

HUD Mark-to-Market Program

Physical Inspection Services Statement of Work April 1999

Background

Under the Multifamily Assisted Housing Reform and Affordability (MAHRA) Act of 1997, the project owner/mortgagee is required to provide the Participating Administrative Entity (PAE) a Physical Condition Assessment (PCA), or recent Capital Needs Assessment (CNA) and replacement reserves analysis. The PAE is required to retain a qualified independent physical inspector to:

- review the accuracy and completeness of the owner's PCA;
- assist the PAE's underwriter in determining the cost and scope of work to address the project's critical repair items, twelve-month physical needs, and long-term physical needs; and
- determine the Rehabilitation Escrow and Reserves for Replacement Requirements.

The PCA shall include the following four (4) major components:

1. **Critical Repair Items.** All health and safety deficiencies or violations of Section 8 housing quality standards or FHA's regulatory agreement standards that require immediate remediation.
2. **Twelve-Month Physical Needs.** An estimate of the repairs, replacements, and significant deferred and other maintenance items that will need to be addressed within 12 months of closing. Includes the minimum market amenities needed to restore the property to the non-luxury standard adequate for the rental market for which the project was originally approved. If the standard has changed over time, the rehabilitation may include improvements to meet current standards.
3. **Long-term Physical Needs.** An estimate of the repairs and replacement items beyond the first year that are required to maintain the project's physical integrity over the next **twenty (20) years**, such as major structural systems that will need to be replaced during this period. (Note that the *Fannie Mae Guidance to the Property Evaluator* only requires an 18 year assessment.)
4. **Analysis of Reserves for Replacement.** An estimate of the initial and monthly deposit to the Reserves for Replacement account needed to fund the project's long-term physical needs, accounting for inflation, the existing Reserves for Replacement balance, and the Expected Useful Life (EUL) of major building systems. (See page 6 of the Fannie Mae Guidelines, Attachment A.) (This analysis should not include the cost of twelve-month physical needs or of any work items that would be treated as an operating expense.) (See Attachment B,

HUD Handbook 4460.1 REV-2, Excerpt: Chapter 5. Architectural Analysis And Inspection - Section 223 (f), for specific guidance.)

Statement of Work

The Contractor shall:

1. Perform a Physical Condition Assessment (PCA) for each asset specified by the PAE and report the findings.
 - a. The report shall be prepared according to the Federal National Mortgage Association (FNMA) document: FNMA DUS Guide Section 3 entitled “Physical Needs Assessment Guidance To The Property Evaluator” (See Attachment A), except as modified herein.
 - b. The report shall be written with detailed narrative and accompanying color photographs and shall describe the property’s exterior and interior physical condition, including architectural and structural components, and mechanical systems.
 - c. The Inspector will consult HUD Asset Management, Real Estate Assessment Center (REAC) and mortgagee (if available) files.
 - d. The report shall:
 - (1) identify in detail any repair items that represent an immediate threat to health and safety, and all other significant defects, deficiencies, items of deferred maintenance and material building code violations (individually and collectively, Physical Deficiencies) that would limit the expected useful life of major components or systems;
 - (2) provide estimated costs to remedy the detailed Physical Deficiencies (for 1 year of immediate needs); and
 - (3) prepare a Replacement Reserve Schedule, including an estimate of the initial and annual deposits (projected to increase at the operating cost adjustment factor) based on a twenty year term.
 - e. The report shall identify any physical deficiencies as a result of:
 - (1) a visual survey;
 - (2) a review of any pertinent documentation; and
 - (3) interviews with the property owner, management staff, tenants, interested local community groups and government officials.
 - f. The report shall provide a description of directly observed potential on-site environmental hazards. The report shall include a completed Environmental Restrictions Checklist (Form 4.14 in Appendix D).
 - g. The report shall assess the twelve-month physical needs. The standard is a non-luxury standard adequate for the rental market intended at the original approval of the project-

based assistance. The physical needs identified should be those necessary for the project to retain its original market position as an affordable project in a decent, safe and sanitary condition (recognizing any evolution of standards appropriate for such a project). The twelve-month physical needs should include those improvements the project requires to compete in the non-subsidized market, resulting in a marketable project that competes on rent rather than amenities. Where a range of options exists, the least costly options for rehabilitation should be chosen, when both capital and operating costs are taken into consideration.

