapps.hud.gov/reac/schedule/index.cfm> . The Physical Inspections Query Page shows inspections scheduled by the quarter year. Make sure all of your repairs have been made before the inspection. Also, ask the HUB director to postpone your inspection if your property is undergoing rehabilitation, is in the mist of an approved corrective action plan, or if there has been a fire or natural disaster. Finally, if you have grounds to appeal a bad inspection, *do so immediately*.

If you are thinking about acquiring a troubled property, make sure you meet with your HUB director to work out an agreement on the time-table for repairs. NAHMA strongly advises members who are considering buying or managing a bad property to have this agreement in place with HUD **BEFORE** assuming responsibility for the property.

### **NAHMA's position**

NAHMA supports quality affordable housing and agrees that poorly performing properties should not be subsidized indefinitely. We simply ask for fairness in the inspection process, and a clearer understanding of what the new DEC referral process entails.

The best way to avoid any negative results from this policy is to ensure the properties are well maintained, in good physical condition, and ready for inspections. That being said, NAHMA strongly believes that official written guidance from HUD should be issued so that industry partners understand the protocols to which they are expected to conform. A written policy explaining the change in protocol would allow owners and managers to understand the process, know what is expected of them, and know what to expect in the way of treatment from HUD.

Likewise, NAHMA believes the 2530 flags should be “decoupled” from this process. Based on what we know about this policy, it is conceivable that an owner /management company with a large HUD portfolio could receive a flag on the 2530 for one property that is not representative of the entire portfolio. Prior to flagging 2530s, HUD should enumerate what circumstances will lead to a 2530 flag, how long it will remain, and how the flag can be removed.

A serious cause for concern is the referral to DEC after the first inspection. NAHMA considers this aspect of the protocol a lack of due process. Likewise, this policy makes no differentiation in DEC referrals between repairs that can be made easily and truly troubled properties. Each set of properties will be referred to DEC after the first inspection. A more solution-oriented, common sense approach would be to withhold actual DEC referrals until after appeals have been exercised and after the reinspection. Waiting until after the reinspection to make the referrals would decrease the likelihood that the property is in DEC as a result of a bad inspection or for deficiencies which could be easily remediated.

NAHMA also believes that waivers should be available for weather-related repairs which may not be able to be completed in 60 days (e.g., filling potholes in the parking lot during the winter).