



February 23, 2010

Carol J. Galante
Deputy Assistant Secretary
Office of Multifamily Housing Programs
U.S. Department of Housing and Urban Development
Room 6106
451 Seventh Street, SW
Washington, DC 20410

Dear Carol:

We are writing to express our serious reservations about HUD's new draft Invitation for Submission of Applications for Contract Administrators and Annual Contributions Contract (ACC) revisions under its Section 8 Performance-Based Contract Administration (PBCA) Initiative. We fear that in trying to reengineer this program to cut its cost in the short-term, HUD has lost sight of the importance of ensuring the financial and physical health of the affected properties and the long-term social and financial consequences of failing to do so.

Given the urgency of our concerns, we have transmitted a copy of this letter to HUD Secretary Shaun Donovan, Assistant Secretary for Housing—Federal Housing Commissioner David Stevens, and Senior Advisor for Rental Assistance Barbara Sard. We ask that you delay the publication of the revised ACC and the rebidding materials until we have an opportunity to address our concerns in person at the highest possible level within the Department. We recommend having a small group of our state Housing Finance Agency (HFA) members with experience serving as program administrators (PBCAs) join us for that meeting.

As you know, the National Council of State Housing Agencies (NCSHA) represents the country's state HFAs, which administer a wide range of affordable housing and community development programs, including Section 8, tax-exempt Housing Bonds, the Low Income Housing Tax Credit (Housing Credit), HOME, down payment assistance, and state trust funds. Thirty-four state HFAs currently perform as PBCAs, with a track record of exemplary performance informed by years of experience in successfully financing and overseeing the management of affordable rental properties.

We and our state HFA PBCA members were shocked and discouraged by the draft ACC and the Invitation for Submission of Applications first presented by your staff at NCSHA's January 2010 HFA Institute. The program structure these documents reflect departs dramatically from the program principles and framework we have been discussing with your staff for months and on which we have provided extensive feedback. In fact, these materials reveal a complete change of direction programmatically for HUD, with, in our view, potentially grave consequences for the PBCA program and the properties, residents, and communities it serves.

We understand that HUD must respond to the Office of Inspector General's (IG) recent reports criticizing its oversight of the PBCA program and questioning the program's cost-effectiveness. The reports did not conclude, however, that PBCAs failed to perform pursuant to their contracts. In fact, most PBCAs exceeded HUD's expectations and provided more value than was required by the contracts. Many of HUD's latest program proposals unfairly penalize the PBCAs instead of responding to the IG's findings and recommendations.

We also understand HUD's desire to rebid the existing contracts to ensure that PBCAs are paid a competitive price. However, the payment methodology HUD now proposes eliminates performance-based incentives entirely and discourages cost containment measures by PBCAs.

HUD's proposed new program structure will likely cause some state HFAs, which have served for years as high-performing PBCAs, not to bid for future PBCA work, recognizing the real risk that they will not be able to even cover their costs. Those state HFAs still considering bidding for this work are concerned that they will not be able to deliver the same high quality property oversight in the future if they are forced to drastically cut costs and absorb all the risks inherent in the program.

We believe the withdrawal of state HFA PBCAs will be a substantial loss for the program, as they have provided consistently high quality property oversight, producing significant costs savings for HUD. They have cut waste in the program, improved the financial and physical condition of the properties, reduced improper subsidy requests, promoted increased compliance with HUD policies and procedures, and significantly reduced HUD's costs and workload. Any profit they have earned has been reinvested in their affordable housing work.

Our specific concerns and recommendations are as follows.

Recommendations for Improving the ACC

Acceptable Quality Level (AQL) Standards

The draft ACC proposes to establish a new standard requiring PBCAs to perform Housing Assistance Payment (HAP) and contract administrator activities at 100 percent of AQL to avoid a disincentive fee. We believe this standard is unrealistic and strongly recommend that HUD return to the 90-95 percent AQL standard outlined in HUD's October 4, 2009 Draft Framework.

PBCAs sometimes face circumstances beyond their control which make 100 percent task achievement impossible every single month. For example, if a snowstorm delays a Management and Occupancy Review (MOR), the PBCA will face a disincentive deduction. In addition, rural states with small but widely dispersed portfolios of properties may find it more cost-effective and efficient to cluster the scheduling of MORs within a few weeks, which may delay the process for some slightly. Further, requiring 100 percent AQL performance ensures that many PBCAs will make appeals to HUD to protest unnecessary disincentive deductions, which will waste everyone's time.