- h. The report shall determine the cost-benefit of each significant work item in the rehabilitation plan (i.e., greater than \$10,000 per work item) that represents an improvement to the product, an upgrade to current elements or that could be considered to reduce the operating expenses. (For example, individual utility metering, extra insulation, thermopane windows, water savers on showers and toilets, automatic setback thermostats, and durable siding.)

Compare the cost of the item with the long-term impact on rent and expenses, taking into account the remaining useful life of building systems, as needed. The Contractor should coordinate with the underwriter and appraiser on this analysis, as needed. (Note: This analysis does not apply to items proposed to address accessibility issues, discussed below in section 1-j of this statement of work.)

- i. The report shall be prepared by an architect, general contractor or engineer licensed in the state where the project is located. (See Attachment C, Selection Criteria for Physical Condition Contractors.)
- j. The report shall explain how the project will meet the requirements for accessibility to persons with disabilities, to the extent applicable. (See the Attachment D, Accessibility Law Compliance Chart, for specific guidance.) Paragraph 2-40 of HUD Handbook 4350.3 (change 24 issued 1-19-93) requires owners to develop a transition plan that identifies physical obstacles that limit accessibility and describes methods to make the project accessible. The contractor shall include in the list of needed repairs items listed in the transition plan.
- k. The contractor shall take part in discussions with the owner, tenants and other interested parties, including neighborhood associations, members of local government, and representatives from the public housing authority, including attendance at a meeting to solicit oral and written comments to be incorporated into the PCA. The contractor shall assist the PAE in evaluating and responding to tenant and local community comments concerning the physical condition of the project and recommended repairs.
- l. The contractor shall act as an independent third-party on behalf of the PAE to certify for the completeness and accuracy of the owner's PCA. The contractor shall work closely with the underwriter, as needed, to ensure agreement with the PCA's conclusions.

- m. The contractor shall provide the PAE with weekly status reports (or upon request) during the preparation phase to track and monitor the progress.
2. Prepare a PCA report, which in addition to the four major components mentioned in the “Background” section of this statement of work, at a minimum shall include the following subcomponents:
 - a. Project Summary Sheet
 - b. Executive Summary (discussion of the physical condition of the property and any major repair/rehab items observed)
 - c. Index
 - d. Introduction to the Report
 - e. Building Evaluation (property identification, including location and description)
 - f. Site Improvements Evaluation/Analysis (utilities, parking, paving, sidewalks, sewer and drainage, landscaping, trash enclosures/compactors and general site improvements.)
 - g. Building Architectural and Structural Systems Evaluation (foundations, superstructure and floors, roof structures and roofing, exterior walls and stairs, siding, downspouts, and common areas, energy efficiency, tenant amenities, playgrounds and playground equipment).
 - h. Building Mechanical and Electrical Systems Evaluation (building HVAC, plumbing, electrical, elevators, fire protection/security systems).
 - i. Interior Dwelling Units Evaluation (interior finishes, all floors, walls, ceilings, paint, kitchens and appliances, carpet, vinyl, interior doors, shelves, cabinets, vanities, closets, interior HVAC, plumbing, bathroom fixtures, electrical fire protection systems, security systems).
 - j. Evaluation/Analysis of Other Structures.
 - k. Environmental Evaluation (including the Environmental Restrictions Checklist).
 - l. Estimated Useful Life Analysis (computation of Repairs and Replacement Reserves).
 - m. The basis for identifying any item for repair or replacement.
 - n. Unit cost breakdowns shall be provided for multiple items (i.e., stoves, refrigerators, cabinets, bathroom fixtures, etc.).
 - o. Acknowledgments (who prepared report, when report was prepared, who received report and when report was reviewed).
 - p. Appendices (photographs, site plans, maps, etc.).
 - q. Identification of any observed hazards, flammable or explosive facilities/ operations in the immediate area of the project.
 - r. State whether the project is located in a Flood Plain.

3. In addition to the above, the Contractor shall:
 - a. Immediate problems: Immediately notify the PAE of any structural defects, any other defects or significant physical inspection issues that may present an immediate hazard to the health and safety of the residents.
 - b. Recommendations for additional reports: The PAE will be responsible for obtaining any additional professional services to determine the degree of structural defects or other compliance issues and propose solutions with cost estimates, i.e. HVAC engineering, structural engineering, etc.
 - c. If the services of a subcontractor were secured to perform the PCA, the Contractor shall review the inspection for quality, consistency and agreed upon format and conformance with FNMA requirements.
 - d. The Contractor shall participate in meetings to review the PCA findings. The meetings may include HUD, the owner, tenants, local government representatives, appraisers and others approved by HUD.
 - e. Compile, organize and summarize information into a report and present it to the PAE.
 - f. Attend a formal kick-off meeting to clarify the requirements and scope of the work to be performed. The meeting will include the PAE, and any other Contractor or party that the PAE requests to be present.
 - g. The original and one copy of the completed PCA Report shall be delivered to the PAE, or its Designee.

