
CHAPTER THREE

ALLOWABLE MANAGEMENT FEES FROM PROJECT FUNDS

3.1 GENERAL

Management agents operating HUD-insured and HUD-assisted properties are paid a management fee for their services. Management fees may be paid only to the person or entity approved by HUD to manage the project. Management agents must cover the costs of supervising and overseeing project operations out of the fee they receive.

Owners determine the actual amount of fee to be paid to the management agent. As provided for in project Regulatory Agreements and rental assistance contracts, for certain projects HUD determines the amount of fee that may reasonably be paid out of project funds.

NOTE: Unless otherwise specified, the term "management fee" in this chapter references to the management fee payable out of project funds.

This chapter addresses reviews of management fees requiring HUD approval.

Section 1: Management Fees and Review Requirements discusses the types of fees that are allowed and summarizes review requirements.

Section 2: Procedures for Performing Management Fee Reviews covers procedural steps in the review process.

Section 3: Assessing Reasonableness of Management Fees provides guidance on the technical review of proposed fees.

Section 4: Special Provisions for Fees Approved On or Before August 1, 1986 highlights special rules for certain "held harmless" projects.

SECTION 1: MANAGEMENT FEES AND REVIEW REQUIREMENTS**3.2 TYPES OF MANAGEMENT FEES**

- a. There are five major types of fees that, when added together, make up the overall management fee for a project. The five types of fees are:
- (1) Residential income fee;
 - (2) Commercial income fee;
 - (3) Miscellaneous income fee;
 - (4) Special fees; and
 - (5) Add-on fees.
- b. Fees derived from project income (residential, commercial, and miscellaneous) must be quoted and calculated as a percentage of the amount of income collected by the agent. Multiplying the fee percentage by the income collected gives the actual amount of fee paid to the agent. This requirement serves two purposes.
- (1) It gives the agent an incentive to maximize collections; and
 - (2) It automatically increases the agent's potential fee yield as project rents increase. These increases help offset increases in the agent's cost due to inflation.
- c. Both special fees and add-on fees are quoted as dollar per unit amounts because they relate to project conditions that are not a function of project rents or income.

3.3 RESIDENTIAL INCOME FEE

HUD specifies the kinds of income that may be treated as residential income when determining the residential income fee. In general, income received from the rental of housing units may be counted as residential income. Figure 3-1 indicates the types of income that may and may not be included in the residential income base amount used when calculating this fee.

Figure 3-1
Determining Residential Income

<u>DO COUNT</u>	<u>DO NOT COUNT</u>
<ol style="list-style-type: none"> 1. Apartment rents. 2. Cooperative carrying charges. 3. Rent Supplement payments. 4. RAP payments. 5. Section 8 regular tenant assistance payments (including utility reimbursement payments made to residents whose Total Tenant Payment is less than the utility allowance). 	<ol style="list-style-type: none"> 1. Section 8 Special Claims: <ol style="list-style-type: none"> a) unpaid rents b) vacancy loss c) debt service d) resident damages. 2. Excess rents and charges for Section 236 when the unit rent paid is greater than the unit Basic Rent. (This condition applies regardless of whether the excess income is due to HUD.) 3. Section 236 Interest Reduction Payments (IRPs) made to mortgagees on Section 236 projects.

3.4 COMMERCIAL INCOME FEE

Most sources of commercial income may be counted when establishing the income base for this fee. Figure 3-2 shows the types of income that may be counted as commercial income.

Figure 3-2
Determining Commercial Income

<u>DO COUNT</u>	<u>DO NOT COUNT</u>
<ol style="list-style-type: none"> 1. Rent receipts from commercial space. 2. Fees for parking spaces or garages. 3. Charges collected by the agent for additional services not included in project rents. 	<ol style="list-style-type: none"> 1. Charges for services paid directly to an outside vendor or contractor.

3.5 MISCELLANEOUS INCOME FEE

- a. HUD will allow management agents to earn fees only on selected types of miscellaneous income. Figure 3-3 lists the types of income that may and may not be counted in the miscellaneous income base amount.

Figure 3-3 Determining Miscellaneous Income	
<u>DO COUNT</u>	<u>DO NOT COUNT</u>
1. Laundry and concession income (e.g., coin machines, car wash, cable TV, etc.).	1. Interest earned on invested security deposits, reserves, or other project funds.
2. Charges collected from residents, such as fees for damages, bad checks, and late payments.	2. Section 8 Special Claims for unpaid rent, vacancy loss, debt service, or resident damages.
3. Proceeds from Loss of Rents Insurance policies.	3. Flexible Subsidy Funds, except as provided for in the MIO plan.
4. Income from furniture, equipment, and other charges shown on the HUD-approved Rent Schedule (Form HUD-92458).	4. Refunds from property tax or utility rate appeals.
5. Pet fees - for clean-up, etc. (not pet deposits).	5. Proceeds from property damage or liability insurance policies.
	6. Recovered legal fees and court costs.
	7. Replacement reserve and residual receipts reimbursements to the project.

3.6 SPECIAL FEES

- a. Use of Special Fees. In addition to the percentage-based fees described above, owners may agree to pay special management fees if a project has special needs or problems. Proposing special fees (rather than adjusting the fee percentage) is an appropriate and cost effective way to address specific project conditions that should be temporary in nature.
- b. Circumstances When Special Fees Are Allowed. Agents may earn special management fees only if all six conditions listed below are met.
- (1) The agent did not cause the problem the fee is designed to address.

- (2) The fee is tied to the correction of specific problems or the accomplishment of specific tasks. Examples of such tasks include:
- (a) Renting-up the project (unless compensation for this is provided from a supplemental management fund);
 - (b) Obtaining or renewing a lease for commercial space at the project;
 - (c) Completing significant rehabilitation work or utility conversion;
 - (d) Reducing vacancies or improving rent collections;
 - (e) Reducing a specific excessive expense (e.g., utility costs or property taxes); and
 - (f) Processing membership transfers at cooperatives.

NOTE: Normally, Loan/Asset Management staff should not approve incentive fees tied solely to an agent's performance in increasing net income, or decreasing total expenses. Such fees might encourage agents to forego necessary maintenance or expenditures.

- (3) The fee is structured so that it is payable only if the agent completes the required actions or obtains the required results.

EXAMPLE: A new agent might receive a special fee for satisfactorily correcting all items of deferred maintenance by a specific date.

- (4) The fee does not include services that are covered by residential, commercial, or miscellaneous management fees, or by other sources of compensation.

EXAMPLE: An agent may not collect a special management fee for supervising rehabilitation work if those services are being paid for through BSPRA (Builders/Sponsors Profit and Risk Allowance), a construction oversight fee.

- (5) The fee is reasonably related to the time, effort, and expertise required of the agent.

- (6) The fee is paid only for a limited period of time. The length of this period should be no longer than the time required to resolve a specific problem or complete a certain task.

- c. Bookkeeping Expenses Are Treated as a Project Cost. The cost of bookkeeping services for a project performed as part of a centralized bookkeeping system are treated as a project cost and should not be treated as a special fee. Such expenses are paid out of project funds based on actual costs attributable to the project. Further guidance on the treatment of such costs and the amount payable out of project funds is provided in Chapter Six, paragraph 6.37.

3.7 ADD-ON FEES

NOTE: ONLY AFTER computation of the permitted percentages for residential, commercial and miscellaneous income have been determined and approved by HUD, may add-on fees be considered. In approving the permissible percentage fees, the PUPM Yield must fit within the range established by the Area Office. Although the total yield including the add-on fees may exceed the range, add-on fees may not be used to increase this range and in turn increase the percentage fee.

