



Why an Issue? Because many PHAs need to take advantage of other programs, such as the low income housing tax credit, to meet the needs of their residents.

June 20, 2007 HUD issued the long-awaited final notice on PHA-affiliated entities (the "Notice").

The Notice Applies to Public Housing Development– The notice covers entities using public housing funds for development. It does not cover Section 8 nor does it deal with PHA-Affiliated entities engaged in other types of work, such as social services. PHAs with Moving to Work Agreements may continue to follow those agreements.

There Are Two Types of Affiliated Entities - PHA

"Instrumentalities" are subject to all the same requirements as the PHA. PHA "Affiliates" are treated like any independent third-party contractor.

1. An **Instrumentality** is "legally and effectively controlled by the PHA."
2. An **Affiliate** is an entity over which the PHA has some control, but not enough so that it qualifies as an Instrumentality.

HUD presumes an entity is an Affiliate, unless the PHA shows it is an Instrumentality with a legal opinion, an opinion from the local government, or by demonstrating that the PHA has control over the entity. The Notice does not establish a bright-line standard for control, but discusses some factors for determining control. Simplified, "indicia of control" described by the Notice are:

1. Direction or management by the PHA's board or governing body, or by PHA employees;
2. Board positions or appointments come with a particular job at the PHA, or the PHA or its employees fill Board vacancies;
3. The organizational documents require public housing assets to be returned to the PHA if the PHA ceases to have control over the entity;

4. The organization is a component unit of a primary government using the suggested criteria and tests included in the Government Accounting Standards Board Statement 14.

Why would a PHA choose on or the other?

Public Housing Funds Can Be Tapped for Formation Costs in Limited Instances - As long as an Instrumentality's or Affiliate's first or only development phase contains some public housing, public housing funds can be used to form the entity.

Subject to Some Limits, Public Housing Funds May Be Used for a Portion of Tax Credit Application Costs - However, public housing funds may only fund an allocable share when the development contains public housing units and non-public housing units or non-housing uses.

PHAs Must Procure Affiliates, But Not Instrumentalities - PHAs do not have to procure an Instrumentality, but the Instrumentalities must follow HUD and local procurement rules. PHA must select Affiliates like any other third party contractor, unless the PHA obtains a HUD waiver. Like other third party contractors, Affiliates do not need to further procure their own contractors.

PHAs and Affiliated Entities May Share Resources, But Must Allocate Costs - A PHA and its Affiliate or Instrumentality may share staff, facilities, equipment and other resources, but resources that are federally funded must be allocated between the entities in accordance with OMB Circular A-87. The PHA administrative fee for development (3% safe harbor) is not subject to federal restrictions and therefore may be used, like other non-federal funds, for Affiliate or Instrumentality costs.

A Conflict of Interest Occurs When A Person Working with Both the PHA and the Affiliated Entity Receives an "Actual or Perceived Personal Financial Benefit" - The conflicts of interest sections of the ACC and Part 85 still apply. Under the Notice, when a PHA board member, employee or officer also serves with the affiliated entity, it will be considered a conflict if the individual receives an actual or perceived personal financial benefit (aside

from normal and customary compensation and bonuses provided by the PHA, Instrumentality or Affiliate). HUD will be most concerned where PHA dealings with its Affiliates or Instrumentalities create a perception of self-dealing or an abuse of authority.

The Notice Addresses Important HUD Development

Monitoring Issues – The Notice also addresses disposition and encumbrance of public housing property, reimbursement of public housing funds “improperly” spent, and monitoring and reporting in the PHA Plan. Please see our separate memo on the above issues.

The Notice Contains Compliance Reminders, Including Need to Obtain HUD Approval For Certain Activities. HUD issued the Notice, in part, to respond to an OIG report questioning whether PHAs were complying with basic public housing development requirements when dealing with affiliated entities. The Notice reminds PHAs that:

- In general, HUD permission is required before a PHA can mortgage or grant a security interest in public housing assets.
- Prior HUD approval is required to pledge future allocations of Capital Funds to support a borrowing to finance physical improvements or development.
- HUD must approve public housing expenditures for mixed-finance public housing development.
- The ACC requires that PHAs follow HUD rules when disposing of public housing assets even when transferring property to an affiliated entity.
- The ACC limits expenditures from a PHA’s “General Fund” to paying operational and development costs of public housing, purchasing HUD-approved investment securities, and other expenditures authorized by HUD.

HUD Will Review the Audited Financial Statements and the PHA’s Plan. HUD will monitor PHA development transactions, including in hot-button areas such as procurement, encumbrances and dispositions, and improper cost allocations. Transactions previously approved by HUD are not subject to further scrutiny or investigation. In its monitoring efforts,

HUD will first focus on disclosures made by the PHA in its audited financial statements and PHA plans. If this review indicates potential non-compliance – for example, if the audit reveals a bank loan secured by public housing assets that HUD had not approved – HUD will investigate further.