Site Inspections

In preparing the PCA, the Contractor shall conduct site inspections of a minimum of 35% of all units. Units shall be randomly sampled while taking into consideration the unit size mix, i.e. one bedrooms, two-bedrooms, etc. However, all vacant units must be examined. If a significant number of units are found to be in poor condition, the PAE may require that additional units be inspected.

Deliverables

1. Physical Condition Assessment. The PCA shall be completed and one original and one copy of the report shall be submitted to the PAE or its Designee within 60 days of the PAE's request for the PCA.
2. The Contractor shall review all reports for quality, consistency and compliance with Contract requirements prior to submitting the reports to the PAE.

HUD Mark-to-Market Program

Physical Inspection Services

Statement of Work

April 1999

HUD Handbook 4460.1 REV-2

**EXCERPT: CHAPTER 5. ARCHITECTURAL ANALYSIS AND INSPECTION -
SECTION 223 (f)**

- C. Method for Computing the Initial Deposit to the Replacement Reserve (IDRR).Account.
A&E/C prepares an analysis of the remaining useful life of short lived building components and systems, and other project features.
1. Eligible items that may be included in the schedule are:
 - a. Replacement of refrigerators, ranges, and other major appliances in the dwelling units.
 - b. Replacement of roofing systems, including replacement of gutters, downspouts, and related eaves or soffits.
 - c. Replacement of major plumbing and sanitary systems or components.
 - d. Replacement of central air conditioning and heating systems or components including cooling towers, water chilling units, water heaters, furnaces, boilers, exhaust fans, and fuel storage tanks.
 - e. Overhaul of elevators
 - f. Major repaving/resurfacing/sealcoating (sidewalks, parking lots, and driveways).
 - g. Replacement of exterior (lawn) sprinkler systems when already included in a project.
 2. Ineligible items that may not be included in the schedule are, but are not limited to:
 - a. Items proposed to be replaced as part of the work write-up.
 - b. Items whose estimated remaining useful life exceeds 1/2 the original (first) mortgage term.
 - c. Painting of interior spaces.
 - d. Replacement of individual dwelling unit air conditioning components such as fan motors and window unit compressors.
 - e. Caulking and sealing.
 - f. Window screens.

- g. Replacement or purchase of maintenance tools and equipment such as lawn mowers or snow blowers.
 - h. Office equipment.
 - i. Replacement of fire extinguishers.
 - j. Items generally considered routine maintenance.
3. Prepare a schedule to estimate the remaining useful life of all eligible short lived building components equipment, etc., included in the project.
- a. To derive the remaining useful life of an item subtract the actual age of the item from the estimated economic life of the item.
 - b. The schedule shall provide a description of the item, actual age and estimated economic life of the item using the format shown below.

Sample

Description	Estimated Economic Life	Estimated Actual Age	Remaining Useful Life
Refrigerators	15	5	10

- c. Rearrange the items in the schedule in ascending order of groups of items in increments of 5-year periods based on the estimate of remaining useful life of items. The group whose useful life is estimated to expire within the first 5-year period will be listed first.
 - d. Estimates of economic life for items are to be developed and updated annually by each FO. Data should be obtained from material manufacturers and suppliers and should be adjusted based on performance under local conditions.
4. Prepare a 100 percent replacement cost estimate (less salvage) for each item in the group whose estimated remaining useful life is expected to expire within 5 years.
- a. Include the sum of the costs of labor/ installation, materials, and appropriate fees, when applicable. Using a cost adjustment factor for time, project the cost of each item from the date (month and year) of the estimate to the expected expiration date. The sum of the estimated cost is the total initial deposit.
 - b. Davis Bacon Requirements are not applicable, therefore, the costs of labor shall not include the provisions of Davis Bacon.
 - c. Identify the location of items, if required for clarification.
5. Evaluation of 10 Year Group. The total initial deposit amount established in C.4. above should be satisfactory to provide for any anticipated replacements which may occur within the first 5-year period. However, to assure that adequate funds are maintained to replace items whose cost may be considered weighty in years 6 through 10, an

additional evaluation must be made to determine whether annual deposits to the reserve account are sufficient.