Earlier versions of HUD's draft ACC required PBCAs to perform Housing Assistance Payment (HAP) and contract administrator activities at 90-95 percent of AQL to avoid a disincentive fee. State HFAs feel that these levels of expectation are reasonable and create a powerful incentive for strong performance.

HUD also should finalize and distribute the new AQL definitions prior to the rebidding process. Finally, we urge HUD to assess AQL performance quarterly, not monthly, and then rate each PBCA's performance according to defined benchmarks, as described in the earlier Draft Framework.

Administrative Fees Should be Streamlined and Simplified

HUD's latest draft of the ACC imposes various limits on the administrative fee that a PBCA can earn. We understand HUD's need to contain costs and do not dispute its intent to amend the current fee structure. We have serious concerns, however, with how HUD proposes to modify the fee structure.

The draft ACC will limit profit to 10 percent of costs which are to be certified quarterly to HUD pursuant to OMB Circular A-87. The accounting principles employed by the A-87 were designed to track costs incurred by a state or local agency that administers a federal public assistance program within that state, such as Medicaid, Food Stamps, and block grants, and is allowed to cover its administrative costs for doing so. Those agencies serve as pass-through public service agencies of the federal government. The A-87 was not designed to track the costs incurred by a subcontractor of the federal government, even if the subcontractor is a public housing agency (PHA) that is an independent agency with its own separate mission and quasi-corporate purpose. Cost-certifying under A-87, as presented by HUD, means that profits exceeding the agreed upon limit are returned to HUD quarterly. This eliminates any financial incentive for PBCAs to reduce costs and improve efficiency.

If the PBCA's costs increase due to unexpected circumstances, HUD will not increase the fee. The PBCA incurs all the risk. Further, quarterly filing of the A-87 financial report is a significant administrative burden, which will unnecessarily increase HUD's costs overall. The IG recommendations do not include the need to report or return funds using this methodology. Unlike federal grants for Food Stamps or block grants, neither states nor their residents benefit from PBCAs performing their assigned tasks at a loss.

In addition, the draft ACC employs two separate limits on fees. The "profit percentage," which is limited to no more than 10 percent of the costs of performing the work, and the "administrative fee percentage," which is limited to no more than three percent of Fair Market Rent (FMR). While we recognize HUD's need to reduce costs, we believe this arrangement is unnecessarily complex and exposes PBCAs to unreasonable risk.

We would prefer that HUD maintain the current administrative fee percentage system, allowing HFAs to bid without imposing an arbitrary cap on their profit or requiring them to complete detailed and burdensome cost estimates and certification. We believe there are ways to reduce what HUD thinks may be excessive profits within this system, including market competition and negotiation with successful bidders.

If HUD determines that it must adopt a profit percentage system, we strongly recommend HUD modify its proposed fee structure to eliminate the feature that penalizes PBCAs when FMRs decline or the number of units decreases. As an alternative, when a PBCA's portfolio expands or contracts, per unit costs (including any profit allowance) could be used to recalculate total fees.

PBCAs should be incentivized to reduce costs by allowing them to keep whatever savings they generate. This would encourage PBCAs to improve efficiency.

In addition, we believe it is vital that HUD's selection process recognize, reward, and prioritize PBCAs that provide additional public benefits, including offering tenant services and leveraging supplementary resources to help preserve PBCA properties and improve their physical condition. These PBCAs may incur total costs in excess of other bidders and submit higher bids. But HUD, the properties, and their residents and communities would receive additional benefits. Taking these additional benefits into account, HUD ought to be ready and willing to accept higher-cost proposals because of the added value some applicants bring to the program. In addition, HUD should take into account the value added when applicants commit to use PBCA profits for affordable housing purposes and should give a preference to such bidders.

HUD Should Establish a Minimum Fee to Cover PBCA Costs

Under HUD's draft ACC, the fee has a ceiling that is determined at the time the applicant submits its Request for Proposals (RFP). However, there is no floor to the fee that will guarantee the PBCA will be able to cover costs for the term of the contract. There is a provision for HUD to pay less if costs and/or FMRs decrease, but no provision to pay more if costs increase and FMRs do not have the same rate of increase or even decrease. Similarly, HUD will reduce payments if a PBCA's units decrease, but will not increase payments accordingly if a PBCA's units increase. Further, it is possible for the PBCA to incur losses if costs unexpectedly increase, for example, if a PBCA faces a lawsuit arising from the PBCA following HUD regulations (as has occurred in several states).

