



**Office of Public and Indian Housing
Washington, DC**

**Public Housing Operating and Capital Fund
Program Central Office Cost Center Fees**



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SUBJECT: HUD Could Not Support the Reasonableness of the Operating and Capital Fund Programs' Fees and Did Not Adequately Monitor Central Office Cost Centers

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG), final results of our review of HUD's Public Housing Operating and Capital Fund program asset management safe harbor fees and HUD's monitoring of central office cost centers.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at <http://www.hudoig.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at 213-534-2471.



June 30, 2014

HUD Could Not Support the Reasonableness of the Operating and Capital Fund Programs' Fees and Did Not Adequately Monitor Central Office Cost Centers

Highlights

Audit Report 2014-LA-0004

What We Audited and Why

We audited the U.S. Department of Housing and Urban Development's (HUD) methodology and monitoring regarding the Office of Public Housing's asset management fees and central office cost centers due to our concerns over potential misspending by public housing authorities and the lack of restrictions in the use of such funds. Our objective was to determine how HUD arrived at the asset management fee limits in its Public Housing Operating and Capital Fund programs and whether its methodology for setting these limits and its monitoring of these fees were reasonable.

What We Recommend

We recommend that HUD (1) revise its asset management fee policy to refederalize the Operating and Capital Fund programs' fee revenue, (2) eliminate the asset management fee, (3) require the San Francisco Housing Authority to support or repay \$6.1 million in fees, (4) require the City of Los Angeles and Southern Nevada Regional Housing Authorities to repay \$751,860 in excessive fee charges, and (5) establish and implement policies and procedures for the assessment and monitoring of the fees.

What We Found

HUD could not adequately support the reasonableness of the Operating Fund management, bookkeeping, and asset management fees and Capital Fund management fee limits. In addition, HUD lacked adequate justification for allowing housing authorities to charge an asset management fee, resulting in more than \$81 million in operating funds being unnecessarily defederalized annually. HUD also did not adequately monitor housing authorities' central office cost center fee charges. Among five housing authorities reviewed, four inappropriately overcharged or transferred \$2.3 million in excessive operating program funds from their asset management projects to their central office cost centers. Two of the housing authorities were unable to support \$6.7 million in management, bookkeeping, and asset management fees charged. Since central office cost center funds are considered non-Federal funds and no longer subject to HUD requirements, there is a greater potential for fraud, waste, and abuse. Consequently, two housing authorities used approximately \$4.3 million in central office cost center fee revenue for questionable costs.

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BACKGROUND AND OBJECTIVE

The U.S. Department of Housing and Urban Development (HUD) published the final rule on the Public Housing Operating Fund program, 24 CFR (Code of Federal Regulations) Part 990, which included two major provisions: to provide a new formula for determining operating subsidies to public housing agencies and to establish requirements for housing authorities to convert to a new business model, called asset management, which was implemented in calendar year 2007. HUD issued a supplement to address the changes in financial management and reporting for housing authorities. The supplement established that housing agencies must be required to replace cost allocation systems with a series of fees for the Public Housing Operating and Capital Fund programs.

Under the Operating Fund rule, housing authorities with 250 or more units must convert to asset management, while housing authorities with fewer than 250 units may voluntarily convert to asset management. The change to asset management was to give greater attention to the performance of each public housing project. A public housing authority can demonstrate successful conversion to the asset management model by implementing five major elements: (1) project-based funding, (2) project-based budgeting, (3) project-based accounting, (4) project-based management, and (5) project-based performance assessment. The public housing authority has the option of contracting with a private management company to manage its projects or it can manage its projects itself. By providing management services to the projects, a public housing authority will pay the private management company or pay itself a fee, which is collected by its central office cost center, the business unit within the housing authority that earns income from fees or revenue from other business activity and charged to its projects.

HUD established the types and amount of fees that housing authorities may charge to their asset management projects.

- (1) Housing authorities could charge each project a reasonable management fee to fund the operation of their central office cost centers. HUD published an annual management fee schedule, which represented the 80th percentile of management fees paid in HUD's multifamily housing programs based on the most recently filed annual financial statements. HUD allowed housing authorities to use the amounts from this schedule to establish the "reasonable" fee charged to each project.
- (2) In addition, housing authorities were permitted to charge a bookkeeping fee for the project accounting functions, which was determined to be \$7.50 per unit month.
- (3) HUD also allowed housing authorities to charge an asset management fee at a rate of \$10 per unit month based on all units under the annual contributions contract as long as the project had excess cash in an amount sufficient to cover 1 month of operating expenses in the prior year.
- (4) Housing authorities could charge up to a maximum of 10 percent of their annual Capital Fund grant as a management fee.

Although HUD limits the fees charged, housing authorities may depart from the guidance as long as they consult with HUD and obtain its view on the reasonableness of the fees intended to be charged.

According to Supplement to HUD Handbook 7475.1, REV, CHG-1, Financial Management Handbook, these fees are considered nonprogram income for purposes of 2 CFR Part 225 and 24 CFR Part 85; however, State and local restrictions may still apply. Consequently, any reasonable fees earned by the central office cost center will be treated as local revenue, and the housing authority may use such fees in accordance with its mission, subject only to any local, but not Federal, restrictions.

Our objective was to determine how HUD arrived at the asset management fee limits in its Public Housing Operating and Capital Fund programs and whether its methodology for setting these limits and its monitoring of these fees was reasonable.

RESULTS OF AUDIT

Finding: HUD Could Not Support the Reasonableness of Its Operating and Capital Fund Programs' Fees and Did Not Adequately Monitor Central Office Cost Centers

HUD could not adequately support the reasonableness of its Operating Fund program's management, bookkeeping, and asset management fees and Capital Fund management fee limits, and it did not adequately justify the need for the asset management fee. In addition, HUD generally did not adequately monitor the housing authorities' central office cost center fee charges. This condition occurred because HUD did not retain the complete working documents used to determine the reasonableness or the basis of the fees of the central office cost centers, nor had it reassessed the reasonableness of the rates since their inception. It also did not monitor charges to its housing authorities' central office cost center because those fees were considered defederalized and no longer subject to HUD's requirements. Therefore, approximately \$353 million in public housing operating funds was defederalized annually as management, bookkeeping, and asset management fees between January 2009 and December 2011, without assurance that the amounts being charged were reasonable. Of this amount, approximately \$81.6 million in asset management fees was unnecessarily charged to the public housing agencies' asset management projects, annually. Among five housing authorities reviewed, four inappropriately overcharged or transferred \$2.3 million in excessive operating program funds from their asset management projects to their central office cost centers. Two of the housing authorities were unable to support \$6.7 million in management, bookkeeping, and asset management fees charged. Since central office cost center funds are considered non-Federal funds and no longer subject to HUD requirements, there is a greater potential for fraud, waste, and abuse. Consequently, two housing authorities used approximately \$4.3 million in central office cost center fee revenue for questionable charges.

HUD Did Not Retain a Basis for Central Office Cost Center Fees

HUD could not adequately support the reasonableness of its Operating Fund program's fee limits. HUD did not retain the complete working documents used to determine the reasonableness of the central office cost center fee rates, nor had it reassessed the reasonableness of the rates since their inception.

Management Fees

HUD provided the data set and methodology it used to derive the 2013 management fees that were published in the annual management fee schedules. However, it could not adequately support the basis for taking the 80th percentile of the management fees paid in HUD's multifamily housing programs. HUD stated

that the 80th percentile was determined by a panel that discussed what was reasonable to set as management fees. This percentage had not been reevaluated since its inception. Some working documents were retained and provided by HUD, but they were incomplete and did not adequately explain the basis for the management fees. As of 2013, HUD still used the data from the multifamily housing program to establish the fees, although it had about 6 years of historical data from housing authorities. HUD stated that it had discussed and considered using housing authority rather than multifamily housing program data; however, a decision had not been made to transition to that approach. On average, approximately \$205.3 million in management fees were defederalized annually by public housing authorities nationwide.¹

Bookkeeping Fees

HUD provided a working document regarding the bookkeeping fees, but a review of the document did not adequately justify the reason for setting the bookkeeping fee rate at \$7.50. HUD stated that at the time the bookkeeping fee rate of \$7.50 was set, the average bookkeeping fee rate for multifamily housing was about \$3.50 per unit month. The higher bookkeeping fee for housing authorities reflected higher centralized information technology and human resources costs in public housing. However, there was no support for the analysis to show how HUD determined that the \$4.00 difference was reasonable. HUD had not considered increasing the fee for public housing. HUD stated that it had not reassessed this rate because housing authorities could exceed the rate as long as they consulted with HUD on fees that might depart from established guidance before charging the fees. On average, approximately \$66.2 million in bookkeeping fees were defederalized annually by public housing authorities nationwide.