- a. Add-on fees are a flat dollar per unit fee paid to agents managing projects with long-term project characteristics/conditions that require additional management effort beyond than the activities covered by the residential management fee. For example, scattered site projects will often will often require greater management effort than single site projects.
- (1) HUD Area Offices will establish a schedule of project characteristics/conditions that warrant add-on fees and a flat fee amount (PUPM) for each characteristic/condition (see paragraph 3.21). Area Offices will make this schedule available to owners/agents of projects within its jurisdiction.
 - (2) Figure 3-4 list examples of project characteristics/conditions that may warrant the use of add-on fees.
 - (3) For short-term or temporary project conditions, owners/agents should seek special management fees (see paragraph 3.6). Area Offices will not approve add-on fees for temporary projects conditions.
 - (4) HUD Area Offices must not establish add-on fees for project characteristics/conditions that are already covered in its residential management fee range. For example, an add-on fee for a subsidy contract would not be appropriate if a significant number of the projects used to establish the residential fee range were Section 8 New Construction or Substantial Rehabilitation projects.

Figure 3-4

Examples of Long-Term Project Conditions That Could Justify Add-On Fees

A. High Density Projects: A high percentage of units with three or more bedrooms increases the population density and can increase the cost of managing a project.

B. Location:

1. Remote location. A higher fee may be justified if:

- No local management is available and agent will incur unusually high travel costs.
- Special outreach is required to attract residents.

2. Scattered site. The agent may be paid additional compensation for the extra travel expenses incurred in overseeing several sites.

3. Adverse neighborhood conditions (e.g., high incidence of crime or vandalism, or large concentration of deteriorated or substandard housing) These characteristics tend to increase maintenance and repair problems, resident turnover, vacancies, and rent collection losses.

NOTE: While higher fees may be allowed for these conditions, Area Offices should not allow higher fees for collection losses caused by these conditions if the owner and agent used a collections base of less than 95 percent to estimate the residential management fee yield.

C. Type of ownership: Because owners of nonprofit projects may be less experienced in property management or because cooperative projects have additional legal and organizational responsibilities, management of these projects may require extra knowledge and effort on the part of the agent.

EXAMPLE: To manage a cooperative, the agent must understand State and local cooperative laws, the cooperative subscription process, how homeownership works in cooperative housing, and other requirements specific to cooperative housing.

D. Subsidy mix: A higher fee may be appropriate if:

1 A project has more than one type of subsidy.

AND

2. The combination of subsidies to the project requires more administrative oversight than the projects that were used to establish the residential fee range.

EXAMPLE A: An agent who manages a 236 project with a Rent Supplement, RAP, or Section 8 contract may receive a higher fee than an agent who manages an otherwise comparable 236 project with no tenant-based subsidy.

EXAMPLE B: An agent who manages a 236 project with both Rent Supplement and Section 8 may receive a higher fee than an agent who manages an otherwise comparable 236 project with only one tenant-based subsidy. **(NOTE:** This does not apply if the project has both RAP and Section 8. Since the rules for these two programs are so similar, having both subsidies does not require significantly more work from the agent.)

- a. **Owner/Agent Requests for Add-on Fees.** Owners/agents requesting add-on fees for a project must submit a new Management Certification (From HUD-9839-A, or B) and list the requested fees under the Special Fees section of Attachment 1 of this form. In completing Attachment 1 of the Management Certification, owners/agents must clearly distinguish any add-on fees requested from any special fees listed on the form. The owner may request any dollar amount for a specific add-on so long as the amount does not exceed the dollar limit established for that add-on fee by the appropriated Area Office.

3.8 PROJECTS SUBJECT TO HUD MANAGEMENT FEE REVIEWS

- a. **General.** Whether a project is subject to a management fee review depends upon several key factors:

- (1) Type of Ownership (i.e., whether the ownership is profit motivated, limited dividend, or nonprofit.)
- (2) Management Agent: (e.g., whether the agent has previously received approval from the Area Office or has outstanding findings of noncompliance.)
- (3) Project Conditions: (i.e., whether the project's financial, physical, or administrative problems suggest the need for a review.)

Projects subject to review may be reviewed either up-front (before the project is obligated to pay the management agent) or after-the-fact (in conjunction with other servicing activities). Figure 3-5 summarizes the requirements and timing of management fee reviews.

- b. **Types of Ownership**

- (1) **Profit-Motivated Project.** A profit-motivated (PM) project is one in which the ownership entity is legally allowed to distributed surplus cash to its members.
- (2) **Limited Distribution Project.** A limited distribution (LD) project is one in which distributions of surplus cash to the ownership are limited and certain conditions must be met before the project's surplus cash can be distributed.
- (3) **Nonprofit Project.** A nonprofit project is one in which the ownership entity generally does not receive distributions of surplus cash from the property. Surplus funds from the operation of these projects are used for project-related improvements or services.

Figure 3-5
Timing of Area Office Review of Management Fees

UP-FRONT REVIEW	AFTER-THE-FACT REVIEW	NO REVIEW
<p>All projects:</p> <ol style="list-style-type: none"> 1. Whose agents have not received previous approval from the HUD Area Office in the jurisdiction. 2. In default under a mortgage or other approved payment program. 3. Where the Director of Housing Management has determined that an up-front review is needed to protect HUD's interests. This determination should be made if a project exhibits <u>any</u> of the following conditions: <ol style="list-style-type: none"> a) Poor financial position with a need to control expenses. Evidence that this condition is present includes: <ul style="list-style-type: none"> -- recent defaults -- delinquent mortgage payments -- marginal or negative cash throw-off (i.e., income less than or only slightly more than operating expenses, debt service, and reserve requirements) -- high vacancy/turnover rates -- excessive accounts receivable/payable. b) Serious noncompliance with HUD financial requirements, including outstanding diversions and/or significantly overdue financial reports. c) Poor physical condition, including significant deferred maintenance. d) Serious outstanding findings from IG or GAO audits. e) Agent has not made satisfactory progress toward correcting problems found in project reviews (HUD, IPA, administrator, or mortgagee). f) A persistent pattern of poor communication or relationships with tenants or tenant associations and/or a persistent pattern of failure to address tenant service requests or complaints. 	<p>Projects <u>not</u> subject to up-front reviews that fall into any of the following categories.</p> <ol style="list-style-type: none"> 1. Limited distribution and nonprofit projects (regardless of how project rents are set). 2. Profit-motivated Section 8 projects subject to budgeted rent reviews. 3. Subsidized cooperative projects. 	<p>No fee review is performed for the following types of projects, <u>unless</u> one or more of the conditions necessitating an up-front review exists.</p> <ol style="list-style-type: none"> 1. Profit-motivated projects that do not have rental assistance contracts. 2. Profit-motivated Section 8 projects that have rents set through use of the Annual Adjustment Factor (AAF). 3. Profit-motivated Preservation projects that use the Operating Cost Adjustment Factor (OCAF) to determine rent adjustments. 4. Unsubsidized cooperatives and Section 234(d) condominium projects.

In certain cases nonprofit entities, such as those receiving Title II or Title VI Preservation funding, are allowed to receive distributions. Such projects retain their nonprofit designation even though the organization is allowed to receive distributions of project funds. For detailed guidance regarding Preservation projects, see Processing Plans of Action under the Low-Income Housing Preservation and Resident Homeownership Act of 1990, HUD Handbook 4350.6.

- (4) Determining the type of ownership. The applicable Regulatory Agreement or rental assistance contract for the project will indicate the extent to which surplus cash can or cannot be distributed to the owner.

NOTE: Generally speaking, Section 8 projects issued a notice of selection after November 5, 1979 (for New Construction) and February 20, 1980 (for Substantial Rehabilitation) should be LD projects.