For planning and budgeting purposes, state HFAs need a minimum floor below which they know their fees cannot drop, except for some extreme failure to perform at a minimally acceptable level. We recommend that HUD include in the annual fee structure a floor that will equal the annual cost figure that HUD has accepted to cover, so that PBCAs may plan accordingly. In addition, we expect HUD to allow PBCAs to submit certifications and receive reimbursement for any unexpected costs which may occur due to changes in the scope of work, natural disasters, lawsuits, or other situations that PBCAs will need to address.

PBCAs Should Have Loan Override/Servicing Fee Option

Even with our proposed recommendations, some HFA PBCAs may be better off financially by declining to participate in the PBCA program and resuming or instituting the 50 basis point loan override/servicing fee they are entitled to under HUD's assisted housing bond financing programs. Because of this financial incentive, some HFAs may have no choice but to consider withdrawing from the PBCA program, which could have dire consequences for many of the properties in the PBCA portfolio.

To avoid this, we recommend that HUD allow such states the option to reinstate their loan override/servicing fee for properties the PBCA has financed in lieu of receiving a profit percentage on their PBCA costs. HFAs that financed PBCA properties perform numerous added functions that are not reimbursed under the proposed fee structure, including servicing the loan, reviewing annual financial audits, inspecting units and overall property, monitoring the regulatory agreement, and monitoring and disbursing replacement reserves. Allowing state HFAs the choice to reinstate their loan override/servicing fee would encourage these HFAs to remain in the PBCA program and limit the PBCA program's costs.

Restructure Calculation of Disincentive Fees

HUD's proposed calculation of disincentives presents a problem when the Performance Based Tasks (PBTs) are not evenly distributed over the 12 months of the contract year. When a disincentive is assessed in a month with a small number of PBTs, the performance percentage will be unreasonably large. PBCAs will be incented to allocate more of their fixed resources from PBTs with more activities in a month to PBTs with fewer because the financial cost of poor performance will be greater when there are fewer activities per PBT. For example, if only two contract renewals need to occur in a month and one is not completed within prescribed time limits, the PBCA would have performed at only 50 percent of the standard and would be heavily penalized.

This problem is exacerbated for small PHAs since they are disproportionately penalized for their lack of performance, due to a lower volume of PBTs in any month. This is particularly true for certain PBTs such as tenant concerns. We are troubled that the draft ACC would hold PBCAs with smaller portfolios to a higher standard than those with larger portfolios. The risk of losing money would be much greater in the proposed ACC and disproportionately so for those with smaller portfolios.

The disincentive structure outlined in HUD's Draft Framework, provided in the PBCA Webinar on October 19, 2009, seems more reasonable. This Framework would require a PBCA to achieve the performance level assigned to each task in the AQL checklist, generally 90-95 percent. If the PBCA did not meet the performance level, it would be subject to a disincentive fee. The Draft Framework would allow a PBCA to fail to complete one action in each task per month without penalty. If such failures cause the quarterly performance to fall below the acceptable performance level assigned to that task, however, then a quarterly disincentive fee for that task would be assessed.

We recommend that HUD adopt this aspect of the Draft Framework. In addition, we strongly encourage HUD to determine and publish for comment the compliance and quality control standards applicable for disincentives and allow for a reasonable cure period before imposing disincentive deductions upon a PBCA that scores less than 100 percent on AQLs. We also urge HUD to provide for an impartial appeal process through which PBCAs may contest disincentives which they believe are unwarranted.

Provide Incentive Fees

The draft ACC eliminates performance-based incentives. The IG report recommended creating incentives that are reasonable and that "promote HUD goals" focusing on quality and/or other results-oriented outcomes, not to eliminate them. When done correctly, performance-based contracting is considered an optimal contracting method by OMB. Incentives for measurable results-oriented outcomes should be returned to the ACC.

