

Physical Needs Assessment Report
Department of Housing and Urban Development
Office of Public and Indian Housing

According to the Senate Report (113-182), accompanied by the Joint Explanatory Statement 2015, the Committee directs the Department to expand on its 2014 report to implement more detailed requirements for the Physical Needs Assessment (PNA) specifically to (1) assess how the specific aspects of the PNA tool compare to PNAs utilized by HUD's Office of Multi-Family Housing, and by unassisted housing managed by PHAs;(2) review if all data sought by the proposed PNA are necessary or if simplification of the tool makes sense from an oversight and management perspective; (3) reflect a department-wide effort to identify similar data collection requirements on PHAs to ensure no duplication or overlapping of requirements; and (4)determine if the objective of the PNA can be achieved by alternative means such as, but not limited to, collection as part of HUD's Line of Credit Control System, or the acceptance of multiple formats.

SUMMARY OF 2014 REPORT-THE IMPORTANCE OF A PNA AND ITS BENEFITS

As discussed in HUD's PNA report¹ submitted to Congress in June 2014, developing a PNA is a standard business practice in both private and public sector real estate management. The previous report described the burden and benefits of the PNA and listed the information PHAs would need to collect. It also listed the measures HUD had taken to balance benefits and burdens throughout the development of the PNA rule and implementing the tool. HUD also reported its proposal to accept submissions of PNA data over an extended period of time to further reduce burden on PHAs.

A PNA, also known as a Condition Needs Assessment, Capital Needs Assessment (CNA), or Physical Condition Assessment (PCA), is a standard operating procedure for real estate management and is a periodic examination and evaluation of real estate to determine a long-term schedule and cost for replacement of major property components. The PNA provides data to evaluate the viability of the real estate to continue serving its intended purpose into the future. A PNA is a foundational document for a number of real estate management functions, including determining a replacement reserve schedule; developing preventative maintenance plans; performing due diligence at sale, purchase, or financing; marketing and repositioning strategy planning; budgeting; and obtaining or providing grant support. Grantors, lenders, or property purchasers generally require some form of a PNA as support for investment in every other sector of real estate.

Since few, if any, real estate enterprises (either private or public) have resources to address every need, a PNA assists a property owner in prioritizing current capital expenditures and identifying synergies and efficiencies in the execution of major repairs and replacements. A

¹ <http://portal.hud.gov/hudportal/documents/huddoc?id=fy14physneedsassemtrpt.pdf>

PNA is a key component of a risk management approach to real estate management and oversight.

HUD seeks to establish the routine practice of performing a PNA in public housing so that PHAs may begin to capitalize on both the current and long-term benefits. HUD is confident that the benefits of implementing the PNA initiative at the proposed level of intensity far exceed the burden of performance. The initiative improves prospects for stabilization of the inventory and advances the evolution of public housing to a sustainable model that inspires confidence among policy makers, public housing residents and taxpayers.

The proposed rule's standards are reasonable, sensible, and practical in the context of public housing. The proposed protocols for public housing are for non-transactional purposes, therefore are generally less burdensome than protocols required for a PNA supporting a transaction.

HUD's proposed PNA benefits PHAs by providing tools and data to:

- develop a long term property specific strategic plan,
- prioritize budget needs in a limited funding environment,
- recognize synergies and efficiencies,
- communicate to stakeholders, including public housing residents
- manage the risk of critical component failure,
- organize project physical data as a reference and resource for future evaluations,
- develop preventative maintenance strategies,
- model alternative work sequences and timetables, and
- assess the long-term viability of the property in its current program structure.

A locally directed PNA helps PHAs evaluate the feasibility of long-term opportunities such as RAD or energy performance contracting (EPC) before proceeding with a complex transaction process to supplement or replace limited public housing funding.

HUD and PHAs invest substantial resources to provide safe and decent housing as a safety net for our nation's most vulnerable populations. This safety net has shrunk at the rate of thousands of units annually for more than a decade while the backlog of deferred work has increased. PHAs and HUD need tools such as the PNA to navigate the changed environment of public housing that is characterized by less federal funding, increasing need, increasing risk exposure, and the necessity of exploring non-traditional strategies to preserve a baseline safety net. HUD has some data on the magnitude of the physical needs of public housing from decennial Capital Needs Assessment (CNA)² surveys of public housing. However, the decennial sample survey's value to HUD is limited by its static nature. This data offers no planning value to individual PHAs since the survey is based upon HUD parameters, and even the survey sample subjects do not have access to their property specific results.

