August 19, 2014

Inspector General Montoya
U.S. Department of Housing & Urban Development
451 7th Street SW
Washington, DC 20410

Dear Inspector General Montoya:

On behalf of the memberships of the Council of Large Public Housing Authorities (CLPHA), the National Association of Housing and Redevelopment Officials (NAHRO), and the Public Housing Authorities Directors Association (PHADA), we are writing to express our profound disappointment with your office’s recently released report entitled *Public Housing Operating and Capital Fund Program Central Office Cost Center Fees*. This report reaches far beyond oversight and accountability and delves deeply—and inappropriately—into reimagining the public policy landscape of the Public Housing Program. To support its broad policy recommendations, the report relies on logical leaps and overgeneralizations drawn from a small number of cherry-picked examples. At its core, the report appears to be a targeted attempt to undermine the foundations of the public housing asset management system. While NAHRO, PHADA, and CLPHA believe that the Inspector General’s role is indispensable, we feel strongly that the recommendations in this report are well outside of the appropriate scope of the OIG and should be left to policymakers at the Department and on Capitol Hill.

In the report, your office concludes that HUD could not adequately support the reasonableness of its Operating and Capital Fund Programs’ Fees and that some funds could have been “put to better use.” As a result, your office recommended that HUD should eliminate the asset management fee and refederalize all fees previously earned by PHAs in order to provide the federal government with additional control over the use of these revenues.

As you know, asset management was introduced in the public housing program in 2007 as a means of giving “greater attention to the performance of each public housing project.” By shifting funding, budgeting, accounting, and management to the property level, HUD sought to create a system that would simultaneously improve transparency and performance in the public housing program and provide PHAs with an incentive to increase efficiency. Through initiatives like the transition to asset management, HUD is moving toward a focus on outcomes instead of process. Your office’s recommendations seek to revert to a system of micromanagement that is both inefficient and ineffective given the limited resources available to the federal government.
The report also conflates an analysis of whether the asset management system is cost-effective with whether it creates a savings for the federal government. To suggest that asset management is not cost-effective and that fees are not reasonable simply because they do not yield savings is to level a policy judgment without understanding the objectives of the program. We would submit that the questions of how much a program “should” cost and what is the highest and best use of resources are policy determinations outside of the scope of your office and that the staff performing this audit are not the appropriate individuals to make these determinations.

The report repeatedly states that HUD was unable to support the reasonableness of the fees which PHAs are allowed by regulation to charge to their Asset Management Properties (AMPs). However, rather than limiting its recommendations to an attempt to address this issue, the report seeks to undermine the entire business model. Instead of a narrowly tailored recommendation with respect to ensuring the reasonability of the fee amounts, the report makes the logical leap to suggest that the fees should not exist simply because “HUD could not provide its analysis for determining the ‘reasonableness’ of the fees.”

The asset management model was developed from the Harvard Cost Study, which sought to benchmark the appropriate costs of operating public housing based on the expenses of owners in HUD’s multifamily portfolio, and generated for each AMP a Project Expense Level (PEL). These PELs underestimate the actual expenses by failing to account for costs associated with the additional regulatory requirements imposed on public housing, including the annual plan, PHAS, Section 3, the pet rule, community service, tenant participation requirements, mixed populations, and more. What’s more, public housing is consistently underfunded, with the present Operating Fund proration at 89 percent and prior years even lower. Despite this highly constrained funding environment, PHAs are required to continue to carry out all of the program functions required by statute and regulation. The report fails to acknowledge that the fees that PHAs charge to their AMPs are part of the PEL and are not an additional cost to taxpayers.

The report also provides only a cursory examination of the evidence which the Department did provide to justify the reasonableness of the fee levels. For property management, HUD has established the 80th percentile of fees charged in the multifamily program as a safe harbor for PHAs. Considering the additional requirements PHAs face relative to their multifamily counterparts, this is a very reasonable fee level. In recognition of the higher bookkeeping costs associated with public housing, the asset management regulations allow for a $7.50 fee per unit month. This fee has not been increased since it was initially established in 2007, suggesting that not only is it not excessive, it is lower than actual costs. Finally, PHAs are allowed to charge an asset management fee to a property that has positive cash flow. This fee is intended to serve as an incentive to efficient management and provides PHAs with a source of income to pay for long-term business analysis and resources for business activities to support the PHA’s long range plans and goals. We believe that all of these fees are necessary and reasonable, and strongly disagree with your recommendation to eliminate the asset management fee.

