



HUD's Office of Multifamily Asset Management and Portfolio Oversight Washington, DC

Multifamily Housing Management Agents



To: Nancie-Ann Bodell, Acting Director, Multifamily Asset Management and Portfolio Oversight, HTN

From: //signed//
Nikita N. Irons, Regional Inspector General for Audit, Atlanta Region, 4AGA

Subject: HUD's Office of Multifamily Asset Management and Portfolio Oversight Did Not Comply With Its Requirements For Monitoring Management Agents' Costs

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 Office of Multifamily Asset Management and Portfolio Oversight.

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 404-331-3369.



Audit Report Number: 2015-AT-0002

Date: August 21, 2015

HUD's Office of Multifamily Asset Management and Portfolio Oversight Did Not Comply With Its Requirements For Monitoring Management Agents' Costs

Highlights

What We Audited and Why

We reviewed the U.S. Department of Housing and Urban Development (HUD), Office of Multifamily Asset Management and Portfolio Oversight. We initiated the audit under the HUD Office of Inspector General's (OIG) annual audit plan. Our audit objective was to determine whether HUD adequately monitored its management agents to ensure that front line costs and direct costs¹ were not excessive across the portfolios as identified in audits² performed by OIG.

What We Found

HUD did not adequately monitor its management agents. HUD's monitoring of its management agents did not always include detailed reviews of management agents' front line costs and direct costs across their portfolios to ensure costs were not excessive. This condition occurred because HUD chose to forego its requirements for monitoring the management agents' portfolios, and performed other broader and less detailed assessments. As a result, funds may not be available to maintain property conditions, and Section 8 reserves may be reduced if project funds are used to pay improper frontline and direct costs.

What We Recommend

We recommend that the Director of HUD's Office of Multifamily Asset Management and Portfolio Oversight comply with its handbook requirements that stipulate HUD must perform management reviews of the management agent's central office activities as well as regular onsite reviews of functions carried out at the projects. These central office reviews should be performed at least once every 18 months.

¹ The Management Agent Handbook, HUD Handbook 4381.5, REV-2 Paragraphs 6.37(a) and 6.38(a)(1) and figure 6.2 describe assigning management costs and charging those costs to project operating accounts. Eligible front line costs are certain reasonable expenses that owners are allowed to charge to a project's operating account, in addition to the management fee. Direct costs are costs for the day-to-day activities of a particular property and are chargeable directly to that respective project's operating account.

² McClain Barr and Associates (2013-AT-1002) managed 17 projects, and The Avesta Housing Management Corporation (2010-BO-1008) managed 30 projects.

Table of Contents

Background and Objectives	3
Results of Audit	4
Finding 1: HUD Did Not Adequately Monitor Front Line And Direct Costs Charged By Management Agents.....	4
Scope and Methodology	8
Internal Controls.....	10
Appendix	11
A. Auditee Comments and OIG’s Evaluation.....	11

Background and Objectives

The Office of Asset Management and Portfolio Oversight is a division within the Office of Multifamily Housing. The Office of Asset Management and Portfolio Oversight is responsible for the portfolio of multifamily projects assets after the development phase. The core roles are to develop supporting policies and to provide interpretation of policy, control participation in the multifamily asset programs, provide oversight of lender and field servicing activities including multifamily management and field operations, and manage relationships with internal and external partners. The Office of Asset Management and Portfolio Oversight is comprised of five Divisions:

- Multifamily Asset and Counterparty Oversight Division,
- Assisted Housing Oversight Division,
- Business Relationships and Support Contracts Division,
- Field Asset Management and Program Administration Division, and
- The Property Disposition Division.

The processing of the multifamily housing programs is done within the Multifamily Regional Centers, Satellite Offices, Hubs and Program Centers. The Office of Multifamily is in the process of restructuring its offices.

