

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

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HUD Handbook 4350.1 Chapter 6, Conducting Management Reviews, Change 2

Effective Date: August 1, 2010

Background

Last June, HUD revised Chapter 6—Conducting Management Reviews—of the HUD Multifamily Asset Management and Project Servicing Handbook 4350.1. This was the first update to Chapter 6 since 1992. However, NAHMA, HUD field staff, and other industry partners brought to HUD’s attention a number of problems within the update.

On July 30, 2009, HUD delayed the implementation of Chapter 6 Change 2 until September 30, 2009 and requested the industry submit comments on the necessary changes and clarifications needed to conduct management reviews.

In response to feedback from the HUD field offices, NAHMA, and others, HUD announced that they planned to revise the chapter to incorporate HUD field office suggestions on Chapter 6 including, but not limited to:

- A revised calculation with appropriate weight for each category;
- Revised guidance for rating MORS related to Under-60 issues to retract the current overall “Unsatisfactory” requirement;
- Clarification for tasks required by HUD staff versus PBCAs; and,
- Clarification for issuing subsequent MOR limited review reports issued by HUD staff for insured/subsidized properties in the PBCA portfolio.

HUD also invited NAHMA to offer comments on the revised version of Chapter 6 after the Department delayed implementation. NAHMA agreed that Chapter 6 needed to be updated. However, NAHMA members felt the new release included a number of problematic requirements.

Therefore, we recommended HUD make the following changes to Chapter 6:

- Rescind all policies that direct reviewing officials to assign unsatisfactory overall MOR ratings to properties based solely on the REAC score or the properties physical condition;
- Modify some of the specific criteria and numerical weights for reviewing officials to use in assigning ratings / performance indicators;
- Offer positive reinforcement to properties that receive above average scores on their management reviews;
- Prohibit PBCAs from imposing additional regulatory requirements on owner/agents beyond what is required by HUD regulations and handbooks; and
- Revise policies to prohibit reviewing officials and/or HUD staff from implementing policy changes that have not been officially approved by HUD and have not been conveyed to owners and management agents.

During this time, NAHMA members reported that some field offices were implementing the new version of Chapter 6 and issuing findings on MORs, despite HUD's transmittal to delay implementation until September 29. To that end, HUD sent out a memo to the field offices and PBCAs that clarified the implementation delay for the revised Chapter 6.

While HUD intended to issue a revised version of Chapter 6, Conducting Management Reviews, and place it into effect on September 29, 2009, they were unable to do so. HUD officials told NAHMA members at both the Fall 2009 and Winter 2010 meetings in Washington, D.C. that the revised version of Chapter 6 was still in the clearance process.

Summary

On July 7, 2010, HUD issued Change 2 for Chapter 6 of its HUD Handbook 4350.1. HUD's revisions to Chapter 6 make a number of additions, removals, clarifications, and improvements for consistency to existing protocol and policies so that they conform to current HUD practices, procedures, and the HUD-9834 form. The last implemented update to Chapter 6 was in 1992.

Change 2 does not include the requirement that the lowest categorical rating assigned to high-impact review areas serve as the overall rating, i.e., there is no longer a stipulation to give an automatic unsatisfactory overall MOR rating for an unsatisfactory REAC.

Change 2 also provides more objective procedures to determine ratings. The revision offers a more detailed set of standards/rating descriptions to apply when assigning the performance indicators (Superior, Above Average, Satisfactory, Below Average, and Unsatisfactory) for each of the seven rated categories. It also gives a consistent overall rating calculation, which is intended to eliminate major inconsistencies and variances in HUD field office ratings.

The effective date for field use of this chapter is August 1, 2010.

HUD Handbook 4350.1, Chapter 6 Revisions

Removals

As noted previously, one of the most important changes in the revised version of Change 2 is the removal of the requirement that the lowest categorical rating assigned to high-impact review areas also serves as the overall rating. This means that there is no longer a stipulation to give an automatic unsatisfactory overall MOR rating for an unsatisfactory REAC.

Change 2 also removes a number of outdated requirements from conducting an MOR, including conducting a physical inspection as part of the on-site management review process. Instead, the revised version requires the reviewer to only perform follow-up activities for REAC inspection reports.

