



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
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A Message from:

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and

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4 Keys for Multifamily Owners' Oversight of Management Agent Activities

Owners of U.S. Department of Housing and Urban Development (HUD)-assisted or -insured properties should similarly have a system of quality control over project operations, especially if they are absentee owners that leave daily operations to a management agent. Owners must be aware of the risks they face from the errors and frauds that may be committed by their agents.

This bulletin emphasizes owners' responsibility for asset management and ensuring that project funds are spent properly and distributions do not violate HUD rules. It also offers best practices for avoiding management agent violations and the potential consequences of not handling them appropriately. It provides four keys for owner oversight: dashboards, distribution, disbursements, and dishonesty. The Bulletin provides examples of consequences that have occurred when owners failed to provide oversight to their management agents.

Owners of HUD -insured or -assisted properties program funds are encouraged to review the Integrity Bulletin and apply lessons contained herein to program delivery activities. Please share with your staff and implement an appropriate oversight protocol if you do not currently use one.

For more information on oversight or other Multifamily program related issues we encourage you to utilize HUD's Technical Assistance website, the HUD Exchange (www.hudexchange.info) or contact your local HUD representative.

Thank you for your time and thank you for your work on HUD's Multifamily programs.

Sincerely,

Robert Iber
Acting Deputy Assistant Secretary for
Multifamily Housing

Helen Albert
Acting Inspector General



Integrity Bulletin

U.S. Department of Housing and Urban Development
Office of Inspector General

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PURPOSE:

President Eisenhower said, "There is an old adage in the military: that which is not inspected deteriorates." He knew that every organization needed oversight to ensure that



rules and procedures were continually followed. Any organization that does not have oversight will eventually break down in the discipline for following its rules. Owners of U.S. Department of Housing and Urban Development (HUD)-assisted or -insured properties should similarly have a system of quality control over project operations, especially if they are absentee owners that leave daily operations to a management agent. Owners must be aware of the risks they face

from the errors and frauds that may be committed by their agents. This bulletin emphasizes owners' responsibilities for ensuring that project funds are spent properly and distributions do not violate HUD rules.

WHAT TO LOOK FOR:

While it is essential that management agents be well versed in HUD requirements regarding project spending, it is equally important that there be checks and balances through strong internal controls and independent oversight. The annual audits and HUD financial and physical monitoring only partially satisfy these needs. There needs to be more frequent oversight. **Owners hold ultimate responsibility for compliance at their properties. When violations occur, owners can suffer financial, operational, reputational, and legal harm up to and including criminal prosecutions.**

There are 4 key areas owners should focus on when conducting their own oversight:

1. Dashboards
2. Distributions
3. Disbursements
4. Dishonesty

Dashboards Owners should require management agents to provide them key data in the form of dashboards or other reports so they can quickly see whether the property is achieving financial, managerial, and compliance goals. Owners should question indicators that fall outside acceptable parameters, approve corrective actions recommended by the agent, and monitor corrective action implementation.

Examples of key areas to monitor for project financial health and compliance are:

- High or increasing vacancy rates.
- Annual or monthly expenses that exceed income potential and are likely to continue.
- Project expenses or rental receipts that are abnormally high or low compared to previous periods or comparable projects.
- Project rents that exceed authorized limits.
- Below satisfactory ratings on the HUD management review report or annual physical inspection report.
- Property insurance with breaks in coverage.
- Routine maintenance expenses that are not paid for with operating funds.
- Agents who do not understand that it is important to work with the owner to implement the Capital Repairs program and Reserve Funds program. Typically, a Reserve Fund is only available for Capital Repairs outlined in a Project Capital Needs Assessment or Capital Repairs program.
- Identity of Interest (IOI) agent/owner contracts that do not provide services at a price comparable non-IOI contracts.
- Agents who do not submit annual financial statements within 90 days after close of the project's fiscal year or required monthly accounting reports to the field office in a timely manner or only sporadically. Non-filings or late filings can lead to a referral to the Departmental Enforcement Center and possible penalties.



Self-identification and correction of problems can save the owner significant aggravation as well as fines or sanctions. HUD staff are available to help the owner devise solutions to problems.

Distributions The regulatory agreement and HUD handbooks state that owners may not take or receive a distribution of cash or assets when a project is in default or a non-surplus-cash position (meaning there is not enough cash to cover the first mortgage, reserve for replacements, all other project-related debts, and tenant deposits held in trust). Restrictions on distributions also apply when a project is under formal notice from HUD of needed project maintenance. Owners must be alert to ensure that their management agents do not

- withdraw surplus cash at other than semiannual or annual fiscal period end,
- repay additional equity contributions, unless approved by HUD, and
- divert project assets or materials other than surplus cash at the appropriate time.

