

CHAPTER 4. MANAGEMENT AGENTS AND MANAGEMENT FEES

Section 1. Selection and Approval of Management Agents

- 4-1. GENERAL. While the project owner is responsible for seeking out and selecting a management agent, any agent selected by the owner must be acceptable to the lender. A management agent may assume management responsibility only after: (a) the lender has issued a letter approving the agent proposed by the owner; and (b) the owner and agent have executed and submitted the Management Certification shown in Appendix 4a. or 4b.
- 4-2. TYPES OF MANAGEMENT ENTITIES. Management entities may assume any of the three forms listed below. While the term management agent is technically inaccurate when applied to an owner/manager, for simplicity this Chapter will use the term "management agent" to refer collectively to all three forms of management entities.
- a. Owner/Manager. This term applies when the individual or entity that owns the project is the same individual or business entity that directs and oversees the operation of the project. If the management entity is a general partner of the limited partnership which owns the project, the management entity is not an owner/manager because the management entity and the mortgagor are different business entities.
 - b. Identity-of-Interest Management Agent. This term applies to a management agent whose relationship with the project owner or any officer, director or partner of the mortgagor entity is such that the management fee will not be determined through arms-length negotiation. Such a relationship should be construed to exist when the owner and the management agent are not the same person but (1) the project owner; or (2) any officer or director of the project owner or (3) any person who directly or indirectly controls 10 percent or more of the project owner's voting rights or directly or indirectly owns 10 percent or more of the project owner; is also (1) an officer or director of the management agent; or (2) a person who directly or indirectly controls 10 percent or more of the management agent's voting rights or directly or indirectly owns 10 percent or more of the management agent. For the purposes of this definition, the term "person" includes any individual, partnership, corporation, or other business entity. Any ownership, control or interest held or possessed by a person's spouse, parent, child, grandchild, brother or sister is attributed to that person. For example, if a limited partnership owns a project and the managing general partner acts as management agent, the general partner would be considered an identity-of-interest management agent.
 - c. Independent Fee Manager. This term applies when the agent is neither an owner/manager nor an identity-of-interest agent. Fee managers have no financial interest or

involvement in the project other than for the provision of management services and the collection of management fees as provided in the management agreement.

5/84

4-1

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- 4-3. OWNER SUBMISSION REQUIREMENTS. Whenever an owner decides to change management agents, the owner must obtain the lender's approval of the proposed agent. To request this approval, the owner must submit the following information to the lender:
- a. Form HUD-2530, Previous Participation Certification. Appendix 1 provides a copy of the Form and instructions for its completion.
 - b. Management Agent Profile. While the profile must include all of the information contained in Appendix 15, the owner may develop its own format for submitting the report. If the lender already has a current profile on file for the proposed agent, the owner/agent will need only assure that the profile previously submitted is still accurate.
 - c. List of Staff whose Salaries will be Charged Against the Project Operating Account. The list should include job titles, salaries, the number of hours worked per week, a statement of the individual duties (if not obvious from the job title), and a statement as to whether those employees will be supplied with rent-free apartments as part of, or in addition to, the salaries shown.
 - d. Additional Information, as Required by the Lender. Lenders may require owners to submit additional information on the project's or agent's operation if the information will assist the lender in determining the acceptability of the proposed management agent, monitoring the agent's compliance with the regulatory agreement, or protecting the lender's or HUD's interests. Exhibit 4-1 lists situations in which the lender might wish to request additional information and the types of information that might be appropriate in each situation.
- 4-4. LENDER REVIEW. To determine whether the proposed agent should be permitted to manage the project in question, the lender should consider the physical, financial and social conditions existing at the project; the qualifications and skills of the agent's staff; and the agent's past performance in managing similar projects. The lender must submit the Form HUD-2530, Previous Participation Certification, to the HUD Field Office having jurisdiction over the project in question. The lender cannot render a decision on the agent's acceptability until HUD has processed the Form HUD-2530 and returned it to the lender. If HUD withholds or denies Previous Participation clearance, the lender must require the owner to propose a new agent. If HUD gives 2530 Approval and the lender finds the agent acceptable, the lender must give the owner written approval of the agent.

