

Physical Needs Assessment Report for the House and Senate Committees on Appropriations

Department of Housing and Urban Development
Office of Public and Indian Housing

This report by the Department of Housing and Urban Development (HUD) responds to the direction of the Joint Explanatory Statement appended to the FY 2014 Appropriation as follows:

HUD is in the process of developing a physical needs assessment (PNA) process to assess the capital needs of the public housing inventory, including a new PNA rule and an energy audit rule. The Secretary is directed to take every possible measure to ensure that any new reporting requirements associated with the PNA process do not increase administrative burdens on public housing authorities. The Secretary is further directed to report to the House and Senate Committees on Appropriations on measures taken to relieve administrative burdens associated with these rules no later than 180 days after enactment.

HUD initiated the Physical Needs Assessment (PNA) process review to enable access to data it could use program-wide for proactive risk management and measuring the effectiveness of the Capital Fund. HUD has understood the burden of this initiative since the program's inception in 2009. During this period, HUD has solicited stakeholder comments regarding balancing this burden and the value of the information gathered. During program design, measures to reduce the burden were incorporated into the proposed rule and protocols. These measures are summarized in this report along with specific new proposals for additional burden reductions. Due to budget constraints in recent fiscal years, HUD's responsiveness to Public Housing Authorities' (PHAs') concerns regarding the administrative burden of the proposed timetable of this initiative has delayed the implementation of these requirements. At the same time many PHAs had need to perform PNAs and for them the delay created an administrative burden of potential duplication of effort. Again, HUD has been responsive in providing the opportunity and flexibility for PHAs to proceed voluntarily on a timetable that accommodates local circumstances.

HUD convened four meetings with PHAs and advocacy groups in 2009 and 2010. Three national advocacy groups published reports of these sessions to their members prior to the proposed rule publication in 2011. HUD visited a number of PHAs throughout the United States in order to review processes for performing PNAs and energy audits. HUD sent presenters to state and regional PHA conferences to discuss PNA and energy audit initiatives, to provide training on the use of the tool, and to listen to PHAs comments and concerns. From its inception, HUD approached this initiative in the spirit of collaboration and sensitivity to the practical needs and limitations of PHAs. HUD believes the PNA initiative, as proposed, balances the burdens and benefits and considers it a baseline management tool necessary for long-term strategic planning and preservation of the PHA inventory while providing data required for HUD's program oversight and risk management.

What is a PNA and Why is it Important?

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

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

As a best practice, numerous public and private sector real estate enterprise use a PNA. As an example, Fannie Mae's PNA requirement for multi-family real estate financings has existed for at least 25 years and updated protocols¹ were recently published which are similar to those proposed by HUD. The HUD Office of Housing requires owners/managers of subsidized housing to perform a rigorous PNA as part of its approval process for capitalization of project-based subsidized properties and as a basis for approving the release of replacement reserve funding. Participation in HUD's Rental Assistance Demonstration (RAD) requires a PNA to be performed to support the viability of the transaction. Applications for Low Income Housing Tax Credits (LIHTC), to be used for property renovation, typically require a PNA. Most states have statutory requirements for common interest communities such as condominiums and cooperatives for disclosure of long-term needs of a property for the benefit of prospective purchasers as well as community residents. A PNA produces useful data to communicate the viability of a property to resident and community stakeholders.

The proposed PNA aligns public housing with established practices in multi-family real estate. The burdens of performing a PNA to industry standard include:

- assembling an inventory of the quantity, characteristics and age data for existing physical components;
- estimating current cost to replace components using local cost data or an index;
- composing a representative sample of a property inventory to inspect;
- inspecting the samples to evaluate current conditions and expectations for remaining useful life of components;

¹ https://www.fanniemae.com/content/guide_form/4099.doc

- evaluating needs for physical components that may not currently exist to comply with code or regulation, or to improve the property;
- evaluating energy and water conservation measures and calculating simple payback;
- inputting needs data into a tool or spreadsheet for calculation and analysis;
- analyzing the data and adjusting it to reflect local business judgment; and
- reporting the result to stakeholders.

How did HUD evolve to this initiative and what is the status?

Over the last decade, HUD gradually evolved the public housing program management model to one that regards public housing as real estate and recognizes broader real estate industry business practices. HUD previously required large PHAs (250 units or more) to perform PNAs in support of their five-year planning effort, but excluded properties operated by small PHAs. The previous requirement was rudimentary with no required data reporting to HUD.

