



U. S. Department of Housing and Urban Development
Office of Inspector General
26 Federal Plaza, Room 3430
New York, NY 10278 0068

January 29, 2007

Memorandum No. 2007-NY-1801

MEMORANDUM FOR: Deborah VanAmerongen, Director, New York Multifamily HUB, 2AHM

Edgar Moore

FROM: Edgar Moore, Regional Inspector General for Audit, 2AGA

SUBJECT: Management Agent Fees Claimed by P. J. Alizio Realty, Inc.

INTRODUCTION

At your request we performed a limited review of the management fees claimed by the management agent, P.J. Alizio Realty, Inc. (Agent), pertaining to six multifamily properties. Our objective was to determine if the Agent's fees were calculated in accordance with the management agreement and other HUD regulations. Our review disclosed that, for the fees we tested, the Agent generally calculated the management fees in compliance with applicable HUD requirements, and did not claim payments in excess of that specified in the Project Owner's and Management Agent's Certifications (management certification). However, the management certifications for two projects were not submitted to HUD as required.

SCOPE AND METHODOLOGY

Our review generally covered the period January 1, 2002 through December 31, 2005, as applicable, and included the six properties¹ that you requested we review, as well as a subsequent one² for which we found that the Agent's president recently began serving as management agent. Our review was limited to determining whether the management fees claimed by the Agent during the review period were calculated in accordance with HUD regulations.

To accomplish our objective, we interviewed officials from HUD's New York Multifamily HUB, and discussed HUD policy with officials in HUD's Office of Multifamily Asset Management and Office of Affordable Housing Preservation. We obtained and reviewed HUD Handbook 4381.5 Rev-2 "The Management Agent Handbook" and New York Multifamily memorandums dated November 12, 1997 and December 5, 1997 regarding local office implementation of management fee policy. We also analyzed the regulatory agreements and management agent certifications for the seven projects reviewed. We reviewed the projects' Profit and Loss Statements contained in the annual financial statements filed with HUD to determine the amount of management agent fees

¹ Bridegview I, II and III, Oceanview I and II, and Heyson Gardens.

² New Haven Plaza

claimed, and obtained and reviewed the independent auditor's work papers relating to the calculation of the Agent's fees to document and verify the basis for the calculation of the management fee. In addition, we reviewed the Agent's records to verify the source and amount of income from which the various fees were earned, and we recalculated the appropriate fees. We interviewed Agent officials and the independent auditor to understand how fees were determined.

We did not review the basis for any front-line management related expenses³ or other Agent expenses claimed because this is the subject of current litigation among the owners and the Agent for the six properties that you requested we review. Because they were not deemed significant to the review objectives, we did not obtain an understanding of internal controls; consequently our work was not conducted in accordance with generally accepted government auditing standards. Our review work was performed between May and July 2006.

We provided the Agent with a copy of the draft memorandum on October 16, 2006, who concurred with its findings.

BACKGROUND

Agents operating HUD-insured and HUD-assisted properties are paid a management fee. HUD Handbook 4381.5 REV-2, Chapter 3 provides that a management fee can be composed of five types of fees: (1) residential income fee, which is generally based upon income received from the rental of housing units; (2) commercial income fee, which is generally based upon rental income from commercial space, fees for parking, and charges for additional services not included in project rents; (3) miscellaneous income fee; (4) special fees, and (5) add-on fees. HUD approves the management agent and the property owner determines the actual amount of fee to be paid an agent. Fees allowed and the percentage or limits are specified in the management certification between the owner and the agent.