The lender's letter must request the owner to submit the Management Certification (Appendix 4a or 4b). Appendix 4a applies to owner-managed projects; Appendix 4b applies to projects with either independent fee agents or identity-of-interest agents. The owner and agent may not change the language of the certification. The lender must send the HUD Field Office a copy of the approval letter.

5/84

4-2

4-5. MANAGEMENT AGREEMENTS. After the lender approves a management agent, the project owner and any identity-of-interest or independent fee manager must execute a management agreement. The agreement is a contract which sets forth the rights and obligations of each party. The management agreement also establishes the management fee and conditions for payment of that fee. HUD does not require owners and agents to execute a standard form of management agreement. The owner and agent are free to negotiate their own form of contract so long as the agreement meets the HUD requirements discussed in Paragraphs 4-5.a., b. and c. below.

- a. Provisions Required in all Management Agreements. All management must contain provisions:
- (1) acknowledging HUD's and the lender's right to terminate the management agreement thirty days after HUD or the lender has mailed the owner and the agent a written notice requiring the termination;
 - (2) acknowledging that HUD's and the lender's rights and requirements will prevail in the event the management agent conflicts with HUD's or the lender's requirements or restricts HUD's or the lender's rights; and
 - (3) requiring the management agent to turn over to the owner all of the project's cash, trust accounts, investments, and records within thirty days after the date the management agreement is terminated.
- b. Additional Provision Required for Projects Managed by Identity-of-Interest Entities. In addition to the provisions in Paragraph 4-5.a., owners must include the following clause in any management agreement executed with an identity-of-interest agent: "Upon request of the Lender, HUD or (Name of Owner), (Name of Management Agent) will make available to the Lender or HUD at a reasonable time and place, its records and records of identity-of-interest companies which relate to goods and services charged to the project. Records and information will be sufficient to permit the lender and HUD to determine the services performed, the dates the services were performed, the location at which the services were rendered, the time consumed in providing the service, the charges made for

materials, and the per unit and total charges levied for said service."

- c. Hold Harmless Clauses. Management agreements may not contain "hold harmless" clauses in which the owner exempts the agent from all liability for damages and injuries. A sample of such a clause is provided in Paragraph 4-5.c.(1) below. This clause would make the owner liable for all damages, including those caused by the agent's negligence or willful misconduct. If a tenant or other third party filed suit and was awarded damages because of the negligence or misconduct of the agent, the project would be liable for those damages and the project's financial condition and the lender's and the Secretary's interests could be adversely affected. An owner may

5/84

4-3

hold an agent harmless only from damages or injuries that: (1) were not caused by the agent's negligence or willful misconduct; and (2) occurred when the agent was acting under the expressed direction of the owner. Thus, an owner could include the hold harmless clause shown in Paragraph 4-5.c.(1) only after editing the clause as shown in Paragraph 4-5.c.(2).

- (1) Sample of a prohibited hold harmless clause:

The owner agrees to hold and save agent harmless from dangers or injuries to persons or property by reason of any cause whatsoever, either in or about the premises or elsewhere, when agent is carrying out the provisions of the Agreement, or acting under the express or implied direction of the owner.

- (2) Edits required to make sample hold harmless clause acceptable:

The owner agrees to hold and save agent harmless from dangers or injuries to persons or property (-strike outs-) either in or about the premises or elsewhere, when agent is carrying out the provisions of the Agreement, or acting under the express (-line thru-) direction of the owner, unless such injuries resulted from the agent's negligence or willful misconduct.

- d. Term of Agreements. Management agreements may be written for open ended (i.e., "remain in effect until cancelled by HUD, the lender, the owner or the agent") or for fixed terms (e.g., one year, three years, etc.). The term of the agreement is negotiated between the owner and management agent. The lender may not dictate the term of a management agreement. Because all management agreements must contain a clause giving HUD and the lender the right to terminate the agreement with thirty days notice, the lender and HUD

will still have the authority to terminate management agreements, as necessary. When a management agreement has a fixed expiration date and the owner and agent decide to extend that agreement or to execute a new agreement, the owner must submit a new Management Certification to the lender.