- c. Projects Not Subject to HUD Management Fee Reviews. Owners of the following types of projects do not have to obtain HUD approval of the management fee payable out of project funds unless the project is in default under a mortgage or other approved payment program or HUD determines a review is necessary to protect its interests. See Figure 3-5 for examples of project conditions that might trigger the requirement for a review.

- (1) PM projects that do not have rental assistance contracts.
- (2) PM projects that hold Section 8 contracts and use the Annual Adjustment Factor (AAF) to compute rental adjustments for Section 8 units.

NOTE: If owners of this type of project request a special rent increase or have their rents set through a budget, HUD will process the rent increase request using the lower of:

- (a) The project's actual management fee (as shown on the current management certification); or
- (b) The maximum fee that would be allowed under this chapter's procedures, if the fee were subject to HUD review.
- (3) PM Preservation projects that use the Operating Cost Adjustment Factor (OCAF) to determine rent adjustments.
- (4) Unsubsidized cooperatives and Section 234 (d) condominium projects.

3.9 APPLICABLE MANAGEMENT FEE FOR RENT INCREASE REQUESTS

- a. **Budget-based Rent Increases.** For projects where rents are set through an expense-based rent formula, HUD will use the approved management fee percentage in processing all rent increase requests. The approved fee percentage is used regardless of the fee yield provided by this percentage fee, except in cases where the provisions of paragraphs (b) or (c) below apply.

EXAMPLE: Last year HUD approved a management fee of five percent for Property X. At that time, this management fee provided a potential fee yield of \$25 per unit per month (PUPM). This year the owner is applying for a budgeted rent increase.

In processing this request, Loan Management staff will use the management fee of five percent. If the five percent fee would result in a potential fee yield of \$28 PUPM and this amount exceeded the upper limit of the reasonableness range of \$26 PUPM for that area (see Section 3), Loan Management staff would use the approved fee percentage and no cap would be placed on the fee yield.

- b. **Capped Fee Percentage for Projects Receiving Significant Rent Increases.** When a project will receive a rent increase equal to 20 percent or more of its current rent potential (e.g., as a result of large increases in project costs, capital improvement activities, or preservation incentives), the management fee percentage must be adjusted. Figure 3-6 illustrates when an owner request for a rent increase affects the residential management fee percentage.
- (1) In such cases, the residential management fee yield is limited to the yield that would be allowed under a 20 percent rent increase using the current management fee percentage.
 - (2) The residential management fee percentage is then adjusted to reflect the maximum allowable yield under the new rent structure for the project.
 - (3) This adjustment to the fee percentage will not be subject to a reasonableness review as described in Sections 2 of this chapter. It is merely an adjustment of the percentage fee which will occur at the same time the rent increase is approved by HUD.
 - (4) This adjusted percentage fee will apply to all future rent potentials without regard to the fee range limits until such time as the agent requests a change in the percentage fee.

Figure 3-6

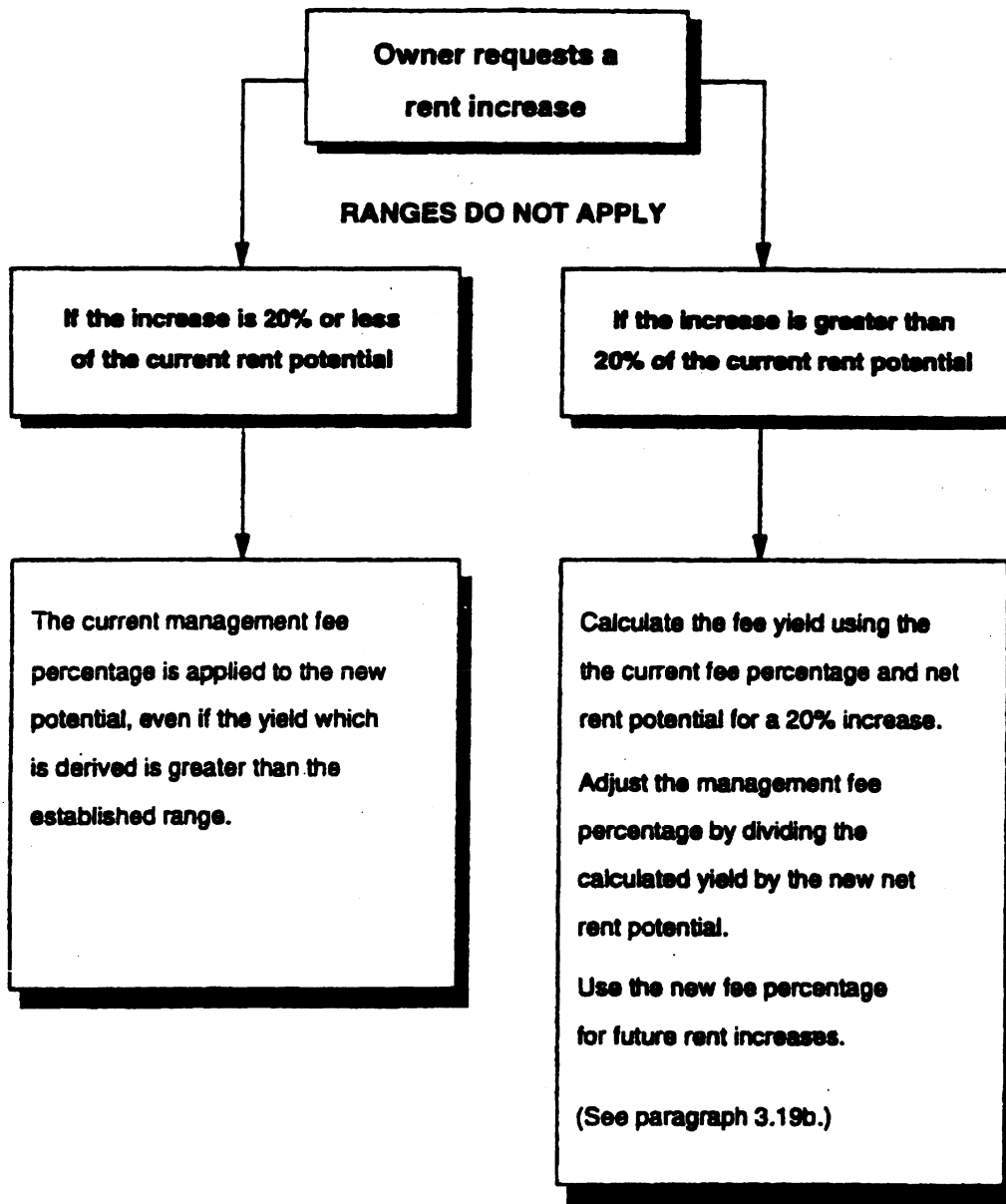
**EFFECT OF A RENT INCREASE
ON THE MANAGEMENT FEE**

Figure 3-7 illustrates the method for determining the revised residential management fee for these projects and adjusting the residential fee percentage for these projects.

- c. Adjusting the Management Fee for Rent Decreases. When project rents are reduced as a result of refinancing or other reason permitted by HUD regulation, HUD will also adjust the residential management fee percentage in order to ensure that agents retain their current yield. In readjusting the percentage, the following formula should be used:

$$\text{Revised Management Fee Percentage} = \frac{\text{Current Fee Yield} \times \text{Number of Units}}{\text{Collections Percentage} \times \text{Reduced Monthly Rent Potential}} \\ \text{(0.95 or other factor determined by HUD)}$$

This adjusted percentage fee will apply to all future rent potentials without regard to the fee range limits until such time as the agent requests a change in the percentage fee.