In addition, Congress mandated the integration of utility management with capital planning in the Energy Policy Act of 2005 “to maximize energy conservation and efficiency measures.” HUD’s existing energy audit requirement for PHAs (24 CFR 965.302) also remains rudimentary, providing no standard for performance or qualifications for a practitioner.

The PNA initiative in public housing complies with the Energy Policy Act by integrating a comprehensive energy audit with the PNA. The energy audit standard proposed is equivalent to a Level 2 energy audit as defined by the American Society of Heating, Refrigeration, and Air Conditioning Engineers (ASHRAE)-the industry standard used by Fannie Mae, RAD, and many local energy audit requirements such as New York City’s local law 87.

Since the PNA initiative was first proposed to PHAs in early 2009, and reinforced with subsequent collaboration and publication of proposed rules, PHAs have continually been required to perform PNAs and energy audits. PHAs are required to comply with existing regulations, as well as to perform these activities for other specific management purposes. Many PHAs have responded positively to HUD regarding proceeding with the proposed PNAs and energy audits. These PHAs are concerned about the burden of duplicative efforts to perform the PNA in advance of a final rule.

HUD completed a working tool, the Physical Needs Assessment (PNA) tool in mid-2012. The tool will be used to record PNA data and automates the proposed reporting. The PNA tool was made available² to PHAs in 2012 for orientation purposes as well as for use on a voluntary basis pending a final rule. To date, more than 20% of PHAs have taken the initial steps to begin

² The GPNA tool and associated training and resources are available at:

http://portal.hud.gov/hudportal/HUD?src=/program_offices/public_indian_housing/programs/ph/capfund/physicalassessment

and

http://portal.hud.gov/hudportal/HUD?src=/program_offices/public_indian_housing/programs/ph/capfund/gpnatool

working with their unique inventory in the PNA tool and several dozen PHAs have completed a PNA and made their data available to HUD.

In October 2013, the final Capital Fund rule was published establishing the requirement that all PHAs regardless of size must perform a PNA, delaying the requirement for small PHAs until an implementation notice was issued. HUD intended the PNA rule as an amendment to the Capital Fund rule outlining the frequency, procedures, and standards for the PNA requirement.

What are the challenges of implementing this initiative for PHAs?

The challenges for PHAs in implementing the PNA and enhanced energy audit standards are both staff burdens and potential financial cost. The staff burden and cost of performing a PNA and energy audit are greater if the PNA and energy audit are performed to industry standards. HUD acknowledges the burden to perform at industry standard as proposed is greater than the existing rudimentary HUD requirements for all PHAs. Small agencies in particular have a greater burden because they were not previously required to perform a PNA, and may be unaccustomed to the concept and its potential benefits.

All PHAs have long been required to perform an energy audit every 5 years, although the more comprehensive energy audit standards of the proposed PNA rule require added effort to achieve a moderate industry standard equivalent to an ASHRAE Level II. The Level II audit is the industry standard threshold to produce immediate actionable and broadly common measures to reduce energy consumption consistent with the mandate of the Energy Policy Act of 2005.

Many PHAs may procure the services of third party providers for PNAs and energy audits either because of capacity limitations or technical inability. HUD is not proposing the requirement to contract out these services, as is typically required when a PNA is used for a transaction to obtain an independent 3rd party assessment. For PHAs to contract or train staff to perform these assessments represents a potential financial burden at a time of fiscal constraint. While an independent 3rd party assessment has benefits to a PHA, HUD does not believe at this time that requiring it for this non-transactional purpose is supported by the added benefits.

Funding reductions over the last two fiscal years have reduced the flexibility of many PHAs to absorb this new initiative. Recent funding decreases have increased near-term needs as PHAs defer improvements. Deferral, in turn, creates a larger volume of needs to prioritize and a greater need for tools such as the PNA to sort these needs. Many PHAs report a near-term reactionary management mode that makes it difficult for them to consider longer term needs as a priority.

What are the benefits of implementing the PNA?

HUD seeks to establish the routine practice of performing a PNA in public housing so that PHAs may begin to capitalize on both the current and long-term benefits. HUD is confident that the benefits of implementing the PNA initiative at the proposed level of intensity far exceed the burden of performance. The initiative improves prospects for stabilization of the inventory and

advances the evolution of public housing to a sustainable model that inspires confidence among policy makers, public housing residents and taxpayers.

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

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

- develop a strategic plan,
- prioritize budget needs in a limited funding environment,
- recognize synergies and efficiencies,
- communicate to stakeholders,
- manage risk,
- organize project physical data,
- develop preventative maintenance strategies,
- model alternatives, and
- assess the long-term viability of the property in its current program structure.