Additions

Change 2 makes a number of additions to Chapter 6. First, it adds a new section identifying reviewing officials as HUD staff, Contract Administrators, and Mortgagees.

Second, the chapter now outlines the frequency of on-site reviews performed by HUD staff based on set timeframes and/or project actions. When resources are available, HUD reviewing officials must complete management reviews within the following timeframes and/or circumstances:

- Within six months after a project commences occupancy;
- Within six months following a change in project ownership/management;
- When desk reviews and risk assessments indicate that physical, financial or management problems exist and the extent or cause of the problem is not immediately apparent (troubled and potentially troubled project category);
- When deficiencies in project operations have been identified at other projects of the same owner/management agent;
- Prior to granting preliminary approval of a transfer of physical assets (TPA) proposal; and,
- As necessary to monitor the owner/agent's implementation of any required corrective actions or project improvement efforts.

In addition to the criteria listed above, Chapter 6 directs HUD field staff to consider the following factors when selecting properties for review. Considerations include:

- Cost of the review (staff, travel, time required, etc.) vs. budget and other priorities;
- Risk assessments obtained from HUD's Online Property Integrated Information Suite (OPIIS);
- Financial performance and compliance;
- New property;
- Change in control of operations;
- Transfer of physical assets;

- Physical condition and related compliance (e.g., progress on approved repairs);
- Existing knowledge of management operations concerns or noncompliance;
- Tenant feedback; and
- Subsidy type (on those contracts where HUD is the contract administrator).

Change 2 provides an additional section to discuss the Desk Review process currently used in the revised HUD-9834. The Desk Review occurs prior to the on-site review, prepares the reviewer for the on-site review, and reduces the burden on the owner/agent to provide information already available in HUD systems and file. During the Desk Review, the reviewing officials examine project files, system reports, and other documents and data relevant to the project under review, including iREMS.

HUD has also updated the Limited Reviews section to emphasize what parts of the MOR are to be done by HUD and those that are the responsibility of the PBCA. CAs are limited to completing certain sections of the management review form to determine compliance with the HAP contract. For HUD-insured projects that are reviewed by CAs, HUD must conduct a limited review of the remaining sections to assess O/A compliance with the Regulatory Agreement and other HUD agreements. HUD will issue a separate MOR for the categories reviewed by the field staff.

HUD has also incorporated actions that should be taken for owner/agent noncompliance issues in the revised version of Chapter 6. First, HUD field office staff must notify the owner/agent when there is a noncompliance issue with outstanding management review conditions. The section specifies that adverse findings should be referred to the Department Enforcement Center (DEC) and all reviewing officials must conduct follow up activities until all corrective actions have been completed. HUD staff may also consider placing a flag in APPS for ongoing deficiencies. CAs must perform due diligence to obtain O/A compliance. If an O/A is non responsive, the CA must refer the O/A to HUD for appropriate administrative action. Sanctions that can be taken against a management entity when noncompliance occurs include, but are not limited to:

- Requiring the owner to replace the management agent;
- Placing a flag against the owner/agent in the Active Partners Performance System (APPS); and,
- Referring the owner/agent to the DEC to initiate a limited denial of participation or other administrative sanction.

HUB directors have discretion to refrain from placing a flag in APPS for an O/A who receives and overall rating of “Below Average” or “Unsatisfactory.”

Next, HUD has added a section discussing the Contract Administrator’s (CA) role and interrelationship with HUD staff. It acknowledges that while management reviews should not duplicate other review activities, the information gathered from these sources should be used to complete Form HUD-9843. It also states that HUD staff should not conduct a management review in the same areas that CAs have oversight responsibility. However, there are some cases where HUD staff may conduct limited reviews to target areas of concern, in which case CAs will be notified if HUD issues an alternative rating. In this case, the CA’s rating is limited to the

O/A's compliance with the HUD contract. The rating from HUD's limited review will be issues to the owner separately. Deficiencies identified by HUD in this limited review will require follow-up by HUD staff. However, this process does not affect the overall rating given by the CA.

Finally, HUD has included a number of follow-up activities and procedures with the HUD-9834 form to ensure property compliance with HUD's lead-based paint rules and Hazard Control Plans, as well as address the automated REAC physical inspection and Annual Financial Submission processes.