² The last CNA was completed in 2010 and can be found at:
http://portal.hud.gov/hudportal/documents/huddoc?id=PH_Capital_Needs.pdf

PNA COMPARISON TO HUD'S OFFICE OF MULTIFAMILY HOUSING AND OTHER NEEDS ASSESSMENTS

While the basic data collected in a PNA is virtually identical throughout real estate management, how and for whom the data is used differs significantly and impacts the burden of collection. The most common uses for PNAs in the real estate industry include property valuation, demonstrating the business viability of a project in support of financing or business restructuring, supporting a long term replacement reserve schedule, providing transparency to resident or common interest stakeholders, and supporting strategic business plans.

HUD's Office of Multifamily Housing requires physical needs assessments and energy audits in its assisted housing programs for privately owned real estate. These activities are comparable to the proposed public housing requirements for PHAs but there are significant differences that necessitate the information be collected in different formats and using different protocols. Multifamily insurance programs require a Project Capital Needs Assessment (PCNA) to establish an adequate replacement reserve fund and schedule for its assisted projects, as well as to assess the viability of new transactions and to extend insurance to market rate properties. Multifamily is primarily interested in the physical needs assessment serving as support and documentation for adequate replacement reserve funding for individual properties in its inventory. A physical needs assessment is required at least every 10 years³ and more frequently when changes occur in the business structure of the property such as a transfer of an assisted property, partial pay down of an insured loan, new or long term extension of a Housing Assistance Payment (HAP) contract, or recapitalization of an assisted property.⁴ These types of property change events are generally irrelevant to public housing.

Multifamily is currently developing the Capital Needs Assessment (CNA) e-tool to collect uniform metrics across its inventory when property changes occur as well as when new developments come into the assisted inventory. The CNA e-tool is intended to be the format for the required PCNA. It is considered an evolution of the tool that was used in the Green Retrofit Program and that which is currently used in the Rental Assistance Demonstration (RAD).⁵ Multifamily anticipates the CNA e-tool will be released in the first quarter of 2015. Because the data collected from the CNA e-tool will be used to determine funding such as replacement reserve disbursements and support for property refinancing, the protocol for the CNA e-tool and design preclude the application of local judgment and decision-making in the PNA process. For example, the CNA e-tool requires a third party provider (PIH's PNA can be done by a PHA with qualified in-house staff), stricter cost standardization for physical components than PIH's PNA, larger sample sizes than the PIH PNA and HUD standardized physical component useful lives.

³ This is largely addressed in Chapter 6 (6.3E 2, and 6.6.B2 and Appendix 5G of the Multifamily Accelerated Processing (MAP) Guide and in the Asset Management Handbook (4350.1)). In July 2010 Multifamily issued a Risk Mitigation Notice (HN 2010-11 & ML 2010-21) that extended the 10 year update requirement to all insured mortgage programs (see III.B.7 for 223(f), III.C.3 for 223(a)(7), and III.D.11 for all MF construction loans).

⁴ (24 CFR 401.451)

⁵ RAD Physical Condition Assessment Tool and PCA requirements:
<http://portal.hud.gov/hudportal/HUD?src=/RAD/tools>

The tool in its initial form requires the use of professional providers to complete the PCNA, since the PNA is primarily used by financial professionals to evaluate the transaction.

In 2010 and 2011 HUD, as part of its Rental Policy Realignment, reviewed the need for PNAs within the Department as well as the Rural Housing program administered through the Department of Agriculture. Several opportunities for alignment were identified, including the 20 year timeline horizon, a regular time interval between performances, and the integration of an energy audit. However, the working group’s final report acknowledged important distinctions between a PNA performed for transactional purposes, such as those for the Multifamily inventory and a PNA performed for strategic planning purposes as public housing proposes. The study acknowledged the objective of less administrative burden for PHAs in performing a PNA for strategic planning purposes and the appropriateness of a different scope and tool: “PHAs would only infrequently use the CNA tool for capital planning as the level of sophistication and complexity associated with it would be greater than with the PNA.”⁶