For these reasons, we urge HUD to reconsider offering incentive fees, in addition to profits PBCAs might otherwise earn, to encourage PBCAs to perform above and beyond the ACC's requirements. For example, PBCAs should be able to earn incentive fees for measurable outcomes such as:

- Repayment agreements entered into as a result of a PBCA's successful administration of the Enterprise Income Verification (EIV) System and/or the Rental Housing Integrity Improvement

Project (RHIP), which results in the return of misappropriated funds to HUD. PBCAs should receive a percentage of the repaid fees.

- Providing training annually to property owners and agents on HUD program changes and initiatives. PBCAs should receive a minimal student fee for each hour of PBCA-sponsored documented attendance.
- Providing or leveraging additional resources for PBCA properties to support affordable housing preservation, capital improvements, or energy efficiency retrofits.
- Making available tenant services such as youth programs, services for the elderly, and dispute resolution courses for PBCA property residents.

Cost Certifications

We are concerned about HUD's requirement for cost certifications during the budgeting phase. A budget is simply a tool on which to base operations over a coming period. A cost certification should only be required when reporting on actual expenditures. We recommend that HUD change the wording on the cost certification requirement to indicate that it is a true and accurate reflection of costs expected to be incurred in the delivery of the PBCA work or require it only at a year-end close out. HUD should acknowledge that a PBCA's budget expectations will include their assumptions about possible future changes to their Section 8 portfolios, due to maturing loans and changes in HUD programs.

Need for Objective Quality Standards

In order for a PBCA applicant to assemble an accurate bid, it will require access to HUD's definitions of AQL standards for each PBT and an up-to-date Statement of Work. We urge HUD to provide PBCA applicants with specific objective standards for PBTs and an updated Statement of Work (SOW) prior to the RFP, so PBCAs can assess any needed adjustments to systems and staffing to perform under the new ACC. Substantive changes or additions to the standards or SOW should not occur between contract cycles, so that costs remain static and PBCA compensation is not unduly reduced. If a change before contract renewal is unavoidable, HUD must communicate this to the PBCA and provide an appropriate amount of time to implement the change. Similarly, if HUD needs to revise the ACC after it is signed and modify the scope of work, HUD should negotiate with the existing PBCA for this expansion of services to accommodate additional program requirements.

Need for Updated Program Guidance

The PBCAs must comply with RHIP and HUD handbook guidance. There are cases in which the RHIP guide conflicts with the handbook or the handbook is out of date. This is particularly true related to monitoring and enforcement of the EIV System. Currently, the handbook and RHIP guide have limited and/or conflicting information related to EIV monitoring and reporting. We urge HUD to update each handbook, guidebook and applicable form. The current SOW also would need to reflect the requirements for the specified monitoring responsibilities or reference to applicable or current guidance.

Recommendations for Improving the Bidding Process

Give Priority to State HFAs

We are pleased that HUD plans to retain the requirement that PBCAs must be PHAs. In the bidding process, we also urge you to establish a preference for state HFAs and give state HFA PBCAs a priority to remain PBCAs for their states. State HFA PBCAs have a strong and well-established track record. Drawing upon their experience in successfully financing and managing affordable rental properties, state HFA PBCAs have provided exceptional oversight services, while producing cost savings for HUD. State HFAs bring to the role of PBCA a deep understanding of their housing markets and needs. They have knowledge of and relationships with property owners and managers operating within their states.

State HFA PBCAs are also uniquely positioned to bring together and leverage other federal and state resources they direct, such as tax-exempt bonds, HOME, and Housing Credits, to address the physical and financial challenges Section 8 properties frequently confront. Successful and consistent state HFA PBCA performance has enabled HUD to focus its attention on the small minority of properties with persistent non-compliance and physical problems.

In choosing state HFAs as PBCAs, HUD receives an important additional benefit. State HFA PBCAs redirect the net revenue they earn to other affordable housing activities, including affordable housing preservation, homeless assistance, and first-time homebuyer help, further advancing the affordable housing mission they share with HUD.

We urge HUD to recognize the successful experience of high performing state HFAs which reinvest profits from the PBCA program back into affordable housing programs in their home states by giving them added consideration in the selection process. Allowing qualified and experienced state HFA PBCAs to remain in their roles will also further program continuity, stability, and success. In addition, it will protect the value of the substantial investments state HFAs have made in technology, equipment, operational systems, and personnel.