Clarifications

Change 2 provides a list of all the projects administered by the Office of Multifamily Housing Programs in order to clarify to which programs the Chapter 6 applies.

Change 2 also clarifies that reviewing officials must confirm the scheduled review with O/As in writing at least two weeks in advance of that review. O/As must also be informed in advance of the documentation needed for the reviewer on the day of the review.

Improving consistency

HUD has updated and streamlined Chapter 6 to improve consistency with the HUD-9834, Management Review for Multifamily Housing Projects, which was revised in 2005.

HUD added detailed standards and rating descriptions to Chapter 6 for reviewers to apply when assigning the performance indicators for each of the seven rated categories in order to improve consistency between management review scores. The performance indicator descriptions are as follows:

- Superior: Actions consistently exceed statutory, regulatory, and Handbook requirements for an above-average rating (Score: 90-100);
- Above Average: Actions occasionally exceed statutory, regulatory, and Handbook requirements (Score: 80-89);
- Satisfactory: Actions meet statutory, regulatory, and Handbook requirements (Score: 70-79);
- Below Average: Actions rarely meet statutory, regulatory, and Handbook requirements (Score: 60-69); and
- Unsatisfactory: Actions did not meet statutory, regulatory, and Handbook requirements (Score: <59).

HUD has included instructions for calculating a consistent, overall rating, which are intended to eliminate major inconsistencies and variances in HUD field office ratings. Once reviewing officials have determined the numerical weight for each category (Superior, Above Average, Satisfactory, Below Average, and Unsatisfactory), as described above, they must multiply the performance indicator value by the assigned percentage of the overall rating for each category (either 10 or 25 percent), rounding up to the nearest whole number, to determine the calculated

points. The points are added, divided by 100, and rounded to the nearest whole number to provide a numerical value which will correspond to the overall rating given in the MOR.

The seven rated categories are assigned a weighted percentage of the overall rating value based on the level of risk for deficiencies, which are:

- General appearance and security 10%;
- Follow-Up and Monitoring of Project Inspections 10%;
- Maintenance and Standard Operating Procedures 10%;
- Financial Management/Procurement 25%;
- Leasing and occupancy 25%;
- Tenant/Management relations 10%; and
- General management practices 10%.

HUD has also included additional guidance in Chapter 6 for communicating the on-site management review results to the owner/agent for consistency with the HUD Desk Monitoring Guide. The HUD Desk Monitoring Guide requires all findings to include the condition, criteria, cause, effect, and corrective action. The HUD-9834 form was revised in 2005 to conform to this requirement. The change also specified that if the deficiencies identified during the on-site review are corrected, the reviewing official must send a letter to the O/A closing the findings and the close out actions must be notated in iREMS.

Finally, HUD has included a section on O/A appeals for “below average” and “unsatisfactory” MOR scores. The initial appeal is to be made to HUD Field Offices and/or the CA in writing. If the O/A wishes to escalate the appeal, he/she may submit a final appeal in writing to the Multifamily Hub Director. Decisions rendered by the Multifamily Hub Director are final and are not subject to further appeal.

Positive Aspects

The revised Chapter 6 Change 2 provides a number of alterations NAHMA requested in our August 14, 2009 comments. One of the most important NAHMA recommendations HUD has incorporated into the changes was the removal of the requirement to give an automatic unsatisfactory in an MOR when the REAC score for the property was unsatisfactory. We are pleased that HUD has recognized that the REAC physical inspection and the MOR ratings are not interchangeable and that the physical condition is only one of several factors used in the MOR to assess how well a property is managed.

NAHMA is also pleased that Chapter 6 listed specific criteria and numerical weights for reviewing officials to use in assigning ratings / performance indicators. We feel these additional criteria and numerical weights are a step in the right direction to improve the consistency of MOR scores across HUBs and PBCAs.