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

HUD and PHAs invest substantial resources to provide safe and decent housing as a safety net for our nation's most vulnerable populations. This safety net has shrunk at the rate of thousands of units annually for more than a decade while the backlog of deferred work has increased. PHAs and HUD need tools such as the PNA to navigate the changed environment of public housing that is characterized by less federal funding, increasing need, increasing risk exposure, and the necessity of exploring non-traditional strategies to preserve a baseline safety net. HUD has some data on the magnitude of the physical needs of public housing from decennial Capital Needs Assessment (CNA)³ surveys of public housing. However, the decennial sample survey's value to HUD is limited by its static nature. This data offers no planning value to individual PHAs since the survey is based upon HUD parameters, and even the survey sample subjects do not have access to their property specific results.

HUD seeks a dynamic data source, using current technology, to enable HUD to use such data program-wide for proactive risk management and measuring the effectiveness of the Capital Fund. With the data that the PNA and its annual updating provide, the Department will know the program-wide character and magnitude of physical need being addressed using Capital Funds. The existence of this aggregate data allows benchmarking and data analysis not previously available to assess the risks to the inventory. HUD further benefits by:

³ The last CNA was completed in 2010 and can be found at:
http://portal.hud.gov/hudportal/documents/huddoc?id=PH_Capital_Needs.pdf

- the ability to respond to reasonable data inquiries from appropriators and policy makers with current information,
- the ability to demonstrate accountability and the value of public housing capital expenditures,
- the ability for HUD and its Field Offices to better target technical assistance and resources, and
- the likelihood of greater implementation of energy conservation.

What measures has HUD taken to relieve administrative burdens in the implementation of the PNA and energy audit requirements?

In designing this initiative, HUD has been mindful of controlling the burden on PHAs. The PNA initiative outlined in the proposed rule is a baseline; it does not mandate subsequent physical improvement via a prescriptive schedule. It does not mandate additional assessments and analyses that flow from the proposed baseline PNA and Level 2 energy audit. It is strictly a strategic planning activity performed at a practical and appropriate level of intensity to inform PHAs' decision making. HUD continues its long tradition of local control over decisions regarding implementing physical improvements or proceeding with additional analyses based upon the PNA and energy audit data by deferring to the judgment of the PHAs.

There is considerable constituency for escalating the burden of PNAs and energy audits beyond what HUD has proposed, such as imposing protocol requirements at the intensity required to support a financial transaction. HUD resisted significant expansions of burden suggested during the proposed rule clearance process that sought to require:

- implementation of energy conservation measures if an energy audit identifies them;
- implementation of the improvements identified in the PNA as a schedule;
- third party performance of PNAs and energy audits;
- universal investment grade energy audits (ASHRAE Level 3);
- evaluation of renewable energy measures;
- requiring all PHAs to proceed with an Energy Performance Contract;
- inclusion of assessment of health and safety measures; and
- production and implementation of a preventative maintenance plan.

These were intra-agency, as well as inter-agency issues or public comments to the proposed rule and each required a thoughtful approach to balancing the burden and benefit of the initiative.

Specific measures already incorporated into the initiative to reduce burden on PHAs include:

1. **The rule does not require PHAs to contract for PNA services.** Many PHAs have staff that can meet the experiential qualifications required by the rule for a PNA provider. PHAs also have the flexibility to customize the scope for any contracted services so that they could perform some of the required tasks with their staff while using contracted services for specific expertise they may need.