Asset Management Fees

HUD had not provided an explanation or methodology in describing how it arrived at its asset management fee rate of \$10 and the basis for allowing the fee. This rate had not been reassessed since its inception. According to HUD, asset management fees are similar in nature to distributions allowed under the multifamily program, since a housing authority may not take an asset management fee unless the project has excess cash. HUD explained that these fees were an “incentive” to the housing authority to both operate its public housing projects and its central offices in a financially prudent manner. However, based on HUD Handbook 4370.2, chapter 2-8 (C), the multifamily program generally did not permit nonprofit entity owners distributions or cash withdrawals, other than for the payment of reasonable expenses necessary to the operation and maintenance of the project, from surplus cash. Surplus cash must be deposited into the residual receipts account and may be released only with prior written approval from HUD (see appendix C).

¹ Capital fund management fees were included in the overall management fees reported in the Subsystem and cannot be separated unless a review is conducted at each housing authority.

HUD denied that asset management fees represented a profit for the housing authorities. However, this fee did not cover additional charges necessary for the operation and maintenance of the projects. As a result, asset management fees did not serve any purpose other than to allow a housing authority to defederalize additional funds from its projects to retain as profit in its central office cost center. Housing authorities are not profit-motivated entities and should always operate in a financially prudent manner. Therefore, we believe that asset management fees should be disallowed in future assessments of central office cost center fees. On average, approximately \$81.6 million in asset management fees were defederalized annually by public housing authorities nationwide.

Capital Fund Management Fees

HUD stated that the 10 percent management fee was statutory and derived from section 9(d) of the U.S. Housing Act of 1937, which allows a housing authority to charge up to 10 percent of the Capital Fund grant for “administration.” These administrative costs must be specifically apportioned and documented. Under a fee-for-service system, the housing authority may charge a management fee of 10 percent, regardless of actual cost. HUD explained that the fee rate had not changed but the treatment of the fee income changed under the asset management model, as it is now considered non-Federal funds. The HUD handbook stated that HUD would periodically review the Capital Fund program management fee amounts to determine whether adjustments were warranted (see appendix C). The 10 percent rate had not been revised since its inception. HUD did not provide its basis for allowing the housing authorities to charge the entire 10 percent of their Capital Fund grant as a management fee or show that this rate was reasonable.

HUD Did Not Adequately Monitor Central Office Cost Center Accounts

HUD headquarters did not have a policy in place to monitor its housing authorities’ central office cost center accounts unless they were deemed to be troubled, standard, or high-moderate risk or if the housing authorities’ asset management projects were having cash flow problems or some other ad hoc event that occurred to raise a question regarding the central office cost center accounts. Because HUD was concerned with the performance of the developments under an asset management model, it would not look at a housing authority’s central office cost center account unless the housing authority was experiencing financial issues or one or more of its asset management projects had limited cash flow. HUD relied on the housing authorities’ compliance with the Office of Management and Budget Circular A-133 Compliance Supplement as determined by audited financial statements and notification edits of the housing authorities’ electronic submissions to the Financial Assessment Subsystem for Public Housing

(Subsystem)² conducted by the Real Estate Assessment Center (Center). Further, HUD stated that the independent public auditor should review the fee structure and if the audit identified a problem, HUD would take appropriate action.

The Los Angeles, San Francisco, Cleveland, and Hartford public housing field offices did not review the central office cost center accounts of their respective housing authorities because they considered those funds as non-Federal and not subject to the public housing rules. They generally stated that their monitoring of housing authorities was triggered by a fee alert letter from the Center, a review of information in the electronic submissions and the independent public audit reports, or a request from HUD headquarters. They would monitor the fees that were charged to the asset management projects to ensure that they were calculated correctly; however, they would not monitor how the fee revenue was used and expended from the central office cost center.

The Center implemented the fee alert letters to identify potential noncompliance with HUD-established limits to its public housing authorities' central office cost center fees in January of 2013. The fee alert letters were designed to assist HUD's field offices and the program office in their monitoring activities. When a public housing authority entered its annual financial information into the Subsystem, it would check for anomalies with the fees charged to the projects. An anomaly would generate a fee alert letter, which would be sent to the HUD field office responsible for the particular public housing authority. This letter would prompt the field office to check into the particular issue identified. Although the asset management model took effect in 2007, the fee alert letters were not implemented until early 2013 due to HUD's resource limitations. In addition, the computation logic to test the asset management fees malfunctioned. As a result, the Center inactivated the letters³ to correct the problem. The Center's program manager did not know when the errors were identified. The computation logic was corrected, and the letters were reactivated in December 2013. However, local field offices notified the Center that the logic was still incorrect. The Center inactivated the letters a second time and planned to reactivate them but HUD local field offices will not receive fee alert notices for asset management until May 2014.

Housing Authorities Had Excessive and Unsupported Charges

We found indications that the housing authorities in our review (1) charged fees in excess of HUD's established limits, (2) lacked supporting documentation when defederalizing fees, (3) transferred public housing operating funds to the central

² The Real Estate Assessment Center receives and analyzes the annual financial statements of the nation's public housing authorities from their submissions to the Financial Assessment Subsystem for Public Housing.

³ The letters for management and bookkeeping fees remained active.

office cost centers in excess of what they earned to cover fund deficits, (4) overcharged projects for cost center type charges with or without supporting documentation, and (5) transferred funds between projects without excess cash in the previous fiscal year. We performed our analysis at the San Francisco, City of Los Angeles, and Nevada housing authorities. We also included the results of Bridgeport and Stark housing authorities, which we audited separately.

San Francisco Housing Authority

According to a Center report, issued on August 16, 2011, the San Francisco Housing Authority failed to demonstrate full compliance with the “stop loss”⁴ criteria. Specifically, the Center cited that San Francisco’s management fee of \$78 per unit month was higher than the 2010 management fee table published rate of \$65, which was \$13 per unit month higher than HUD deemed reasonable and, therefore, an overcharge of almost \$900,000. We attempted to validate whether San Francisco had corrected the use of this rate by reviewing its fiscal year 2010 general ledger and management and bookkeeping fee calculations. However, San Francisco did not provide the necessary supporting documents. Since San Francisco was unable to provide support for its general ledger entries for both management and bookkeeping fees, we determined the \$5.8 million⁵ to be unsupported for fiscal year 2010.

We compared San Francisco’s internal records with the electronic submission to the Subsystem and noted a disparity of \$332,246. The internal records showed an asset management fee calculation of \$418,320, while the electronic submission showed \$750,566 for fiscal year 2009. We asked San Francisco for the fiscal year 2009 general ledger and an explanation of the variance; however, San Francisco did not provide the general ledger or explain the variance. Based on our analysis, San Francisco should have charged only \$418,320 to its asset management projects. Therefore, asset management fees charged in excess of \$418,320 would not be eligible. Since we could not verify whether the \$332,246 was an asset management fee or another fee that was categorized incorrectly, we determined this amount to be unsupported.

San Francisco was designated troubled by HUD, based on the Public Housing Assessment System score for the fiscal yearend September 30, 2011. Coupled with the Center report, San Francisco executed a stop loss corrective action plan with HUD in July 2013, which required demonstration of compliance with the stop loss criteria as outlined in a Center report within 180 days of plan execution. San Francisco received conditional approval for stop loss funding in fiscal year 2013. Also, the HUD San Francisco field office performed a stop loss onsite review in January 2014 and determined that San Francisco had demonstrated successful conversion to asset management. As part of the review, the HUD San

⁴ Under the new operating rule, public housing authorities that will experience a decline in funding can have their losses “stopped” by demonstrating a successful conversion to asset management.

⁵ Management (\$5,398,225) and bookkeeping (\$460,850) fees identified in San Francisco’s fiscal year 2010 audited financial statements

Francisco field office used San Francisco's responses and supporting documents as outlined in its stop loss corrective action plan agreement, which included reviewing the management and asset management fees. Given the issues identified above, we requested that HUD and the San Francisco field office provide documentation used to lift the corrective action plan or input related to the management and asset management fees, but we received nothing.

Housing Authority of the City of Los Angeles

The City of Los Angeles inappropriately overcharged its asset management projects \$714,000 in asset management fees in fiscal years 2009 and 2010 because it misapplied HUD's 3-year implementation criteria, which sets guidelines that would allow a housing authority to charge asset management fees. The City of Los Angeles should not have charged an asset management fee for four asset management projects in fiscal year 2009 and 11 projects in fiscal year 2010.

The July 2007 criteria, Table of Fees Under Asset Management, was posted on the HUD Office of Public Housing's Web site as a supplement to HUD Handbook 7475.1, REV, CHG-1, Financial Management Handbook (see appendix C). Although the criteria were not published in a public and Indian housing notice or incorporated into a handbook, HUD confirmed the criteria to be official and effective. The criteria apply only to the first 3 years of asset management implementation.

HUD clarified that for the second and third year of implementation, the prior year's financial information should be reviewed to determine eligibility for an asset management fee. The City of Los Angeles commented that the criteria did not specifically state that prior-year data should be reviewed and the only mention of looking at excess cash from the prior year applied in the fourth year of asset management implementation and onward. We agree that the criteria could be easily misinterpreted, which raised the concern that other housing authorities may have also misapplied the criteria.