The 2010 change also addressed NAHMA’s concern from the 2009 version of Chapter 6 regarding the definition of a “superior” rating. The last sentence of the “superior” rating definition in the 2009 required that “there are no incidences of errors disclosed in the review or

major adverse findings.” NAHMA members were concerned that this would mean that any single finding, no matter how insignificant, would disqualify the property from receiving a "superior" rating. Because achieving absolute perfection is unrealistic, NAHMA requested that HUD allow for additional flexibility in the superior rating. HUD's 2010 language answers NAHMA's request by allowing a "few incidences of errors disclosed in the review and no major adverse findings (page 6-9)" in order to obtain a "superior" rating.

NAHMA was generally pleased with the approach HUD has taken to implement Chapter 6 in 2010 in comparison with the initial 2009 release. During Summer 2009, NAHMA received numerous complaints from members about PBCAs implementing and enforcing undisclosed "new HUD policies" prematurely. The changes to Chapter 6 had not been conveyed appropriately to the owners and agents before HUBs and PBCAs began implementing them. Despite HUD's transmittal to delay implementation until September 29, NAHMA members reported that some HUBs and PBCAs continued to implement Change 2 to Chapter 6 and issued findings on MORs.

NAHMA is heartened by the notice procedures and implementation time provided by HUD with the revised version of Change 2 to Chapter 6 on July 7, 2010. The Department notified owners and agents and provided a 3-week window for owners, agents, HUBs, and PBCAs to conform their procedures to the new policy before it became effective. NAHMA has been requesting HUD to provide adequate notification time and follow proper notification procedures for substantial policy and regulatory changes as part of our top ten regulatory priorities.

Finally, we are pleased HUD has included a section that allows O/As to appeal below average and unsatisfactory scores and lays out the process for doing so. We feel it is very important that O/As have the opportunity to appeal scores that may not accurately reflect the operations and services they provide that are reviewed in the MOR.

NAHMA Concerns

NAHMA was disappointed to see that Chapter 6 did not include NAHMA's proposal to stagger the scheduling of management reviews, based on the overall rating listed on the HUD-9834 within Chapter 6. Under the proposal, HUD would schedule management reviews every three years for affordable properties with "superior" overall ratings on the HUD-9834, every two years for "above average" properties and annually for all others. We strongly believe that this policy would incentivize strong management performance, improving the average management review score.

While NAHMA appreciates the clarifications HUD has made in Change 2 to improve consistency in the MOR process, we do not believe these changes go far enough to prevent CAs from imposing additional regulatory requirements on owner/agents beyond what is required by HUD regulations and handbooks. The language that specifies that that CAs must perform management reviews in accordance with established contractual requirements and procedures (page 6-3) is not specific or strong enough to prevent additional administrative burdens. NAHMA members have reported significant variations across HUBs and PBCAs in their administration of HUD policies. In order to achieve greater program consistency, NAHMA continues to request that HUD clarify that PBCAs are to administer HAP contracts pursuant to

HUD's regulatory requirements, and PBCAs may not impose additional paperwork, policies or procedures on owner/agents. We have also included this request in our recent comments on the new ACC for PBCAs.

In addition to the extra regulatory requirements, many NAHMA O/As—who operate in multiple regions/states—have reported seeing inconsistent implementation of HUD policy across field offices and CAs. NAHMA continues to request that HUD provide stronger language in all subsequent documents to ensure that field offices and CAs are implementing Headquarters policy in a consistent manner.

NAHMA Position

NAHMA is generally pleased with the revisions made by July 7, 2010 Change 2 to Chapter 6. We are relieved to see that an unsatisfactory REAC will not automatically result in an unsatisfactory MOR. We feel that several of the clarifications and language tweaks HUD has made within Chapter 6 will help improve consistency within the MOR reviews. We believe the addition of the specific criteria and numerical weights for reviewing officials to use in assigning ratings / performance indicators will also provide improved consistency across reviews.

Nevertheless, we were disappointed by HUD's decision not to include NAHMA's proposed schedule staggering of the management reviews, similar to the current staggered inspections for REAC. In addition, NAHMA feels there is a need for continued monitoring from HUD headquarters to ensure consistency across PBCAs and HUD field offices in implementation of the Chapter 6 MOR procedures.

NAHMA will continue encouraging HUD to use proper administrative procedures every time it releases new policies and regulations. It is imperative that HUD provides owners, agents, field offices, and PBCAs adequate notification and preparation time before implementation so that owners and agents are not unfairly penalized for non-compliance.