Section 2. HUD Requirements Relating to Management Fees

4-6. INTRODUCTION. This section discusses how the management fee is calculated and how management costs are distributed between the management fee and the project account. This section also reiterates the regulatory agreement requirement that management fees be reasonable in amount. The management fee is the amount the project owner pays to the management entity for the time and expertise required to direct and oversee project operations in accordance with HUD's guidelines and accepted practices of income property management. The management fee is paid from project income and is reported as a project expense on the project's financial statements. An owner may pay management fees only to the individual or business entity which the lender has authorized to manage the project.

5/84

4-4

4-7. DISTRIBUTING COSTS BETWEEN THE MANAGEMENT FEE AND THE PROJECT ACCOUNT. The management fee is designed to compensate the management agent for performing the following property management functions: designing the procedures and systems needed to keep the project running smoothly; recruiting, hiring, training and supervising project personnel; monitoring project operations by visiting the project or analyzing performance reports; keeping the project owner abreast of project operations; and analyzing project problems and developing and implementing solutions to those problems. The fee is not designed to cover all management costs. The management costs discussed in Paragraph 4-7.a., b. and c. below are generally not paid from the management fee.

- a. Expenses incurred for "front-line", day-to-day management tasks must be charged against the project operating account. "Front-line" activities include, but are not limited to, taking applications, screening tenants, maintaining the project and accounting for project income and expenses. Costs associated with "front-line" activities are paid from project income regardless of whether the staff work out of the agent's office or at the project site.
- b. Asset management services may be paid only from amounts available for distribution to owners. Thus, on limited distribution projects, any fees paid for asset management services must be included in the distributions paid entry on Line 2c of the Surplus Cash Computation (Form HUD 93486.) Since asset management fees are paid out of

amounts available for distribution, payment of asset management fees does not require the lender's prior approval. Asset management functions include those activities associated with overseeing the management agent's performance and managing and protecting the assets of the ownership entity. Asset management activities include disbursing surplus cash, preparing tax analysis projections for the partners, periodically visiting the project to review the agent's performance and reporting to the partners on project operations.

- c. Costs of tuition and books associated with training of "front-line" staff may be charged against the project account if the amounts charged are reasonable and the conditions listed below are met.
 - (1) The training is designed to improve the employee's ability to perform traditional property management functions. Such training could include bookkeeping, maintenance or other property management courses taught by local colleges or by recognized industry educational organizations.
 - (2) The employee performs "front-line" project functions (e.g., takes applications, performs grounds or maintenance work, etc.). On-site occupancy clerks or resident managers are considered "front-line" employees. Rental clerks who are physically located at the management agent's office are also considered "front-line" employees.

5/84

4-5

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- d. The project may not be charged for training costs incurred for supervisory staff (e.g., occupancy, maintenance and regional supervisors) who carry out the management agent's responsibility for overseeing project operations, analyzing project problems, supervising project personnel and developing and implementing solutions to project problems.

4-8. HOW THE MANAGEMENT FEE IS ESTABLISHED.

- a. Fee as a Percentage of Collections. Except as noted in Paragraph 4-8.b. below, the management fee should be established as a percentage of collections. This gives the management agent an incentive to collect amounts due and yields increases as periodic rental increases push up the collections base. These increases help offset inflationary increases in the management agent's costs. The collections base should include only rents collected; the base should not include miscellaneous or interest income. The management agent may charge one rate for rents collected on apartments and a different rate for rents collected on commercial space shown on the Form HUD-92264.

b. Alternate Forms of Fees. In addition to or in lieu of the percentage-based fee described above, owners may agree to pay management fees in forms other than a percentage of collections if the project has special problems or if such fees would be more cost-effective. Fees may be awarded for dealing with special project problems if:

- (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 and structured so that it is payable only if the agent completes the required actions or obtains the required results;
- (3) the fee does not duplicate payment for services which are to be compensated through a percentage fee; and
- (4) the fee is reasonably related to the time, effort and expertise required of the agent.