The multifamily property owners contract with management agents, through a management agreement, to oversee the day-to-day operations of the property, and maintain the financial and accounting records. The owners and HUD must ensure that the projects will be managed in a prudent, efficient, and costs-effective manner, in accordance with applicable laws and HUD requirements. The management agents that oversee the HUD-insured and HUD-assisted multifamily properties play a key role in helping HUD provide quality affordable housing. The management agents execute a management certification providing that it will comply with the property's regulatory agreement and other HUD requirements. Management agents provide property owners with dedicated property management services focused on ensuring that all expenses of the project are reasonable and necessary, increasing property cash flow, improving resident satisfaction, and improving properties' physical condition.

Our audit objective was to determine whether HUD adequately monitored its management agents to ensure that front line costs and direct costs were not excessive across the portfolios as identified in audits performed by OIG.

Results of Audit

Finding: HUD Did Not Adequately Monitor Front Line and Direct Costs Charged by Management Agents

HUD did not adequately monitor its management agents. HUD's monitoring of its management agents did not always include detailed reviews of management agents' front line costs and direct costs across their portfolios to ensure costs were not excessive. This condition occurred because HUD chose to forego its requirements for monitoring the management agents' portfolios, and performed other broader and less detailed assessments. As a result, funds may not be available to maintain property conditions, and Section 8 reserves may be reduced if project funds are used to pay improper frontline and direct costs.

HUD Did Not Follow Its Management Agent Handbook Requirements for Monitoring

HUD's monitoring of its management agents were inadequate to ensure management agents' front line costs and direct costs were not excessive for their portfolios, as required by its Management Agent Handbook 4381.5, Rev 2.³ Handbook 4381.5, Rev 2 provides guidance for charging only reasonable expenses incurred for frontline costs and day-to-day activities to the project's operating account.⁴ Owners are allowed to charge certain management costs to the project's operating account. However, other management costs may be paid only out of the management fee.⁵

Additionally, the Management Agent Handbook states that management agents with more than one project may perform certain management functions from a centralized location. The HUD Multifamily staff must perform management reviews of the agent's central office activities, as well as regular onsite reviews of functions carried out at the projects.⁶ These central office reviews should be performed at least once every 18 months.⁷ These types of reviews were not normally performed.

³ The Management Agent Handbook, HUD Handbook 4381.5, REV-2, Paragraph 1.3(a) defines the purpose of the handbook.

⁴ The Management Agent Handbook, HUD Handbook 4381.5, REV-2, paragraphs 6.38(a)(1) defines eligible front line expenses that management agents may charge HUD properties. Some examples include taking applications, screening tenants, maintaining the project, and accounting for project income and expenses.

⁵ The Management Agent Handbook, HUD Handbook 4381.5, REV-2, Paragraph 6.37(a) discusses assigning management costs to the project.

⁶ The Management Agent Handbook, HUD Handbook 4381.5, REV-2, Paragraph 6.33(a) provides guidance for HUD review of management agents' central offices.

⁷ The Management Agent Handbook, HUD Handbook 4381.5, REV-2, Paragraph 6.33(c) requires that HUD perform central office management reviews at least once every 18 months.

We interviewed HUD Multifamily officials with governance over the program and determined that they did not perform detailed monitoring to ensure management agents were not overcharging for front line costs and direct costs across the portfolio. Instead, HUD officials delegated the monitoring to the field office staff and relied on them to oversee the monitoring. The HUD officials were not aware of the specifics about the field offices monitoring of management agents and if the monitoring included steps to ensure that management agents did not overcharge for front line costs and direct costs across the portfolio.

Interviews of 17 HUD field staff, and 4 individuals from 2 of HUD's performance based contract administrators, revealed that they did not perform detailed monitoring to ensure management agents were not overcharging for front line costs and direct costs across the portfolio.

HUD's field staff monitoring was generally performed through the review of the annual audited financial statements or during a request for a budget based rent increase. Additionally, projects that were troubled or those with indicators of other financial performance concerns were reviewed more closely. HUD field staff monitoring typically included general consideration of the overall amount of the charges and if those overall charges exceeded 5 percent, or \$500 from the previous year. However, budget based reviews are becoming far less common as more and more projects are being restricted by market rents, and rents are more frequently being adjusted by operating cost adjustment factors. Additionally, many of the multifamily staff's portfolios have increased because of attrition and the multifamily reorganization.

