

ASSISTED HOUSING FINANCIAL MANAGEMENT INSIDER[®]

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IN THIS ISSUE

HUD Tougher on Enforcing Prior Approval of Owner Advances Repayments

We will tell you how to increase your chances of getting HUD approval of repayments on owner advances.

- ▶ Model Letter: Use *Insider's* Letter to Request Monthly Repayments (p. 3)

HUD Issues FY 2007 OCAFs

Ask the *Insider*: Obtaining Site Insurance

Consider your options when attaching an "umbrella" policy to preexisting liability/casualty insurance.

HUD Audits

- ▶ Utah's Largest Nonprofit Must Implement Management Controls
- ▶ Owner to Repay Site for Unauthorized Cash Distributions
- ▶ Prior Managing Agent Paid itself Excessive Fees

Annual Index

In Future Issues

- ▶ Reduce Site Liability Arising from Crime
- ▶ Using Consultant to Hire Additional Security
- ▶ How to Deal with Troublemaking Guests

HUD Tougher on Enforcing Prior Approval of Owner Advances, Repayments

If you have advanced money to a site, you probably know that HUD lets you get repaid from surplus cash—that is, money left over at the end of the fiscal year, after you have paid bills, made mortgage payments, and funded escrow accounts. But recent litigation reveals that HUD is getting tough on enforcing its rules on owner advances and monthly repayments.

You should not repay an advance with site funds unless you have obtained HUD's prior approval of those repayment terms. And nowadays you should not even make the initial advance without first obtaining approval. Otherwise, HUD may sue you for repaying the advance and making the advance in the first place. You risk stiff consequences, including steep fines or even criminal penalties.

With the help of Washington, D.C.-based affordable housing attorney Richard M. Price, we will tell you how to increase your chances of getting

(continued on p. 2)

HUD Issues FY 2007 OCAFs

On Oct. 2, 2006, HUD announced FY 2007 operating cost adjustment factors (OCAFs) to be used for rent adjustments in Section 8 contract renewals. The OCAFs will take effect on Feb. 11, 2007. OCAFs increased from their FY 2006 levels in approximately half of all states. Increases for 2007 ranged from a high of 6.7 percent for Rhode Island to a low of 2.0 percent for the U.S. Virgin Islands, with a national average of 4.3 percent. OCAFs for each state and territory are listed in the chart on this page. (For last year's OCAFs, see "HUD Issues FY 2006 OCAFs," *Insider*, Jan./Feb. 2006, including corrections, pp. 4-5.)

HUD uses these factors to calculate rent adjustments for certain Section 8 contact renewals, says Denise Muha, executive director of the National Leased Housing Association. Knowing the OCAF rent adjustment for your site can help you assess your renewal options. Although the 2007 OCAFs are higher than last year's, the increases still may not be enough to address the rise in utility costs in many parts of the country if natural gas and oil prices rise higher than projected, says Muha. Once again, this could lead to operating shortfalls, she adds.

(continued on p. 5)

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Owner Advances (continued from p. 1)

HUD's approval of your request for monthly repayment terms. We will tell you what to include in your request and how to document HUD's approval. And we will provide a Model Letter that you can adapt and use to ask for HUD's approval of monthly repayments of owner advances (p. 3).

HUD Rules on Repayment of Owner Advances

HUD Handbook 4370.2 says that you must get HUD's prior approval for monthly repayments of an owner advance, and that HUD "may approve" such requests, on a case by case basis [Handbook 4370.2-11, Par. 2-11(B)(1)(2)]. If you make the advance "for reasonable and necessary operating expenses," you can reimburse yourself "from surplus cash" [Handbook 4370.2-11, Par. 2-11(A)]. But if you do so "when the project is in a nonsurplus cash position," HUD can seek criminal and civil monetary penalties against you.

HUD lists the following as reasonable and necessary operating expenses for which you can expect to get reimbursed for an advance: 1) expenses that benefited the welfare of residents, such as emergency repairs or improvements; 2) operating expenses, such as taxes or utility bills; or 3) mortgage or loan payment on a site's behalf to avoid default [Handbook 4370.2, Par. 2-11 (B)(1)].

Recently, HUD has prosecuted owners who repaid themselves from site funds without first getting HUD's formal approval to make the repayment, says Price. And owners got into trouble even if the advance "benefited the welfare of site residents"—or HUD, for that matter, by preventing a default that could have required HUD to extend government resources to the site, he says.

HUD Seeks Double Damages for Unauthorized Repayments

Last year, HUD sued the owner of an assisted site in upstate New York for violating the rules on repayment of owner advances. HUD sought double damages. The owner contended that he had advanced funds into the site's reserve fund for replacements account. Meanwhile, he did not make mortgage payments, as required by his agreement with HUD.

Then, at a time when the site was in a nonsurplus cash position, he repaid advances with site funds, depositing rental income into a nonsegregated bank account. And he did so without first obtaining HUD's approval for either the advance or monthly repayments from site funds, as required by HUD rules.