These alternate fees should be linked to a specific time frame, such as the time it takes to resolve a particular problem or complete a certain task. Normally, lenders should not approve incentive fees which are tied to increasing net income or decreasing total operating expenses. These fee structures could encourage agents to forego necessary maintenance or expenditures so as to increase project income and, hence, management fees. Fees tied to increasing occupancy levels or collection percentages or to reducing a specific, excessive expense (e.g., property taxes) are generally more appropriate.

5/84

4-6

c. Advising the Lender of the Fee Amount. The Management Certification required by Paragraph 4-4 will inform the lender as to the percentage management fee proposed and will estimate the yield the agent should receive from that percentage fee.

4-9. OWNER RESPONSIBILITY TO SHOP AND COMPARE. The regulatory agreement requires that owners obtain contracts, materials, supplies and services on the terms most advantageous to the project and at costs not in excess of amounts normally paid for such contracts, materials, supplies and services in the area in which such services are rendered or supplies and materials furnished. Project owners, therefore, are required to shop and compare management fees as necessary to determine that the fee proposed by the owner does not exceed the amount normally paid on similar projects, except as justified by special conditions existing at that project. Fees negotiated by identity-of-interest owners and agents must fall within

the range of fees negotiated between owners and independent agents of comparable projects.

4-10. CHANGES IN MANAGEMENT FEES. Owners of projects not subject to the "up-front" review requirements of Paragraph 4-12.a. may renegotiate management fees with in-place agents without lender approval so long as the new fee complies with the reasonableness standards set out in Paragraph 4-11. On projects subject to the "up-front" review requirements of Paragraph 4-12.a., the fee can be changed only following the lender's review and approval. This paragraph applies only to changes in the percentage fee, not to changes in the dollar yield which occur automatically as periodic rental increases push up the collections base. When the owner and agent negotiate a change in the fee stated in Paragraph 1.a.(2) of the Management Certification, the owner must submit a revised Certification to the lender.

Section 3. Lender Review of Reasonableness of Management Fees

4-11. REASONABLENESS OF THE FEE. The regulatory agreement requires that all project expenses (including management fees) be reasonable in amount and necessary to the operation of the project. The lender should consider a particular project's management fee expense to be reasonable if the fee: (a) provides sufficient compensation to attract the quality of management needed to administer the project during the period in which the fee will be in effect; and (b) does not significantly exceed the amount ordinarily paid by similar projects in the same geographic/cost area, except as justified by conditions which will require more time and effort on the part of the management agent. Time required of "front-line" staff should not be a consideration because their salaries are billed directly to the project and are not paid from the management fee. The assessment of reasonableness must be based upon a consideration of:

- a. the total fee structure - i.e., the percentage fee and any alternate form of fee negotiated pursuant to Paragraph 4-8.b.; and

5/84

4-7

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- b. the yield likely to be derived. The dollar yield should vary by the size of the project and the difficulty of managing the project. Reasonableness tests cannot be based upon the percentage fee since the same percentage fee will produce different dollar yields for projects which have different income potentials but require the same amount of expertise, time and effort of the agent.

4-12. TIMING OF LENDER REVIEW OF MANAGEMENT FEE. While all coinsured projects are subject to the reasonableness requirements of Paragraph 4-11, the intensity and timing of the lender's monitoring of compliance may vary according to type of

management entity, the quality of management provided and the financial condition of the project.

- a. Projects Requiring "Up-Front" Lender Review. An "upfront" review means that the owner and management entity must have the lender review the proposed management fee prior to charging the fee against the project operating account, executing a management agreement or otherwise obligating the project to pay that amount. "Up-front" reviews are required in the following instances.
- (1) Projects which are owner-managed or managed by identity-of-interest agents. These projects are required to be reviewed "up-front" because fees on these projects are not set through arms-length negotiations and, hence, abuse is more likely than when a fee is negotiated between an independent agent and owner.
 - (2) Projects which have been in default under their mortgage at any time within the previous three years prior to the date the agent will assume management responsibility.
 - (3) If the proposed management agent received an overall below average or unsatisfactory rating on any management review report, or a below average or unsatisfactory rating on any review category during the three years preceding the date the fee is scheduled to be effective and conditions which caused the adverse rating still exist. Any unsatisfactory or below average rating, regardless of whether it was given on the project under review or another project in the agent's portfolio, triggers the need for an "up-front" review.
 - (4) When the owner requests an "up-front" review. Owners may request upfront reviews to avoid repayments which could be required if the lender later determines that the fee is excessive.
 - (5) When the lender believes that an "up-front" review is necessary to assure the reasonableness of the fee and to protect the lender's or Secretary's financial interest. For example, the lender may wish to require an "up-front" review when the project's cash flow or working capital position is poor; when deferred maintenance exists; when the project's operating costs are high and the owner has not made a serious effort to control

from that or other projects.