For PHAs to use the PNA tool for planning purposes, it must reflect their local reality as opposed to a HUD-mandated input structure required for a transactional purpose. In order for data from the tool to be useful to HUD, HUD must receive it in a format that can be aggregated and analyzed according to public housing property types and inventory configurations. The public housing PNA tool provides numerous benefits. It can be used by the housing authority staff rather than through a third party provider. It can also serve as a management tool for PHAs to model different scenarios at the local level to minimize administrative burden and to create reporting both for the local agency and for HUD’s aggregation purposes. The CNA e-tool was not designed for these purposes, some of which conflict with those of public housing. As a result, a different format and protocol is appropriate. Unlike in Multifamily, there is no routine influence of market forces in public housing that would cause an assessment to logically occur. Five years is a common interval for the assessment of real estate held long term, for example, property in a cooperative community structure that requires replacement reserves.⁷ HUD believes a five year interval is the appropriate standard to apply to public housing.

Summary Comparison of CNA and PNA		
	Multifamily CNA	Public Housing PNA
Planning Horizon	20 years	20 years
Frequency	At any transitional events; 10 years minimum	5 years
Integrated Energy Audit	Yes	No
Primary PHA purpose	Financing/Transaction	Strategic Planning
Primary HUD purpose	Monitor Transaction	Aggregate Data
Client for the Assessment Data	Lender	PHA
Third Party performance required	Yes	No
Component cost mandated by HUD	Yes	No
Component life mandated by HUD	Yes	No
Prepopulated components not requiring		

⁶Federal Rental Alignment Administrative Proposals 12/31/2011 Rental Policy Working Group http://www.huduser.org/portal/aff_rental_hsg/RPWG_Conceptual_Proposals_Fall_2011.pdf (See page 49)

⁷For example, the Virginia Condominium Act and POA Act each require a new replacement reserve study every 5 years and annual review (Virginia Condominium Act 55-79.83.1). General discussion see: http://en.wikipedia.org/wiki/Reserve_study

data entry	<30	>250
Available to PHA for modeling	No	Yes
Tool creates reports/exports for PHA use	No	Yes
Tool stores information for PHA reference	Minimal	Yes
Create replacement reserve schedule	Yes	No

OVERLAP AND DUPLICATION OF DATA COLLECTION

There typically is no overlap between properties in public housing and those in assisted Multifamily programs—PHAs would not be performing PNAs on the same properties to different standards.⁸ The Senate Report language also questions whether the PNA requirement duplicates other information collections for the same properties. HUD believes there is no such duplication. The PNA is the first step in a continuum of property management activities. The information collected by the PNA is the threshold information needed to make business decisions and report on capital investments in the physical inventory. These activities include drafting a five-year action plan, establishing an annual plan/budget, drawing down payment for approved work from the Line of Credit Control System (LOCCS) and submitting Performance and Evaluation reports. HUD has taken steps in the Energy and Performance Information Center (EPIC) system to make it easy for PHAs to select PNA items to include in these reports. The PNA establishes the “big picture” from which all subsequent decision making flows. At the same time, the PNA is the one place where needs that are not included in the five-year plan and PHA budget are recorded. The character and magnitude of the needs “left behind” form the basis for an evaluation of ongoing feasibility or impending obsolescence. No other PHA reporting captures this information.

NEED FOR DATA COLLECTED, SIMPLIFICATION OF THE TOOL AND ALTERNATE COLLECTIONS

The data collected by the PNA is required to produce a baseline 20-year spreadsheet of needs. Anyone developing a PNA in any format must collect the same minimum data points to produce a 20-year spreadsheet of needs.⁹ All of this data is information that property managers typically have available from initial construction or subsequent contract data. None of it is collected specifically for the purpose of a PNA. A PNA simply organizes the information that is already available to a property manager. For those PHAs that have this data in another format, there may be some burden associated with entering the data points into the public housing tool. Because nearly all professional providers use their own proprietary collection format, it is not

A potential exception occurs in relation to a PHAs decision to enter into a Rental Assistance Demonstration (RAD) transaction when the timing of the PHA’s entry into RAD does not coordinate with the due date of the PNA for public housing. Since there has been no public housing requirement pending the final rule, this circumstance has not occurred, but HUD is aware of the potential, is coordinating the public housing PNA with the more stringent requirements of the RAD Physical Condition Assessment (PCA), and will address this circumstance in the implementation notice for the public housing PNA. With the lifting of the cap on RAD conversions and HUD’s policy change to allow PNA reporting to be spread over a period of 3 years, the incidence of overlapping requirements between the public housing PNA and the RAD assessment are significantly reduced or non-existent.