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HUD sued him for equity skimming, seeking double damages and criminal penalties. The owner claimed that he had not personally benefited from the advances and that, in fact, he "paid more money into this project than the government now says I skimmed." The court found that even if his claims were true, the mere fact that he advanced money to the site and used site funds to repay himself without HUD's prior approval violated HUD's prohibition against owner advances and repayments.

The court ruled for HUD, without a trial, on the equity skimming charge. But the court ordered a trial to be held on the issue of damages [*U.S. v. Livecchi*].

As the above case illustrates, HUD is taking a tougher stance on its owner advance rules. It is suing owners who make advances and repayments without prior HUD approval, seeking double damages, fines of up to \$250,000, and criminal penalties. Price adds.

Although owners have routinely advanced funds without prior HUD approval, they are now finding that when they repay themselves, HUD is more likely to sue not only for making repayment without approval but also for merely making the advance, even if the whole matter was approvable in the first place, he adds. "It's part of the HUD 'gotcha complex' that former HUD chief Henry Cisneros used to talk about," Price says.

Avoid Risk by Getting Approval Before Making Advance

To avoid these stiff consequences, get HUD's approval before you advance money to the site and repay yourself with site funds, Price advises. By asking for HUD's prior approval, you will:

(continued on p. 4)

MODEL LETTER

Use Insider's Letter to Request Monthly Repayments

To ask HUD's permission for a site to make monthly repayments of an owner advance, send a request letter to your local HUD office. The letter assumes that you are asking for

HUD's approval *before* you have made the advance. Consult an attorney in your area before sending your letter.

(insert date)

(insert name of site)

(insert site number)

Dear Sir/Madam:

We, owners of (insert name and address of site), hereby request your approval for repayment from our site operating account on a monthly basis for an advance of \$(insert amount) that we plan to make to the site.

The advance is required to pay outstanding utility bills, copies of which are attached.

There is insufficient cash in our operating account to pay the past due bills. As you may already know, HUD has not made housing and assistance payments to our site for the past several months.

In addition, funds in our replacement reserve account are insufficient to cover the expense because we depleted the account to pay for an overhaul of the site's electrical system. Our residual receipts are also inadequate to cover the past due utility bills.

We propose the following repayment terms: We will take, on a monthly basis, the amount of site revenue that exceeds current bills plus one month's operating cash. Records will be kept for three years showing how we calculated each payment.

HUD Handbook 4370-2, Par. 2-14 allows you to approve repayment requests if the advance is to pay site operating expenses, such as utility bills. However, if any monthly repayment would cause the site to default on its mortgage, we would not use that payment to reimburse the advance. Our mortgage is not in default, nor is it subject to an existing workout agreement.

Our proposed repayment plan would not harm the site financially. We would take a payment against the balance owed on our advance to the site only when site revenues exceeded current bills and one month's operating cash.

In evaluating our proposed repayment terms, please take into consideration that our site has consistently received excellent management ratings. We are in compliance with our HUD agreement, and HUD has not found any problems arising from its management reviews or audits of our site.

If the advance we are contemplating is not made, we will have to choose between paying our bills and paying our mortgage. If maintenance projects become necessary for the safety of site residents, we will have to defer making those expenditures.

If you have questions about our request or require additional information, please contact me at (insert management office tel. #).

Thank you in advance for considering our proposed repayment plan.

Yours truly,

(insert name of site owner)



Owner Advances

(continued from p. 3)

Avoid risk. Asking HUD up front to approve an advance and monthly repayment terms eliminates the risk if HUD denies your request.

Better plan your finances. Knowing that you will not be repaid quickly (or regularly) means that you can better plan your finances. This knowledge may help you to decide that it is not practical to make the advance if you can't replace the advanced money. And you may decide to investigate alternative sources of funding.

Avoid HUD denial after making the advance. Some owners are so confident in their relationship with the local HUD office—based on a clean management record, for example—that they believe HUD's approval of an owner advance is a mere formality, Price notes. But their expectation that HUD will approve repayment of any advance is an illusion, he says. By not requesting HUD's prior approval, they risk getting a denial when they later apply for monthly repayment of the advance, he adds.

What to Include in Request

The handbook does not specify what to include in your request, but, like our Model Letter, your request should make the following points, suggests Price.

Ask for approval of monthly repayments. Ask HUD to let you repay the advance monthly from the site's operating account [Ltr., Par. 1].

State why site needs advance. As previously noted, the handbook gives three reasons for repayment of an owner advance: residents' welfare (emergency repairs or security measures); making payments to avoid a mortgage default; and paying site operating expenses (taxes or utility bills).

Tell HUD which of these reasons applies to your site, and give proof. If, for example, you need to cover back taxes, attach tax bills and notices that payment is overdue [Ltr., Par. 2].

Explain why operating revenue does not cover costs. Explain why other sources of cash, such as residual receipts and replacement reserve accounts, are not available. If the reason for the site's cash shortfall is that HUD has been late in making its monthly housing and assistance payments, make this point, Price recommends [Ltr., Par. 3].