HUD's performance based contractors stated that they did not always conduct reviews to ensure management agents were not overcharging for front line costs and direct costs. The current court case⁸ protesting HUD's performance based contracts has put the responsibility of conducting management operating reviews back on HUD's multifamily staff.

HUD Chose To Perform Broader Less Detailed Assessments.

HUD chose to forego its handbook requirements for performing central office reviews of management agents portfolios at least once every 18 months and decided to perform other broader, less detailed assessments. Also, HUD did not intend to include adding any detailed review of front line or direct costs in its updated matrix as part of the Multifamily Division reorganization.

- HUD Multifamily officials performed a more broad assessment of risk designed to evaluate the financial condition of the management agent to assess if they could pay back the loan and properly maintain the condition.

⁸ The case is CNS Contract Management Services Inc., et al vs. United States. Case number for the US Court of Appeals for the Federal Circuit is 13-5093. HUD is appealing the latest decision and it is currently waiting to be heard by the Supreme Court.

- HUD field staff evaluations of front line and direct costs focused on the overall charges and if charged amounts at the project level appeared reasonable instead of verifying that charges were comprised of eligible and supported costs.
- HUD's performance-based contractors' evaluations were limited to reviewing and processing the monthly HAP vouchers and did not include evaluations of front line and direct costs across portfolios.

Less Funding Available To Maintain The Properties

By not performing management reviews of the agent's central office activities, as well as regular onsite reviews of functions carried out at the projects at least once every 18 months, funds may not be available that otherwise would be used to maintain property conditions. Also, Section 8 reserves may be reduced because the surplus cash position may be reduced, if project funds are used to pay improper frontline and direct costs.

Prior OIG audits determined that the management agent did not follow HUD's requirements and charged more than \$1.6 million for ineligible and unsupported frontline and direct costs.

- OIG audited McClain Barr and Associates (management agent) based on a request from the HUD Greensboro, NC, Office of Multifamily Housing.⁹ The management agent did not follow HUD's requirements for charging its properties frontline expenses. It failed to maintain documentation supporting the eligibility of its charges, made charges based on budgeted amounts, charged management agent staff costs to properties, and charged some ineligible items. This condition occurred because the agent disregarded both HUD's requirements and its management agreements with the property owners. As a result, the agent charged more than \$872,000 of ineligible and unsupported front line and direct costs to the project which could have been used for project operations, improvements, or other allowable expenditures.
- OIG also audited the Avesta Housing Management Corporation (management agent), located in Portland, ME in response to a request from HUD's Manchester, NH, Office of Housing field office.¹⁰ The management agent failed to comply with HUD requirements to ensure that the allocation of the time spent by its property managers working with HUD projects was adequately supported. As a result, there was no assurance that the property manager salaries were allocated equably among the 30 HUD and 30 non-HUD projects it managed. The management agent also could not support the reasonableness of costs for accounting and bookkeeping services it charged. As a result, more than \$796,000 charged over a 3-year period was unsupported.

⁹ McClain Barr and Associates (2013-AT-1002) managed 17 projects.

¹⁰ Avesta Housing Management Corporation (2010-BO-1008) managed 30 projects.

Conclusion

HUD did not adequately monitor front line and direct costs charged by its management agents. HUD did not follow its management agent handbook requirements for monitoring. Instead, HUD chose to perform broader and less detailed assessments designed to assess the overall financial condition of the management agent and if charged amounts at the project level appeared reasonable. By not performing management reviews of the agent's central office activities, as well as regular onsite reviews of functions carried out at the projects at least once every 18 months, HUD lacks assurance that management agents have not used project funds to pay improper frontline and direct costs. Prior OIG audits determined that the management agent did not follow HUD's requirements and charged more than \$1.6 million for ineligible and unsupported frontline and direct costs. Consequently, project funds may not be available that otherwise would be used to maintain property conditions. Also, Section 8 reserves could be reduced because the surplus cash position may be reduced.