During the HUD Los Angeles field office limited financial management review conducted between December 2011 and February 2012, the field office concluded that the asset management fee calculation, based on review of the Center's financial data schedules from 2009 and 2010, proved to be reasonable under HUD-published limits. This review was in draft form and had not been issued by the field office. Although the report stated, "HUD Financial Analysts reviewed fee-for-service expenses from HCV [the Housing Choice Voucher program] and PH [public housing] to ensure these programs were not overcharged," HUD stated that the field office did not verify the excess cash computations but was limited to verifying that the City of Los Angeles used the correct number of units to calculate the asset management fee rates and that the per unit rates were reasonable. To demonstrate that asset management fees were not overcharged in fiscal years 2009 and 2010, the field office should have tested whether the asset

management project met the 3-year implementation criteria, and its failure to do so left the overcharges undetected.

Southern Nevada Regional Housing Authority

The Nevada housing authority inappropriately charged asset management fees of \$37,860 to three asset management properties in fiscal year 2011, although those properties reported cash deficiencies in the prior year. The Nevada housing authority stated that excess cash was low in this fiscal year because it was the first year of their agency's regionalization. The financial analyst responsible for monitoring this agency did not receive a fee alert letter from the Center; therefore, the issue was not identified. Because this issue occurred before the implementation of the asset management fee letters in January 2013, the HUD field office would not have caught the inappropriate charges unless it actively monitored the Nevada housing authority's asset management fee calculations.

Bridgeport Housing Authority

The Bridgeport Housing Authority (OIG audit report number 2014-BO-1001, issued January 23, 2014) overcharged its projects \$281,611, including management (\$108,193), bookkeeping (\$14,538), and asset management (\$158,880) fees, between October 2009 and April 2013. In addition, Bridgeport paid \$297,083 in charges with its asset management projects that should have been charged directly to its central office cost center. It also improperly transferred \$225,000 in funds between asset management projects in fiscal year 2012 when the projects did not have the required excess cash. Finally, Bridgeport did not provide adequate documentation to support charges of \$584,119 and as a result, may have overcharged its asset management projects and undercharged its central office cost center.

Stark Metropolitan Housing Authority

Stark Metropolitan Housing Authority (OIG audit report number 2013-CH-1003, issued July 15, 2013) made ineligible transfers of \$773,049 in public housing operating funds from its asset management projects to its central office cost center in excess of what it earned.

Charges From Central Office Cost Centers Were Questionable

Fees earned by and transferred into the central office cost center are defederalized and no longer subject to HUD requirements. Therefore, the charges paid from the central office cost center are not transparent to the public, and housing authorities cannot be held accountable to HUD for inappropriate uses of central office cost center funds. Since there is no Federal oversight with respect to the use of these funds, there is a much greater potential for fraud, waste, and abuse. Because HUD was unable to demonstrate the reasonableness of the fees, public housing agencies nationwide may have defederalized excessive amounts of taxpayer

dollars for use on questionable expenses that did not agree with HUD's mission and goals.

To illustrate our concerns with HUD's policy of defederalizing fees, we performed a limited review of our sample housing authorities' central office cost centers and identified more than \$4.3 million⁶ in expenses from the City of Los Angeles' and San Francisco Housing Authority's central office cost centers that would appear excessive or questionable if charged to restricted HUD program funds (see chart below). For instance, the former executive director of the City of Los Angeles earned a six-figure salary, benefits, and generous "perks," including a bonus, housing allowance, and surveillance system installed at his home. Media reports of his salary contributed to HUD implementing a \$155,500 limit⁷ on executive salaries. He also negotiated and received a seven-figure severance package for a wrongful termination settlement with the City of Los Angeles. The funds used to pay for these expenses came from the central office cost center. They were primarily funded by defederalized HUD fees and were, therefore, beyond HUD's control. In another instance, the former executive director of the San Francisco Housing Authority was on medical leave from January 29 to March 29, 2013, yet his six-figure salary in excess of the \$155,500 limit HUD instituted, was paid out of the central office cost center with de-federalized HUD fees. Media reports indicated that he led the San Francisco Housing Authority to the brink of financial ruin as a result of ongoing deficits in the past three or four years, while receiving a paycheck even though he was on medical leave for two months. Another media article stated that while the former executive director was on medical leave, he was setting up a restaurant in Berkeley, which was slated to open on May 1, 2013. These matters were covered extensively in the local media, portraying both housing authorities primarily funded by HUD in a negative light.

⁶ The \$4.3 million in questionable expenses for the City of Los Angeles and San Francisco Housing Authorities (\$3,911,651 and \$456,601, respectively) were spent with defederalized funds and therefore, were not included in our questioned costs and funds to be put to better use totals.

⁷ Public and Indian Housing Notice 2012-14 limits the salary a housing authority is allowed to charge to the fiscal yearend 2012 Section 8 and Section 9 funds for a chief executive office or other officials to \$155,500 (see appendix C).

Housing Authority of the City of Los Angeles		
Expense type	Amount	Description
Security camera system	\$36,926	Installed at former executive director's home.
Jordan Downs project – property with extensive soil contaminants purchased without proper environmental studies	\$51,559	Represents predevelopment type costs and is only a portion of what OIG was able to identify. There may have been more expenses hidden within the central office cost center.
Travel	\$64,056	Questionable travel charges paid from individually held “P-cards” that were identified by the Los Angeles city controller’s office. OIG did not validate the results of the controller’s office.
Former executive director’s housing allowance	\$294,126	This amount represents the former executive director’s housing allowance between January 2009 and October 2012. Of the total amount, \$96,789 represents his housing allowance for the period May 2011 to October 2012, and this amount was negotiated in the former executive director’s severance package.
Bonuses	\$403,848	Bonuses awarded to staff and senior management between fiscal years 2009 and 2010. The former executive director was awarded a bonus of \$46,887 in 2010.
Senior manager salaries	\$522,453	Represents senior manager salaries earned between fiscal years 2009 and 2011 over the salary cap if it was in place before 2012.
Former executive director’s settlement-severance package	\$1,102,719	Settlement payment, attorney fees, insurance, severance, Public Employees’ Retirement System service credit purchase payoff, final payoff. This amount does not include the housing allowance portion of his severance package.
Legal settlements	\$1,435,965	Eleven cases were settled and paid from the central office cost center between January 2007 and October 2013. This does not include cases that were tried before the court.
Subtotal - Los Angeles	\$3,911,651	

San Francisco Housing Authority		
Expense type	Amount	Description
Former executive director’s severance package	\$112,636	Payout and severance package to executive director.
Former executive director’s salary	\$165,000	Represents former executive director’s salary earned between fiscal years 2010 and 2012 over the salary cap if it was in place before 2012.
Legal settlements	\$178,965	Settlement payments between fiscal years 2010 and 2013.
Subtotal - San Francisco	\$456,601	

Defederalization and Reduced Oversight Increased Risk to Program

HUD stated that part of the reason for the transition to this defederalized fee approach was to reduce administrative requirements for Federal oversight

agencies. HUD benefited from housing authorities adopting this management fee approach because HUD's monitoring responsibilities were greatly reduced. HUD did not need to evaluate whether a housing authority's allocation system was reasonable nor did it need to monitor the spending of fee income that was charged to the asset management projects. However, this hands off policy conflicts with OMB Circular A-123, which states that "proper stewardship of Federal resources is a fundamental responsibility of agency managers and staff. Federal employees must ensure that government resources are used efficiently and effectively to achieve intended program results. Resources must be used consistent with agency mission, in compliance with law and regulation, and with minimal potential for waste, fraud, and mismanagement." Although adopting this fee approach reduced HUD's administrative requirements, it has been detrimental to HUD's program and overall mission and created further opportunity for fraud, waste, and abuse of taxpayer dollars.

Conclusion

HUD could not support the reasonableness of its Operating Fund program's management, bookkeeping, and asset management fees and its Capital Fund program's management fees because it did not retain the necessary documentation. HUD also did not adequately justify the need for an asset management fee. In addition, it generally did not adequately monitor the housing authorities' central office cost center expenses because the fees were defederalized and no longer subject to HUD's requirements. Consequently, about \$353 million in public housing operating funds was defederalized annually as fees between January 2009 and December 2011, without adequate assurance that the fees were reasonable or justified. Of this amount, about \$81.7 million in asset management fees nationwide could be put to better use for the purpose of achieving HUD's mission if procedures are implemented to ensure that the fees are reasonable and justified. Based on our analyses, the asset management fee is not justified and should be discontinued. Prior to implementing this fee structure and defederalizing these funds, excess operating and capital funds could only be used for their respective programs. By not ensuring the fees charged are appropriate, excess funds can now be moved out of and no longer benefit the program. Four of the five housing authorities reviewed inappropriately defederalized \$2.3 million in excessive Operating Fund program funds by either overcharging or transferring funds of their asset management projects to their central office cost centers. Further, the housing authorities were unable to support \$6.7 million in management, bookkeeping, and asset management fees. The lack of HUD monitoring increased the potential for fraud, waste, and abuse with the use of central office cost center funds. We identified approximately \$4.3 million in central office cost center funds that were used for excessive and questionable charges.