Reference is made to the list of data to be collected in the previous HUD report under the heading “What is a PNA and why is it Important?”

technically possible for HUD to aggregate the information from multiple formats. To address any associated burdens of data entry, HUD has worked in cooperation with a provider who has developed an internal “crosswalk” to automate population of a public housing PNA submittal from its proprietary software. HUD has tested and confirmed this submission validates in the same manner as one produced directly from the public housing PNA tool. We are aware that other providers have produced similar software crosswalks that offer their clients the additional features and sophistication of their proprietary tools as well as a mechanism for the HUD reporting. HUD is also aware that additional providers will create similar crosswalks to the PNA tool. Finally, HUD is working on a template crosswalk to assist the individual vendors in their efforts.

The PNA tool can be used for basic planning purposes, but it also has features that are useful for PHAs that wish to pursue a more comprehensive assessment than HUD requires. Public Housing Agencies have a highly varied inventory of properties and special circumstances. Some PHAs have multiple building types mixed within the same project, floating units in mixed-financed projects, demolition and disposition circumstances, or variable local costs that must be considered. The PNA tool addresses and responds to this inherent complexity that does not generally exist in a typical Multifamily inventory. HUD has produced a simplified entry webinar (https://www.youtube.com/watch?v=Xz--2-AMW58&feature=player_embedded¹⁰) to demonstrate how the tool can also be used by PHAs that have less complex inventory characteristics. Further, HUD is revising the tool to highlight the locations of the required entries for ease of use. The tool is flexible and appropriate to the complexities of public housing properties, many of which reflect circumstances that do not generally exist in Multifamily.

The Senate Report specifically asked about the alternate capability of collecting the PNA data as a part of LOCCS, the secure electronic payment portal PHAs use to request grant funds by requisition based on the approved distribution of funds in very broad categories. HUD uses LOCCS, which records the withdrawal of funds from the PHA’s grant account to enforce obligation and expenditure deadlines for the grant funds. LOCCS currently does not collect any of the data points the PNA collects to project needs into the future. LOCCS only records disbursements of funds up to the grant amount with no information about the character or amount of residual need that remains after all grant funds have been expended. There is no direct connection between the total needs for a PHA and the activity data is tracked in LOCCS. Stated another way, LOCCS is a checkbook that cannot be overdrawn whereas the PNA is an ideal budget that lists what would be spent if all needs were funded far into the future.

STATUS OF PHYSICAL NEEDS ASSESSMENT

Since the June 2014 report, HUD has decided not to require small PHAs (those with fewer than 250 public housing units under management) to perform a PNA. Small PHAs experience the greatest burden of a new requirement since they had not previously been required to perform a PNA. Although HUD continues to believe very strongly that a PNA is integral to property management regardless of the size of the assets, many small PHAs are disproportionately challenged to address the core work required to viably manage the inventory due to the very

¹⁰ For demonstration of simplified entry into PNA tool. Green Physical Needs Assessment Training #4 Simplified Entry YouTube: see intro at 1min 20 sec.; 54:00-58:00; and 1:02-1:30.

small annual Capital Fund grants they receive. HUD will pursue rulemaking to exempt small PHAs from this requirement as they previously were.

HUD has also decided to delay implementation of the more detailed energy audit standards to integrate with the PNA activity. HUD has several energy conservation incentive proposals pending. While the Department continues to strongly believe in the value of the moderate ASHRAE Level II energy audit standards proposed in the rule, it plans to pursue a strategy of encouraging rather than requiring PHAs to shift to the proposed standard at this time.

CONCLUSION

As demonstrated in both this report and our earlier report submitted in June 2014, the Department is working diligently to develop a PNA tool that provides the greatest value and the least burden to PHAs. The proposed PNA requirements for large PHAs are consistent with those required for other types of HUD assisted housing but are much less stringent. HUD has performed a comprehensive review of PNA/CNA and energy audit standards across the Department and has concluded that it is appropriate for public housing to employ a less burdensome PNA process because of the non-transactional nature of its use. The proposed rule nevertheless preserves baseline asset management principles inherent in standard industry PNA practices.