These and other such acts subject the owner, agent, or manager to equity skimming charges (18 U.S.C. (United States Code) 1715z-19). HUD's Office of Inspector General (OIG) investigates and prosecutes equity skimming cases. Owners can be fined up to \$500,000, imprisoned up to 5 years, or both, so owners and their agents should take extra precautions to avoid violating this provision.

Disbursements HUD requires that project expenses be reasonable and necessary, and documented for operations and repairs. Ineligible or unsupported expenses identified by OIG audits include:

- Using project funds for staff celebrations, lunches and gifts.
- Paying invoices, contracts, etc., that are not adequately supported.
- Using project funds for expenses that should have been paid out of management fees.
- Loaning project funds.
- Charging less than market rental rates to “identity of interest firms” which provide services such as child care, laundromats, convenience stores, etc.
- Using project funds to pay partnership fees such as legal or tax preparation fees.
- Paying excessive management fees, paying fees in advance, or participating in fee splitting. These fees can be illegal kickbacks if the receiving company refunds a portion of its fees to the owner in return for awarding the contract to the company.
- Lending project funds to other businesses, affiliated companies, relatives, or owners/partners.
- Repaying owner advances when the project is in default or a non-surplus cash position.

Dishonesty Any company can be vulnerable to theft or fraud. Owners can mitigate their risk if they are aware of common types of dishonesty and require controls to provide proper checks and balances. Common problems identified in OIG audits and investigations include:

- theft of cash or diverting income (rents, laundry, cable services, etc.),
- theft of project materials or equipment,
- embezzlement of funds by staff or even other partners,
- unreported conflicts of interest in contracts and procurements, or
- encumbering the project or arranging its sale without HUD approval.

CONSEQUENCES IF OVERSIGHT IS LACKING

Without management controls and oversight by the owners, mismanagement or fraud can happen. When these things occur it is the owner that suffers the financial consequences of its own or its agent’s mistakes and non-compliance. Following are examples from OIG audits.

- An owner’s management agent made payments in violation of the regulatory agreements. The agent made ineligible payments to
 1. The general partner, for social activities like painting and art programs, after-school programs, and holiday event activities which were not reasonable and necessary expenses for the operation of the project.
 2. A consultant for work that the management agent was paid to do.
 3. A law firm for a lawsuit that was properly an ownership expense.
 4. Itself for excessive bookkeeping fees.

In addition, the management agent secured \$10.9 million in unsupported loans, which encumbered the project, without HUD approval.

These condition occurred because the owners did not have proper controls or oversee the agent and its own actions, and faces repaying \$1.5 million

- A former management agent
 1. Inappropriately provided rent-free housing to two households.
 2. Did not always properly support transactions charged to the project.
 3. Did not always fully maintain the project's security deposit account,
 4. Failed to submit the required audited financial statements to HUD timely.

These weaknesses occurred because the project's owner did not adequately oversee the management agent to ensure compliance with HUD's requirements and the regulatory agreement. As a result the owner faces repaying \$16,260 in ineligible and unsupported costs.

- A condominium association received a grant from HUD to rehabilitate and sell 69 units. It failed to obtain the title on nine units and sell them as required. This condition occurred because the condominium association's board of directors lacked an adequate understanding of HUD's requirements and the grant agreement. Therefore, it was unable to provide oversight and guidance to its management agent. As a result, the condominium association is at risk of having to reimburse HUD nearly \$13.9 million in program funds.

WHAT MORE OWNERS CAN DO



- Ensure that staff or management agents have risk-based internal control policies and procedures that are designed to prevent and deter questionable expenditures and fraud, and detect them when they do occur.
- Add a section to the management agent contract and management plan emphasizing the owner's right to obtain project data, and conduct oversight. Conduct periodic risk assessments to determine areas of heightened risk for possible fraud and the adequacy of the control environment.
- Set the tone at the top by implementing processes for reporting possible fraud or questionable expenditures. When assessing complaints on management agent staff, do not be immediately dismissive of such reports. Don't overreact, but have and follow a formal process to determine if allegations are credible and act on them. If fraud is alleged, contact HUD OIG as shown below.

If you have questions regarding any aspect of your responsibilities under the regulatory agreement, contact your local HUD representative. **Allegations of fraud must be reported to the HUD OIG hotline at <http://www.hudoig.gov/report-fraud>, or call 800-347-3735 (Toll-Free).**