Prior to 1998, the HUD Multifamily New York field office policy was that the residential income fees for projects subject to HUD Handbook 4381.5 Rev-2 not exceed \$50 and \$59 per unit per month for projects located in low cost areas and high cost areas, respectively. These fees included front-line management related expenses. On December 5, 1997, the field office issued a memorandum, effective January 1, 1998, to all owners, agents and contract administrators for projects under budget-based rent increase procedures that implemented the requirements of HUD Handbook 4381.5 REV-2, Chapter 3. Specifically, the memo allowed front-line management related expenses to be charged directly to the project, required that all fees be calculated as a percentage of income actually collected, and established the maximum acceptable management fee yield at \$44 per unit per month. Once the fee percentage was approved, it was to be applied to the collections base as periodic rent increases raised the collections base, regardless of whether or not it falls above the \$44 per unit per month maximum. Additionally, per HUD Handbook 4381.5 Rev-2, section 3.8c., HUD does not need to review management fees for profit-motivated Section 8 projects that have rents set through use of the annual adjustment factor or do not have rental

³ Front-line expenses include office salaries, office supplies, bookkeeping and other expenses as defined by HUD Handbook 4381.5, section 6.38.

assistance contracts or are preservation projects that use the operating cost adjustment factor to determine rent adjustments.

The Agent served as the management agent for the six HUD subsidized properties (three Section 236 properties, two Section 221 properties, and one Section 223 property) for which an identity-of-interest relationship existed between the Agent and the owners of the properties. However, presently the Agent is no longer serving as the management agent. We were informed by the current management agent that litigation is pending between the Agent and the owners of these other properties over management agent expenses. Currently, the president of the Agent is the president of A-1 Realty Management, Inc., which serves as the management agent for the seventh project, a Section 221 property.

RESULTS OF REVIEW

During calendar year 2002 and 2003, the Agent claimed \$1,190,094 in management agent fees at the seven properties. The total fee at the various properties was composed of a variety of fees, and was based upon the percentage of collections specified in the management certification as follows:

<u>Project</u>	<u>Type of Fee and Specified Rate</u>			<u>Fee Claimed</u>
	<u>Residential</u>	<u>Commercial</u>	<u>Miscellaneous</u>	
Bridgeview I	9.54 (1/1- 9/30/02) 6.84 (as of 10/1/02 ⁴)	4.5	4.5	\$193,194
Bridgeview II	6.95 (1/1-10/30/02) 4.34 (as of 11/1/02 ⁵)	4.5	4.5	\$160,000
Bridgeview III	8.57	4.5	4.5	\$199,698
Oceanview I	5.79	N/A	4.5	\$206,734
Oceanview II	5.79	N/A	4.5	\$198,336
Heyson Gardens	6.74	N/A	4.5	\$ 41,728
New Haven Plaza	4.8542 (2005)	4.5	4.5	\$190,404
Total fees				\$1,190,094

⁴ The project rent was approved under an occupancy cost adjustment factor in October 2001. A management certification was executed between the owner and the Agent on October 1, 2002 approving a residential management fee of 6.84 percent. However, the Agent implemented this rate in April 2002. Officials in the New York Multifamily HUB advised that this project was not subject to the \$44 per unit per month yield.

⁵ The project rent was approved under an occupancy cost adjustment factor in April 2002 for rent increases effective November 2001. The owner and the Agent executed a management certification effective November 1, 2002 that authorized a residential management fee of 4.34 percent. However, the Agent implemented this rate in November 2001. Officials in the New York Multifamily HUB further advised that this project was not subject to the \$44 per unit per month yield.

The fees claimed were generally computed in accordance with the management certification and other HUD requirements, and did not result in payments in excess of that specified in the management certifications.

A revised management certification was executed between the owner and the Agent for two projects, which had received rent increases. While these certifications documented lower management fee percentages to be applied against residential income, the net management fee income increased because of the rental income increase, resulting in a yield significantly greater than the previously approved \$44 per unit per month. However, since these rents were set under a market-based approach, the management fees were no longer subject to the per unit per month yield cap. Nevertheless, Section 1.c. of the management certification requires that a certification be submitted to HUD prior to disbursing management fees based upon revised fees. However, the certifications with revised fees for these two projects were executed without submission to HUD.

Accordingly, we recommend that the Director, New York Multifamily HUB, request that (1) the Agent submit the certifications as required for the two projects to HUD, and (2) implement procedures to ensure that whenever management fees are revised a new management certification is submitted to HUD.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit. If you have any questions relating to this review, please contact John Harrison, Assistant Regional Inspector General for Audit at 212-264-4174.