Recommendations

We recommend that the Deputy Assistant Secretary for Public Housing and Voucher Programs

- 1A. Revise HUD's asset management fee policy to refederalize the Operating Fund program's management and bookkeeping fees and the Capital Fund program's management fees.
- 1B. HUD should remove the provision that allows public housing authorities to charge asset management fees, which would ensure that at least \$81.6 million in operating funds could be put to better use in meeting HUD program objectives.
- 1C. Establish and implement procedures to reassess the management and bookkeeping fees periodically to ensure that they are reasonable. HUD should retain the documentation justifying the calculation of the rates.
- 1D. Require the San Francisco Housing Authority to support or repay from non-Federal funds management fees of \$5,398,225, bookkeeping fees of \$460,850, and asset management fees of \$332,246 charged to its projects for fiscal years 2009 and 2010.
- 1E. Recapture excessive asset management fee charges of \$714,000 from the Housing Authority of the City of Los Angeles or require it to repay this amount from non-Federal funds.
- 1F. Recapture excessive asset management charges of \$37,860 from the Southern Nevada Regional Housing Authority or require it to repay this amount from non-Federal funds.

We recommend that the Deputy Assistant Secretary for Real Estate Assessment Center

- 1G. Develop and implement automated controls in the Subsystem to ensure that housing agencies nationwide do not charge excessive asset management fees.

We recommend that the Acting Deputy Assistant Secretary for Field Operations

- 1H. Develop, document, and implement written procedures to ensure that fees charged to the asset management projects and Capital Fund program and expenses from the central office cost center are used to support HUD's mission.

SCOPE AND METHODOLOGY

We conducted our onsite work from September 2013 to March 2014 at the Nevada, City of Los Angeles, and San Francisco housing authorities. Our audit generally covered the period March 2009 to November 2013. We expanded our scope as necessary.

To accomplish our objective, we

- Interviewed HUD headquarters, HUD field office, Housing Authority of the City of Los Angeles, Southern Nevada Regional Housing Authority, and San Francisco Housing Authority staff.
- Interviewed Columbus and Boston OIG auditors and reviewed their work papers for information on their audits of the Stark and Bridgeport authorities.
- Reviewed applicable HUD requirements, including Supplement to HUD Handbook 7475.1, Financial Management Handbook; 24 CFR Part 990; and Office of Management and Budget Circular A-87.
- Analyzed and sorted the audit universe provided by the Center from the Subsystem. We relied on the information in HUD’s Subsystem since the data submitted was from an audited source. We also verified that the information submitted to the Subsystem by the City of Los Angeles and the Nevada Housing Authorities were supported by their general ledgers. We analyzed the information from housing authorities with audited financial statements for the period January 1, 2009, to December 31, 2011, which represents the first three full years of information submitted into the Subsystem, and isolated the housing authorities that reported management, bookkeeping, and asset management fees. We did not include subsequent periods’ data because the housing authority submissions to the Subsystem were incomplete. Based on that, we averaged the management and bookkeeping fees of \$271.5 million (\$205.3 and 66.2 million, respectively) and asset management fees of \$81.6 million for each housing authority recognized nationwide.

Fiscal Year	Management fee	Bookkeeping fee	Asset management fee
2009	\$ 192,708,551	\$ 64,118,800	\$ 80,857,266
2010	\$ 211,745,300	\$ 65,763,631	\$ 83,264,833
2011	\$ 211,532,527	\$ 68,864,575	\$ 80,718,914
Total	\$ 615,986,378	\$ 198,747,006	\$ 244,841,013
Average	\$ 205,328,793	\$ 66,249,002	\$ 81,613,671

- Reviewed City of Los Angeles, Nevada, and San Francisco authorities’ electronic submissions to the Subsystem between fiscal years 2008 and 2012.

- Reviewed City of Los Angeles, Nevada, and San Francisco authorities' internally maintained calculations and records of their management, bookkeeping, asset management, and Capital Fund management fees. We also reviewed their unit data and excess cash analysis based on the financial audited statement submitted to the Center.
- Reviewed City of Los Angeles, Nevada, and San Francisco authorities' central office cost center accounts to identify substantial or questionable charges.
- Reviewed HUD field offices' monitoring reports on their housing authorities.

We selected the City of Los Angeles, San Francisco, and Nevada housing authorities for review from a population of housing authorities managed by the local HUD field offices of Honolulu, Los Angeles, Phoenix, San Francisco, and Sacramento. The information was obtained from the Inventory Management System, Public and Indian Housing Information Center. We sorted the listing based on the largest public housing units. We opted to not perform a review at the Hawaii Public Housing Authority due to the excessive cost of travel. We were unable to select a sample on a statistical basis from a nationwide population because the Center did not provide the data in a timely fashion.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

INTERNAL CONTROLS

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objective:

- Controls to ensure that HUD assesses or reassess fee rates periodically to ensure that they are reasonable.
- Policies and procedures designed to ensure that HUD monitors central office cost center fees for excessive charges and to ensure that funds are spent according to HUD requirements.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- HUD could not support the reasonableness of its Operating Fund program's fee limits, nor did it monitor the fees expensed from the central office cost centers (see finding 1).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

Recommendation number	Ineligible <u>1/</u>	Unsupported <u>2/</u>	Funds to be put to better use <u>3/</u>
1B			\$81,613,671
1D		\$6,191,321	
1E	\$714,000		
1F	\$37,860		
Total	\$751,860	\$6,191,321	\$81,613,671

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations. The ineligible amount represents asset management fees charged in excess of HUD's requirement for the Housing Authority of the City of Los Angeles (\$714,000) and the Southern Nevada Regional Housing Authority (\$37,860). We did not include \$1,576,743 in ineligible charges since those amounts were already included in the Bridgeport (\$803,694) and Stark (\$773,049) audit reports (OIG audit report number 2014-BO-1001, issued January 23, 2014 and 2013-CH-1003, issued July 15, 2013)

2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures. The unsupported amount represents \$5,398,225 in management fees, \$460,850 in bookkeeping fees, and \$332,246 in asset management fees at the San Francisco Housing Authority. We did not include \$584,119 in unsupported charges since that amount was already included in the Bridgeport audit report (OIG audit report number 2014-BO-1001, issued January 23, 2014)

3/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an OIG recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other

savings that are specifically identified. In this instance, by HUD not allowing PHAs to collect unneeded asset management fees, we estimate, over the next year, it would have available approximately \$81.6 million more for use by asset management projects (see Scope and Methodology section).

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

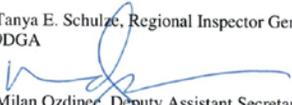
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-5000



May 29, 2014

OFFICE OF PUBLIC AND INDIAN HOUSING

MEMORANDUM FOR: Tanya E. Schulze, Regional Inspector General for Audit, Los Angeles Region,
9DGA

FROM: 
Milan Ozdince, Deputy Assistant Secretary, Office of Public Housing
and Voucher Programs, PE


D.J. Lavoy, Deputy Assistant Secretary for Real Estate Assessment Center, PX


Lindsey Reames, Acting Deputy Assistant Secretary for Field Operations, PQ

SUBJECT: **Response to Discussion Draft Report, Public Housing Asset Management
Fee Rates and Central Office Cost Centers**

For your consideration, the Office of Public Housing and Voucher Programs (OHVP); the Office of Real Estate Assessment Center (REAC); and the Office of Field Operations, hereby provides our consolidated Office of Public and Indian Housing (PIH) comments. Please see the attachment relating to the Discussion Draft Report on Public Housing Asset Management Fee Rates and Central Office Cost Centers.

If you have any question, please contact Miguel Fontánez, Director FMD, at (202) 402- 4212.

Attachment

cc: Vincent Mussetter

PIH COMMENTS ON RECOMMENDATIONS RELATING
TO THE DISCUSSION DRAFT REPORT
PUBLIC HOUSING ASSET MANAGEMENT FEE
RATES AND CENTRAL OFFICE COST CENTERS

Recommendations

We recommend that the Deputy Assistant Secretary for Public Housing and Voucher Programs

1A. Revise HUD's asset management fee policy and refederalize the Operating Fund program's management and bookkeeping fees and the Capital Fund program's management fees.

PIH Response/Comments:

PIH strongly disagrees with this recommendation. The fee for service model is one of the pillars of the Public Housing program's conversion to asset management. The OIG's recommendation would undermine this massive accomplishment. Further, it would serve as a barrier to the Department's objective of moving to a single platform for the provision of affordable housing given that fee for service is a staple in HUD's Multifamily programs (and long-recognized that such fee income is defederalized). The continued defederalization of fees in Public Housing serves as a significant step toward the merger of the two programs.