- d. Capped Fee Yield In Hold-Harmless Projects. For projects where the residential management fee yield has been capped pursuant to the hold-harmless provisions set forth in paragraphs 3.24 and 3.27, Loan Management staff must use the capped fee yield when processing rent increases. (NOTE: This only applies to Pre-1986 contracts covered by paragraphs 3.24 and 3.27)

3.10 OWNER REQUESTS FOR CHANGES IN EXISTING FEES

- a. Owner Submission. To initiate a change in the management fee percentage, the owner and agent must submit a new Management Certification showing the revised management fee(s).
- (1) For projects subject to up-front reviews, the fee can be changed only after the HUD Area Office has given written approval of the fee.
 - (2) Owners of projects subject to after-the-fact reviews may negotiate and implement revised fees with in-place agents without HUD approval, as long as the fee complies with the reasonableness standards described in Section 3. A new Management Certification must be submitted before the revised fee can be charged.
 - (3) For projects not subject to HUD review, owners may negotiate fees and revise fees without HUD review or approval. However, the owner/agent must submit a new Management Certification.
- b. HUD Review. When HUD receives a request from an owner to change the management fee for an in-place agent, Loan/Asset Management staff should take the following steps:

Figure 3-7

**Adjusting the Residential Management Fee Percentage
for Projects Receiving Significant Rent Increases**

METHODOLOGY

Step 1: DETERMINE ALLOWABLE FEE YIELD

$$\text{Allowable Fee Yield} = \text{Projected Fee Yield}^{**} \text{ Under a 20\% Rent Increase Using Current Management Fee Percentage}$$

Step 2: CALCULATE REVISED MANAGEMENT FEE PERCENTAGE

$$\text{Revised Management Fee Percentage} = \frac{\text{Allowable Fee Yield Under New Project Rents}}{\text{Annual Net Rent Potential Under New Project Rents}}$$

**** Projected Fee Yield =** $\frac{\text{Yield Under New Rent Structure Using Applicable Occupancy Factor Adjustment}}{\text{Annual Net Rent Potential Under New Project Rents}}$

EXAMPLE

ABC Apartments Assumptions:

A 30% rent increase has been approved

Annual Gross Rent Potential Under 30% Rent Increase = \$1,300,000

Annual Gross Rent Potential Under 20% Rent Increase = \$1,200,000

Current Management Fee = 7.00%

Step 1: Determine Allowable Fee Yield Under New Project Rents

\$1,200,000	(Annual Gross Rent Potential Assuming 20% Increase)
x .95	(Standard Occupancy Adjustment Factor **)
1,114,000	(Adjusted Gross Rent Potential)
x .07	(Current Management Fee)
\$ 79,800	(Allowable Fee Yield)

Step 2: Revise Fee Percentage

\$1,300,000	(Annual Gross Rent Potential Assuming 30% Increase)
x .95	(Standard Occupancy Adjustment Factor **)
\$1,235,000	(Adjusted Gross Rent potential)

$$\$79,800 \text{ (Allowable Fee Yield)} \div \$1,235,000 \text{ (Adjusted Gross Rent Potential)} = 6.46\%$$







**** Standard Occupancy Adjustment factor of 95% is used in this example. However, the factor normally used in the budgeted rent increase process and/or in processing the Management Fee percentage should be used.**

- (1) Review the Management Certification to determine the type of review required, if any.
- (2) Write the applicable review category (i.e., up-front, after-the-fact, or no review) on the first page of the Management Certification.
- (3) For projects not subject to up-front reviews, Loan/Asset Management staff should update the office computer system with data items used in determining reasonableness ranges. This information will be used when revising residential fee ranges.
- (4) Follow the procedures in Section 2 to assess the reasonableness of the proposed changes in the existing management fees.

3.11 TERM OF HUD-APPROVED MANAGEMENT FEES

- a. Once HUD has reviewed and approved the percentage management fees for a project (i.e., completed an up-front or after-the-fact review), these management fees will not be subject to further review unless:
 - (1) There is a change in management agents; or
 - (2) Owners/agents request a change in the approved management fee percentage (see paragraph 3.10).
- b. Rents increases do not trigger HUD management fee reviews. Large rent increases may require an adjustment of the fee percentage (see paragraph 3.9).

SECTION 2: PROCEDURES FOR PERFORMING MANAGEMENT FEE REVIEWS**KEY STEPS IN MANAGEMENT FEE REVIEW PROCESS**

-  Receive owner/agent request and management certification
-  Determine if up-front or after the fact review is required
-  Determine if "Hold-Harmless Provisions" are Applicable
-  Determine whether fees are reasonable
-  Notify the owner and agent
-  Document the results of the review

3.12 BASIC PROCEDURES FOR PERFORMING MANAGEMENT FEE REVIEWS

Loan/Asset Management staff must follow the procedures below when performing management fee reviews. These procedures are used for both up-front and after-the-fact management fee reviews. See Figure 3-5 to determine the type of review required.

- a. Determining If "Hold-Harmless Provisions" Are Applicable. HUD instituted reasonableness reviews of management fees on August 1, 1986. If an owner/agent is seeking an increase in the residential management fee percentage and the agent's current management agreement was executed prior to August 1, 1986, specific hold-harmless provisions may apply to the review of the residential fee. See Section 4 of this chapter.
- b. Determining Whether Management Fees Are Reasonable. Section 3 of this Chapter provides guidance for determining the reasonableness of these fees.
 - (1) If the agent listed on the Management Certification is a new agent for the project, all four types of management fees (i.e., residential, commercial, miscellaneous, and special fees) must be reviewed for reasonableness.
 - (2) If the fee review is being performed because the existing agent for the project is requesting an increase in the percentages for any management fee or new special fees, only the fees where a change is

requested must be reviewed. For example, if the Management Certification submitted indicates the owner/agent is seeking a higher residential fee percentage but no change in the commercial fee percentage or special fees for the project, then Loan/Asset Management staff need only review the reasonableness of the proposed increase in residential fee percentage.

- c. Documenting the Results of the Review. The analysis and results of the review must be documented as required by paragraph 3.17.
- d. Notifying the Owner and Agent. The owner and agent must be notified of the results of the review as required by paragraph 3.15.

3.13 UP-FRONT MANAGEMENT FEE REVIEWS

For affected projects, an up-front review is required whenever an owner proposes a new management agent or requests a change in the fee percentages or special or add-on fees paid to the existing agent. Loan/Asset Management staff determine the reasonableness of the proposed fees following the criteria provided in Section 3.

- a. HUD Notice to Owners. Loan/Asset Management staff must notify the owner and agent in writing if an up-front review is required. Owners/agents receiving notices that an up-front management fee review is required remain subject to up-front reviews until notified by HUD that such reviews are no longer required.
- b. Prior Approval is Required. For projects subject to an up-front review of management fees, owners/agents must obtain HUD approval of the amount listed in the management fee line item of the project's operating budget before (1) charging any portion of the fee against the project operating account or (2) otherwise obligating the project to pay a management fee.
 - (1) If the proposed agent has not previously received HUD approval, the owner and the agent may sign a management agreement that contains a clause specifying that the agreement is conditional upon HUD approval of the agent. The agent may not be paid from project funds until the owner receives HUD approval of the agent.
 - (2) If, in an emergency, an agent assumes management of a project without prior HUD approval of the management fee, the agent may begin collecting the fee and charging these amounts against the project's account. However, the management fee is subject to reduction if Loan/Asset Management staff determine the fee amount is excessive. In such cases, Loan/Asset Management staff must review the fee immediately upon receipt of the Management Certification.

- c. Owner Requests for Up-front Review. An owner with a project subject to an after-the-fact review may request that HUD perform an up-front review. Loan/Asset Management staff must conduct an up-front review if the owner requests one.
- d. Time Period for Completion of Review. Loan/Asset Management staff should complete up-front management fee reviews within 60 days of receiving the Management Certification.
 - (1) If the owner and agent do not receive written notice of the results of HUD's management fee review within 60 days, the agent may begin collecting the management fees documented in the Management Certification under review.
 - (2) If the results of a HUD review completed after this date indicate that the management fees must be reduced, these reductions will take effect on the date that notice of the review results is issued to the owner and agent.