HUD May Allow Cures or Require Enforcement of Non-Compliant Transactions.

In cases of non-compliance, HUD may require the PHA to reimburse (or cause reimbursement of) any improperly spent PHA funds, or to unwind any improper development activities. For example, if HUD finds that a third party developer misspent HUD funds, the PHA will need to pursue the developer for reimbursement. HUD could also require a PHA to revise or terminate executed agreements, or stop an ongoing development process. Further, HUD may choose to pursue an enforcement action, which presumably includes referring the matter to the Enforcement Center for further prosecution.

The Notice Includes a Monitoring Checklist for Affiliated Entity Issues. The attached Affiliate/Instrumentality Reference Sheet (the “affiliates checklist”) applies to HUD review of affiliated entities. The Notice does not have a checklist for the non-affiliated monitoring issues. The affiliates checklist states that no investigation is required where:

- The PHA does not have any Instrumentalities or Affiliates; or
- No public housing funds have been used, and Affiliates or Instrumentalities have not conducted public housing development activities; or
- HUD previously approved the development activities.

But, HUD will investigate:

- Basic facts about the Instrumentalities or Affiliates;
- Whether formation costs were properly paid for;
- The cost allocation arrangement between the PHA and its affiliated entities;

- Compliance with Generally Accepted Accounting Principles, if required; and
- Procurements of and by Affiliates and Instrumentalities.

As with all PHA activities, PHAs should keep good records to easily respond to HUD reviews so that evidence of compliance is easily available.

Fees Earned by Affiliates and Instrumentalities

a. Instrumentalities (Development Activities)

- i. PIH Notice 2007-15 – covers only expenditure of public housing funds and/or creation of public housing units
- ii. An instrumentality is an entity whose “assets, operations and management are legally and effectively controlled by the PHA.”
- iii. Any “fees” or “program income” earnable by a PHA are characterized as if the PHA itself earned the income
- iv. If a fee is NOT program income to the PHA, it is also NOT program income to the instrumentality.

b. Affiliates (Development Activities) – Earn Fees Like Private Parties

- i. PIH Notice 2007-15 – covers only expenditure of public housing funds and/or creation of public housing units
- ii. “Affiliate” is an entity “formed by a PHA in which the PHA has a financial or ownership interest or participates in governance,” but the PHA’s control does not rise to the level of an instrumentality.
- iii. A PHA must procure an affiliate prior to contracting with it

- iv. Fees and other income earned by the affiliate are not program income, just as income of private parties contracting with a PHA would not be program income.

c. Affiliates and Instrumentalities – Non-Development Activities
Earned Fees are Restricted!

- i. 24 CFR 943, Based on 1437k of the law, governing consortia, joint ventures, affiliates, and subsidiaries of PHAs
- ii. PHA may enter into “joint ventures, partnerships, or other business arrangements with, or contract with, any person, organization, entity, or governmental unit”
- iii. Any income generated under such arrangement “shall be used for low-income housing or to benefit the residents assisted by the public housing agency”
- iv. Example of a hiccup in the new scheme – statute and implementing regulation are MORE restrictive than new asset management regime.

2. **Entrepreneurial Issues – Program Income v. Fee for Service**

a. Program Income – 24 CFR 85.25

- i. Defined extremely broadly – “gross income received by the grantee ... directly generated by a grant supported activity, or earned only as a result of the grant agreement during the grant period”
- ii. Authorized Uses – use for “grant purposes”, but no restrictions on income earned after the grant period. 24 CFR 85.25(g).
- iii. Authorized Mixed-Finance Uses – HUD requires program income earned after the grant period to be used for “affordable housing purposes.”

b. *Development Fee* (also known as development services fee)

- i. Program income-not fee for service
- ii. Note difference from Administrative Fee
 - 1. Don't rely on the label
 - 2. Paid by a third party, not HUD
 - 3. Gray area right now – arguably any fee earned by a PHA in excess of mixed-finance administrative fee

c. *Loan Repayments (Short Term or Bridge Loans)*

- i. Program income and treated as such by HUD

d. *Loan Repayments (Long-Term Loans)*

- i. Only program income if received during the grant period
- ii. Mixed-Finance typically includes later payments as program income, or at least as requiring use for affordable housing

e. *General Partner Asset Management Fee*

- i. Fee earned for providing non-public housing services to manage a partnership
- ii. Typically, but not always, small annual amount
- iii. Probably program income under 24 CFR 85.25, technically
- iv. HUD informally recognizes that it is a fee for service, but has not issued guidance