Comment 1

Consider, for example, the Housing Authority of the City of Portland, OR (HACP). The HACP has approximately 3,000 public housing units under Annual Contributions Contract (ACC). In addition, the HACP owns nearly 3,000 units of other affordable housing, including not just low-income housing tax credit projects but also Section 8 Project-Based Rental Assistance (PBRA).

Comment 2

For its public housing, the HACP contracts for property management services at one of its HOPE VI sites. As part of that arrangement, the HACP is charged, by the property management company, a management fee, as is standard in the property management industry. Because the management fees that the HOPE VI property manager charges are considered reasonable, the management company is free to determine how it uses those fees. The management company must decide how much each year to spend on direct costs of the management company (personnel, advertising, recruitment, IT, debt service, etc.) versus how much to receive in net cash flow or profit. These are the decisions that all management companies must face. But the key is that the HACP doesn't have to get involved in regulating how much of the fee income the management company spends between direct costs and profit, or even how the management company uses its profit. What's important to the HACP is just that the HOPE VI project was charged a fee that is considered reasonable and the property is well managed.

Comment 2

Similarly, the HACP self-manages many of the PBRA units that it owns. For these units, the HACP also earns a management fee, which is dictated by HUD's local Office of Housing. Additionally, the HACP earns developer fees whenever it develops low-income housing tax credits. In those cases, the development fees are regulated by the state tax-credit issuing agency. In neither of these instances must the HACP demonstrate to either HUD or the tax-credit agency how it spent its fee income. Rather, it is standard industry practice that, since a public body regulates the fees, the recipients of those fees can spend those amounts according to their mission, charter, or business purpose.

In essence, the IG is asking PIH to turn back the clock on asset management and do just the opposite of what is practiced not just throughout the housing industry, but throughout the federal government when it

Comment 3

comes to fee for service. At a time when government resources are scarce, it is essential that we use our administrative resources to concentrate not on processes, but on outcomes. The whole fee for service system is designed to do just that. If the amounts are reasonable, i.e., if that is what the government would otherwise spend in the marketplace for that service or activity, there is not a need for the government to regulate how those funds are spent. This basic structure was the foundation of the National Performance Review and subsequently adopted by OMB in Circular A-87:

Federal agencies should work with States or localities which wish to test alternative mechanisms for paying costs for administering Federal programs. The Office of Management and Budget (OMB) encourages Federal agencies to test fee for service alternatives as a replacement for current cost reimbursement payment methods in response to the National Performance Review's (NPR) recommendation. The NPR recommended the fee for service approach to reduce the burden associated with maintaining systems for charging administrative costs to Federal programs and preparing and approving cost allocation plans. This approach should also increase incentives for administrative efficiencies and improve outcomes.

Comment 4

The implementation of asset management fees, including their defederalization, is consistent with OMB guidance. And, as noted, OMB encourages Federal Agencies to utilize fee for service as opposed to cost reimbursement. The OIG's recommendation to refederalize the fees is contrary to OMB guidance as well as the NPR's recommendation as a way to increase overall efficiency and effectiveness in administering federal programs.

Comment 5

Asset Management was a singular achievement of Public Housing, took immense time and resources to accomplish, and was attained in a completely transparent manner. The effort included negotiated rule making, publication of an interim rule, a final rule, several Federal Register Notices, countless PIH Notices, and a revision to the financial management handbook. PIH coordinated these efforts with a multiplicity of actors, including OMB and OIG. OMB confirmed that the defederalization of the fees was in accordance with OMB circulars. The OIG concurred on the Federal Register Notice which established the safe harbors for the various fees and clarified that the income PHAs derived from these fees was defederalized.

Comment 6

OMB not only permits, but encourages Federal Agencies to undertake fee for service structures. Further, by definition, the fees earned by PHAs pursuant to the Asset Management program are not Program Income when received by the PHA. As such Fee Income is not program income, as defined in OMB Circular A-110, as HUD noted by Federal Register Notice (FR-5099-N-01) dated September 6, 2006 (the 2006 HUD Federal Register Notice). Rather, the fee income is considered local revenue and control over its use is subject only to state or local requirements imposed on PHAs as well as Board oversight.

Comment 7

The OIG's Audit Finding 1A would hold Public Housing Authorities to a different standard than owners of Multifamily Project Based Section 8 developments. Both programs generate revenue from the administration of HUD funded project-based assistance. While the expenditures of the funds noted by the OIG may be inadvisable, they are a responsibility of the local jurisdiction to oversee, and correct. The examples identified by the OIG, the Housing Authority of the City of Los Angeles, and the San Francisco Housing Authority, represent a case in point of effective local oversight. As identified by the OIG, each authority had operational shortcomings. Both Housing Authorities went through significant changes to correct the deficiencies as a result of local oversight. In both cases, the Executive Director was replaced. In the case of San Francisco, the Authority is undergoing a major restructuring aimed at addressing the types of issues identified by the OIG, among others. Rather than demonstrating the failure of local oversight to address the types of issues identified by the OIG, the examples provided validate that a system of local control can be effective.

Comment 8

The recommendation made by the OIG is not implementable in the absence of a sharp reversal of many of the core achievements of the conversion to asset management. More specifically, fee income cannot be refederalized without eliminating the fees in their entirety. PHAs were incentivized to move away from a

Comment 8

cost allocation system to a fee based system specifically because the fee income was defederalized. To the extent that the fees are refederalized, any fee amounts in excess of their actual costs would be subject to the same, or similar, restrictions that they are now.

Comment 9

Principal among the achievements of the conversion of Public Housing to asset management is its progress away from bloated operational structures and a funding strategy that did not effectively constrain or incentivize efficient administration of the program. The fee structure was established to move public housing to a structure which was more akin to HUD's Multifamily program and private sector property management practices. In archetypical real estate or asset management practices, owner/operator's are incentivized to lower costs and maintain and operate their real estate in an efficient manner. By contrast, prior to the conversion to asset management, the accounting and reporting of PHAs was opaque, and resulted in bloated central offices, which were pervasive. Furthermore, cost allocation led to a record keeping and reporting practices where front line or direct costs were indistinguishable from indirect or overhead costs. With this structure, good property management and asset management practices were difficult, at best, and private sector financing models were impossible to implement. Returning to this type of funding structure would negate many of the achievements public housing has been able to achieve over the past decade, and imperil the Department's ability to implement RAD, one of its key objectives.

Comment 10

As noted above, the defederalization of income by the owner entity has been a central and longstanding component of Multifamily programs, such as Project Based Section 8. While it is understandable that the OIG would have an interest in ensuring that the levels at which the safe harbors for the fees are set, and HUD's monitoring of the fees being charged to public housing projects, the OIG has not presented any rationale as to why Public Housing should be treated differently than Multifamily housing on this issue. In fact, the OIG seems to hold a belief that simply because the program administrator is a PHA they should somehow be held to a different standard and subject to different treatment. The basis for this belief is unstated and unsupported.

Comment 10

If OIG's logic were carried to its full conclusion, it would seem to suggest that PHAs that operate PBRA properties should not be entitled to draw fees on those properties and in fact be subject to a different set of rules around the issue of fees and revenue. PHAs do operate PBRA properties and they are subject to the very same rules as private owners who hold contracts under HUD's Multifamily PBRA program – as they should be. There is no basis for treating a PHA differently and if the Department were to proceed it would result in illogical and unjustifiable complications and delineations across its affordable housing programs. Property owners who administer federally funded affordable housing programs should be held to the same high standards around operating efficiency and effectiveness, regardless of their organizational or ownership structure.

Comment 5

PIH shared with the OIG email correspondence between HUD and OMB, by which OMB confirmed that the above interpretation of the OMB circulars was accurate. Further, PIH consulted extensively with the OIG on various matters related to the transition to Asset Management, including the establishment of the fees, the safe harbor fee levels, and the defederalization of those fees. The OIG evidenced its acceptance of all these matters by its concurrence on the 2006 HUD Federal Register Notice. This finding reverses a longstanding acceptance by the OIG of these matters, and should be dropped from the Audit.

1B. HUD should remove the provision that allows public housing authorities to charge asset management fees, which would ensure that at least \$81.6 million in operating funds could be put to better use in meeting HUD program objectives.

PIH Response/Comments:

Comment 11

PIH does not agree with this recommendation. The asset management fee was established to compensate PHAs for the ownership function they perform for public housing. PHA's asset management efforts focus on long term, strategic financial and physical planning, activities that go well beyond day to day property management activities. This includes an upper tier, or owner-centric, review of the financial and physical performance of projects. Armed with an understanding of the physical and financial performance and needs of projects, the asset manager conducts analysis and makes long term strategic decisions, such as those regarding risk management, financing, asset disposition, acquisition, or development. For PHAs, this function also includes establishing and updating the ACOP, creating and publishing the PHA Plan, interacting with elected officials. Property management is distinct from asset management. Instead of being long term and strategic, the focus of property management is short term and reactive, involving the day to day operational needs of the properties.

Comment 11

As demonstrated by the description above, which shows that asset management and property management are different functions, the elimination of the asset management fee would have the effect of not compensating the PHA for activities that they are required to undertake as part of their fiduciary duties as stewards of public housing.