State proposed repayment terms. Tell HUD how you would prefer to be repaid. For instance, you could propose that you get monthly site revenue that exceeds current bills and one month's operating expenses—that is, the cash necessary to run your site—until the advance is repaid. If you propose monthly payments that must be calculated, tell HUD you will keep records for at least three years showing how you calculated the monthly payment, Price suggests [Ltr., Par. 4].

PRACTICAL POINTER: The handbook discusses only monthly repayments because most bills and costs are determined monthly, Price explains. Other terms may be acceptable if there is a rational basis. HUD typically will not agree to interest payments on the advance, Price notes.

Show that repayment will not hurt site financially. The handbook states that you can't get monthly repayments if doing so would cause a mortgage default, the mortgage is already in default, or the repayment would hurt an existing workout agreement [Handbook 4370.2, Par. 2-11(B)(1)]. If your site's mortgage is not in default or is subject to a work-

out agreement, your letter to HUD should explain that you will not request monthly repayments if they would cause your site to default on its mortgage. And demonstrate why monthly repayments would not damage your site's overall financial condition [Ltr., Par. 7].

PRACTICAL POINTER: The term "workout agreement" typically refers to a mortgage payments plan described in HUD Handbook 4350.1, Chap. 11, Price notes. But the term also is commonly taken to mean any form of corrective action plan, management improvement operations plan, or similar document related to addressing site performance, he adds.

Emphasize good management record. If you have a good record with HUD, you should indicate that in your letter. And you can take credit for having no outstanding problems stemming from management reviews of audits [Ltr., Par. 8].

Address consequences of rejection. Tell HUD what the consequences to your site will be if it denies your request [Ltr., Par. 9].

Tell HUD you are available to answer questions. Tell your local HUD contract administrator how to contact you if there are questions pertaining to your request [Ltr., Par. 10].

Documenting HUD Approval

HUD's approval of your request must be writing, Price advises. If HUD approves your request for monthly repayments of an owner advance, you should document the response, to help you avoid getting into trouble with HUD over repayments, Price says. The form that your documenta-



tion takes will depend on how HUD responds to your request.

► *In writing.* If HUD replies with a letter or an email, retain a copy, advises Price.

► *Orally.* If your local contract administrator telephones to approve

your request, try to get a letter from HUD, Price says. Send HUD a letter confirming the oral approval and ask the representative to sign the letter, he advises. Do the same if HUD sends you an email: Reply by email confirming that the information is correct, he suggests. 🏠

■ U.S. v. Livecchi; No. 03-CV-6451P, 2005 U.S. Dist. LEXIS 26497 (U.S. Dist. Ct. W.D.N.Y. 9/30/05).

Insider Source

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FY 2007 OCAF's

(continued from p. 1)

To calculate the rent adjustment, HUD subtracts the per-unit debt service cost from the contract rent and then applies the OCAF to the amount remaining.

Example: The contract rent for a two-bedroom unit at an assisted site in New York is \$2,000, and the debt service attributable to that unit is \$200. As noted in the chart, the OCAF for New York is 5.8 percent. To calculate the new contract rate for the two-bedroom unit, HUD would multiply \$1,800 (\$2,000 contract rent minus \$200 debt service) by 5.8 percent to arrive at a rent adjustment of \$104.40 for the unit.

HUD determines OCAF's based on nine categories of operating expenses at FHA-insured projects: electricity, employee benefits, fuel oil, insurance, natural gas, property taxes, supplies and equipment, wages, and water and sewer. In 2006, HUD used the Residential Property Tax Index

► **FY 2007 State OCAF's**

State	OCAF (%)	State	OCAF (%)	State	OCAF (%)
Alabama	3.2	Maine	5.1	Pennsylvania	3.9
Alaska	5.6	Maryland	4.0	Rhode Island	6.7
Arizona	3.0	Massachusetts	5.9	South Carolina	3.1
Arkansas	4.1	Michigan	4.7	South Dakota	4.9
California	3.7	Minnesota	4.6	Tennessee	3.4
Colorado	3.6	Mississippi	4.0	Texas	5.8
Connecticut	6.3	Missouri	3.2	Utah	3.2
Delaware	4.4	Montana	4.0	Vermont	4.0
Dist of Columbia	3.8	Nebraska	3.9	Virginia	3.5
Florida	3.9	Nevada	3.4	Washington	3.1
Georgia	3.8	New Hampshire	4.6	West Virginia	3.1
Hawaii	4.4	New Jersey	3.9	Wisconsin	4.3
Idaho	3.1	New Mexico	3.4	Wyoming	3.4
Illinois	4.3	New York	5.8	Pacific Islands	3.8
Indiana	4.1	North Carolina	3.0	Puerto Rico	2.6
Iowa	4.9	North Dakota	4.7	Virgin Islands	2.0
Kansas	3.3	Ohio	4.7	U.S. Average	4.3
Kentucky	3.3	Oklahoma	5.0		
Louisiana	4.1	Oregon	3.1		

from the Census Consumer Expenditure Survey, not the Consumer Price Index, as a surrogate to determine the property tax component of the OCAF. This year, the surrogate for the property tax component is Table 1 of the census quarterly summary of state and local government tax revenue. 🏠

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