Recommendation

We recommend that the Director of HUD's Office of Multifamily Asset Management and Portfolio Oversight

- 1A. Comply with its Management Agent Handbook requirements that stipulate HUD must perform management reviews of the management agent's central office activities as well as regular onsite reviews of functions carried out at the projects. These central office reviews should be performed at least once every 18 months.

Scope and Methodology

We performed the audit from November 2014 through July 2015 at headquarters offices located at 451 7th Street SW, Washington DC, HUD Multifamily Field office located in Atlanta, GA, and at HUD Office of Inspector General's (OIG) Atlanta regional office. We also made site visits to management agent offices located in Savannah, GA and Greenville, SC. Our review generally covered the period October 1, 2012, through September 30, 2014, and was adjusted as necessary.

To accomplish our objective, we

- Interviewed Multifamily officials with governance over the program and the six projects reviewed.
- Interviewed personnel from HUD's performance-based contract administrators that provided contract administration services for the six projects.
- Interviewed management agent personnel, and project managers for the six projects.
- Reviewed applicable criteria, including HUD handbook 4381.5, REV 2, Office of Multifamily Asset Management and Portfolio Oversight organizational charts, and monitoring reports relating to the monitoring of management agents' charges for frontline and direct costs.
- Reviewed HUD's applicable management controls and policies and procedures used to administer the program.
- Reviewed two prior HUD OIG audit reports. We summarized the information from these reports for inclusion in our report.
- Reviewed management agreements, management agent and project ledgers, bank statements, financial statements, and supporting documentation for the frontline and direct costs charged to the six projects.

We relied in part on data maintained in HUD's system and on data maintained by the management agents and the project managers. Although we did not perform detailed assessments of the data, we performed minimal levels of testing and found the data to be adequately reliable for our purposes. Testing for reliability included comparison of the computer-processed data to source documents and records such as general ledgers, bank statements, audited financial statements, and invoices maintained by the management agent and/or the project managers.

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 objectives:

- Compliance with applicable laws and regulations – Policies and procedures to ensure that resource use is consistent with laws and regulations.

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's monitoring of its management agents did not adequately comply with its Management Agent Handbook requiring detailed reviews of management agents' front line costs and direct costs across their portfolios to ensure costs were not excessive (see finding).

Appendix A

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

Comment 1

Response to OIG Recommendation Regarding Evaluation of Management Agents

OIG Recommendation

HUD add monitoring for the front line and direct costs or revises its handbook requirements that stipulate HUD Multifamily Staff must perform reviews of the agent's central office activities as well as regular onsite reviews of functions carried out at the projects. These central office reviews should be performed at least once every 18 months.

Background

The Management Agent Handbook 4381.5 Chapter Six: Program Monitoring, contains the requirements for the monitoring of management agents. The monitoring activities consist of physical inspections, on-site management reviews and financial reviews.

Proposed Action

Multifamily Asset and Counterparty Oversight Division ("MACOD") will develop the following process to evaluate management agents:

1. Identify data collected through the Financial Accounting Sub System ("FASS") submitted at the property level to develop reports to evaluate the direct and indirect costs associated with management agents.
2. Identify those management agents with central office activities.
3. Develop a questionnaire to be completed by management agents with central office activities to collect information on the activities. The questionnaire will focus on policies, processes and personnel.
4. Develop management review template and process that utilizes a desk review approach to evaluate the management agent and its central office activities.
5. Establish a schedule to ensure management agents with central office activities are being reviewed at least every 18 months.

John E. Hall
Deputy Director
Office of Asset Management and Portfolio Oversight

OIG Evaluation of Auditee Comments

Comment 1 We agree with HUD's Office of Multifamily Asset Management and Portfolio Oversight proposed action. HUD's Office of Multifamily will submit the management decisions with acceptable timelines after the report is issued.