Comment 12

Consider for a moment the Chicago Housing Authority, which has about 24,000 public housing units. About 15 years ago, the CHA contracted for the property management of all of its public housing units. As such, the CHA pays various management companies a property management fee as compensation for doing the day-to-day management of the properties. The CHA, as owner, has other tasks that are above-and-beyond property management. In other words, the work of the CHA does not end after it contracts out property management. The CHA must still: oversee the private property managers, conduct board meetings, make long-term investment decisions, determine flat rent policies, select and monitor the performance of property managers, etc. The CHA, as any PHA, still has "owner functions" that it must perform. Additionally, the PHA is still subject to the ensuring that all program requirements are met. That obligation never transfers to a contracted property management entity. The asset management fee, as specified in 24 cfr 990.190(f) and 990.270, is for these owner-specific functions.

Comment 13

Asset management fee expenses are part of the Operating Subsidy formula by which eligibility is determined. The Operating Subsidy rule was established via negotiated rule making as required by Congress. It would be indefensible to acknowledge asset management as a cost of owning Public Housing, which is effectively what the regulation does, but then not permit PHAs to charge such expenses against the projects.

Comment 5

Asset management fees were established in the 2006 HUD Federal Register Notice. PIH consulted extensively with the OIG on various matters related to the transition to Asset Management, including the establishment of the fees, the safe harbor fee levels, and the defederalization of those fees. The OIG evidenced its acceptance of all these matters by its concurrence on the 2006 HUD Federal Register Notice. This finding reverses a longstanding acceptance by the OIG of these matters, and should be dropped from the Audit.

IC. Establish and implement procedures to reassess the management and bookkeeping fees periodically to ensure that they are reasonable. HUD should retain the documentation justifying the calculation of the rates.

PIH Response/Comments:

Comment 14

HUD agrees with this recommendation and asks that it be closed. The Multifamily Office of HUD reviews management fees and bookkeeping fees periodically, and establishes caps for those fees as an outcome of their review process. Public Housing management fees are established at 80% of the median PUM management fee set for Multifamily PBRA properties. PIH relies upon the review that is completed annually to update management fee safe harbors for public housing. As such, HUD, via the Multifamily Office, does periodically reassess the management fee safe harbors.

Comment 15

Bookkeeping fees were established as an outcome of a review of the fees for Multifamily PBRA properties, and have been fixed since that time. There is no need to implement additional procedures since the fees have been fixed for seven years. Further, while the bookkeeping fees for public housing were initially established to be higher than the average fee for Multifamily PBRA projects, that is no longer the case. The fees for multifamily projects have grown significantly over the past seven years. Depending upon the locality, the safe harbor bookkeeping fee for public housing is often less than the cap for Multifamily. While no additional procedures need to be implemented at this time, HUD agrees to implement procedures to reassess the bookkeeping fee should it change the safe harbor in the future.

Comment 16

HUD retains documentation related to the establishment of the fees in accordance with the HUD Records Disposition Schedules Handbook (2225.6). The safe harbor for property management fees and bookkeeping fees were established in the 2006 HUD Federal Register Notice, published on September 6, 2006. Section 1(A)(3) of Appendix 3 indicates that General Notice Files, which include the records associated with Federal Register Notices, are to be destroyed five years after the publication of the Federal Register Notice. To the extent it resets the rates, PIH will maintain documentation related to the establishment of new rates for five years, whether or not those rates are reset through publication in the Federal Register.

Comment 16

Throughout its Audit the IG stated that HUD had not maintained sufficient documentation to support the safe harbors for the fees established as part of the conversion to Asset Management. This is inaccurate and should be corrected in the final Audit report. HUD was required by the HUD Records Disposition Schedules Handbook to maintain documentation for five years, until September, 2011. The OIG initiated its audit in 2013, seven years after the publication of the 2006 HUD Federal Register Notice. While the date for which HUD was required to maintain documentation had passed two years beforehand, HUD continued to maintain a significant amount of documentation, and provided that documentation to the OIG. The OIG should revise its report to recognize that, rather than having insufficient documentation related to the safe harbors, it had more than it was required to maintain.

ID. Require the San Francisco Housing Authority to support or repay from non-Federal funds management fees of \$5,398,225, bookkeeping fees of \$460,850, and asset management fees of \$332,246 charged to its projects for fiscal years 2009 and 2010.

PIH Response/Comments:

HUD will review the management fees, bookkeeping fees, and asset management fees the SFHA charged to its projects for fiscal years 2009 and 2010. HUD will require the SFHA to repay any amounts determined to be unreasonable from defederalized or other non-Federal funds.

1E. Recapture excessive asset management fee charges of \$714,000 from the Housing Authority of the City of Los Angeles or require it to repay this amount from non-Federal funds.

PIH Response/Comments:

HUD will review the asset management fees charged to the HACLA's projects for fiscal years 2009 and 2010. HUD will require the HACLA to repay any amounts determined to be unreasonable from defederalized or other non-Federal funds.

1F. Recapture excessive asset management charges of \$37,860 from the Southern Nevada Regional Housing Authority or require it to repay this amount from non-Federal funds.

PIH Response/Comments:

HUD will review the asset management fees charged to the HACLA's projects for fiscal year 2011. HUD will require the HACLA to repay any amounts determined to be unreasonable from defederalized or other non-Federal funds.

We recommend that the Deputy Assistant Secretary for Real Estate Assessment Center

1G. Develop and implement automated controls in the Subsystem to ensure that housing agencies nationwide do not charge excessive asset management fees.

PIH Response/Comments:

REAC agrees with the recommendation to correct and re-activate the Low Rent Asset Management Alert Fee Letter. Accordingly, the Low Rent Asset Management Alert Fee Letter will be corrected and reactivated for the May 30, 2014 system release.

We recommend that the Acting Deputy Assistant Secretary for Field Operations

1H. Develop, document, and implement written procedures to ensure that fees charged to the asset management projects and Capital Fund program and expenses from the central office cost center are used to support HUD's mission.

PIH Response/Comments:

As I have previously discussed, our response will depend on what the comments are on the other recommendations. But without that information, we request that the recommendation be revised to reflect language similar to the following:

Incorporate the review of asset management fees charged by PHAs into the OFO monitoring and oversight plan for the fiscal year to ensure compliance with program requirements and HUD guidance

Comment 17

OIG Evaluation of Auditee Comments

Comment 1 Our audit report identified weaknesses and vulnerabilities in the asset management fee for service model that could add risk to the program and shed negative light on HUD and its program. The purpose of the recommendation was to mitigate that risk, not to undermine HUD's accomplishment. We did not review HUD's plans for moving to a single platform with Multifamily, as this was not presented as a justification for a fee for service model during the course of the audit. Therefore, we cannot comment on the appropriateness of such a merger. However, given the issues we identified in our audit report, HUD may want to reconsider whether it is prudent to merge HUD's Public and Indian Housing program with the Multifamily program.

Comment 2 We cannot address comments regarding the HOPE VI or Project Based Rental Assistance programs since we did not audit those programs. Our scope was limited to the Low Rent program. Therefore, we do not know what HUD's methodology was in determining what a "reasonable" fee was with respect to those programs. However, we did note that OIG performed a separate review of the Section 8 Housing Choice Voucher program (OIG audit report number 2012-LA-0001), of which a public housing authority's project based vouchers are a component. That report concluded that HUD did not adequately support or reassess the reasonableness of the fee-for service amounts or monitor the amounts charged.

We also did not perform an audit of a public housing authority's developer's fees and the low-income housing tax credits program. To our understanding, tax credits are awarded to developers of qualified projects. The developers then sell these credits to investors to raise capital for their projects. The program is dissimilar to the fee for service model; therefore, there is no comparison between the two.

Comment 3 We are asking HUD to re-evaluate the fee for service model to ensure that it is cost effective and to refederalize the funds to mitigate risks to the program. HUD could not provide its analysis for determining the "reasonableness" of the fees, which is of particular importance when government resources are scarce. HUD has provided no information to support that it is spending less by implementing this model. Without being able to explain how it came to its reasonability standard, HUD is not performing its due diligence in safeguarding tax dollars by failing to monitor how those funds are spent.

We agree that the May 2004 OMB Circular A-87 includes language that encourages Federal agencies to work with States or localities for alternative means of administering Federal programs. However, HUD is not required to implement a fee for service system and had the option of incorporating other methodologies to administer its programs. Furthermore, in the recently published

Omnibus, published December 26, 2013, the specific language HUD quoted was removed. This may indicate the movement away from the fee for service model.