- a. Review the 10 year group to determine if there are notable items whose replacement costs raise concerns that there may not be ample funds available to cover years 6 through 10.
 - b. Prepare a separate list of notable items and estimated costs to replace them using the instructions of C.4. above. This is only required when notable items that raise concern have been identified.
 - c. The list and cost estimate of notable items must be forwarded to AM.
6. AM Determination of Adequacy of Reserve Account Funds.
- a. AM determines the adequacy of the funds in the existing reserve account. Compare the total initial deposit provided by AE/C with the minimum amounts derived using the method described in HUD Handbook 4350.1 REV-1 paragraph 4-11. It should be noted that the minimum threshold of 144 (12 years) times the initially established monthly deposit prescribed in 4350.1 has been modified to use 60 months (5 years). This is more agreeable with the new methodology. Use the greater of the following to determine the adequacy of the existing reserve account.
 - (1) The initial deposit determined in C.4. above.
 - (2) The initially established monthly deposit times 60 (5 years); or
 - (3) At least \$1,000 per unit.
 - b. The amount established in 6(a) above should provide for any anticipated replacements which may occur within the first 5 year period. To provide that adequate funds are maintained for the replacement of high cost notable items in years 6 through 10, an additional evaluation must be made to determine whether annual deposits to the reserve account will be sufficient.
 - (1) Use the information included in the list of noted items and the cost estimate provided by AE/C to determine what amount, if any, should be considered when determining adequacy of the account.
 - (2) Derive the sum of annual deposits to the reserve account made in years 1 through 5 and add them to the amount determined in 6a above.
 - (3) Derive the sum of the total estimated costs of notable items and the amount determined in 6a.
 - (4) Compare the amounts derived in (2) and (3) above. If the amount derived in (2) exceeds the amount derived in (3), the amount derived in (2) above (6a and annual deposits) shall be used to determined if there is a shortfall.

If the amount of (2) does not exceed the amount of (3) above (6a and costs of notable items) the amount of (3) shall be used to determine if there is a shortfall.

- (5) The Director of MF Housing must evaluate the decision to increase the amount determined in 6a based on the costs of notable items.
- c. The Director of MF Housing must evaluate the determinations made in 6a and b above and be responsible for determining the adequacy of the reserve account including the shortfall amount, if any.
 - d. Owners must analyze the amounts in their reserve fund in light of anticipated needs on an annual basis for the first 7 years following closing and request appropriate increases to assure that adequate reserve funds are available. Thereafter, owners must perform needs assessments bi-annually. This analysis must also be submitted with any subsequent rent increase request.
- (1) The owner follows the requirements of paragraphs 4-10, 11 and 12 of Handbook 4350.1. and provide the results of the analysis to HUD with:
 - (a) A request for appropriate increases, such as annual deposits and/or rental rates, if required.
 - (b) Updated information regarding replacements of eligible reserve for replacement items. The information shall include the name and number of items, when they were replaced, and an estimate of their remaining useful life.
 - (c) Any other information required by HUD.
 - (2) AM reviews the information provided by an owner and recomputes the annual deposit to the reserve account to determine the adequacy of reserve funds.
 - (a) Decides what action is necessary following its review of all pertinent data including but not limited to project condition, Section 8 amendment availability, resident input, resident affordability, owner/agent past actions, etc.
 - (b) May request, if needed, the services of AE/C and Valuation.

ATTACHMENT C
to
Statement of Work:
Physical Inspection Services
HUD Mark-to-Market Program

Selection Criteria for Physical Condition Assessment (PCA) Contractors

The PAE's physical inspector must have the following qualifications:

1. Trained to evaluate building systems, health, and safety conditions, and physical and structural conditions, and to provide cost estimates for maintaining, rehabilitating, or improving deficiencies. Also has environmental expertise, as inspection will include environmental issues as well. Has required licenses.
2. Completed at least five (5) written evaluation reports for five (5) separate similar types of multifamily rental housing projects in similar physical condition and age in the subject market or in the surrounding area, preferably including two (2) or more buildings that were receiving Section 8 or some other type of housing assistance when the report was prepared; and
3. Not under suspension or debarment by HUD, or involved in criminal or civil action with HUD.
4. Reference check shows Physical Condition contractor to be well regarded in marketplace in terms of content, timeliness and responsiveness. Ensure that the inspector has this personal experience, rather than only the company. The Physical Condition Assessment inspection needs to include an environmental inspection which is not always in the traditional scope of a Physical Condition Assessment. Address this in the reference check also.
5. Time Frame: Timeliness is critical. Physical Condition contractor should have the capacity to complete a project inspection and prepare a summary report, including general cost estimates, within one week of receiving notice to proceed.
6. Where possible, proposals should be obtained from more than one firm.