3.14 AFTER-THE-FACT MANAGEMENT FEE REVIEWS

For projects which are subject to after-the-fact reviews (See Figure 3-5), owners/agents may establish and charge the management fee amount listed in the project's budget without prior HUD approval. Owners/agents must submit a new management certification prior to changing the management fee for a project.

- a. Timing of Review. Loan/Asset Management staff may assess the reasonableness of these fees at any time, but will usually perform this review in conjunction with other servicing activities (e.g., reviewing annual or monthly financial reports, processing rent increase requests, or negotiating transfers of physical assets or provisional workout arrangements). Whether performed in conjunction with other servicing activities or independently, Loan/Asset Management staff should complete the fee review within 12 months of receiving the owner/agent's request for a fee increase.
- b. Results of the Review. If the review shows that the residential fee yield falls within the applicable fee range at the time the fee was established, the fee will be approved. If the fee exceeds the applicable range, the fee must be reduced to an amount considered reasonable under the range.
- c. Fee Reviews Performed in Conjunction With Financial Reviews. If the fee review is performed in conjunction with the review of the project's annual financial statements or monthly accounting reports, Loan/Asset Management staff should perform the procedures established in paragraph 3.12 in accordance with the following requirements.

- (1) Use the data on actual rent collections from the project's most recent financial statement to make reasonableness determinations.
- (2) If a review of the project's financial statements show that the owner/agent's collection assumptions were wrong, rework the yield computation using the actual collections data.
- (3) Compare the yield with the acceptable range that is in effect at the time of the after-the-fact review.
- (4) If after-the-fact reviews reveal that the fee amount charged to the project exceeds the amount the HUD Area Office determines to be reasonable, Loan/Asset Management staff should immediately review fees at all other projects that are:
 - (a) Managed by the same agent; and
 - (b) Subject to after-the-fact reviews and have not already been reviewed.
- (5) Loan/Asset Management staff must also perform a compliance check on the amount of management fee charges, as required in Paragraph 2.21.d of HUD Handbook 4370.1, Reviewing Annual and Monthly Financial Reports. These checks assess whether the fees collected by the agent are within the limits shown on the Management Certification.

d. Fee Reviews Performed in Conjunction With Rent Increase Requests. If the review is performed in conjunction with the processing of a rent increase request, Loan/Asset Management staff should take the review in the following manner.

- (1) Complete the procedures established in paragraph 3.12. Assess the reasonableness of the management fee and determine the residential income fee percentage on the basis of current rents.
- (2) Use the instructions in Appendix 4 to process rent increases that use a cost approach.

NOTE: If an after-the-fact review is done in conjunction with the processing of a rent increase request, review the fee early during the rent increase processing so that HUD's decision on the rent increase will not be delayed.

3.15 NOTIFICATIONS TO OWNERS AND AGENTS

- a. **Acceptable Fees.** If the fee amount to be charged to the project account is acceptable, Loan/Asset Management staff must send a letter to both the owner and agent stating that: "HUD has approved a residential management fee of ___[specify]% and other fees set forth in the Management Certification dated ___ [enter the date shown in the top right portion of Page 1 of the Management Certification]."
- b. **Unacceptable Fees.** If the fee amount(s) is(are) not acceptable under the procedures set forth in this chapter, Loan/Asset Management staff must send the owner and agent a letter that:
- (1) Explains the reasons HUD cannot approve the fees shown in the Management Certification.
 - (2) Sets forth the fees HUD could approve.
 - (3) Indicates whether the residential fee is held harmless due to the transition provisions in Section 4 of this chapter.
 - (4) Includes the statements required by paragraph 3.27(d) if the residential fee yield is capped under the provisions of that paragraph.
 - (5) Within 30 days of the letter, requires the owner and agent to:
 - (a) reduce the fee(s) to the amount(s) specified in the letter;
- OR
- (b) appeal HUD's decision (see paragraph 3.16).
 - (6) With 30 days of the initial notification letter or HUD's decision letter responding to the owner's/agent's appeal:
 - (a) Refund to the project any excessive fees collected.
 - (b) Reduce any management fees payable by the excessive amounts included in them.

3.16 APPEALS

- a. The owner and management agent may appeal the results of a management fee review to the Multifamily Division Director in the Area Office.

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- (1) Appeals must be submitted in writing within 30 days after the date of HUD's decision letter.
 - (2) In the appeal, owners/managers must show how special needs and conditions at the project and the type of management services required justify a higher fee.
 - (3) If agents submit an appeal without the owner's signature, the agent must certify that the owner consents to the appeal.
- b. The Director of Housing in the Area Office must issue a decision within 30 days after receiving an appeal.
- c. From the time the Area Office issues its initial decision letter until the Director of Housing renders a decision on the appeal, management agents can collect fees only as provided below.
- (1) If the appeal follows an up-front review and HUD has approved the agent, the agent may collect only the fee specified in HUD's initial decision letter.
 - (2) If the appeal follows an after-the-fact review, the agent can continue to collect the disputed fee until the Area Office issues a decision on the appeal. If the appeal decision requires a reduction in the fee, the reduction will be retroactive to the date the agent began charging the excessive fee. Therefore, within 30 days after the date of the appeal decision, the owner and the agent must:
 - (a) Reduce the fee to the amount specified in Area Office decision on the appeal.
 - (b) Refund to the project any excessive fees collected.
- AND
- (c) Reduce any excessive fees payable by the excessive amounts included within them.
- d. If the agent submitted the appeal without the owner's signature and, on appeal, HUD allows part or all of the amount appealed, the appeal decision letter must state that HUD's approval of the fee is subject to the owner's written approval of that fee.
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3.17 DOCUMENTING MANAGEMENT FEE DECISIONS

Loan/Asset Management staff must document their approvals and disapprovals of management fees.

a. Fees Approved.

If the fees are approved:

- (1) Indicate HUD's approval on the last page of the Management Certification; and
- (2) Staple a copy of the HUD approval letter to the Management Certification.

b. Fees Disapproved.

If fees are disapproved:

- (1) Annotate Page 1 and Attachment 1 of the Management Certification to show which fee(s) were not approved;
- (2) Indicate HUD's disapproval on the last page of the Management Certification and enter the date of the disapproval letter. If the residential fee percentage is held harmless, indicate this condition on the certification and enter the hold harmless percentage or yield; and
- (3) Staple a copy of the disapproval letter to the Management Certification.

c. Retaining Key Documents.

Management fee documents must be retained in the project file for at least three years. This documentation must include:

- (1) Management Certifications;
- (2) Decision letters; and
- (3) Management fee correspondence with owners/agents.

d. Updating Computerized Files.

Loan/Asset Management staff must enter information on approved management fees into their office's computer system.

SECTION 3: ASSESSING REASONABLENESS OF MANAGEMENT FEES

NOTE: The procedures in this Section are intended to apply only when assessing the reasonableness of a percentage fee when an agent requests a change in the fee percentage. Once a percentage fee is approved by HUD, reasonableness is not further assessed under this Section. (See Chapter 3, Section 4 and Paragraph 3.9(b)-(d) for reasonableness tests which may be applicable to a specific project after the approval of a percentage fee by HUD).