2. **Similarly, the rule does not require PHAs to contract for energy audits.** Some PHAs have certified staff capable of performing an energy audit, although it is likely that most PHAs will not have staff with the technical expertise to meet the qualification requirements for an energy audit.
3. **HUD developed a tool.** Tools of this nature are normally proprietary to fee providers of PNA services who use them to automate repetitive calculations and organize the data collection for documentation. The tool HUD created to collect PNA data provides PHAs with an instrument that increases the possibility that PHAs can perform much or all of the work with their own staff.
4. **Automated entry of existing inventory data.** Inventory confirmation is a significant entry and verification function in any PNA process. HUD takes advantage of the existing data collection in the Public Housing Information Center (PIC) to significantly reduce additional data collection and entry burden. PHA's self-certified PIC inventory data is electronically imported into the tool with a simple one click process.
5. **The tool uses current accessible technology to reduce process burden.** The tool organizes typical inputs needed to complete any PNA process and automates tedious and time consuming calculations. The tool has a number of optional features PHAs can use to advance management understanding of their inventory, but these are not necessary or required for HUD reporting. For each capital component that exists on the PHAs real estate, the PHA is only required to enter the quantity, the cost per unit of quantity, the expected useful life of such new component and the remaining useful life of the component in place over a 20 year planning horizon. These four data elements are the minimum standards for any PNA process. Any real estate management endeavor as a matter of routine business practice accesses this information.
6. **Minimized required data entry and reporting.** PHAs may use the tool simply as a reporting mechanism without using any of its other features. As a simplified alternative protocol, the tool allows PHAs to populate the "cost projection" page; the page contains data required by HUD. The required submittal is the output from the "cost projection" page of the tool, which is essentially the 20-year projection of capital needs. HUD does not require submittal of individual inspection results from which the cost projection is derived, although the tool does have functionality for PHAs to enter all individual inspection data. HUD has created training resources which describes this streamlined reporting procedure. It is anticipated that small PHAs with limited inventory, who may be more intimately aware of their needs, would particularly benefit from this direct entry protocol.
7. **Organizing PNA data produces time saving benefits and efficiencies for PHAs.** The cost projection can be continuously used by the PHA to prioritize spending decisions, which is particularly useful in constrained budget environments. The tool allows PHAs to model timing and cost scenarios to make efficient annual budgeting

and spending decisions. The tool's features organize basic physical data pertaining to the property for reference purposes. Timely property positioning decisions reduce management burdens and are facilitated by tools and data such as this.

8. **Automated local reporting is produced.** The tool automatically produces the summary reports required for PHAs' reporting to Resident Advisory Boards and executives. These "big picture" summary reports are useful for communicating to community resources that may be a source of supplemental funding.
9. **Automated submission to HUD.** The tool automatically creates the appropriate submission for HUD. Creating the submission is a single simple step creating a file to email to HUD.
10. **Streamlines other required reporting.** The data organized by the tool considerably streamlines the Capital Fund required 5-year action plan reporting, and Performance and Evaluation reporting.
11. **Delayed the final rule and implementation.** HUD delayed processing of the final PNA Rule which was departmentally cleared in June 2012. As a result, implementation of the requirement has been delayed for 2 years due largely to the imposed burden on PHAs resulting from the sequestration.
12. **Additional delay for small PHAs.** The new requirement for small PHAs to perform a PNA was included in the final Capital Fund rule published in October 2013, but its effectiveness was delayed until issuance of an implementation notice associated with the final PNA rule.

Additional measures to reduce PHA burden are proposed in the final rule and its implementation:

13. **Allow multi-purpose use and increase shelf life for use of existing recent information.** PHAs have multiple reasons for performing energy audits and PNAs other than for compliance with the final PNA regulation. PNAs and energy audits are required documents for financing programs, EPCs, RAD and other programs. HUD proposes to allow PHAs to use data collected for such other purposes for compliance with the information collection requirements of this rule. HUD proposes acceptance of PNA and energy audit data that is up to three years old at the time of submission to further accommodate flexibility and reduction of duplication for PHAs that may have conducted these activities at any time since the publication of the proposed rule.
14. **Increased flexibility in timetable for performance including additional accommodation to small PHAs.** HUD proposes to lengthen the period of the initial performance to allow PHAs the flexibility to perform the work on a timetable that better accommodates their local circumstance in terms of staff and funds availability.

- a. The period of initial performance for large PHAs which have always had, and continue to have, a PNA requirement is proposed to be distributed over a period of three years from the effective date of the rule. Large authorities would therefore have the ability to spread the burden and expense over multiple fiscal years by dividing the activity into three roughly equal tranches.
- b. Small PHAs newly required to perform PNAs are offered the increased flexibility of making an initial submission at any time within five years of the effective date of the final PNA rule. With this timing, small PHAs would not be required to submit anything for a full ten years from agreeing to perform a PNA as a condition of receiving a grant under the American Recovery and Reinvestment Act of 2009.

Conclusion

HUD shares Congress's concern for the burdens PHAs face. HUD engaged PHAs directly regarding the PNA initiative and believes that every practical and reasonable step to reduce administrative burden on PHAs are incorporated. HUD believes its appropriate balancing of the burden with its responsibility for Capital Fund program oversight results in value to the taxpayer and to the PHAs. HUD believes it is necessary to implement the final PNA and energy audit rule to strengthen public housing. Further delay represents a significant lost opportunity.