ACCESSIBILITY LAW COMPLIANCE
Summary of HUD's Responsibilities to Accessibility Laws

ARCHITECTURAL BARRIERS

Code of Federal Regulations Number	Act/Section Application	Uniform Federal Accessibility Standards Apply (USFAS)*	Accessibility Requirements
42 USC 4151-4157	<p>Certain buildings financed with Federal funds are so designed and constructed as to be accessible to the physically handicapped.</p> <p>Projects financed with Federal funds including:</p> <ul style="list-style-type: none"> • Section 202/811 capital advances • All newly constructed low-income public housing projects or; • Public housing projects undergoing rehabilitation financed by Comprehensive Improvement Assistance Program (CIAP) funds. 	Yes	

ACCESSIBILITY LAW COMPLIANCE
Summary of HUD's Responsibilities to Accessibility Laws

SECTION 504 OF THE REHABILITATION ACT OF 1973

Code of Federal Regulations Number	Act/Section Application	Uniform Federal Accessibility Standards Apply (USFAS)*	Accessibility Requirements
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ACCESSIBILITY LAW COMPLIANCE
Summary of HUD’s Responsibilities to Accessibility Laws

<p>24 CFR Part 8</p>	<p>Projects receiving Federal financial assistance including:</p> <ul style="list-style-type: none"> • Section 202/811 capital advances • Section 8 project based assistance • Newly constructed public housing projects or; • Public housing projects undergoing rehabilitation financed by Comprehensive Improvement Assistance Program (CIAP) funds. 	<p align="center">Yes</p>	<p>New Construction (24 CFR 8.22 (6)):</p> <ul style="list-style-type: none"> • 5% or a minimum of one dwelling unit (DU) must meet <u>mobility impairment regulations</u> • An additional 2% or a minimum of one DU must meet <u>hearing and visual impairment regulations</u> <p>Substantial Alteration (24 CFR 8.32(a)):</p> <ul style="list-style-type: none"> • Buildings undergoing substantial alteration are only affected if they contain 15 or more DU <u>and</u> the cost of the alterations is 75% or more of the replacement cost. <p>Other Alterations / Clarifications (25 CFR 8.23(b)):</p> <ul style="list-style-type: none"> • Regulation states that alterations “shall to the maximum extent feasible, be made to be readily accessible to and usable by individuals with handicaps. <i>NOTE: This also applies to alterations to common parts of facilities that affect accessibility of existing housing facilities.</i> • Alterations to DUs or common areas that affect accessibility of existing housing facilities must be completed to allow access for all persons. • Owners and sponsors are not required to make the prescribed alterations if doing so would impose an undue financial or administrative burden on the operation of the multifamily housing project. • If alterations, when considered together, to single elements or spaces of a DU, amount to an alteration of a DU, the entire unit must be made readily accessible. • If 5% of DU are readily accessible to the <u>mobility impaired</u>, no further alterations are necessary. This section is silent on visual/hearing impairments. However, additional requirements <i>to</i> include these may be prescribed by the field office. <p>(24CFR 8.23(b)(2))</p>
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FAIR HOUSING AMENDMENTS ACT OF 1988

ACCESSIBILITY LAW COMPLIANCE
Summary of HUD's Responsibilities to Accessibility Laws

Code of Federal Regulations Number	Act/Section Application	Uniform Federal Accessibility Standards Apply (USFAS)*	Accessibility Requirements
	24 CFR Part 100	No	<ul style="list-style-type: none"> • At least one unit must be on an accessible route unless impractical due to terrain. (24 CFR 100.205(a)) • All public and common use areas must be accessible. (24 CFR 100.205(c)(1)) • All external and internal doors must be wide enough to accommodate wheel chair access. (24 CFR 100.205 (c)(21)) • All dwelling units must contain the following features of adaptable design: <ul style="list-style-type: none"> ◊ Accessible route into and through the DU (24 CFR 100.205 (C)(3)(i)) ◊ Light switches in accessible locations (24 CFR 100.205 (C)(3)(ii)) ◊ Reinforcements in bathroom walls for grab bars and; (24 CFR 100.205 (C)(3)(iii)) • Usable kitchens and bathrooms for persons in wheelchairs (24 CFR 100.205 (C)(3)(iv))