- Comment 4** We agree that OMB encourages Federal agencies to use the fee for service system; however, if HUD cannot demonstrate the fees are cost effective, it would be contrary to OMB's intent. Because several years have passed since the initial implementation, HUD should gather information to gauge whether this model is actually increasing the overall efficiency and effectiveness of administering the program. As noted in the finding, HUD has not re-evaluated its fees since inception. The fees may not be saving the government money and may not be "reasonable."
- Comment 5** We disagree with HUD's statement that OIG concurred with the Federal Register Notices that supported the asset management fee structure. We did not comment on the notices, which is different from specifically concurring, and OIG may not have had enough information at the time to strictly oppose the defederalization of funds. OIG does not concur on HUD policy to maintain objectivity. We offer comments and non-concur if we have strong indications that risks are excessive or for known issues related to the policy. However, our having no comment does not indicate we guarantee the policy will be sufficient or, in practice, will not reveal risks not foreseen. Therefore, HUD cannot expect we will not issue audit reports on any program areas where policy has gone through clearance. In addition, receiving authority from OMB to implement the changes does not imply the implementation will be acceptable or safe harbors are at the appropriate amount. The purpose of this audit was to review asset management fees and the defederalization of funds in the Central Office Cost Centers.
- Comment 6** We agree that the current criteria states that the fee income earned by a public housing authority from its asset management projects are considered local revenue. However, HUD was not required to utilize asset management or establish the fees as non-program income. Based on the fact that HUD could not support how it arrived at its "reasonability" threshold and the use by the public housing authorities of these funds in our sample, we recommend the current criteria be adjusted to refederalize those fees so that they remain under HUD's purview.
- Comment 7** We did not perform a review of the Multifamily program; therefore, we cannot comment on that program. In general, however, an Assisted Project Based Multifamily property is privately owned, while the public housing stock are publicly owned and operated. Owners of a Multifamily property are provided with a variety of incentives and financial assistance in exchange for an agreement to rent to low- and moderate-income people. Conversely, a public housing authority does not have a vested interest in its asset management projects because it does not run those projects for profit. The projects are a means of servicing the public. Therefore, it is not reasonable to compare the Multifamily program with the Public and Indian Housing program since both are fundamentally dissimilar.

We disagree with HUD's contention that the example public housing authorities demonstrate that a system of local control can be effective. Although both Executive Directors at the housing authorities of the cities of Los Angeles and San Francisco were replaced, the funding to pay for their excessive salaries and perks were not reimbursed. In fact, because the funds are "defederalized" and no longer under HUD's control, the housing authorities will continually go to that source of funding to pay for its questionable expenditures. Case in point, while the audit team was at the City of Los Angeles housing authority, and had inquired about the source of funds to pay for settlement cases, the authority determined that two settlement cases were inappropriately paid with program/restricted funds. As a result, the Chief Finance Officer had reclassified the payments from the "restricted" funds to the "unrestricted" funds from the central office cost center. By allowing these fees to maintain its "unrestricted" status and failing to monitor the use of the funds under the guise that they are "local revenues," HUD is openly allowing public housing authorities to use taxpayer monies without any restrictions or sanctions.

Comment 8 HUD may want to reconsider whether the current asset management structure is feasible. Recall that in OMB A-123:

The proper stewardship of Federal resources is an essential responsibility of agency managers and staff. Federal employees must ensure that Federal programs operate and Federal resources are used efficiently and effectively to achieve desired objectives. Programs must operate and resources must be used consistent with agency missions, in compliance with laws and regulations, and with minimal potential for waste, fraud, and mismanagement.

We do not agree that allowing taxpayer monies to be defederalized should be necessary to incentivize a public housing authority to adjust its systems. In addition, if the fees were refederalized any amounts collected over actual would be subject to HUD monitoring, per recommendation 1H.

Comment 9 We are not necessarily asking HUD to return its previous cost allocation structure. We are asking HUD to re-evaluate the structure they currently have in order to further improve upon and mitigate potential risks and vulnerabilities. Doing so would involve re-federalizing fees so that the funds maintain their Federal identity and control.

Comment 10 We did not audit the Multifamily program and therefore cannot speak about the structure it operates under. We can only speak of the work we conducted within the scope of our review.

Comment 11 According to HUD criteria, a public housing authority may only receive an asset management fee if its individual asset management projects had excess cash in the prior year. The elimination of the asset management fee would not have the

effect HUD is stating because public housing agencies without excess cash in the prior year still must make do without the additional “distribution.” In such instances, public housing agencies still need to perform asset management functions, without receiving a fee, regardless of whether or not there is an actual distinction between property management and asset management functions.

Comment 12 HUD has not provided any information concerning the amounts the CHA was paying its contractors to perform the property management function. As a result, there is no information to suggest the management fees CHA was collecting from HUD were insufficient to cover the contractor costs and the other tasks listed, thus requiring additional taxpayer monies to be defederalized.

Comment 13 HUD could not explain how it determined the \$10 per unit month asset management fee was reasonable. According to 24 CFR 990.190 (f), each PHA with at least 250 units shall receive a \$4 per unit month asset management fee while PHAs with fewer than 250 units that elect to transition into asset management shall receive an asset management fee of \$2 per unit month. HUD could not explain the \$6 - \$8 difference.

Comment 14 Although HUD’s Multifamily Office periodically reviews and adjusts the management fee, HUD has not provided documentation to show how the 80 percent rate was determined. As a result, it remains unclear if this rate was reasonable and we cannot close the recommendation without support that fees are reassessed and that procedures are developed to ensure reasonableness and updated often.

Comment 15 HUD has not provided documentation to show how it determined the bookkeeping fee rate. As a result, it is unclear if this rate was reasonable and future assessments will evaluate the fee for reasonableness.

Comment 16 According to HUD Records Disposition Schedules Handbook 2225.6, Section 1(A)(2), Internal Files, which include copies of proposed and final rules as sent through internal clearance process; clearance records; significant working papers, studies, reports, and other materials; internal HUD comments on the proposed and final rules; and notes from internal HUD meetings held to discuss the proposed or final rules, are to be destroyed 10 years after close of file. We agree that HUD’s Disposition Schedule Handbook states that *general* notices are destroyed 5 years after close of file. However, the *final rules*, such as 24 CFR 990, new Operating Fund final rule, which was published in the Federal Register on September 19, 2005, should not be destroyed until September 19, 2015. This rule was used to establish requirements for housing authorities to convert to the asset management business model, which outlined the various fees that each public housing agency may charge its asset management projects. Therefore, the working papers, studies, and reports that HUD used to arrive at the rates should still be maintained. However, HUD did not retain such documentation, contrary to its own record

retention policy. The documentation that HUD provided was incomplete and did not show the reasonableness of the various asset management fees.

Comment 17 We disagree. We believe the procedures should be documented and given to the field offices nationwide to ensure consistent understanding at each field office of its monitoring responsibilities.

Appendix C

CRITERIA

24 CFR 990.325, Record retention requirements.

The PHA [public housing agency] shall retain all documents related to all financial management and activities funded under the Operating Fund for a period of five fiscal years after the fiscal year in which the funds were received.

24 CFR 990.290, Compliance with asset management requirements.

(a) A PHA is considered in compliance with asset management requirements if it can demonstrate substantially, as described in paragraph (b) of this section, that it is managing according to this subpart.

(b) Demonstration of compliance with asset management will be based on an independent assessment.

(1) The assessment is to be conducted by a professional familiar with property management practices and costs in the region or state in which the PHA is located. This professional is to be procured by HUD.

(2) The professional review and recommendation will then be forwarded to the Assistant Secretary for Public and Indian Housing (or designee) for final determination of compliance to asset management.

(c) Upon HUD's determination of successful compliance with asset management, PHAs will then be funded based on this information pursuant to § 990.165(i).

(d) PHAs must be in compliance with the project-based accounting and budgeting requirements in this subpart by FY [fiscal year] 2007. PHAs must be in compliance with the remainder of the components of asset management by FY 2011.

Table of Fees Under Asset Management, Supplement to HUD Handbook 7475.1, dated July 27, 2007

For first year of implementation, no excess cash requirement. For second year, current assets must exceed current liabilities to earn asset management fee. For third year, current assets must exceed current liabilities by one month of operating expenses to earn an asset management fee. Fee may not be accrued by Central Office Cost Center if insufficient excess cash.

5.2 – Capital Fund Program of Management Fee of Supplement to HUD Handbook 7475.1, REV, CHG-1, Financial Management Handbook

The PHA may charge a management fee of up to 10 percent of the Capital Fund Program formula grant(s) amount, excluding RHF [Replacement Housing Factor] grants and Emergency and Disaster grants. The Capital Fund Program management fee is considered part of the Capital Fund Program Budget Line Item (BLI) 1410, Administration, subject to the regulatory limitation of 10 percent of the Capital Fund grant. HUD will periodically review the Capital Fund Program management fee amounts to determine if any adjustments are warranted.

The Capital Fund Program management fee is available to be earned (drawn down) upon the awarding and availability of the Capital Fund Program grant at any time during the grant period and in any amount up to the 10 percent limit.

6.4 – Excess Cash Defined of Management Fee of Supplement to HUD Handbook 7475.1, REV, CHG-1, Financial Management Handbook

Excess cash will be calculated using PHA-reported data from the FDS [Financial Data Schedule]. It represents the sum of certain current asset accounts less the sum of all current liability accounts, less one month worth of operating expenses for the project. The determination of one-month operating expenses will be calculated by dividing FDS line 969 (Total Operating Expenses) by 12. The result of this calculation is defined as the excess cash of the AMP [asset management project].