3.18 OVERVIEW

- a. Goals of the Reasonableness Determination. The goals of HUD's review of management fees for reasonableness are to assure that fees approved for projects:
 - (1) Provide sufficient compensation to attract the quality of management needed to administer the project during the time period covered by the fee.
 - (2) Do not significantly exceed the amount that HUD determines independent agents and owners would ordinarily negotiate for comparable services at projects in the same geographic/cost area, except as justified by conditions that require more time and effort on the part of the management agent.
- b. Determining Comparable Costs for the Residential Management Fee. HUD Residential income fee ranges are established by HUD that reflect costs by geographic/cost area. Paragraph 3.19 below provides instructions for developing and updating fee ranges.
 - (1) For projects subject to fee reviews, Loan/Asset Management staff use the applicable ranges to determine whether the owner-proposed fee percentages initially yield a PUPM dollar amount that is reasonable.
 - (2) If using the owner's proposed percentage results in a dollar yield that falls within the applicable range, the proposed percentage will be approved and remain in effect until the management agent requests an increase in the percentage fee amount.
- c. Additional Fees Based upon Project Conditions. Residential Income fee ranges are developed using data on the fees independent management agents charge for managing projects with market-based incentives for controlling both operating costs and management fees. The presence of certain project characteristics or conditions may warrant the approval of fees in excess of the residential fee.

- (1) Add-on fees may be approved to recognize long-term characteristics or conditions. Paragraph 3.21 below provides instructions for developing a list of permissible Add-on fees and determining the reasonableness of proposed Add-on fees.
- (2) Special fees may be approved to recognize temporary project conditions. Paragraph 3.23 below provides instructions for determining the reasonableness of Special Fees.

d. Additional Fees Based upon Income

- (1) Commercial Fees. Commercial fees are considered reasonable if they do not significantly differ from the fee yield HUD determines would be generated by projects with similar types of commercial space.
- (2) Miscellaneous Income Fees. Miscellaneous income fees are considered reasonable if the fee percentage does not exceed the approved residential income fee percentage.

e. Compensation for Section 202/Section 811 Project Administrators

Loan/Asset Management staff must also determine whether the salaries of Section 202/811 Project Administrators are reasonable. Project administrators' salaries should be compared to the salaries of other project administrators in the area, taking into consideration the level of management required to operate the property.

3.19 CALCULATING THE RANGE OF ACCEPTABLE RESIDENTIAL FEE YIELDS

Each Super A Area Office must assure that residential fee ranges are established for its jurisdiction. An individual Area Office may establish their own residential fee range, if the market (or a specific portion of the market) covered by the Area Office varies significantly from the Super A Office. At the Area Office's option, a single range may be used with add-ons, several different ranges may be established, or the Area Office may develop its own process for developing ranges. For example, if fee data show that yields vary significantly by a project's location, a range for high and low cost areas might be appropriate. Ranges must be reviewed and updated every two years. Updated ranges should be set more frequently if: (1) staff workload permits; or (2) the fees used to set the range(s) change significantly. If the ranges are not reviewed and published by an Area Office at the two year interval, they will automatically be adjusted by the Services Consumer Price Index (CPI) for the total of the 2 years.

At the request of an owner/agent, information regarding the process for which ranges are established should be made available. Area Offices are encouraged to publish their method for deriving the range as well as the approved range on an annual basis.

Whenever the permissible fee range is developed or revised, a copy should also be forwarded to HUD Headquarters, Attention: Director of Multifamily Housing Management. This will assist in the monitoring and review of nationwide financial data.

NOTE: As used in this paragraph and throughout this chapter, "monthly rent potential" means the sum of the contract rents of all units, including rent-free units, shown on the most recent Rent Schedule (Form HUD-92458) submitted to HUD.

- a. **Data Collection.** To establish a range of acceptable fee yields, HUD Area Office staff will gather information on the fees charged for HUD-insured and HUD-assisted projects where the owners/agents have incentives to control management costs.
- (1) If possible, ranges should be established using data from unassisted, HUD-insured projects.
 - (2) Projects included must meet all of the following criteria:
 - (a) Be owned by profit-motivated entities and have fees that are not subject to HUD review.
 - (b) Be managed by independent agents who have no identity-of-interest with the owners.
 - (c) Properly allocate the management costs between the management fee and the project account as required by the procedures specified in Chapter 6.
 - (d) Have no problems that would merit special or add-on fees, whether or not these fees are paid.
 - (e) Be well-managed and in good physical condition (e.g., generally receive at least satisfactory ratings on any IPA, GAO, IG or HUD reviews). Mortgagee physical inspections should show that the physical condition of the project is satisfactory.

- (3) If an Area Office does not have enough unassisted, HUD-insured projects to establish a meaningful range for a particular market area, the office may include data from Section 8 New Construction or Substantial Rehabilitation projects that meet the criteria in paragraph (2) above.
- (4) If the office still does not have enough projects to establish a meaningful range for a particular cost area or project type, the office may further expand the range by including projects subject to after-the-fact fee reviews that also meet criteria (b) through (e) in paragraph (2) above. Projects must be added in the following sequence.
- (a) Limited Distribution Section 8 New Construction and Substantial Rehabilitation projects.
 - (b) Nonprofit Section 8 New Construction and Substantial Rehabilitation projects.

NOTE: Use the fee yield proposed by the owners/agents rather than any revised amount allowed by HUD following an after-the-fact review.

EXAMPLE: The proposed residential fee yield shown on Line 1d of Attachment 1 of the original Management Certification of a LD was \$22 per-unit per-month (PUPM). As a result of an after-the-fact review, the Area Office approved a fee yield of \$19 PUPM. The originally quoted yield of \$22 should be used rather than the \$19 figure approved by HUD.

- b. Calculating the Fee Yield. Residential fee yields used for establishing the range(s) must be computed by applying the residential fee percentage to the monthly rent potential for all revenue-producing units (adjusted to reflect a 95 percent collection rate).
- (1) The fee percentage and the rent potential used must be those in effect at the time the ranges are established.
 - (2) Yields must be computed on a per-unit per-month (PUPM) basis.

- c. **Determining the Acceptable Range.** HUD will use the following procedures to set the acceptable range. These will ensure that the top of the acceptable range does not exceed "amounts ordinarily paid" for management services and is not distorted if some fee yields significantly exceed the average amount of most fee yields. Figure 3-8 provides an example of the range determination process.

- (1) List all fee yields in ascending order. Express fee yields in dollars PUPM. Show the number of projects with each fee yield.
- (2) Determine the mean (average) fee yield by dividing the total dollar amount in column (c) by the total number of projects in column (b). Round the result to the nearest dollar.
- (3) Determine the top of the acceptable range. If the highest fee yield is:
 - (a) Less than or equal to 120 percent of the mean, use the highest fee yield rounded to the nearest dollar.
 - (b) Greater than 120 percent of the mean, use 120 percent of the mean fee yield rounded to the nearest dollar.
- (4) Use the lowest fee yield among the figures collected to establish the lower end of the acceptable range.

Figure 3-8		
Example of Residential Fee Range Determination		
(a) Fee Yield (PUPM)	(b) Number of Projects	(c) Total (a x b)
\$12	2	\$ 24
\$14	1	\$ 14
\$15	4	\$ 60
\$17	5	\$ 85
\$18	7	\$126
\$19	5	\$ 95
\$20	4	\$ 80
\$21	1	\$ 21
\$25	2	\$ 50
Total	31	\$555
Average: $\$555 \div 31 = \17.90 (rounded to \$18 PUPM)		
Top of Acceptable Range: Lower of: $\$18 \times 1.20 = \21.60 or \$25		
Lower End of Acceptable Range = \$12		

3.20 REVIEWING RESIDENTIAL MANAGEMENT FEES**a. Review Owner Estimate of Monthly Collections for Accuracy and Reasonableness.**

Loan/Asset Management staff must examine the occupancy/collections assumptions and yield computations shown in Attachment #1 of the Management Certification (Form HUD-9839-A, B, or C) and confirm that they are accurate. If inaccuracies are found, the figures must be corrected.