Term of Contract Should Be Extended

State HFAs must conduct long-term planning and invest in staff, resources and systems to support their role as PBCAs. HUD's draft RFP proposes an ACC term of only two years with two one-year renewals possible. This short term imposes undue risk upon PBCAs. We strongly recommend that HUD extend the term of the ACC to five years with two possible renewals.

Provide HUD's Scoring Methodology

HUD has indicated that certain portions of the PBCA application will affect an applicant's score more than others. We urge HUD to define publicly how much weight it will give to each section of the Invitation for Application and to provide a copy of the application scoring sheet with the RFP. We also strongly recommend that HUD provide transparency throughout the application evaluation process and allow an applicant that is not selected as a PBCA an opportunity to appeal.

Section 236 Properties

Currently, HUD requires PBCAs to administer Section 236 units if they are within the overall unit count at a Section 8 PBCA development. For example, a 200-unit property with 100 Section 236 units and 100 Section 8 units would be included in a PBCA's portfolio. The PBCA is expected to process rent increases, administer rent schedules, and monitor replacement reserve balances for all 200 units. We understand that the IG issued an opinion indicating that since the financing applied to all the units, the Section 236 units must be subsumed within the PBCA ACC. We urge HUD to share this opinion with the PBCAs and to include in the ACC compensation for the costs associated with administering the Section 236 units.

Outstanding Questions

The state HFAs have several outstanding questions about the draft revised ACC. We encourage you to provide as much information about these issues as possible, so that HFAs can fully prepare for the rebidding process as well as their continued role as PBCAs:

- Has HUD given any consideration to the possibility of PBCAs facing unexpected costs such as legal fees or lawsuits? Will HUD address this in the cost proposal portion of the RFP? Can PBCAs submit as a program cost a contingency for unanticipated costs due to changes in the required scope of work, transition expenses, natural disasters, or lawsuits?
- Will a PHA currently serving as a PBCA need to submit documentation on its legal qualifications?
- The draft ACC requires each PBCA applicant to submit a plan for transferring responsibility from the incumbent PBCA. For a PHA currently serving as a PBCA, will HUD expect any response or plan to accomplish this, even if no transition will be needed if HUD selects the incumbent PBCA? For HUD's evaluation, will the incumbent receive full points for this component of the application, since no transition is required? Will HUD utilize any scoring of transition risk? Using that concept, an incumbent PBCA would receive points for reducing the transition risk as none would be required.
- The revised ACC indicates that a PHA may not submit combined applications that exceed 300,000 units. In the January 21 PBCA/CAOM call, HUD staff stated that a PHA may not administer more than 300,000 units. Which statement is correct? Does this limitation apply to private sector partners that may be submitting applications with multiple PHAs?
- For the past two years, PBCAs have submitted to HUD Continuity of Operations Plans (COOP), but HUD has not prescribed the form or content for these plans. HUD has indicated that a COOP and COOP certification will be required as part of each PBCA's application. Certain state HFAs are in the midst of developing COOPs according to State Emergency Management Office (SEMO) requirements. Will a COOP prepared according to SEMO requirements meet HUD's specifications? If so, will the COOP need to be finalized before the PBCA application deadline or will the COOP certification by an HFA's Chief Executive Officer provide HUD the required assurance that the COOP will be finalized, tested, and employees trained within the 12 months following submission of the PHA application to HUD?

We urge HUD to consider seriously our recommendations for redesigning the ACC and the Invitation for Submission of Applications. Our comments represent the extensive input we have received from many state HFAs currently serving as PBCAs. We believe that our suggestions provide a

better way of containing program costs while maintaining performance-based incentives than the plans recently outlined by HUD staff.

We urge you to delay publishing the revised ACC until we have had the opportunity to further discuss our recommendations. To push forward hastily without fully considering the possible consequences could put the Section 8 assisted housing portfolio and its residents at risk. We implore you to carefully consider our comments before drastically changing the nature of this important program. Please contact us at your earliest convenience to arrange a time when we can discuss our concerns in person.

Sincerely,

A handwritten signature in blue ink that reads "Barbara". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Barbara Thompson
Executive Director

cc: Shaun Donovan, Secretary
Deborah Lear, Director, Office of Housing Assistance Contract Administration Oversight
Barbara Sard, Senior Advisor for Rental Assistance
David Stevens, Assistant Secretary for Housing—Federal Housing Commissioner