6.5 Fungibility – Effective Date of Supplement to HUD Handbook 7475.1, REV, CHG-1, Financial Management Handbook

The Operating Fund Program regulations (§ 990.205) state that operating subsidy will remain fully fungible between ACC [annual contributions contract] projects until subsidy is calculated by HUD at the AMP level. After subsidy is calculated at the AMP level, PHAs are limited in transferring excess cash between AMPs or to the Central Office Cost Center.

7.2 – Treatment of Fee Income Under Office of Management and Budget Circular A-87 and 24 CFR Part 85 of Supplement to HUD Handbook 7475.1, REV, CHG-1, Financial Management Handbook

OMB [Office of Management and Budget] Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments (also at 2 CFR Part 225)*, as well as 24 CFR part 85, *Administrative Requirements for Grants and Cooperative Agreements to State, Local, and Federally Recognized Indian Tribal Governments*, establish the basic requirements on the use of federal program funds. For PHAs that convert to asset management (required of PHAs with 250 or more units), any internal fee-for-service charges to AMPs or programs (property management fees, asset management fees, etc.) are used to reimburse the PHAs for its claim of the overhead costs related to these programs (these overhead costs are previously claimed through the cost allocation process under OMB Circular A-87). The fee-for-service amounts are considered non-program income for purposes of A-87 and 24 CFR part 85; however, other state and local restrictions may still apply. Consequently, any reasonable fees earned by the PHA/Central Office Cost Center will be treated as local revenue subject only to the controls and limitations imposed by the PHA's management, Board or other authorized governing body.

7.5 – Property Management Fees of Supplement to HUD Handbook 7475.1, REV, CHG-1, Financial Management Handbook

Reasonableness. A PHA may charge a reasonable management fee based on any of the following:

- The property management fee schedules established for each HUD Multifamily Field Office. Generally, the Office of Multifamily Housing establishes fee ranges for federally subsidized properties that reflect 120 percent of the mean property management fee for profit-motivated properties that are well managed, in good physical condition, and are managed by independent agents with no identity-of interest involvement; or

- The 80th percentile property management fee paid by all unlimited dividend, limited dividend, and non-profit Federal Housing Administration (FHA) properties, by HUD Field Office, excluding such programs as cooperatives and nursing homes. These amounts are included as Attachment A.

Amount Earned. The property management fee is calculated as a per-unit-month (PUM) fee and earned for each occupied unit and HUD-approved vacancy, as described under the final rule. In other words, management fees are to be earned monthly for each occupied unit or approved vacancy, as per §§ 990.140 and 990.145, respectively. PHAs will not earn a property management fee on units defined as “limited vacancies” pursuant to § 990.150. New units that come on line during the PHA’s fiscal year begin to earn the property management fee in the month the units first become occupied. Once initially leased, new units are also eligible to earn the property management fee for HUD approved vacancies as described in § 990.145.

Bookkeeping Fee. The property management fee may include a reasonable bookkeeping fee for the property accounting function. The average bookkeeping fee in HUD’s multifamily housing programs is about \$3.73 per unit monthly (PUM) (2005 data). Generally, HUD will consider \$7.50 PUM to be a reasonable fee. A higher bookkeeping fee for PHAs reflects higher centralized information technology and human resource costs present in public housing. For financial reporting purposes, this bookkeeping fee, as is standard business practice, is to be presented separately from the property management fee on the PHA’s financial statements. The bookkeeping fee is earned for each occupied unit and HUD-approved vacancy, as described under § 990.145.

7.6 – Asset Management Fees of Supplement to HUD Handbook 7475.1, REV, CHG-1, Financial Management Handbook

Reasonableness. The Central Office Cost Center may earn an asset management fee. HUD will generally consider an asset management fee charged to each project of \$10 PUM as reasonable. Asset management fees shall be based on all units under an ACC. In multifamily housing, the asset management functions of owners are primarily funded through cash flows. This \$10 PUM asset management fee was determined based on an examination of cash flows in HUD’s multifamily projects and the consideration that certain asset management activities in public housing are also recovered through the Capital Fund Program management fee.

Amount Earned. The asset management fee is calculated as a PUM fee and earned for all units under ACC (including Mixed Finance ACC units), regardless of occupancy status or ownership/management. In other words, asset management fees are to be earned based on the total number of units under the ACC for each project. New units that come on line during the PHA’s fiscal year begin to earn the asset management fee in the month the units first become occupied. The Central Office Cost Center is eligible to earn the asset management fee on an ACC unit until the unit becomes vacant after a HUD-approved demolition or disposition plan.

Restrictions. Payment of asset management fees to the Central Office Cost Center can be made throughout the PHA’s fiscal year, but only up to the amount of excess cash as calculated from the prior year’s FDS. Asset management fees may not be accrued by the Central Office Cost

Center if in any fiscal year the AMP lacks sufficient excess cash to pay the fee or is otherwise noncompliant with the guidelines described in Chapter 6.

7.11 – Method of Payment and Supporting Documentation of Supplement to HUD Handbook 7475.1, REV, CHG-1, Financial Management Handbook

The preferred method of assessing fees to AMPs and programs is via an invoice. However, the Central Office Cost Center may use a more informal method of billing. Regardless of the method the Central Office Cost Center uses for assessing fees to AMPs and programs, supporting documentation of how each fee was earned must be maintained and available. For example, to document the property management and bookkeeping fee the PHA must be able to support the number of leased units as well as HUD-approved vacancies (type of approval, unit number, category, etc.) that were used to make the calculation. In addition, the PHA will need to document how it determined that the fee rate was reasonable (i.e., it was based on a local multifamily management fee letter or the fee schedule provided by PIH [the Office of Public and Indian Housing]).

Public and Indian Housing Notice 2012-14

This notice provides guidance on implementing the provision in HUD’s FFY [Federal fiscal year] 2012 Appropriations, P.L. [public law] 112-55, that limits the use of FFY 2012 Section 8 Tenant-Based Rental Assistance and Section 9 appropriations to pay salaries to public housing agency (PHA) employees. This limitation applies to all PHA employees, including chief executive officers, other officials, and any other employees.

Beginning on March 17, 2012, and continuing for the duration of the PHA’s FY 2012, no PHA may use 2012 appropriations funding for Section 8 HCV administrative fees or Section 9 Capital Fund or Operating Fund to pay any amount of salary to the PHA chief executive officer or other officials or employees that exceeds \$155,500, the current level IV Executive Schedule salary.

Any funds remaining from previous fiscal years (e.g., FY 2011, FY 2010, etc.) are not impacted by the FY 2012 salary limitation. Carrying over previous years’ funds or using other unrestricted funds to support salaries will remain at the PHA’s discretion, according to appropriate eligibility restrictions and other applicable requirements.

Under this Notice and the Act, “salary” does not include bonuses and overtime nor does it include benefits such as retirement, life insurance, medical insurance, or the use of a PHA vehicle. The term salary includes payments to all covered individuals who are paid on an annual basis. It also includes, for example, situations where multiple PHAs collectively hire one person for an annual amount under a single agreement.

HUD Handbook 4370.2, REV-1, CHG-1, issued January 23, 1996 – Financial Operations and Accounting Procedures for Insured Multifamily Projects

2-8 Surplus Cash and Residual Receipts

- A. Basically, surplus cash is the cash remaining after all necessary and reasonable expenses of the project have been paid or funds have been set aside for such payment.

C. On profit-motivated projects, all surplus cash is available for distribution to project owners. On most nonprofit projects, on which distributions are not permitted, the regulatory agreement requires that all surplus cash available as of the end of an annual fiscal period be deposited in the residual receipts account.

E. Funds may be released from residual receipts funds only with prior written approval by HUD.

2-10 Distribution to Owners

A distribution is any withdrawal or taking of cash or any assets of the project other than for the payment of reasonable expenses necessary to the operation and maintenance of the project. The term distributions includes, for example, supervisory fees paid to general partners and any salaries or other fees paid to the sponsor or mortgagor, unless those salaries or fees have been approved by HUD as essential to the operation of a project (e.g., a management fee approved by HUD or paid on an Owner-Managed project).

Office of Management and Budget Circular A-123, I, Introduction

Management has a fundamental responsibility to develop and maintain effective internal control. The proper stewardship of Federal resources is an essential responsibility of agency managers and staff. Federal employees must ensure that Federal programs operate and Federal resources are used efficiently and effectively to achieve desired objectives. Programs must operate and resources must be used consistent with agency missions, in compliance with laws and regulations, and with minimal potential for waste, fraud, and mismanagement. Management is responsible for developing and maintaining effective internal control. Effective internal control provides assurance that significant weaknesses in the design or operation of internal control, that could adversely affect the agency's ability to meet its objectives, would be prevented or detected in a timely manner.