- (1) Determine if the estimate of monthly collections shown on Line 1(a) of the attachment is accurate. Except for the following cases, this figure should be 95 percent of the monthly contract rent potential shown in the last HUD-approved Rent Schedule (Form HUD-92458).
 - (a) Owners may use a collections base of less than 95 percent of potential only if the conditions that impede collections were not caused or exacerbated by the current management agent.
 - (b) If the conditions leading to collections of less than 95 percent will last less than one year, a special fee should be used instead of a lower estimate of collections.
- (2) If the owner/agent listed rent collections of less than 95 percent on the Management Certification, review the following items to identify the cause of the lower rent collections.
 - (a) The owner's/agent's explanation for the lower collections base provided in Attachment 1 of the Management Certification.
 - (b) The project's recent monthly accounting and occupancy reports.
 - (c) Market area vacancy trends.
 - (d) Any marketing/management initiatives the agent is or will be taking to increase occupancy and/or reduce collection losses.
- (3) If the lower rent collections percentage is due to the current agent's poor rent collection or leasing practices, compute the PUPM yield using 95 percent rather than the collections percentage proposed by the owner/agent.
- (4) If the lower rent collections percentage is due to factors beyond the current agent's control:

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- (a) Use the collections percentage most likely to be realized through aggressive management effort during the term the fee will be in effect.
 - (b) Limit the term of that collections percentage. Generally, the term should not exceed one year. If collections will improve significantly within the year, different percentages may be used during the year (e.g., 85 percent for first six months and 90 percent for the next six months).
 - (c) Determine if the agent will receive a special fee for the conditions related to lower rent collections. If the agent will receive special fees for these conditions, a 95 percent rent collections figure should be used to determine the fee yield.
 - (d) Recompute the PUPM fee yield using the allowable collections percentage.
- b. **Review the Owner's Estimate of total fee yield and PUPM yield shown on the Management Certification to ensure that they were properly computed.**
- c. **Assess Whether the Proposed Fee Percentage is Reasonable.** Loan Management staff must assess whether the yield produced by the fee percentage is reasonable. If the yield is not reasonable, the fee percentage may not be approved. (Note: If PUPM fee yield listed in the Management Certification was inaccurate, use the corrected fee yield calculated under paragraph (b) above.)
- (1) If the PUPM fee yield falls within the residential fee range established by the Area Office at the time approval was requested, the residential management fee is considered reasonable and the fee percentage may be approved. As future rent increases are approved, this percentage fee may provide a fee yield that exceeds the upper limit of the range. This yield is allowable as long as the fee percentage remains the same.
 - (2) If the PUPM fee yield falls below the current residential fee range established by the Area Office, Loan/Asset Management should assess the project's past and current performance. The agent may have proposed a low fee to win the management contract with the owner. If the fee percentage is unrealistically low, the agent may experience management problems resulting in poor services and conditions at the project.
 - (a) If there are no problems attributable to the management agent, Loan/Asset Management staff should approve the fee and

monitor the project periodically to make sure that management services are adequate.

- (b) If there have been problems with management agent performance, Loan/Asset Management staff should discuss with the owner the possible need to upgrade management services and to propose a fee commensurate with these services.
- (3) If the PUPM fee yield exceeds the acceptable range, the requested residential fee percentage may not be approved. Loan/Asset Management staff must advise the owner/agent of the residential fee percentage that could be approved.

3.21 REVIEWING THE REASONABLENESS OF ADD-ON FEES

a. Developing an Add-on Fee Schedule. An add-on fee reflects the amount HUD will pay management agents to cover a higher level of management service for a project with specific characteristics or recognized long-term conditions.

- (1) Each Area Office must develop and publish a list of permissible Add-on fees that may be applicable to projects within its jurisdiction.

Whenever this fee list is developed or revised, a copy should be forwarded to HUD Headquarters, Attention: Director of Multifamily Housing Management. This will assist in the monitoring and review of nationwide financial data.

- (2) Add-on fees are separate and distinct from residential fee percentage and should not be used to provide agents a fee for functions covered by the residential fee percentage. For example, if the projects used to establish the residential fee range were all unassisted, HUD-insured projects, allowing an Add-on fee for subsidy contract administration could be appropriate. However, if the residential fee was established by relying heavily on assisted projects, an add-on fee for this project characteristic would be inappropriate.
- (3) Add-on fees may be established for specific types of projects and locations (e.g., an add-on fee for projects located in high-cost areas). Add-on fees must be reviewed and published every two years.
- (4) The schedule of Area Office approved add-on fees must be made available to owners/agents upon request.

- b. **Determine Whether the Project's Characteristics Warrant Add-On Fees.** Examine the add-on fees listed by the owner/agent in the Management Certification (see Item #4 - Special Fees, Attachment 1 to the Management Certification form) and determine whether the project's characteristics or conditions qualify the agent to receive the add-on fees requested.
- (1) Loan/Asset Management staff should review the project's records to assess whether add-on fees are warranted. For example, an add-on fee is not warranted if the owner/agent has requested the add-on fee for small projects established by the Area Office, but the number of units in the project exceeds the size limit to qualify for the fee.
 - (2) Loan/Asset Management staff must not allow add-on fees for short-term problems or services when a special management fee would be more appropriate. For example, the Area Office may have established an add-on fees for adverse neighborhood conditions, but the adverse conditions at the project under review are temporary. The following steps should be taken to determine whether add-on fees are warranted.
 - (a) Assess whether the project conditions the add-on fee is intended to cover are likely to be long-term conditions.
 - (b) If the project conditions are likely to be short-term, the add-on fee must not be approved.
 - (c) If the add-on cannot be approved, consider whether the project conditions warrant a special fee. If such fees are appropriate, inform the owner/agent.
 - (3) If the owner/agent has requested an add-on fee for a project condition that does not have an established add-on fee, the add-on fee should be disallowed.
 - (a) If this occurs, Loan/Asset Management staff should assess whether the condition warrants a special fee.
 - (b) If a special fee is warranted, the notice issued to the owner/agent should indicate that the add-on fee was not allowed but that a special fee could be used.
- c. **Assess Whether the Project's Add-On Fees are Reasonable.** Loan/Asset Management staff must assess whether the add-on fee amounts requested are reasonable.
- (1) Only the add-on fees warranted for the project need to be reviewed for reasonableness.

- (2) The amount of the add-on fee listed on the Management Certification must be compared to the schedule of add-on fees established by the Area Office.
- (3) Add-on fees that do not exceed the current schedule are considered reasonable and may be approved.
- (4) If the amount requested exceeds the fee amount on the current fee schedule, the add-on fee may not be approved. The notice to the owner/agent should indicate the amount the Area Office could approve.

3.22 REVIEWING THE REASONABLENESS OF COMMERCIAL AND MISCELLANEOUS FEES

- a. Commercial Fees. The yield likely to be derived from the fee proposed for the project must not exceed the yields generated by projects with comparable types of commercial space (e.g., stores, offices, etc.)
- b. Miscellaneous Fees. The miscellaneous fee percentage must not exceed the residential income fee percentage.

3.23 REVIEWING THE REASONABLENESS OF SPECIAL FEES

- a. Determine if Circumstances Warrant Special Fees. Loan/Asset Management staff must confirm that:
 - (1) The agent did not cause the problem that the fee is designed to address.
 - (2) The fee is tied to the correction of specific problems or the accomplishment of specific tasks.
 - (3) The fee is structured so that it is payable only if the agent completes the required actions or obtains the required results.
 - (4) The fee does not include services that are covered by residential, commercial, or miscellaneous management fees, or by other sources of compensation.
 - (5) The fee is reasonably related to the time, effort, and expertise required of the agent.
 - (6) The fee is paid only for a limited period of time. The length of this period should be no longer than the time required to resolve a specific problem or complete a certain task.