The report goes on to conflate asset management fees with profit, saying that a PHA “does not have a vested interest in its asset management projects because it does not run those projects for profit.” Asset management fees are not profits—they are payment for services provided to the property. In the narrowest views, asset management includes all of the owner functions in real estate, including long-term analysis and decision making about the best use of the asset. In many communities, however, PHAs are much more than just owners and operators of real estate, providing additional services and resources to their residents and communities. Many of these investments are supported by asset management fees,
and could be considered vital to the long-term stability of the real estate investment. Furthermore, the importance of asset management is unquestioned in the private sector, as evidenced by the important role that asset managers play in the LIHTC program.

We believe that the report’s recommendation regarding the refederalization of fees is largely unrelated to the actual findings of the audit; rather, it simply reflects an ideological opinion. While we question the underlying facts of some of the individual examples discussed, we particularly object to the use of the examples from the San Francisco and Los Angeles HAs as support for the report’s argument that defederalization allowed for resources to be used for “questionable expenses.” (See the attached response from the Housing Authority of the City of Los Angeles.) The defects cited for the two agencies have nothing to do with asset management or fee-for-service, but the report attempts to connect the issues, and even suggests a causal relationship. Both cases instead involve individual issues unrelated to fees or the policy around defederalization. The connection is sweeping, disingenuous, and entirely without substance.

By recommending that HUD refederalize all fees earned by PHAs through asset management, the report is suggesting that PHAs be treated differently than any other contractor of the federal government. This recommendation reflects a fundamental misunderstanding of the nature of the relationship between HUD and PHAs. In the report, you repeatedly criticize HUD for its failure to “monitor charges to its housing authorities’ central office cost center because those fees were considered defederalized and no longer subject to HUD’s requirements.” What your office fails to recognize, or chooses to ignore, is that PHAs are not components of HUD, but rather are independent entities which enter into a contract with the federal government to administer certain programs.

In your office’s response, you deliberately sidestep HUD’s arguments in support of defederalization, claiming that there is no relevant comparison between program fees earned through asset management to management fees paid to third-party property managers or developer fees earned through the Low Income Housing Tax Credit program. While the mechanism by which subsidy is provided between the public housing and LIHTC programs differs, HUD’s fundamental assertion that “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” remains unchallenged. Certainly your office would not argue that income earned by defense contractors engaged in fee-for-service programs must be refederalized to protect taxpayers—we fail to see a valid distinction.

We are also concerned about the issue of HUD oversight. If a layperson were to read the report, they might get the wrong impression that the Department exercises very little oversight of PHAs under the asset management system. For example, page 14 says that “HUD benefitted from housing authorities adopting this management fee approach because HUD’s monitoring responsibilities were greatly reduced.” With scant evidence, the report then opines that the system “has been detrimental to HUD’s program and overall mission and created further opportunity for fraud, waste, and abuse of taxpayer dollars.” On this point, the report is very misleading and simply wrong. HUD and other parties exercise more than enough oversight of PHAs. In addition to PHAS and SEMAP, PHAs regularly undergo independent audits and are subject to Board of Directors/Commissioners oversight, Government Accounting Office and IG investigations, HUD’s various risk management protocols, and local public and media scrutiny.
We also concur with HUD-PIH’s point that the asset management program and fees have been in place for seven years, and that the IG’s office was consulted throughout the program’s development. “The OIG concurred on the Federal Register Notice which established the safe harbor for the various fees and clarified that the income from these fees was defederalized,” PIH notes in its rebuttal. Furthermore, the recent Bush and Obama Administrations have strongly supported the asset management/fee for service concept, and Congress backed the transition, too. Changing course based on such a flawed report as this would be bad public policy, to say the least.

Finally, we object to the report’s efforts to portray its sample of five PHAs as reflective of the larger universe. The report fails to adequately explain that, far from being a random sample, two of the five PHAs were hand-picked based on previous OIG audit findings responding to specific complaints. Two additional PHAs were the subject of highly publicized media reports. These instances reflect very specific circumstances, each different from the other, and are not reflective of broader trends or systemic defects. As an industry, we resent the implications to the contrary contained within this report and we strongly urge Congress and others to reject your findings and recommendations.

Sincerely,

[Signatures]

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cc: Mr. Julian Castro, Secretary
Ms. Jemine Bryon, Acting Assistant Secretary
Mr. Milan Ozdinec, Deputy Assistant Secretary
Senate Appropriations Committee
Senate Banking, Housing and Urban Affairs Committee
House Appropriations Committee
House Financial Services Committee

Attachment