- b. Projects Not Requiring "Up-Front" Lender Review. No "upfront" lender review of management fees is required for projects which are managed by independent management agents and do not have any of the characteristics listed under Paragraphs 4-12.a.(2) through (5) above. In these cases, once the lender has approved the owner's choice of management agent, the owner and agent may immediately execute a management agreement which includes the negotiated fee percentage. While the lender will not review these fees "up-front", the lender will review the reasonableness of these fees in conjunction with other servicing activities (e.g., when analyzing the project's financial statements, processing rental increases, or negotiating workouts).

4-13. GUIDANCE FOR LENDER REASONABLENESS ASSESSMENT REVIEW. The objective of the lender's review of the proposed management fee is to determine if the fee is reasonable compared to the management fees of similar projects in the same market area. The lender should identify similar projects in the same market area and compare amounts ordinarily paid for management services on those projects with the yield that can reasonably be expected to result from the fee structure proposed for the project under review. While lenders are encouraged to develop their own data base for making these comparisons and assessments, lenders may ask the local HUD Field Office to make available the management fee data maintained in the OLMS computer system. If the proposed fee is substantially higher than the fees paid at comparable projects, the lender should determine if conditions at the subject project justify part or all of the higher fee.

- a. If the lender finds that the fee is not reasonable, the lender should notify the owner in writing and require the owner to submit evidence that the owner has "shopped" for the best deal and to submit any other information which would justify the fee in question.
- b. If the owner is unable to justify the fee to the satisfaction of the lender, the lender must notify the owner in writing and require the owner to repay the excess amounts already paid and to reduce future fees to the amount the lender determines to be reasonable. The owner, in turn, may seek recovery from the agent.
- c. The lender must send the HUD Field Office a copy of the letters discussed in Paragraphs 4-13.a. and 4-13.b. and any follow-up correspondence sent to, or received from, the owner/agent.

4-14. DISTRIBUTION OF MANAGEMENT CERTIFICATIONS. The lender must send the Field Office Loan Management Branch a copy of each initial or revised Management Certification. The lender must submit the Certification regardless of whether or not it has approved the proposed fee. HUD needs this information to

develop a data base on the fees owners would pay in the absence of HUD or lender controls. HUD will use this data to evaluate fees on HUD-insured and HUD-held projects.

5/84

4-9

EXHIBIT 4-1

TYPES OF INFORMATION THE LENDER MIGHT REQUEST REGARDING
PROJECT CONDITIONS OR A MANAGEMENT AGENT'S OPERATIONS

Situation	Information that might be helpful to the Lender
Lender is familiar with the proposed agent's operating procedures and the agent has satisfactorily managed projects similar to the one under consideration.	Explanation of how operating and oversight procedures for this project will vary from the procedures normally used by the agent.
Lender has had no experience with the agent or is unsure of the agent's ability to manage the project in question.	Narrative explaining how the agent will handle the management tasks listed on Form HUD-9834, Management Review Report, and/or a copy of the agent's procedures manuals.
Project has significant physical, financial and social problems.	<ul style="list-style-type: none">o Statement of project's problems and their causes.o List of actions that will be taken to eliminate those causes and correct the problems. The list should include any major repairs, physical improvements, rental increases, or changes in operating procedures.o Time schedules for implementing the above actions. <p>NOTE: Prior to drafting this statement, the owner should meet with the lender and reach agreement on what are the project's problems, their causes, and the resources available for their solution.</p>
New project preparing for rent-up.	Listing of advertising and marketing efforts to be undertaken. Description of how staff will be trained on civil rights and fair housing laws.

NOTE: More than one of these four situations may exist at one time.

5/84

4-10