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- b. If the amount requested exceeds the amount determined by the Area Office to be reasonable, the special fee may not be approved. The notice to the owner/agent should indicate the amount the Area Office could approve.

**SECTION 4: SPECIAL PROVISIONS FOR FEES APPROVED
ON OR BEFORE AUGUST 1, 1986**

3.24 GENERAL

The provisions in this section apply only to management fees subject to HUD review that were approved by HUD on or before August 1, 1986 and continue to remain in effect. These provisions are referred to as the "hold harmless" provisions for management fees. Figure 3-9 contrasts the fee review procedures for projects with management fees approved prior to August 1986 with the procedures for all other projects subject to HUD management fee reviews.

3.25 CONTINUATION OF EXISTING AGREEMENTS

On August 1, 1986, HUD implemented the reasonableness criteria for management fees described in the above sections of this chapter for projects that are subject to management fee reviews. If the current management agreement and fee percentages payable from project funds were approved by HUD on or before August 1, 1986, the agent may continue collecting that approved fee percentage for the term of the agreement. This is true even if the per-unit per-month (PUPM) fee yield exceeds the upper limit of the fee range that the Area Office would use to assess the reasonableness of the agent's fees if a fee review were being performed.

3.26 REQUESTS FOR INCREASES IN PERCENTAGE FEES AT OWNER-MANAGED PROJECTS AND PROJECTS WITH OPEN-ENDED AGREEMENTS

The following procedures apply to projects with active management agreements signed on or before August 1, 1986 that have self-managing owners or owners/agents with open-ended agreements. If the owner/agent requests an increase in the residential management fee percentage payable out of project funds and the fee is subject to HUD review, Loan/Asset Management staff must use the following procedures.

- a. The proposed fee percentage increase may not be approved if the PUPM yield under the new fee would exceed the maximum amount allowed by HUD under the criteria set forth in Sections 2 and 3 of this chapter. A smaller increase in the percentage fee may be approved as long as the fee yield does not exceed the maximum allowable amount.
- b. If the proposed increase cannot be approved because it exceeds the reasonableness range, the existing fee percentage is held harmless. Area Offices may not reduce the current HUD-approved residential fee percentage for these projects, even if the yield produced by this percentage exceeds the applicable reasonableness range.

Figure 3-9

THE MANAGEMENT FEE REVIEW PROCESS

OWNERS REQUESTING FEE PERCENTAGE INCREASES		
Post-1986 Agreements Subject to HUD Review	Pre-1986 Fixed Term Agreements	Pre-1986 Open Ended Agreements
Use ranges to determine the approvable fee.	Use ranges to determine the approvable fee.	Any increase in the fee percentage must result in a yield within the range limits. However, the old percentage may continue to be used, even if the yield exceeds the range limits.

RENEWALS OF PRE-1986 FIXED TERM AGREEMENTS
<p>If the fee percentage is not increased but the current fee yield exceeds the range:</p> <ol style="list-style-type: none">(1) cap the yield at the current yield(2) adjust the fee percentage by dividing the capped PUPM yield by the new net monthly rent potential <p>See paragraph 3.27</p>

EXAMPLE: An owner who has an open-ended management agreement with the in-place agent executed in November 1985 requests a residential fee increase from the previously approved figure of six percent to 6.25 percent. The results of the review by Loan/Asset Management staff reveal that not only does the yield under the proposed increase (\$32 PUPM) exceeds the maximum allowable yield of \$26 PUPM, but the yield under the current fee of six percent (\$29 PUPM) also exceeds the maximum. In this case, the residential fee percentage must remain at the previously approved figure of six percent.

- c. Commercial and miscellaneous income percentage fees remain subject to the reasonableness criteria discussed in paragraph 3.12.

REMINDER: Commercial and miscellaneous income percentage fees cannot exceed the residential fee percentage.

3.27 RENEWALS OF EXISTING FIXED-TERM AGREEMENTS

The provisions of this paragraph apply only to management agreement renewals where the residential management fee percentage remains the same as the fee percentage previously approved by HUD. Owners/agents of projects with fixed-term agreements that propose to change the management fee percentage must be reviewed in accordance with Section 3 of this chapter.

- a. If the fee is subject to HUD review and the residential fee yield shown on the Management Certification exceeds the maximum amount allowed under Sections 3 of this chapter, Loan/Asset Management staff must cap the fee at its current yield.
- b. If the fee was not previously capped, Loan/Asset Management staff must use the procedures described in paragraphs 3.20(a) and (b) to compute the yield the agent is likely to collect. The residential fee yield must be capped at this amount.

EXAMPLE: In a letter dated October 31 of last year, HUD approved a monthly rent potential of \$94,737 for Project A, which consists of 200 units. On November 15, Project A submitted a Management Certification showing a six percent residential management fee, which is the same percentage that HUD approved under the initial Management Agreement signed in November 1985. (Note: The fee for this property was not previously capped.) Attachment 1 of the Management Certification shows that this fee's yield at 95 percent of the \$94,737 rent potential is \$27 PUPM. The maximum amount HUD would otherwise approve under Sections 2 and 3 of this chapter is \$26 PUPM. In this case, the residential fee yield must be capped at \$27 PUPM.

- c. The residential fee for such projects will remain capped at this level until conditions change and HUD approves a revised fee due to such changes. The types of situations in which Loan/Asset Management staff may consider revising the approved fee payable from project income include the following:
- (1) The capped yield no longer exceeds the maximum allowable yield;
 - (2) The financial or physical condition of the project have changed; or
 - (3) The scope of management services have changed.
- d. In the decision letter authorizing the renewal of the Management Agreement, Loan/Asset Management staff must:
- (1) State the capped residential fee yield.
 - (2) If the fee was previously capped and the fee percentage had to be reduced to comply with the cap (see paragraph (e)(1)), state the revised fee percentage payable out of project income.
 - (3) If necessary, require the owner and the agent to revise their Management Agreement to show the revised management fee.
 - (4) State that the cap on the residential fee yield will remain in effect until HUD approves a revised fee as a result of changes in one of the following:
 - (a) Acceptable fee range.

- (b) Project conditions.
 - (c) Scope of management services.
- e. Each time Loan/Asset Management staff approve a rent increase for these projects, the following steps must be taken.
- (1) Recompute the residential fee percentage using the formula below.

Revised Residential Management Fee %	$\frac{\text{Capped PUPM Fee Yield} \times \text{No. of Units}}{\text{Collections Percentage} \times \text{New Monthly Rent Potential}}$
	(Standard = 95%)

- (2) Highlight the adjusted residential management fee percentage in the letter approving the rent increase. Require this adjustment to be effective on the date on which the rent increase takes effect.
- (3) Enter the following items on the last page of the Management Certification.
 - (a) Effective date of the rent increase/management fee adjustment.
 - (b) New monthly rent potential.
 - (c) Collections percentage assumed.
 - (d) Adjusted management fee percentage.
- (4) An owner/agent of a project where HUD has capped the fee yield as provided above may request that HUD reconsider the fee at any time. Loan/Asset Management staff must perform such a review up-front, even if the project would otherwise be eligible for an after-the-fact review.

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- f. Commercial and miscellaneous income percentage fees remain subject to the reasonableness criteria discussed in paragraph 3.12.

REMINDER: Commercial and miscellaneous income percentage fees cannot exceed the residential fee percentage. If the residential fee percentage is reduced to maintain the capped fee yield, the commercial and miscellaneous income percentage fees must be reduced accordingly.